

Mellanox Technologies, Ltd.  
Form 10-Q  
November 02, 2018

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

Form 10-Q  
(Mark One)

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

For the quarterly period ended: September 30, 2018

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

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

Commission File Number 001-33299

MELLANOX TECHNOLOGIES, LTD.

(Exact name of registrant as specified in its charter)

Israel 98-0233400

(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification Number)

Beit Mellanox, Yokneam, Israel 20692

(Address of principal executive offices, including zip code)

+972-4-909-7200

(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer,"

"accelerated filer", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
Emerging growth company

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

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

The total number of shares outstanding of the registrant's Ordinary Shares, nominal value NIS 0.0175 per share, as of October 26, 2018, was 53,520,741.



MELLANOX TECHNOLOGIES, LTD.

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PART I. FINANCIAL INFORMATION  
ITEM 1 — FINANCIAL STATEMENTS

MELLANOX TECHNOLOGIES, LTD.  
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	September 30, 2018	December 31, 2017
	(in thousands, except par value)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$64,248	\$62,473
Short-term investments	285,955	211,281
Accounts receivable, net	142,772	154,213
Inventories	105,049	64,657
Other current assets	14,675	14,295
Total current assets	612,699	506,919
Property and equipment, net	105,007	109,919
Severance assets	17,780	18,302
Intangible assets, net	194,540	228,195
Goodwill	473,916	472,437
Deferred taxes and other long-term assets	99,835	66,162
Total assets	\$1,503,777	\$1,401,934
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$72,922	\$59,090
Accrued liabilities	100,426	114,058
Deferred revenue	20,326	23,485
Total current liabilities	193,674	196,633
Accrued severance	22,603	23,205
Deferred revenue	17,829	17,820
Term debt	—	72,761
Other long-term liabilities	35,768	34,067
Total liabilities	269,874	344,486
Commitments and Contingencies - (see Note 8)		
Shareholders' equity:		
Ordinary shares: NIS 0.0175 par value, 200,000 shares authorized, 53,517 and 51,488 shares issued and outstanding at September 30, 2018 and December 31, 2017, respectively	232	221
Additional paid-in capital	956,281	873,979
Accumulated other comprehensive income (loss)	(167	) 1,618
Retained earnings	277,557	181,630
Total shareholders' equity	1,233,903	1,057,448
Total liabilities and shareholders' equity	\$1,503,777	\$1,401,934

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



## MELLANOX TECHNOLOGIES, LTD.

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	Three Months Ended		Nine Months Ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
	(in thousands, except per share data)			
Total revenues	\$279,211	\$225,699	\$798,673	\$626,312
Cost of revenues	95,562	77,335	288,228	215,212
Gross profit	183,649	148,364	510,445	411,100
Operating expenses:				
Research and development	92,930	90,916	266,508	271,755
Sales and marketing	36,344	37,829	111,511	111,696
General and administrative	13,895	13,039	54,046	38,034
Restructuring and impairment charges	947	—	10,308	—
Total operating expenses	144,116	141,784	442,373	421,485
Income (loss) from operations	39,533	6,580	68,072	(10,385 )
Interest expense	(66 )	(2,016 )	(2,108 )	(6,005 )
Other income, net	1,112	956	2,283	2,466
Interest and other, net	1,046	(1,060 )	175	(3,539 )
Income (loss) before taxes on income	40,579	5,520	68,247	(13,924 )
Provision for (benefit from) taxes on income	3,522	2,117	(23,179 )	2,908
Net income (loss)	\$37,057	\$3,403	\$91,426	\$(16,832 )
Net income (loss) per share — basic	\$0.70	\$0.07	\$1.74	\$(0.34 )
Net income (loss) per share — diluted	\$0.68	\$0.07	\$1.68	\$(0.34 )
Shares used in computing net income (loss) per share:				
Basic	53,232	50,587	52,560	49,999
Diluted	54,612	51,575	54,383	49,999

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

MELLANOX TECHNOLOGIES, LTD.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(in thousands)			
Net income (loss)	\$37,057	\$3,403	\$91,426	\$(16,832)
Other comprehensive income (loss), net of tax:				
Change in unrealized gains (losses) on available-for-sale securities, net of tax	134	(11 )	54	11
Change in unrealized gains (losses) on derivative contracts, net of tax	1,881	(2,689 )	(1,839 )	2,053
Other comprehensive income (loss), net of tax	2,015	(2,700 )	(1,785 )	2,064
Total comprehensive income (loss), net of tax	\$39,072	\$703	\$89,641	\$(14,768)

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

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

	Nine Months Ended September 30,	
	2018	2017
	(in thousands)	
Cash flows from operating activities:		
Net income (loss)	\$91,426	\$(16,832)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	77,455	76,564
Deferred income taxes	(27,973)	(704)
Share-based compensation	49,046	50,993
Gain on investments, net	(3,135)	(2,632)
Impairment and loss on disposal of property and equipment	2,806	—
Changes in assets and liabilities:		
Accounts receivable	11,441	8,420
Inventories	(41,837)	2,349
Prepaid expenses and other assets	(128)	(5,802)
Accounts payable	13,661	(14,876)
Accrued liabilities and other liabilities	(4,273)	(3,104)
Net cash provided by operating activities	168,489	94,376
Cash flows from investing activities:		
Purchase of severance-related insurance policies	(916)	(983)
Purchase of short-term investments	(228,229)	(139,861)
Proceeds from sales of short-term investments	53,809	95,414
Proceeds from maturities of short-term investments	102,935	31,008
Proceeds from sales of property and equipment	3,239	—
Purchase of property and equipment	(28,992)	(35,243)
Purchase of intangible assets	(6,512)	(1,836)
Purchase of investments in private companies	(7,500)	(13,500)
Acquisition, net of cash acquired	(7,379)	(872)
Net cash used in investing activities	(119,545)	(65,873)
Cash flows from financing activities:		
Principal payments on term debt	(74,000)	(46,000)
Payments on capital lease and intangible asset financings	(6,519)	(5,969)
Proceeds from issuances of ordinary shares through employee equity incentive plans	33,267	25,102
Net cash used in financing activities	(47,252)	(26,867)
Net increase in cash, cash equivalents, and restricted cash	1,692	1,636
Cash, cash equivalents, and restricted cash at beginning of period	70,498	56,780
Cash, cash equivalents, and restricted cash at end of period	\$72,190	\$58,416
Supplemental disclosure of non-cash investing and financing activities		
Intangible assets financed with debt	\$2,480	\$12,892
Unpaid additions to property and equipment	\$1,635	\$8,042
Transfer from inventory to property and equipment	\$1,445	\$1,565



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

MELLANOX TECHNOLOGIES, LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1—THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Company

Mellanox Technologies, Ltd., an Israeli corporation (the "Company" or "Mellanox"), was incorporated and commenced operations in March 1999. Mellanox is a supplier of high-performance interconnect products for computing, storage and communications applications.

Principles of presentation

The unaudited condensed consolidated financial statements include the Company's accounts as well as those of its wholly owned subsidiaries after the elimination of all intercompany balances and transactions.

The unaudited 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 balance sheet data were derived from audited consolidated financial statements, but do not include all disclosures required by accounting principles generally accepted in the United States ("GAAP"). Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with GAAP 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 unaudited 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 unaudited 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 for the fiscal year ended December 31, 2017, filed with the SEC on February 16, 2018. The results of operations for the nine months ended September 30, 2018 are not necessarily indicative of the results to be anticipated for the entire year ending December 31, 2018 or thereafter.

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; ordered product mix; 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 the Company's 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; the timing of announcements or introductions of new products by the Company's competitors; and the Company's ability to successfully integrate acquired businesses.

Use of estimates

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the dates of the financial statements and the reported amounts of net revenue and expenses in the reporting periods. The Company regularly evaluates estimates and assumptions related to revenue recognition, allowances for doubtful accounts, allowances for price adjustments, investment valuation, warranty reserves, inventory reserves, share-based compensation expense, long-term asset valuations, useful lives of property, equipment, and intangibles, accounting for business combinations, goodwill and purchased intangible asset valuation, investments in privately-held companies, accounting and fair value of financial instruments and derivatives, deferred income tax asset valuation, uncertain tax positions, and litigation and other loss contingencies. These estimates and assumptions are based on current facts, historical experience and various other factors that the Company believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities and the recording of revenue, costs and expenses

that are not readily apparent from other sources. The actual results that the Company experiences may differ materially and adversely from the Company's original estimates. To the extent there are material differences between the estimates and actual results, the Company's future results of operations will be affected.

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MELLANOX TECHNOLOGIES, LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

Significant accounting policies

Other than the changes discussed below, there have been no changes in the Company's significant accounting policies that were disclosed in its Annual Report on Form 10-K for the fiscal year ended December 31, 2017, filed with the SEC on February 16, 2018.

On January 1, 2018, the Company adopted Accounting Standards Codification ("ASC") Topic 606, Revenue from Contracts with Customers (ASC 606-10), using the modified retrospective method. Prior to the adoption of ASC 606-10, the Company deferred the recognition of revenue and the cost of revenue from sales to distributors until the distributors reported that they had sold the products to their customers (known as "sell through" revenue recognition). Under ASC 606-10, the Company recognizes revenue on sales to all distributors upon shipment and transfer of control (known as "sell-in" revenue recognition), net of estimated allowances for price adjustments. As a result of this adoption, the Company revised its accounting policy for revenue recognition as detailed below.

Revenue Recognition

The Company recognizes revenue when (or as) it satisfies performance obligations by transferring promised products or services to its customers in an amount that reflects the consideration the Company expects to receive. The Company applies the following five steps: (1) identify the contract with a customer, (2) identify the performance obligations in the contract, (3) determine the transaction price, (4) allocate the transaction price to the performance obligations in the contract, and (5) recognize revenue when a performance obligation is satisfied.

The Company considers customer purchase orders, which in some cases are governed by master sales agreements, to be the contracts with a customer. For each contract, the Company considers the promise to transfer tangible products, extended warranty and post-contract customer support, each of which are distinct, to be the identified performance obligations. In determining the transaction price, the Company evaluates whether the price is subject to rebates and adjustments to determine the net consideration to which the Company expects to receive. As the Company's standard payment terms are less than one year, the contracts have no significant financing component. The Company allocates the transaction price to each distinct performance obligation based on their relative standalone selling price. Revenue from tangible products is recognized when control of the product is transferred to the customer (i.e., when the Company's performance obligation is satisfied), which typically occurs at shipment. The revenues from fixed-price support or maintenance contracts, including extended warranty contracts and software post-contract customer support agreements, are recognized ratably over the contract period and the costs associated with these contracts are recognized as incurred. The Company's standard arrangements with its customers typically do not allow for rights of return.

The Company maintains inventory, or hub arrangements with certain customers. Pursuant to these arrangements, the Company delivers products to a customer or a designated third party warehouse based upon the customer's projected needs, but does not recognize product revenue unless and until the customer reports it has removed the Company's product from the warehouse to be incorporated into its end products.

A portion of the Company's sales are made to distributors under agreements which contain price protection provisions. Revenue from sales to distributors is recognized upon shipment and transfer of control, net of estimated allowances for price adjustments. Frequently, distributors submit distribution price adjustment ("DPA") claims to the Company to adjust the distributor's cost from the standard price to the pre-approved lower price. After the Company verifies the DPA claim, a credit memo is issued to the distributor. The Company records an allowance for these unprocessed DPA claims and for estimated future DPA claims as a reduction of revenue and a reduction of accounts receivable. The allowance is recorded as a reduction to revenue in the same period that the related revenue is recorded and is calculated based on specific authorized DPA claims and an analysis of historical DPA claims, at the distributor level, over a period of time considered adequate to account for current pricing and business trends.

Most of the Company's distributors are entitled to a limited right of return related to stock rotation. Distributors have the right to return a limited amount of product not to exceed a percentage of distributor's prior quarter's net purchases. However, a simultaneous, compensating order of equal or greater value must be placed by distributor within the same

quarter of the return. Therefore, no stock rotation reserves are recorded.

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MELLANOX TECHNOLOGIES, LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

Restricted cash

The Company maintains certain cash amounts that are restricted as to withdrawal or use over the long-term. The cash is securing bank guarantees primarily issued against long-term tenancy agreements. The long-term restricted cash balance of \$7.9 million was reported in other long-term assets on the balance sheet as of September 30, 2018, and was included in the ending balance of cash, cash equivalents and restricted cash in the statement of cash flows for the nine months ended September 30, 2018. There was no restricted cash as of September 30, 2017. The following table provides a reconciliation of the cash and cash equivalents balances reported on the balance sheets and the cash, cash equivalents and restricted cash balances reported in the statements of cash flows:

	September 30,	
	2018	2017
	(In thousands)	
Cash and cash equivalents, as reported on the balance sheets	\$64,248	\$58,416
Restricted cash in other long-term assets, as reported on the balance sheets	7,942	—
Cash, cash equivalents, and restricted cash, as reported in the statements of cash flows	\$72,190	\$58,416

Concentration of credit risk

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

	Three		Nine	
	Months		Months	
	Ended		Ended	
	September		September	
	30,		30,	
	2018	2017	2018	2017
Dell Technologies Inc. ("Dell")	11 %	*	12 %	11 %
Hewlett Packard Enterprise ("HPE") *	12 %		12 %	13 %

\* Less than 10%

The following table summarizes accounts receivable balances in excess of 10% of total accounts receivable as of September 30, 2018 and December 31, 2017.

	September 30, 2018	December 31,	
		2017	
HPE	*	13	%

\* Less than 10%

## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

## Product warranty

The following table provides changes in the product warranty accrual for the nine months ended September 30, 2018 and 2017:

	Nine Months Ended September 30, 2018 2017 (in thousands)	
Balance, beginning of the period	\$889	\$1,474
New warranties issued during the period	1,441	1,128
Reversal of warranty reserves	—	(355 )
Settlements during the period	(1,334)	(1,082 )
Balance, end of the period	996	1,165
Less: long-term portion of product warranty liability	(183 )	(189 )
Current portion, end of the period	\$813	\$976
Net income (loss) per share		

The following table sets forth the computation of basic and diluted net income (loss) per share for the three and nine months ended September 30, 2018 and 2017:

	Three Months Ended September 30, 2018 2017		Nine Months Ended September 30, 2018 2017	
	(in thousands, except per share data)			
Net income (loss)	\$37,057	\$3,403	\$91,426	\$(16,832)
Basic and diluted shares:				
Weighted average ordinary shares outstanding	53,232	50,587	52,560	49,999
Effect of dilutive shares	1,380	988	1,823	—
Shares used to compute diluted net income (loss) per share	54,612	51,575	54,383	49,999
Net income (loss) per share — basic	\$0.70	\$0.07	\$1.74	\$(0.34 )
Net income (loss) per share — diluted	\$0.68	\$0.07	\$1.68	\$(0.34 )

The Company excluded 0.2 million and 0.5 million potentially dilutive share options and restricted share units ("RSUs") from the computation of diluted net income per share for the three and nine months ended September 30, 2018, respectively, 1.8 million potentially dilutive share options and RSUs from the computation of diluted net income per share for the three months ended September 30, 2017, and 5.1 million outstanding share options and RSUs from the computation of diluted net loss per share for the nine months ended September 30, 2017, because including them would have had an anti-dilutive effect.

## Adoption of new accounting principles

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606). The standard replaced the revenue recognition guidance in U.S. GAAP under Topic 605, and was required to be applied retrospectively to each prior period presented, or applied using a modified retrospective method with the cumulative effect recognized in the beginning retained earnings during the period of initial application. Subsequently, the FASB issued several additional ASUs related to ASU No. 2014-09, collectively they are referred to as the "new revenue standards", which became effective for the Company beginning January 1, 2018. The Company adopted the standard using the modified retrospective method. See Note 2, "Revenue" for details about the impact from adopting the new revenue standard and other required disclosures.





## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

In January 2016, the FASB issued ASU 2016-01, Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. ASU 2016-01 amended various aspects of the recognition, measurement, presentation, and disclosure of financial instruments, and became effective for the Company beginning January 1, 2018. One aspect that may have a material impact on the Company's consolidated financial statements relates to the measurement of its equity investments in privately-held companies whose fair values are not readily determinable. With the election to use the measurement alternative (as opposed to fair value), the Company measures these equity investments at cost, less impairments, adjusted by observable price changes. No gain or loss was recorded in the nine months ended September 30, 2018 as a result of remeasuring the Company's equity investments in privately-held companies.

## Recent accounting pronouncements

In August 2018, the FASB issued ASU No. 2018-15, Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract. This ASU clarifies the accounting treatment for implementation costs for cloud computing arrangements (hosting arrangements) that are service contracts. This standard becomes effective for the Company beginning January 1, 2020. The Company is currently assessing the effect that this ASU will have on its consolidated financial statements and related disclosures.

In July 2018, the FASB issued ASU No. 2018-11, Leases (Topic 842): Targeted Improvements. The standard provides an additional transition method that allows entities to apply the new leases standard at adoption date and recognize a cumulative effect adjustment to the opening balance of retained earnings in the period of adoption. The Company will elect this new transition method when it adopts ASU 2016-02 on January 1, 2019.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). The standard requires lessees to recognize almost all leases on the balance sheet as a right-of-use asset and a lease liability and requires leases to be classified as either an operating or a finance type lease. The standard excludes leases of intangible assets or inventory. Early adoption of the standard is allowed. The standard becomes effective for the Company beginning January 1, 2019. The Company expects that the adoption of the standard will have a material impact on its consolidated balance sheets due to the recognition of the right-of-use assets and lease liabilities related to the Company's operating leases. In addition, a material portion of the Company's leases are denominated in currencies other than the U.S. Dollar, mainly in New Israeli Shekels ("NIS"). As a result, the associated lease liabilities will be remeasured using the current exchange rate in the future reporting periods, which may result in material foreign exchange gains or losses. The Company is currently reviewing its options to address this foreign exchange exposure. Other than the matters discussed above, the standard is not expected to have a material impact on the Company's results of operations or cash flows. The Company is continuing its assessment, which may identify additional impacts this guidance will have on its consolidated financial statements and disclosures.

## NOTE 2—REVENUE

On January 1, 2018, the Company adopted ASC Topic 606-10 using the modified retrospective method and applied the standard to those contracts which were not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under Topic 606-10, while prior period amounts are not adjusted and continue to be reported in accordance with the historic accounting under Topic 605.

The Company recognized the cumulative effect of initially adopting Topic 606-10 as an adjustment to the opening balance of retained earnings as of January 1, 2018. Distributor revenue was recognized using the sell-through method under Topic 605, while such revenue is recognized using the sell-in method under Topic 606-10, which primarily contributed to the adjustment to the opening balance of retained earnings as well as the impact of adoption disclosed in the tables below.

The cumulative effect of the changes made to the consolidated balance sheet as of January 1, 2018 for the adoption of Topic 606-10 were as follows:

## Adjustments

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	December 31, 2017	January 1, 2018
	(in thousands)	
Deferred revenue, short term	\$23,485	\$18,984
Retained earnings	\$181,630	\$186,131

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## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

In accordance with Topic 606-10, the disclosure of the impact of adoption on the consolidated balance sheet as of September 30, 2018 was as follows:

	As Reported	Impact of Adoption	Amounts under Topic 605
(in thousands)			

## Condensed Consolidated Balance Sheet

Deferred revenue, short term	\$20,326	\$10,550	\$30,876
Retained earnings	\$277,557	\$(10,550)	\$267,007

In accordance with Topic 606-10, the disclosure of the impact of adoption on the consolidated statement of operations and cash flows was as follows:

Three Months Ended September 30, 2018			
	As Reported	Impact of Adoption	Amounts under Topic 605
(in thousands, except per share data)			

## Condensed Consolidated Statement of Operations

Total revenues	\$279,211	\$ 550	\$279,761
Cost of revenues	95,562	200	95,762
Net income	\$37,057	\$ 350	\$37,407
Earnings per share			
Basic	\$0.70	\$ —	\$0.70
Diluted	\$0.68	\$ —	\$0.68

Nine Months Ended September  
30, 2018

	As Reported	Impact of Adoption	Amounts under Topic 605
(in thousands, except per share data)			

## Condensed Consolidated Statement of Operations

Total revenues	\$798,673	\$(8,549 )	\$790,124
Cost of revenues	288,228	(2,500 )	285,728
Net income	\$91,426	\$(6,049 )	\$85,377
Earnings per share			
Basic	\$1.74	\$(0.12 )	\$1.62
Diluted	\$1.68	\$(0.11 )	\$1.57

## Condensed Consolidated Statement of Cash Flows

Cash flows from operating activities:

Net income	\$91,426	\$(6,049 )	\$85,377
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Accrued liabilities and other liabilities                      \$(4,273 ) \$ 6,049    \$ 1,776

Revenues by geographic region are as follows (prior period amounts have not been adjusted under the modified retrospective method):

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## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(in thousands)			
United States	\$93,566	\$84,502	\$291,222	\$238,453
China	76,514	55,352	186,909	120,543
Europe	51,123	40,870	128,573	126,103
Other Americas	39,709	27,690	100,561	69,938
Other Asia	18,299	17,285	91,408	71,275
Total revenue	\$279,211	\$225,699	\$798,673	\$626,312

The following tables represent our total revenues for the three and nine months ended September 30, 2018 and 2017 by product type and interconnect protocol (prior period amounts have not been adjusted under the modified retrospective method):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(in thousands)			
ICs	\$46,397	\$48,074	\$103,918	\$124,559
Boards	130,047	84,247	384,806	228,964
Switch systems	53,484	56,677	166,205	160,012
Cables, accessories and other	49,283	36,701	143,744	112,777
Total revenue	\$279,211	\$225,699	\$798,673	\$626,312

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(in thousands)			
InfiniBand:				
EDR	\$51,658	\$45,067	\$166,923	\$144,126
FDR	33,227	46,123	110,624	138,930
QDR/DDR/SDR	12,980	8,995	25,567	22,225
Total	97,865	100,185	303,114	305,281
Ethernet	175,517	110,673	469,935	278,173
Other	5,829	14,841	25,624	42,858
Total revenue	\$279,211	\$225,699	\$798,673	\$626,312

The Company recognizes contract liabilities, or deferred revenues, when it receives advance payments from customers before performance obligations primarily related to extended warranty and post-contract customer support have been performed. Advance payments are received at the beginning of the service period and the related deferred revenues are reclassified to revenue ratably over the service period. The balance of deferred revenues approximates the aggregate amount of the transaction price allocated to the unsatisfied performance obligations at the end of reporting period. The Company expects to recognize the long-term portion of deferred revenue over the remaining service period of up to five years.



## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

The following table presents the significant changes in the deferred revenue balance during the nine months ended September 30, 2018:

	(in thousands)
Balance, beginning of the period	\$ 36,804
New performance obligations	21,305
Reclassification to revenue as a result of satisfying performance obligations	(19,954 )
Balance, end of the period	38,155
Less: long-term portion of deferred revenue	17,829
Current portion, end of the period	\$ 20,326

Because all performance obligations in the Company's contracts with customers, other than extended warranty and post-contract customer support, relate to contracts with a duration of less than one year, the Company has elected to apply the optional exemption and is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period.

## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

## NOTE 3—BALANCE SHEET COMPONENTS:

	September 30, 2018	December 31, 2017
	(in thousands)	
Accounts receivable, net:		
Accounts receivable, gross	\$ 143,404	\$ 154,845
Less: allowance for doubtful accounts	(632 )	(632 )
	\$ 142,772	\$ 154,213
Inventories:		
Raw materials	\$ 13,643	\$ 12,656
Work-in-process	44,194	22,769
Finished goods	47,212	29,232
	\$ 105,049	\$ 64,657
Other current assets:		
Prepaid expenses	\$ 4,969	\$ 7,518
Derivative contracts receivable	23	982
VAT receivable	4,442	2,259
Other	5,241	3,536
	\$ 14,675	\$ 14,295
Property and equipment, net:		
Computer, equipment, and software	\$ 177,037	\$ 164,707
Furniture and fixtures	2,740	3,198
Leasehold improvements	49,889	47,262
	229,666	215,167
Less: Accumulated depreciation and amortization	(124,659 )	(105,248 )
	\$ 105,007	\$ 109,919
Deferred taxes and other long-term assets:		
Equity investments in private companies	\$ 36,755	\$ 29,255
Deferred taxes	52,536	24,563
Long-term restricted cash	7,942	8,025
Other assets	2,602	4,319
	\$ 99,835	\$ 66,162
Accrued liabilities:		
Payroll and related expenses	\$ 60,705	\$ 71,868
Accrued expenses	27,520	31,951
Intangible asset financings	5,564	6,915
Derivative contracts payable	900	17
Product warranty liability	813	706
Other	4,924	2,601
	\$ 100,426	\$ 114,058
Other long-term liabilities:		
Income tax payable	\$ 28,143	\$ 24,425
Deferred rent	2,545	2,220
Other	5,080	7,422
	\$ 35,768	\$ 34,067





## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

## NOTE 4—FAIR VALUE MEASUREMENTS:

## Fair value hierarchy:

The Company measures its cash equivalents and marketable securities at fair value. The Company's cash equivalents are classified within Level 1. Cash equivalents are valued primarily using quoted market prices utilizing market observable inputs. The Company's investments in debt securities and certificates of deposits are classified within Level 2 as the market inputs to value these instruments consist of market yields, reported trades and broker/dealer quotes. In addition, foreign currency contracts are classified within Level 2 as the valuation inputs are based on quoted prices and market observable data of similar instruments. The Level 3 valuation inputs include the Company's best estimate of what market participants would use in pricing the asset or liability at the measurement date. The inputs are unobservable in the market and significant to the instrument's valuation. As of September 30, 2018 and December 31, 2017, the Company did not have any assets or liabilities valued based on Level 3 valuations.

## Financial Assets and Liabilities Measured at Fair Value on a Recurring Basis:

The following table represents the fair value hierarchy of the Company's financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2018:

	Level 1	Level 2	Total
	(in thousands)		
Money market funds	\$10,103	\$—	\$10,103
Certificates of deposit	—	74,873	74,873
U.S. Government and agency securities	—	36,170	36,170
Commercial paper	—	45,438	45,438
Corporate bonds	—	98,548	98,548
Municipal bonds	—	9,688	9,688
Foreign government bonds	—	21,238	21,238
	10,103	285,955	296,058
Long-term restricted cash	—	7,942	7,942
Derivative contracts	—	23	23
Total financial assets	\$10,103	\$293,920	\$304,023
Derivative contracts	—	900	900
Total financial liabilities	\$—	\$900	\$900

## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

The following table represents the fair value hierarchy of the Company's financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2017:

	Level 1	Level 2	Total
	(in thousands)		
Money market funds	\$1,857	\$—	\$1,857
Certificates of deposit	—	58,003	58,003
U.S. Government and agency securities	—	43,872	43,872
Commercial paper	—	27,029	27,029
Corporate bonds	—	54,447	54,447
Municipal bonds	—	15,169	15,169
Foreign government bonds	—	12,761	12,761
	1,857	211,281	213,138
Long-term restricted cash	—	8,025	8,025
Derivative contracts	—	982	982
Total financial assets	\$1,857	\$220,288	\$222,145
Derivative contracts	—	17	17
Total financial liabilities	\$—	\$17	\$17

There were no transfers between Level 1 and Level 2 securities during the nine months ended September 30, 2018 and 2017.

## NOTE 5—INVESTMENTS:

## Cash, cash equivalents and short-term investments:

The short-term investments are classified as available-for-sale securities. The cash, cash equivalents and short-term investments at September 30, 2018 and December 31, 2017 were as follows:

	September 30, 2018			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
	(in thousands)			
Cash and cash equivalents	\$54,122	\$ 23	\$ —	\$54,145
Money market funds	10,103	—	—	10,103
Certificates of deposit	74,922	—	(49 )	74,873
U.S. Government and agency securities	36,260	—	(90 )	36,170
Commercial paper	45,482	1	(45 )	45,438
Corporate bonds	98,863	—	(315 )	98,548
Municipal bonds	9,715	—	(27 )	9,688
Foreign government bonds	21,292	—	(54 )	21,238
Total	350,759	24	(580 )	350,203
Less amounts classified as cash and cash equivalents	(64,225 )	(23 )	—	(64,248 )
Short-term investments	\$286,534	\$ 1	\$ (580 )	\$285,955

## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

	December 31, 2017			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
	(in thousands)			
Cash and cash equivalents	\$60,616	\$ —	\$ —	\$60,616
Money market funds	1,857	—	—	1,857
Certificates of deposit	58,039	—	(36 )	58,003
U.S. Government and agency securities	44,070	—	(198 )	43,872
Commercial paper	27,073	1	(45 )	27,029
Corporate bonds	54,673	—	(226 )	54,447
Municipal bonds	15,227	—	(58 )	15,169
Foreign government bonds	12,809	—	(48 )	12,761
Total	274,364	1	(611 )	273,754
Less amounts classified as cash and cash equivalents	(62,473 )	—	—	(62,473 )
Short-term investments	\$211,891	\$ 1	\$ (611 )	\$211,281

Interest income and gains on short-term investments, net were \$1.5 million and 1.0 million for the three months ended September 30, 2018 and 2017, respectively. Interest income and gains on short-term investments, net were \$3.4 million and \$2.8 million for the nine months ended September 30, 2018 and 2017, respectively. At September 30, 2018, gross unrealized losses on investments that were in a gross unrealized loss position for greater than 12 months were \$0.2 million. These investments were not deemed to be other-than-temporarily impaired and the gross unrealized losses were recorded in other comprehensive income (loss) ("OCI").

The contractual maturities of short-term investments at September 30, 2018 and December 31, 2017 were as follows:

	September 30, 2018		December 31, 2017	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
	(in thousands)			
Due in less than one year	\$237,434	\$237,055	\$148,232	\$147,921
Due in one to three years	49,100	48,900	63,659	63,360
	\$286,534	\$285,955	\$211,891	\$211,281

Equity investments in privately-held companies:

As of September 30, 2018 and December 31, 2017, the Company held a total of \$36.8 million and \$29.3 million, respectively, in equity investments in privately-held companies. No gain or loss was recorded during the nine months ended September 30, 2018 as a result of remeasuring the Company's equity investments in privately-held companies.

## NOTE 6—GOODWILL AND INTANGIBLE ASSETS:

The following table represents changes in the carrying amount of goodwill:

## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

Balance as of December 31, 2017 \$472,437

Acquisitions 1,479

Balance as of September 30, 2018 \$473,916

The carrying amounts of intangible assets as of September 30, 2018 were as follows:

	Gross Carrying Value (in thousands)	Accumulated Amortization	Net Carrying Value	Useful Life (in years)
Licensed technology	\$49,399	\$ (26,499 )	\$22,900	1-8
Developed technology	285,443	(154,643 )	130,800	4-7
Customer relationships	69,776	(29,680 )	40,096	4-9
Trade names	5,600	(4,856 )	744	3
Total intangible assets	\$410,218	\$ (215,678 )	\$194,540	

The carrying amounts of intangible assets as of December 31, 2017 were as follows:

	Gross Carrying Value (in thousands)	Accumulated Amortization	Net Carrying Value	Useful Life (in years)
Licensed technology	\$40,407	\$ (16,478 )	\$23,929	1-8
Developed technology	279,543	(122,414 )	157,129	4-7
Customer relationships	69,776	(24,783 )	44,993	4-9
Trade names	5,600	(3,456 )	2,144	3
Total intangible assets	\$395,326	\$ (167,131 )	\$228,195	

Amortization expense of intangible assets totaled approximately \$15.7 million and \$15.2 million for the three months ended September 30, 2018 and 2017, respectively. Amortization expense of intangible assets totaled approximately \$48.5 million and \$45.3 million for the nine months ended September 30, 2018 and 2017, respectively.

The estimated future amortization expense from amortizable intangible assets is as follows:

	(in thousands)
2018 (remainder of the year)	\$ 17,048
2019	61,756
2020	54,372
2021	33,018
2022	11,950
Thereafter	16,396
Total	\$ 194,540

## NOTE 7—DERIVATIVES AND HEDGING ACTIVITIES:

The Company enters into foreign currency forward and option contracts with financial institutions to protect against foreign exchange risks, mainly the exposure to changes in the exchange rate of the NIS against the U.S. dollar that are associated with forecasted cash flows and existing assets and liabilities. The Company accounts for its derivative instruments as

MELLANOX TECHNOLOGIES, LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

either assets or liabilities and carries them at fair value. The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and the resulting designation.

Fair Value of Derivative Contracts

The fair value of derivative contracts in the unaudited condensed consolidated balance sheets at September 30, 2018 and December 31, 2017 were as follows:

	Other current assets	Accrued liabilities	Other current assets	Accrued liabilities
	September 30, 2018	September 30, 2018	December 31, 2017	December 31, 2017
	(in thousands)			
Derivatives designated as hedging instruments				
Currency forward and option contracts	\$23	\$ 882	\$ 980	\$ —
Derivatives not designated as hedging instruments				
Currency forward and option contracts	\$—	\$ 18	\$ 2	\$ 17
Total derivatives	\$23	\$ 900	\$ 982	\$ 17

The gross notional amounts of derivative contracts were NIS denominated. The notional amounts of outstanding derivative contracts in U.S. dollars at September 30, 2018 and December 31, 2017 were as follows:

	September 30, 2018	December 31, 2017
	(in thousands)	
Derivatives designated as hedging instruments		
Currency forward and option contracts	\$64,075	\$ 52,380
Derivatives not designated as hedging instruments		
Currency forward and option contracts	\$38,599	\$ 47,015

Effect of Derivatives Designated as Hedging Instruments on Accumulated Other Comprehensive Income

The following table represents the unrealized gains (losses) of derivatives designated as hedging instruments, net of tax effects, that were recorded in accumulated other comprehensive income as of September 30, 2018 and December 31, 2017 and their effect on OCI for the nine months ended September 30, 2018:

	(in thousands)
December 31, 2017	\$ 925
Amount of loss recognized in OCI (effective portion)	(4,528 )
Amount of loss reclassified from OCI to income (effective portion)	2,689
September 30, 2018	\$ (914 )

Effect of Derivative Contracts on the Unaudited Condensed Consolidated Statement of Operations

The effect of derivative contracts on the unaudited condensed consolidated statements of operations for the three months ended September 30, 2018 and 2017 was as follows:

Derivatives designated as hedging instruments	Derivatives not designated as hedging instruments

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	Three Months Ended September 30,	Three Months Ended September 30,	Three Months Ended September 30,	Three Months Ended September 30,
	2018	2017	2018	2017
	(in thousands)			
Operating income (loss)	\$(1,805)	\$1,976	\$—	\$—
Other income (loss)	\$—	\$—	\$66	\$(538)

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## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

The effect of derivative contracts on the unaudited condensed consolidated statements of operations for the nine months ended September 30, 2018 and 2017 was as follows:

	Derivatives designated as hedging instruments Nine Months Ended September 30, 2018		Derivatives not designated as hedging instruments Nine Months Ended September 30, 2017	
	(in thousands)			
Operating income (loss)	\$ (2,689)	\$ 5,791	\$ —	\$ —
Other income (loss)	\$ —	\$ —	\$ (2,638)	\$ 2,767

## NOTE 8—COMMITMENTS AND CONTINGENCIES:

## Commitments

## Leases

At September 30, 2018, future minimum payments under non-cancelable operating leases are as follows:

	(in thousands)
2018 (remainder of the year)	\$ 5,946
2019	23,263
2020	19,728
2021	17,108
2022	12,689
Thereafter	76,640
Total minimum lease payments	\$ 155,374

## Purchase commitments

At September 30, 2018, the Company had the following non-cancelable purchase commitments:

	(in thousands)
2018 (remainder of the year)	\$ 120,545
2019	102,354
2020	2,096
2021	536
2022	261
Thereafter	—
	\$ 225,792

## Other Commitments

## Operating lease

On May 3, 2016, the Company entered into a lease agreement for additional office space expected to be built in Yokneam, Israel. The lease term expires 10 years after lease inception with no options to extend the lease term. The Company's occupancy of the additional office space and its obligation under the lease agreement was contingent on



the lessor's attainment of stated milestones in the lease agreement. The estimated total future lease obligation is approximately \$30.3 million. As of September 30, 2018, substantially all of the contingencies have been resolved, and the future lease obligation has been included in the future minimum payments under non-cancelable operating leases as reported above.

MELLANOX TECHNOLOGIES, LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

Royalty-bearing grants

In April 2018, the Company entered into a settlement agreement with the Israeli Innovation Authority, formerly known as the Office of the Chief Scientist of Israel's Ministry of Economy and Industry (the "IIA"), which eliminated the future contingent royalty payment obligations of the Company (approximately \$36.4 million at March 31, 2018) and the associated future interest payments. These obligations were related to the funding the Company received from the IIA prior to the date of the agreement under approved plans in accordance with the Israeli Law for Encouragement of Research, Development and Technological Innovation in Industry, 1984 and the regulations and rules of the IIA (the "R&D Law"). As part of the agreement, the Company paid approximately \$9.3 million to the IIA and the expense was included in cost of revenues during the second quarter of 2018. The Company could be subject to the payment to the IIA of transfer fees or license fees, if the related know-how is transferred outside of Israel.

Unrecognized tax benefits

Due to the inherent uncertainty with respect to the timing of future cash outflows associated with the Company's unrecognized tax benefits, it is unable to reliably estimate the timing of cash settlement with the respective taxing authorities. As of September 30, 2018, the Company's unrecognized tax benefits totaled \$48.9 million, out of which an amount of \$23.7 million would reduce the Company's income tax expense and effective tax rate, if recognized.

Contingencies

Legal proceedings

The Company is involved in a variety of claims, suits, investigations and proceedings that arise from time to time in the ordinary course of its business, including actions with respect to contracts, intellectual property, taxation, employment, benefits, securities, personal injuries and other matters. The results of these proceedings in the ordinary course of business are not expected to have a material adverse effect on the Company's condensed consolidated financial position or results of operations.

The Company records a liability when it believes that it is both probable that a liability will be incurred, and the amount of loss can be reasonably estimated. The Company evaluates, at least quarterly, developments in its legal matters that could affect the amount of liability that has been previously accrued and makes adjustments as appropriate. Significant judgment is required to determine both the probability and the estimated amount of a loss or potential loss. The Company may be unable to reasonably estimate the reasonably possible loss or range of loss for a particular legal contingency for various reasons, including, among others: (i) if the damages sought are indeterminate; (ii) if proceedings are in the early stages; (iii) if there is uncertainty as to the outcome of pending proceedings (including motions and appeals); (iv) if there is uncertainty as to the likelihood of settlement and the outcome of any negotiations with respect thereto; (v) if there are significant factual issues to be determined or resolved; (vi) if the proceedings involve a large number of parties; (vii) if relevant law is unsettled or novel or untested legal theories are presented; or (viii) if the proceedings are taking place in jurisdictions where the laws are complex or unclear. In such instances, there is considerable uncertainty regarding the ultimate resolution of such matters, including a possible eventual loss, if any.

NOTE 9—SHARE INCENTIVE PLANS

Stock Option Plans

On July 25, 2018, the Company's shareholders approved the Mellanox Technologies, Ltd. Third Amended and Restated Global Share Incentive Plan (2006) (the "Third Restated Plan"), which constitutes an amendment and restatement of the Mellanox Technologies, Ltd. Second Amended and Restated Global Share Incentive Plan (2006) (the "Second Restated Plan"). The Third Restated Plan increased the ordinary shares reserved for issuance under the Second Restated Plan by 2,077,000 shares to 4,467,000 shares plus any shares subject to issued and outstanding awards under certain of the Company's prior equity plans that expire, are cancelled or otherwise terminated after March 14, 2016, the effective date of the first amendment and restatement of the Global Share Incentive Plan (2006).

The Third Restated Plan also implements certain additional amendments, including specifically providing for the grant of performance share units.

## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

## Share option activity

Share option activity under the Company's equity incentive plans in the nine months ended September 30, 2018 is set forth below:

	Options Outstanding	
	Number	Weighted
	of Shares	Average
		Exercise
		Price
Outstanding at December 31, 2017	1,110,061	\$ 38.35
Options exercised	(451,878 )	\$ 23.05
Options canceled	(20,522 )	\$ 100.57
Outstanding at September 30, 2018	637,661	\$ 47.19

The total pretax intrinsic value of options exercised in the nine months ended September 30, 2018 and 2017 was \$25.5 million and \$6.3 million, respectively. This intrinsic value represents the difference between the fair market value of the Company's ordinary shares on the date of exercise and the exercise price of each option. Based on the closing price of the Company's ordinary shares of \$73.45 on September 28, 2018, the last trading day of the quarter ended September 30, 2018, the total pretax intrinsic value of options outstanding at September 30, 2018 was \$20.8 million. The total pretax intrinsic value of options outstanding at December 31, 2017 was \$35.5 million.

There were 636,308 and 1,107,712 options exercisable at September 30, 2018 and December 31, 2017, respectively. The total pretax intrinsic value of exercisable options at September 30, 2018 was \$20.7 million. The total pretax intrinsic value of exercisable options at December 31, 2017 was \$35.4 million.

## Restricted share unit activity

RSU activity under the Company's equity incentive plans in the nine months ended September 30, 2018 is set forth below:

	Restricted Share	
	Units Outstanding	Weighted
		Average
	Number of	Grant
	Shares	Date
		Fair
		Value
Non-vested restricted share units at December 31, 2017	3,414,705	\$ 48.45
Restricted share units granted	1,640,018	\$ 79.72
Restricted share units vested	(1,087,426)	\$ 48.07
Restricted share units canceled	(475,267 )	\$ 51.02
Non-vested restricted share units at September 30, 2018	3,492,030	\$ 62.90

The weighted average fair value of RSUs granted in the nine months ended September 30, 2018 and 2017 was \$79.72 and \$50.05, respectively.

The total intrinsic value of all outstanding RSUs as of September 30, 2018 and December 31, 2017 was \$256.5 million and \$220.9 million, respectively.

The non-vested restricted share units at September 30, 2018 included 36,000 performance share units.

## Employee Stock Purchase Plan activity

There were 490,123 and 568,876 shares purchased under the ESPP for the nine months ended September 30, 2018 and 2017 at an average price per share of \$46.62 and \$38.83, respectively.



## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

## Shares reserved for future issuance

The Company had the following ordinary shares reserved for future issuance under its equity incentive plans as of September 30, 2018:

	Number of Shares
Share options outstanding	637,661
Restricted share units outstanding	3,492,030
Shares authorized for future issuance	1,690,557
ESPP shares available for future issuance	2,935,346
Total shares reserved for future issuance as of September 30, 2018	8,755,594

## Share-based compensation

The Company accounts for share-based compensation expense based on the estimated fair value of the share equity awards as of the grant dates.

The following weighted average assumptions were used to value ESPP shares issued pursuant to the Company's share incentive plans for the nine months ended September 30, 2018 and 2017:

	Nine Months Ended September 30,	
	2018	2017
Dividend yield	— %	— %
Expected volatility	24.9%	24.6%
Risk free interest rate	2.36%	1.20%
Expected life, years	0.5	0.5

The following table summarizes the distribution of total share-based compensation expense in the unaudited condensed consolidated statements of operations:

	Three Months Ended September		Nine Months Ended September	
	30, 2018	2017	30, 2018	2017
	(in thousands)			
Cost of goods sold	\$515	\$473	\$1,341	\$1,530
Research and development	10,395	10,811	26,909	29,799
Sales and marketing	4,645	4,336	11,890	11,684
General and administrative	3,601	2,940	8,906	7,980
Total share-based compensation expense	\$19,156	\$18,560	\$49,046	\$50,993

At September 30, 2018, there was \$205.2 million of total unrecognized share-based compensation costs related to non-vested share-based compensation arrangements. The costs are expected to be recognized over a weighted average period of approximately 3.07 years.

## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

## NOTE 10—ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS):

The following table summarizes the changes in accumulated balances of other comprehensive income (loss) for the nine months ended September 30, 2018 and 2017:

	Unrealized Gains (Losses) on Available-for-Sale Securities	Unrealized Gains (Losses) on Derivatives Designated as Hedging Instruments	Total
	(in thousands)		
Balance at December 31, 2017	\$693	\$ 925	\$1,618
Other comprehensive income/(loss) before reclassifications, net of taxes	50	(4,528 )	(4,478 )
Realized (gains)/losses reclassified from accumulated other comprehensive income	4	2,689	2,693
Net current-period other comprehensive income/(loss), net of taxes	54	(1,839 )	(1,785 )
Balance at September 30, 2018	\$747	\$ (914 )	\$(167 )
Balance at December 31, 2016	\$(236)	\$ (692 )	\$(928 )
Other comprehensive income/(loss) before reclassifications, net of taxes	5	7,844	7,849
Realized (gains)/losses reclassified from accumulated other comprehensive income	6	(5,791 )	(5,785 )
Net current-period other comprehensive income/(loss), net of taxes	11	2,053	2,064
Balance at September 30, 2017	\$(225)	\$ 1,361	\$1,136

The following table provides details about reclassifications out of accumulated other comprehensive income (loss) for the nine months ended September 30, 2018 and 2017:

	Realized (Gains)/Losses Reclassified from Accumulated Other Comprehensive Income (Loss) Nine Months Ended September 30, 2018 2017 (in thousands)	Affected Line Item in the Statement of Operations
Realized (gains)/losses on derivatives designated as hedging instruments	\$2,689 \$(5,791)	Cost of revenues and Operating expenses:
	132 (329 )	Cost of revenues
	304 (644 )	General and administrative
	238 (566 )	Sales and marketing
	2,015 (4,252 )	Research and development
Realized (gains)/losses on available-for-sale securities	4 6	Other income, net
Total reclassifications for the period	\$2,693 \$(5,785)	Total

NOTE 11—INCOME TAXES:

As of September 30, 2018 and December 31, 2017, the Company had gross unrecognized tax benefits of \$48.9 million and \$45.2 million, respectively. It is the Company's policy to classify accrued interest and penalties as part of the unrecognized tax benefits and record the expense in the provision for income taxes. The amount of accrued interest and penalties related to unrecognized tax benefits totaled \$2.6 million at September 30, 2018 and \$1.6 million at December 31, 2017.



MELLANOX TECHNOLOGIES, LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

During the nine months ended September 30, 2018, the Company released \$26.1 million of valuation allowance against the deferred tax assets primarily related to net operating loss carryforwards ("NOLs") and tax credit carryforwards related to its U.S. subsidiaries. After the discontinuation of the Company's 1550nm silicon photonics development activities in the first quarter of fiscal 2018, the Company expects its U.S. subsidiaries will have sufficient taxable income in the future to utilize the deferred tax assets before they expire.

On December 22, 2017, the Tax Cuts and Jobs Acts was enacted into law. The new legislation contains several key tax provisions that will impact the Company. Changes include, but are not limited to, a corporate tax rate decrease from 35% to 21% effective for tax years beginning after December 31, 2017, a one-time repatriation tax on accumulated foreign earnings, an elimination of U.S. federal income taxes on dividends from foreign subsidiaries, a limitation on the tax deductibility of interest expense, limitations to the deductibility of executive officers remuneration, and a change in rules related to uses and limitations of NOLs created in tax years beginning after December 31, 2017.

The lower corporate income tax rate required the Company to remeasure its U.S. deferred tax assets and liabilities as of December 31, 2017 as well as reassess the realizability of its deferred tax assets and liabilities. ASC 740 requires the Company to recognize the effect of the tax law changes in the period of enactment. However, the SEC staff has issued SAB 118 which allowed the Company to record provisional amounts during a measurement period.

The Company has concluded that a reasonable estimate could be developed for the effects of the tax reform, and recorded a provisional decrease to deferred tax assets of \$3.2 million and corresponding decrease to the valuation allowance as of December 31, 2017. However, due to the fundamental changes of the tax law, the accounting complexity, and the expected ongoing guidance and accounting interpretations during the measurement period, the Company considers the accounting for the deferred tax remeasurement and other items to be incomplete. These effects have been included in the consolidated financial statements for the year ended December 31, 2017 as provisional amounts.

During the measurement period, the Company might need to reflect adjustments to the provisional amounts upon obtaining, preparing, or analyzing additional information about facts and circumstances that existed as of the enactment date that, if known, would have affected the income tax effects initially reported as provisional amounts.

No adjustments to the provisional amounts were recorded during the nine months ended September 30, 2018.

The measurement period will end when the Company obtains, prepares, and analyzes the information needed in order to complete the accounting requirements under ASC Topic 740 or on December 22, 2018, whichever is earlier. The Company expects to complete its analysis within the measurement period in accordance with SAB 118.

On August 21, 2018, the Internal Revenue Service issued Notice 2018-68 providing guidance regarding amendments to Section 162(m) of the Internal Revenue Code contained in the Tax Act ("IRS Guidance"), which limit tax deductions for compensation granted to certain executives. Our provision for income taxes for the three and nine months ended September 30, 2018 includes the impact of this tax deduction limitation. However, the impact is not material.

As of September 30, 2018, the 2014 through 2017 tax years are open and may be subject to potential examinations in the United States. The Company has NOLs in the United States from prior tax periods beginning in 2003 which may be subject to examination upon utilization in future tax periods. As of September 30, 2018, the 2013 through 2017 tax years are open and may be subject to potential examinations in Denmark and Israel. As of September 30, 2018, the income tax returns of the Company and one of its subsidiaries in Israel are under examination by the Israeli Income Tax Authorities for certain years from 2013 to 2015.

The Company's operations in Israel were granted "Approved Enterprise" status by the Investment Center in the Israeli Ministry of Economy and Industry and "Beneficiary Enterprise" status from the Israeli Income Tax Authority, which makes the Company eligible for tax benefits under the Israeli Law for Encouragement of Capital Investments, 1959 (the "Encouragement Law"). Under the terms of the Beneficiary Enterprise program, income that is attributable to the Company's operations in Yokneam, Israel, is exempt from income tax commencing fiscal year 2011 through 2021. Income that is attributable to the Company's operations in Tel Aviv, Israel is subject to a reduced income tax rate

(generally between 10.0% and the current corporate tax rate, depending on the percentage of foreign investment in the Company) commencing fiscal year 2013 through 2021. The tax holiday has resulted in a cash tax savings of \$18.7 million for the nine months ended September 30, 2018, increasing diluted earnings per share by approximately \$0.34 in the nine months ended September 30, 2018.

On June 14, 2017, the Israeli government legislated new regulations regarding the "Preferred Technological Enterprise" regime, under which a company that complies with the terms may be entitled to certain tax benefits. The Company expects that its operation in Israel will comply with the terms of the Preferred Technological Enterprise regime. Therefore, the Company

## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

may utilize the tax benefits under this regime after the end of the benefit period of its Approved and Beneficiary Enterprise statuses (i.e. from fiscal year 2022 onwards). Under the new legislation, the majority of the Company's income from its operations in Yokneam, Israel, will be subject to a corporate rate of 7.5%, while the majority of the income from its operations in Tel-Aviv, Israel, will be subject to a corporate rate of 12.0%.

The Company's effective tax rate is highly dependent upon the geographic distribution of its worldwide earnings or losses, tax regulations and tax holiday benefits in Israel, and the effectiveness of the Company's tax planning strategies. The Company's effective tax rates were (34.0)% and (20.9)% for the nine months ended September 30, 2018 and 2017, respectively. The difference between the Company's effective tax rate and the 21.0% federal statutory rate for the nine months ended September 30, 2018 resulted primarily from the release of valuation allowance of \$26.1 million against the deferred tax assets related to U.S. subsidiaries, the excess benefits of share-based compensation, the tax holiday in Israel and foreign earnings taxed at rates lower than the federal statutory rates, partially offset by the accrual of unrecognized tax benefits, interest and penalties associated with unrecognized tax positions, non-tax-deductible expenses such as share-based compensation and losses generated from subsidiaries without tax benefit.

The application of income tax law is inherently complex. Laws and regulations in this area are voluminous and are often ambiguous, and the Company is required to make many subjective assumptions and judgments regarding its income tax exposures. In addition, interpretations of and guidance surrounding income tax laws and regulations are subject to change over time. Any changes in the Company's subjective assumptions and judgments could materially affect amounts recognized in its condensed consolidated balance sheets and statements of operations.

At September 30, 2018, the Company maintained a valuation allowance against deferred tax assets of certain subsidiaries. The Company assesses its ability to recover its deferred tax assets on an ongoing basis. Significant management judgment is required in determining any valuation allowance recorded against deferred tax assets. In evaluating the ability to recover deferred tax assets, the Company considers available positive and negative evidence including its recent cumulative losses, its ability to carry-back losses against prior taxable income and its projected financial results. The Company also considers, commensurate with its objective verifiability, the forecast of future taxable income including the reversal of temporary differences and the implementation of feasible and prudent tax planning strategies. A valuation allowance may be recorded in the event it is deemed to be more-likely-than-not that the deferred tax asset cannot be realized. Previously established valuation allowances may also be released in the event it is deemed to be more-likely-than-not that the deferred tax asset can be realized. Any release of valuation allowance will be recorded as a tax benefit which will positively impact the Company's operating results. Management has determined on the basis of the quarterly assessment performed at September 30, 2018, that these deferred tax assets are not more-likely-than-not to be realized.

## NOTE 12—OTHER INCOME, NET:

Other income, net is summarized in the following table:

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
	2018	2017	2018	2017
	(in thousands)			
Interest income and gains on short-term investments, net	\$1,459	\$1,018	\$3,398	\$2,846
Foreign exchange loss, net	(300 )	(94 )	(878 )	(414 )
Other	(47 )	32	(237 )	34
Other income, net	\$1,112	\$956	\$2,283	\$2,466

## NOTE 13—TERM DEBT:

In connection with the Company's acquisition of EZchip, on February 22, 2016, the Company and its wholly owned subsidiary, Mellanox Technologies, Inc., entered into a \$280.0 million variable interest rate Term Debt note maturing February 21, 2019. Debt issuance costs of \$5.5 million on the Term Debt were being amortized to interest expense at the effective interest rate over the contractual term of the Term Debt. The Term Debt allowed for voluntary prepayments at any time and additional term loan borrowings under certain conditions.

MELLANOX TECHNOLOGIES, LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

On April 30, 2018, the Company paid off all outstanding principal and interest related to the Term Debt. As a result, the unamortized debt issuance costs were fully amortized when the outstanding principal and interest were fully paid.

**NOTE 14—RESTRUCTURING CHARGES:**

In connection with the discontinuation of its 1550nm silicon photonics development activities, the Company initiated a restructuring plan to wind down the business operations related to these activities, which primarily included terminating employees, exiting contracts with vendors, selling assets, and exiting facilities.

The Company recorded no employee separation and severance costs during the three months ended September 30, 2018, and recorded \$3.5 million of such costs during the nine months ended September 30, 2018. The Company has completed the employee termination activities, and does not expect additional costs related to employee terminations in future periods.

The Company recorded no contract exit costs with vendors during the three months ended September 30, 2018, and recorded \$3.4 million of such costs during the nine months ended September 30, 2018. The Company does not expect additional exit costs in future periods.

The Company recorded no impairment charges or losses on disposal of assets during the three months ended September 30, 2018, and recorded \$2.4 million of such costs during the nine months ended September 30, 2018. The Company does not expect additional losses on the disposal of assets in future periods.

As of September 30, 2018, the Company is still using the facilities related to the discontinued activities and therefore has not recorded any related restructuring charges. The Company expects to record up to \$0.5 million of facility related charges in the fourth quarter of 2018.

**NOTE 15—RELATED PARTY TRANSACTIONS:**

On June 19, 2018, the Company entered into a settlement agreement (the “Settlement Agreement”) by and among the Company and Starboard Value LP and certain of its affiliates (“Starboard”), together holding, on such date, approximately 10.3% of the Company’s outstanding ordinary shares. The Settlement Agreement provided for, among other things, the concurrent resignations of three members of the Company’s Board of Directors (the “Board”) and the concurrent appointment of two independent directors nominated by Starboard and one mutually agreed upon independent nominee to the Board. Starboard also agreed to terminate its proxy contest against the Company and withdraw its notice of shareholder nomination of individuals for election as directors at the Company’s 2018 annual general meeting of shareholders. Furthermore, the Company agreed to reimburse Starboard for its reasonable, documented out-of-pocket fees and expenses (including legal expenses) incurred through the date of the Settlement Agreement in connection with Starboard’s interactions with the Company up to a maximum of \$2.0 million. On July 11, 2018, the Company paid \$2.0 million for such costs to Starboard.

## 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 September 30, 2018 and results of operations for the three and nine months ending September 30, 2018 and 2017 should be read together with our financial statements and related notes included elsewhere in this report. This discussion and analysis contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), that involve risks, uncertainties and assumptions. Words such as "believe," "may," "will," "estimate," "continue," "anticipate," "intend," "expect," "predict," "potential" and similar expressions, as they relate to us, our business and our management, are intended to identify forward-looking statements, but are not the exclusive means of identifying forward-looking statements in this report. The identification of certain statements as "forward-looking" is not intended to mean that other statements not specifically identified are not forward-looking. All statements other than statements about historical facts are statements that could be deemed forward-looking statements, including, but not limited to, statements that relate to our future revenues, product development and introductions, customer demand, our dependence on key customers for a substantial portion of our revenue, performance of our subcontractors, growth rates, market adoption of our products, competitive factors, gross margins, levels of research, development and other related costs, expenditures, protection of our proprietary rights and patents, tax expenses and benefits, cash flows, management's plans and objectives for current and future operations, and worldwide economic conditions.

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 the section entitled "Risk Factors" in Part II, Item 1A of this report and in the section entitled "Risk Factors" in Part 1, Item 1A of our Annual Report on Form 10-K for fiscal year ended December 31, 2017. 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.

Unless the context requires otherwise, references in this report to the "Company," "we," "us" and "our" refer to Mellanox Technologies, Ltd. and its wholly owned subsidiaries.

### Overview

#### General

We are a fabless semiconductor company that designs, manufactures (through subcontractors) and sells high-performance interconnect products and solutions primarily based on the Ethernet and InfiniBand standards. Our products facilitate efficient data transmission between servers, storage systems, communications infrastructure equipment and other embedded systems. We operate our business globally and offer products to customers at various levels of integration. The products we offer include integrated circuits ("ICs"), adapter cards, switch systems, cables, modules, software, services and accessories. Together these products form a total end-to-end integrated networking solution focused on computing, storage and communication applications used in multiple markets, including cloud, Web 2.0, High Performance Computing ("HPC"), Big Data, machine learning, storage, telecommunications, financial services, and enterprise data centers. These solutions increase performance, application efficiency and improve return on investment. Through the successful development and implementation of multiple generations of our products, we have established significant expertise and competitive advantages.

As a leader in developing multiple generations of high-speed interconnect solutions, we have established strong relationships with our customers. Our products are incorporated in servers and associated networking solutions produced by the largest server vendors. We supply our products to leading storage and communications infrastructure equipment vendors. Additionally, our products are used in embedded solutions.

We are a leader in high performance Ethernet interconnects, including adapters, switches, and optical and copper cables and transceivers. We have gained significant market share in the 25Gb/s and greater market segment and are the leading provider of adapters at these speeds. We work closely with key cloud, web 2.0, server, storage, machine learning and telco customers to develop hardware and software that accelerate workloads and make data centers more

efficient. This deep engagement with our customers enables us to deliver unique acceleration capabilities and thereby differentiate our products from our competitors. This provides us with the opportunity to gain share in the Ethernet market as users upgrade from 1Gb/s or 10Gb/s directly to 25/40/50 or 100Gb/s.

We are one of the pioneers of InfiniBand, an industry-standard architecture for high-performance interconnects. We believe InfiniBand interconnect solutions deliver industry-leading performance, efficiency and scalability for clustered computing and storage systems that incorporate our products. We are the leader in the HPC and machine learning markets and

provide the most efficient, highest bandwidth, and lowest latency end to end interconnect solutions for scientific, data intensive, big data, and analytics applications.

#### Our Business

Revenues. We derive revenues from sales of our ICs, boards, switch systems, cables, modules, software, accessories and other product groups. Revenues for the three months ended September 30, 2018 were \$279.2 million compared to \$225.7 million for the three months ended September 30, 2017, representing an increase of \$53.5 million, or approximately 23.7%. Revenues for the nine months ended September 30, 2018 were \$798.7 million compared to \$626.3 million for the nine months ended September 30, 2017, representing an increase of \$172.4 million, or approximately 27.5%. Our revenues for the nine months ended September 30, 2018 are not necessarily indicative of our future results. In order to increase our annual revenues, we must continue to achieve design wins over other Ethernet providers and providers of competing interconnect technologies. We consider a design win to occur when an original equipment manufacturer ("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.

Our products have broad adoption with multiple end customers across cloud, Web 2.0, HPC, Big Data, artificial intelligence, machine learning, storage, telecommunications, enterprise data center, financial services, and media and entertainment markets. These markets are mainly served by leading server, storage and communications infrastructure OEMs. Therefore, we have derived a substantial portion of our revenues from a relatively small number of OEM customers. Sales to our top ten customers represented 54% and 56% of our total revenues for the nine months ended September 30, 2018 and 2017, respectively. Sales to customers representing 10% or more of revenues accounted for 24% of our total revenues for both the nine months ended September 30, 2018 and 2017, respectively. The loss of one or more of our principal customers, the reduction or deferral of purchases, or changes in the mix of our products ordered by any one of these customers could cause our revenues to decline materially if we are unable to increase our revenues from other customers. 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.

Cost of revenues and gross profit. The cost of revenues consists primarily of the cost of silicon wafers purchased from our foundry supplier, costs associated with the assembly, packaging and production testing of our ICs, outside processing costs associated with the manufacture of our products, royalties due to third parties, warranty costs, excess and obsolete inventory costs, depreciation and amortization, and costs of personnel associated with production management, quality assurance and services. In addition, after we purchase wafers from our foundries, we also face 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 foundry suppliers and contract manufacturers.

Accordingly, our costs are subject to price fluctuations based on the overall 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, lead times for delivery from our adapter card manufacturing subcontractor are approximately eight to ten weeks, lead times for delivery from our cable and transceiver manufacturing subcontractor are approximately ten to twelve weeks, and lead times for delivery from our switch systems manufacturing subcontractors are approximately twelve weeks. We build inventory based on forecasts of customer orders rather than the actual orders themselves. During the recent quarters, our inventory has risen to higher than normal levels to meet expected future growth opportunities. As the growth opportunities are realized, we expect our inventory levels to decrease and the turnover to be more in line with our normal and historical levels during fiscal year 2019.

We expect our cost of revenues as a percentage of sales to increase in the future as a result of a reduction in the average sale price of our products and a lower percentage of revenue deriving from sales of ICs, which generally yield higher gross margins than sales of boards, switches and cables. This trend 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, share-based compensation and associated costs for employees engaged in research and development, depreciation, amortization of intangibles, allocable facilities related and administrative expenses and tape-out costs. Tape-out costs are expenses related to the

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manufacture of new ICs, including charges for mask sets, prototype wafers, mask set revisions and testing incurred before releasing new ICs into production.

**Sales and Marketing Expenses.** Sales and marketing expenses consist primarily of salaries, incentive compensation, share-based compensation and associated costs for employees engaged in sales, marketing and customer support, advertising, trade shows and promotions, travel, amortization of intangibles, and allocable facilities related and administrative expenses.

**General and Administrative Expenses.** General and administrative expenses consist primarily of salaries, share-based compensation and associated costs for employees engaged in finance, legal, human resources and administrative activities, professional service expenses for accounting, corporate legal fees and allocable facilities related and administrative expenses.

#### Taxes on Income

Our operations in Israel have been granted "Approved Enterprise" status by the Investment Center of the Israeli Ministry of Economy and Industry and "Beneficiary Enterprise" status by the Israeli Income Tax Authority, which makes us eligible for tax benefits under the Encouragement Law. Under the terms of the Beneficiary Enterprise program, income that is attributable to our operations in Yokneam, Israel is exempt from income tax commencing fiscal year 2011 through 2021. Income that is attributable to our operations in Tel Aviv, Israel is subject to a reduced income tax rate (generally between 10.0% and the current corporate tax rate, depending on the percentage of foreign investment in the Company) commencing fiscal year 2013 through 2021.

On June 14, 2017, the Israeli government legislated new regulations regarding the "Preferred Technological Enterprise" regime, under which a company that complies with the terms may be entitled to certain tax benefits. The Company expects that its operation in Israel will comply with the terms of the Preferred Technological Enterprise regime. Therefore, the Company may utilize the tax benefits under this regime after the end of the benefit period of its Approved and Beneficiary Enterprise statuses (i.e. from fiscal year 2022 onwards). Under the new legislation, the majority of the Company's income from its operations in Yokneam, Israel, will be subject to a corporate rate of 7.5%, while the majority of the income from its operations in Tel-Aviv, Israel, will be subject to a corporate rate of 12.0%. To prepare our unaudited condensed consolidated financial statements, we estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual tax exposure together with assessing temporary differences resulting from the differing treatment of certain items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our condensed consolidated balance sheet.

#### Critical Accounting Policies and Estimates

Our unaudited condensed consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States. The preparation of these unaudited condensed 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, allowances for doubtful accounts, investment valuation, warranty reserves, inventory reserves, long-term asset valuations, useful lives of property, equipment, and intangibles, accounting for business combinations, goodwill and purchased intangible asset valuation, investments in privately-held companies, accounting and fair value of financial instruments and derivatives, deferred income tax asset valuation, uncertain tax positions, and litigation and other loss contingencies have the greatest potential impact on our unaudited condensed consolidated financial statements. Therefore, we consider these to be our critical accounting policies and estimates.

See our Annual Report on Form 10-K for the year ended December 31, 2017, filed with the SEC on February 16, 2018, for a discussion of critical accounting policies and estimates. Other than the adoption of the new revenue standards as discussed in Notes 1, "The Company and Summary of Significant Accounting Policies" and 2, "Revenue" in the notes to the unaudited condensed consolidated financial statements, there have been no changes in our critical accounting policies as compared to what was disclosed in the Form 10-K for the year ended December 31, 2017.



Results of Operations

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Total revenues	100	% 100	% 100	% 100
Cost of revenues	34	34	36	34
Gross profit	66	66	64	66
Operating expenses:				
Research and development	34	40	33	43
Sales and marketing	13	17	14	18
General and administrative	5	6	7	6
Restructuring and impairment charges	—	—	1	—
Total operating expenses	52	63	55	67
Income (loss) from operations	14	3	9	(1 )
Interest expense	—	(1 )	—	(1 )
Other income, net	—	1	—	—
Interest and other, net	—	—	—	(1 )
Income (loss) before taxes on income	14	3	9	(2 )
Provision for (benefit from) taxes on income	1	1	(2 )	1
Net income (loss)	13	% 2	% 11	% (3 )

Comparison of the Three Months Ended September 30, 2018 to the Three Months Ended September 30, 2017

The following tables represent our total revenues for the three months ended September 30, 2018 and 2017 by product type and interconnect protocol:

	Three Months Ended September 30,			
	2018	% of Revenues	2017	% of Revenues
	(dollars in thousands)			
ICs	\$46,397	16.6 %	\$48,074	21.3 %
Boards	130,047	46.6 %	84,247	37.3 %
Switch systems	53,484	19.2 %	56,677	25.1 %
Cables, accessories and other	49,283	17.6 %	36,701	16.3 %
Total Revenue	\$279,211	100.0 %	\$225,699	100.0 %

	Three Months Ended September 30,			
	2018	% of Revenues	2017	% of Revenues
	(dollars in thousands)			
InfiniBand:				
EDR	\$51,658	18.5 %	\$45,067	20.0 %
FDR	33,227	11.9 %	46,123	20.4 %
QDR/DDR/SDR	12,980	4.7 %	8,995	4.0 %
Total	97,865	35.1 %	100,185	44.4 %
Ethernet	175,517	62.9 %	110,673	49.0 %
Other	5,829	2.0 %	14,841	6.6 %
Total revenue	\$279,211	100.0 %	\$225,699	100.0 %

Revenues. Revenues were \$279.2 million for the three months ended September 30, 2018, compared to \$225.7 million for the three months ended September 30, 2017, representing an increase of \$53.5 million, or approximately 23.7%.  
Ethernet

product sales increased by \$64.8 million due to the increased adoption of our 25 gigabit per second and above solutions. The revenues for the three months ended September 30, 2018 are not necessarily indicative of future results. Gross Profit and Margin. Gross profit was \$183.6 million for the three months ended September 30, 2018, compared to \$148.4 million for the three months ended September 30, 2017, representing an increase of \$35.3 million, or approximately 23.8%. Gross margin was 65.8% in the three months ended September 30, 2018, which was comparable to the gross margin of 65.7% in the three months ended September 30, 2017.

#### Research and Development.

The following table presents details of our research and development expenses for the periods indicated:

	Three Months Ended September 30,					
	2018	% of	2017	% of		
		Revenues		Revenues		
	(dollars in thousands)					
Salaries and benefits	\$51,564	18.6	%	\$50,480	22.4	%
Share-based compensation	10,396	3.8	%	10,812	4.8	%
Development and tape-out costs	10,546	3.8	%	8,115	3.6	%
Other	20,424	7.3	%	21,509	9.5	%
Total Research and development	\$92,930	33.5	%	\$90,916	40.3	%

Research and development expenses were \$92.9 million for the three months ended September 30, 2018, compared to \$90.9 million for the three months ended September 30, 2017, representing an increase of \$2.0 million, or approximately 2.2%. The increase in salaries and benefits expenses was primarily attributable to higher bonuses and merit-based increases, partially offset by headcount decreases primarily related to the discontinuation of our 1550nm silicon photonics development activities. The increase in development and tape-out costs was primarily due to higher tape-out costs during the three months ended September 30, 2018.

Please refer to "Share-based Compensation Expense" below for a discussion of its impact on research and development expenses.

#### Sales and Marketing.

The following table presents details of our sales and marketing expenses for the periods indicated:

	Three Months Ended September 30,					
	2018	% of	2017	% of		
		Revenues		Revenues		
	(dollars in thousands)					
Salaries and benefits	\$22,573	8.1	%	\$22,842	10.1	%
Share-based compensation	4,646	1.7	%	4,336	1.9	%
Trade shows and promotions	3,376	1.2	%	4,188	1.9	%
Other	5,749	2.0	%	6,463	2.9	%
Total Sales and marketing	\$36,344	13.0	%	\$37,829	16.8	%

Sales and marketing expenses were \$36.3 million for the three months ended September 30, 2018, compared to \$37.8 million for the three months ended September 30, 2017, representing a decrease of \$1.5 million, or approximately 3.9%. The decrease was primarily due to lower trade show activities and professional services.

Please refer to "Share-based Compensation Expense" below for a discussion of its impact on sales and marketing expenses.

## General and Administrative.

The following table presents details of our general and administrative expenses for the periods indicated:

	Three Months Ended September 30,					
	2018	% of Revenues		2017	% of Revenues	
	(dollars in thousands)					
Salaries and benefits	\$5,556	2.0	%	\$5,191	2.3	%
Share-based compensation	3,601	1.3	%	2,940	1.3	%
Professional services	2,946	1.1	%	3,185	1.4	%
Other	1,792	0.6	%	1,723	0.8	%
Total General and administrative	\$13,895	5.0	%	\$13,039	5.8	%

General and administrative expenses were \$13.9 million for the three months ended September 30, 2018, compared to \$13.0 million for the three months ended September 30, 2017, representing an increase of \$0.9 million, or approximately 6.6%.

Please refer to "Share-based Compensation Expense" below for a discussion of its impact on general and administrative expenses.

## Share-based Compensation Expense.

The following table presents details of our share-based compensation expense that is included in each functional line item in our condensed consolidated statements of operations:

	Three Months Ended September 30,	
	2018	2017
	(in thousands)	
Cost of goods sold	\$515	\$473
Research and development	10,395	10,811
Sales and marketing	4,645	4,336
General and administrative	3,601	2,940
	\$19,156	\$18,560

Share-based compensation expense was \$19.2 million for the three months ended September 30, 2018, compared to \$18.6 million for the three months ended September 30, 2017, representing an increase of \$0.6 million, or approximately 3.2%. The increase was mainly due to the higher grant date fair values of the 2018 RSU grants.

Restructuring and impairment charges for the three months ended September 30, 2018 primarily consisted of an impairment charge related to fixed assets.

Interest and other, net in the three months ended September 30, 2018 represented income of \$1.0 million as compared to an expense of \$1.1 million for the three months ended September 30, 2017. The change was primarily attributable to a decrease in interest expense of \$2.0 million related to the pay-down of the Term Debt.

Provision for (benefit from) taxes on income. Our provision for taxes on income was \$3.5 million for the three months ended September 30, 2018 as compared to a provision for taxes on income of \$2.1 million for the three months ended September 30, 2017.

Our effective tax rate was 8.7% and 38.4% for three months ended September 30, 2018 and 2017, respectively. For the three months ended September 30, 2018, the difference between the 8.7% effective tax rate and the 21.0% federal statutory rate resulted primarily from the excess benefits of share-based compensation, the tax holiday in Israel and foreign earnings taxed at rates lower than the federal statutory rates, partially offset by the accrual of unrecognized tax positions, interest and penalties associated with unrecognized tax positions, non-tax-deductible expenses such as share-based compensation expense, and losses generated from subsidiaries without tax benefits.

We assess our ability to recover our deferred tax assets on an ongoing basis. Significant management judgment is required in determining any valuation allowance recorded against deferred tax assets. In evaluating the ability to recover deferred tax assets, we consider available positive and negative evidence including our recent cumulative losses, our ability to carry-back





losses against prior taxable income and our projected financial results. We also consider, commensurate with objective verifiability, the forecast of future taxable income including the reversal of temporary differences and the implementation of feasible and prudent tax planning strategies. A valuation allowance may be recorded in the event it is deemed to be more-likely-than-not that the deferred tax asset cannot be realized. Previously established valuation allowances may also be released in the event it is deemed to be more-likely-than-not that the deferred tax asset can be realized. Any release of valuation allowance will be recorded as a tax benefit which will positively impact our operating results.

Comparison of the Nine Months Ended September 30, 2018 to the Nine Months Ended September 30, 2017

The following tables represent our total revenues for the nine months ended September 30, 2018 and 2017 by product type and interconnect protocol:

	Nine Months Ended September 30,					
	2018	% of Revenues		2017	% of Revenues	
	(dollars in thousands)					
ICs	\$103,918	13.0	%	\$124,559	19.9	%
Boards	384,806	48.2	%	228,964	36.6	%
Switch systems	166,205	20.8	%	160,012	25.5	%
Cables, accessories and other	143,744	18.0	%	112,777	18.0	%
Total Revenue	\$798,673	100.0	%	\$626,312	100.0	%

	Nine Months Ended September 30,					
	2018	% of Revenues		2017	% of Revenues	
	(dollars in thousands)					
InfiniBand:						
EDR	\$166,923	20.9	%	\$144,126	23.0	%
FDR	110,624	13.9	%	138,930	22.2	%
QDR/DDR/SDR	25,567	3.2	%	22,225	3.5	%
Total	303,114	38.0	%	305,281	48.7	%
Ethernet	469,935	58.8	%	278,173	44.4	%
Other	25,624	3.2	%	42,858	6.9	%
Total revenue	\$798,673	100.0	%	\$626,312	100.0	%

Revenues. Revenues were \$798.7 million for the nine months ended September 30, 2018, compared to \$626.3 million for the nine months ended September 30, 2017, representing an increase of \$172.4 million, or approximately 27.5%. Ethernet product sales increased by \$191.8 million due to the increased adoption of our 25 gigabit per second and above solutions. The revenues for the nine months ended September 30, 2018 are not necessarily indicative of future results.

Gross Profit and Margin. Gross profit was \$510.4 million for the nine months ended September 30, 2018, compared to \$411.1 million for the nine months ended September 30, 2017, representing an increase of \$99.3 million, or approximately 24.2%. Gross margin decreased to 63.9% in the nine months ended September 30, 2018 from approximately 65.6% in the nine months ended September 30, 2017. The decrease in gross margin was primarily due to a \$9.3 million settlement of a contingent royalty obligation recorded during the second quarter of 2018 and changes in product mix. Gross margin for the nine months ended September 30, 2018 is not necessarily indicative of future results.

## Research and Development.

The following table presents details of our research and development expenses for the periods indicated:

	Nine Months Ended September 30,					
	2018	% of	2017	% of		
		Revenues		Revenues		
	(dollars in thousands)					
Salaries and benefits	\$155,750	19.5	%	\$146,681	23.4	%
Share-based compensation	26,909	3.4	%	29,799	4.8	%
Development and tape-out costs	22,529	2.8	%	31,058	5.0	%
Other	61,320	7.6	%	64,217	10.1	%
Total Research and development	\$266,508	33.3	%	\$271,755	43.3	%

Research and development expenses were \$266.5 million for the nine months ended September 30, 2018, compared to \$271.8 million for the nine months ended September 30, 2017, representing a decrease of \$5.3 million, or approximately 1.9%. The increase in salaries and benefits expenses was primarily attributable to higher bonuses and merit-based salary increases, partially offset by headcount decreases primarily related to the discontinuation of our 1550nm silicon photonics development activities. The decrease in development and tape-out costs was primarily due to lower tape-out costs during the nine months ended September 30, 2018 and the discontinuation of our 1550nm silicon photonics development activities. The decrease in other expenses was mainly due to lower outsourcing of research and development activities during the nine months ended September 30, 2018.

Please refer to "Share-based Compensation Expense" below for a discussion of its impact on research and development expenses.

## Sales and Marketing.

The following table presents details of our sales and marketing expenses for the periods indicated:

	Nine Months Ended September 30,					
	2018	% of	2017	% of		
		Revenues		Revenues		
	(dollars in thousands)					
Salaries and benefits	\$70,033	8.8	%	\$67,157	10.6	%
Share-based compensation	11,890	1.5	%	11,684	1.9	%
Trade shows and promotions	11,894	1.5	%	14,391	2.3	%
Other	17,694	2.2	%	18,464	2.9	%
Total Sales and marketing	\$111,511	14.0	%	\$111,696	17.7	%

Sales and marketing expenses were \$111.5 million for the nine months ended September 30, 2018, compared to \$111.7 million for the nine months ended September 30, 2017, representing a decrease of \$0.2 million, or approximately 0.2%. The increase in salaries and benefits expenses was primarily related to merit-based salary increases, higher bonuses and sales commissions, partially offset by headcount decreases. The decrease in trade shows and promotions was primarily due to lower trade show activities.

Please refer to "Share-based Compensation Expense" below for a discussion of its impact on sales and marketing expenses.

## General and Administrative.

The following table presents details of our general and administrative expenses for the periods indicated:

	Nine Months Ended September 30,					
	2018	% of Revenues		2017	% of Revenues	
	(dollars in thousands)					
Salaries and benefits	\$17,200	2.2	%	\$15,919	2.5	%
Share-based compensation	8,906	1.1	%	7,980	1.2	%
Professional services	22,400	2.8	%	9,100	1.5	%
Other	5,540	0.7	%	5,035	0.9	%
Total General and administrative	\$54,046	6.8	%	\$38,034	6.1	%

General and administrative expenses were \$54.0 million for the nine months ended September 30, 2018, compared to \$38.0 million for the nine months ended September 30, 2017, representing an increase of \$16.0 million, or approximately 42.1%. The increase in professional services was primarily due to \$13.5 million of expenses related to the proxy contest during the nine months ended September 30, 2018.

Please refer to "Share-based Compensation Expense" below for a discussion of its impact on general and administrative expenses.

## Share-based Compensation Expense.

The following table presents details of our share-based compensation expense that is included in each functional line item in our condensed consolidated statements of operations:

	Nine Months Ended September 30,	
	2018	2017
	(in thousands)	
Cost of goods sold	\$1,341	\$1,530
Research and development	26,909	29,799
Sales and marketing	11,890	11,684
General and administrative	8,906	7,980
	\$49,046	\$50,993

Share-based compensation expense was \$49.0 million for the nine months ended September 30, 2018, compared to \$51.0 million for the nine months ended September 30, 2017, representing a decrease of \$1.9 million, or approximately 3.8%. The decrease was mainly due to the headcount decreases.

Restructuring and impairment charges for the nine months ended September 30, 2018 primarily consisted of employee termination and severance costs of \$3.5 million, contract exit costs with vendors of \$3.4 million, and impairment charges and a net loss on disposal of assets of \$2.4 million primarily related to the discontinuation of our 1550nm silicon photonics development activities. There was also a \$0.9 million impairment charge on fixed assets not related to the 1550nm silicon photonics development activities recorded during the third quarter of 2018.

Interest and other, net in the nine months ended September 30, 2018 represented income of \$0.2 million as compared to an expense of \$3.5 million for the nine months ended September 30, 2017. The change was primarily attributable to a decrease in interest expense of \$3.9 million related to the pay down of the Term Debt.

Provision for (benefit from) taxes on income. Our benefit from taxes on income was \$23.2 million for the nine months ended September 30, 2018 as compared to a provision for taxes on income of \$2.9 million for the nine months ended September 30, 2017.

Our effective tax rate was (34.0)% and (20.9)% for nine months ended September 30, 2018 and 2017, respectively. For the nine months ended September 30, 2018, the difference between the (34.0)% effective tax rate and the 21.0% federal statutory rate resulted primarily from the release of a valuation allowance of \$26.1 million against the deferred tax assets related to our U.S. subsidiaries, the excess benefits of share-based compensation, the tax holiday in Israel and foreign earnings taxed at rates



lower than the federal statutory rates, partially offset by the accrual of unrecognized tax positions, interest and penalties associated with unrecognized tax positions, non-tax-deductible expenses such as share-based compensation expense, and losses generated from subsidiaries without tax benefits.

#### Liquidity and Capital Resources

Historically, we have financed our operations through a combination of sales of equity securities and cash generated by operating activities. As of September 30, 2018, our principal sources of liquidity consisted of cash and cash equivalents of \$64.2 million and short-term investments of \$286.0 million. In our first quarter ended March 31, 2016, we completed the acquisition of EZchip and financed it with cash on hand and with \$280.0 million from a variable-interest rate three-year Term Debt. On April 30, 2018, we paid off all outstanding principal and interest related to the Term Debt.

We are an Israeli company and as of September 30, 2018, our subsidiaries outside of Israel held approximately \$16.0 million in cash, cash equivalents and short-term investments.

Our cash, cash equivalents, short-term investments and working capital balances at September 30, 2018 and December 31, 2017 were as follows:

	September 30, 2018	December 31, 2017
	(in thousands)	
Cash and cash equivalents	\$64,248	\$62,473
Short-term investments	285,955	211,281
Total	\$350,203	\$273,754
Working capital	\$419,025	\$310,286

Our ratio of current assets to current liabilities was 3.2:1 and 2.6:1 at September 30, 2018 and December 31, 2017, respectively.

#### Operating Activities

Net cash provided by our operating activities amounted to \$168.5 million in the nine months ended September 30, 2018. The adjustments from net income of \$91.4 million to net cash provided by operating activities mainly included net non-cash items of \$101.3 million, partially offset by changes in assets and liabilities of \$21.1 million and a gain on investments of \$3.1 million. Non-cash items consisted primarily of \$77.5 million of depreciation and amortization, and \$49.0 million of share-based compensation, partially offset by the increase in deferred tax assets of \$28.0 million primarily due to the release of a valuation allowance. The \$21.1 million cash outflow from changes in assets and liabilities was attributed to an increase in inventory of \$41.8 million primarily due to higher demand for our products and a decrease of \$4.3 million in accrued liabilities and other liabilities, partially offset by a decrease in accounts receivable of \$11.4 million primarily due to timing of invoicing and collections and an increase in accounts payable of \$13.7 million primarily due to an increase in inventory related purchases and timing of payments.

Net cash provided by our operating activities amounted to \$94.4 million in the nine months ended September 30, 2017. The adjustments from net loss of \$16.8 million to net cash provided by operating activities mainly included net non-cash items of \$126.9 million, partially offset by gain on investments of \$2.6 million, and changes in assets and liabilities of \$13.0 million. Non-cash expenses consisted primarily of \$76.6 million of depreciation and amortization, and \$51.0 million of share-based compensation. The \$13.0 million cash outflow from changes in assets and liabilities is attributed to a decrease of accounts payable of \$14.9 million primarily due to timing of payments, an increase in prepaid expenses and other assets of \$5.8 million, and a decrease of \$3.1 million in accrued liabilities and other liabilities, partially offset by a decrease in accounts receivable of \$8.4 million primarily due to timing of invoicing and collections, and a decrease in inventory of \$2.3 million.

#### Investing Activities

Net cash used in investing activities was \$119.5 million in the nine months ended September 30, 2018. Cash used in investing activities was primarily attributable to the net purchases of short-term investments of \$71.5 million, \$29.0 million for purchases of property and equipment, \$7.5 million for purchases of investments in private companies, \$7.4 million for acquisitions, and \$6.5 million for purchases of intangible assets, partially offset by the proceeds from sales of property and equipment of \$3.2 million.

Net cash used in investing activities was \$65.9 million in the nine months ended September 30, 2017. Cash used in investing activities was primarily attributable to \$35.2 million for purchases of property and equipment, \$13.5 million for

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purchases of investments in private companies, net purchases of short-term investments of \$13.4 million, and \$1.8 million for purchases of intangible assets.

#### Financing Activities

Net cash used in financing activities was \$47.3 million in the nine months ended September 30, 2018. Cash used in financing activities was primarily due to \$74.0 million of principal payments on the Term Debt and \$6.5 million of payments on intangible asset financings. These were partially offset by \$33.3 million of proceeds from issuances of ordinary shares through our employee equity incentive plans.

Net cash used in financing activities was \$26.9 million in the nine months ended September 30, 2017. Cash used in financing activities was primarily due to \$46.0 million of principal payments on the Term Debt, and \$6.0 million of payments on intangible asset financings. These were partially offset by \$25.1 million of proceeds from issuances of ordinary shares through our employee equity incentive plans.

#### Contractual Obligations

The following table summarizes our contractual obligations at September 30, 2018 and the effect those obligations are expected to have on our liquidity and cash flows in future periods:

	Contractual Obligations:		
	Total	Non-cancelable operating lease commitments	Purchase commitments
	(in thousands)		
2018 (remainder of the year)	\$ 126,491	\$ 5,946	\$ 120,545
2019	125,617	23,263	102,354
2020	21,824	19,728	2,096
2021	17,644	17,108	536
2022	12,950	12,689	261
Thereafter	76,640	76,640	—
Total	\$ 381,166	\$ 155,374	\$ 225,792

Purchase commitments. Purchase commitments 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. Purchase orders for inventory are based on our current manufacturing needs and are generally fulfilled by our subcontractors within a period of eight to twelve weeks. 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.

#### Other Commitments

For additional information about other commitments, see Note 8, "Commitments and Contingencies" in the notes to the unaudited condensed consolidated financial statements.

#### Recent Accounting Pronouncements

See Note 1, "The Company and Summary of Significant Accounting Policies—Recent accounting pronouncements" in the notes to the unaudited condensed consolidated financial statements for a full description of recent accounting standards, including the respective dates of adoption and effects on our condensed consolidated financial position, results of operations and cash flows.

#### Off-Balance Sheet Arrangements

As of September 30, 2018, we did not have any off-balance sheet arrangements.

### ITEM 3—QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

#### Interest rate fluctuation risk

**Investments.** Our investments consist of cash, money market funds, time deposits and interest bearing investments in government debt securities, commercial paper, corporate bonds and municipal bonds with an average maturity of 7.8 months. The primary objective of our investment activities is to preserve principal and ensure liquidity while maximizing income without significantly increasing risk. By policy, we limit the amount of our credit exposure through diversification and restricting our investments to highly rated securities. At the time of purchase, we do not invest more than 4% of the total investment portfolio in individual securities, except U.S. Treasury or agency securities. Highly rated long-term securities are defined as having a minimum Moody's, Standard & Poor's or Fitch rating of A2 or A, respectively. Highly rated short-term securities are defined as having a minimum Moody's, Standard & Poor's or Fitch rating of P-1, A-1 or F-1, respectively. We have not experienced any significant losses on our cash equivalents or short-term investments. 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. An immediate 100 basis point change in interest rates would have a \$1.5 million effect on the fair market value of our portfolio.

#### Foreign currency exchange risk

We derive all of our revenues in U.S. dollars. The U.S. dollar is our functional and reporting currency in all of our foreign locations. However, a significant portion of our liabilities, as well as our operating expenses, consisting principally of salaries and related personnel costs and facilities expenses, are denominated in 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 net income.

To protect against foreign exchange risks associated with forecasted future cash flows and existing assets and liabilities, we have established a balance sheet and anticipated transaction risk management program. Currency derivative instruments and natural hedges are generally utilized in this hedging program. We do not enter into derivative instruments for trading or speculative purposes. We account for our derivative instruments as either assets or liabilities and carry them at fair value. The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and the resulting designation.

Our hedging program reduces, but does not eliminate the impact of currency exchange rate movements (see Part II, Item 1A, "Risk Factors"). If we were to experience an immediate strengthening of NIS against USD of 10%, the impact on assets and liabilities denominated in NIS, after taking into account hedges and offsetting positions, would result in a loss before taxes of approximately \$0.2 million at September 30, 2018. There would also be an impact on future operating expenses denominated in currencies other than the U.S. dollar. For the month ending September 30, 2018, approximately \$18.7 million of our monthly expenses were denominated in NIS. As of September 30, 2018, we had derivative contracts designated as cash flow hedges in the notional amount of approximately 232.4 million NIS, or approximately \$64.1 million based upon the exchange rate on that day. In addition, as of September 30, 2018, we had derivative contracts hedging against NIS denominated assets and liabilities in the notional amount of approximately 140.0 million NIS, or approximately \$38.6 million based upon the exchange rate on that day.

Our derivatives expose us to credit risk to the extent that the counterparties may be unable to meet the terms of the agreement. We seek to mitigate such risk by limiting our counterparties to major financial institutions and by spreading the risk across a number of major financial institutions. However, failure of one or more of these financial institutions is possible and could result in incurred losses.

#### Inflation related risk

We believe that the rate of inflation in Israel has not had a material impact on our business to date. 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.



#### ITEM 4—CONTROLS AND PROCEDURES

##### Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our CEO (principal executive officer) and V.P., Corporate Controller (interim principal financial and accounting 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 CEO and V.P., Corporate Controller, of the effectiveness of our disclosure controls and procedures as of September 30, 2018. Based on this evaluation, our CEO and V.P., Corporate Controller concluded that our disclosure controls and procedures were effective as of September 30, 2018 to provide the reasonable assurance described above.

##### Changes in Internal Control Over Financial Reporting

There were no changes during the three months ended September 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### ITEM 1—LEGAL PROCEEDINGS

See Note 8, "Commitments and Contingencies—Contingencies—Legal Proceedings" in the notes to the unaudited condensed consolidated financial statements, included in Part I, Item 1 of this report, for a full description of legal proceedings and related contingencies and their effects on our condensed consolidated financial position, results of operations and cash flows.

We may, from time to time, become a party to various other legal proceedings arising in the ordinary course of business. We may also be indirectly affected by administrative or court proceedings or actions in which we are not involved, but which have general applicability to the semiconductor industry.

### 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 and results of operations, as well as decrease the value of an investment in our ordinary shares.

#### Risks Related to Our Business

The semiconductor industry may be adversely impacted by worldwide economic uncertainties which may cause our revenues and profitability to decline.

We operate primarily in the semiconductor industry, which is cyclical and subject to rapid change and evolving industry standards. From time to time, the semiconductor industry has experienced significant downturns characterized by decreases in product demand and excess customer inventories. Economic volatility can cause extreme difficulties for our customers and vendors to accurately forecast and plan future business activities. This unpredictability could cause our customers to reduce spending on our products and services, which would delay and lengthen sales cycles. Furthermore, during challenging economic times our customers and vendors may face issues gaining timely access to sufficient credit, which could affect their ability to make timely payments to us. As a result, we may experience growth patterns that are different than the end demand for products, particularly during periods of high volatility.

We cannot predict the timing, strength or duration of any economic slowdown or recovery or the impact of such events on our customers, our vendors or us. The combination of our lengthy sales cycle coupled with challenging macroeconomic conditions could have a compound impact on our business. The impact of market volatility is not limited to revenue but may also affect our product gross margins and other financial metrics. Any downturn in the semiconductor industry may be severe and prolonged, and any failure of the industry to fully recover from downturns could seriously impact our revenue and harm our business, financial condition and results of operations.

We may pursue acquisitions of other companies or new or complementary products, technologies and businesses, which could harm our operating results, may disrupt our business and could result in unanticipated accounting charges.

Our growth depends upon market growth, our ability to enhance our existing products, and our ability to introduce new products on a timely basis. We intend to continue to address the need to develop new products and enhance existing products through acquisitions of other companies, product lines, technologies, and personnel.

Acquisitions create additional material risk factors for our business that could cause our results to differ materially and adversely from our expected or projected results. Such risk factors include:

- difficulties in integrating the operations, systems, technologies, products, and personnel of the acquired companies, particularly companies with large and widespread operations and/or complex products;
- the diversion of management's attention from normal daily operations of the business and the challenges of managing larger and more widespread operations resulting from acquisitions;
- possible disruption to the continued expansion of our product lines;
- potential changes in our customer base and changes to the total available market for our products;
- reduced demand for our products;

- potential difficulties in completing projects associated with in-process research and development intangibles;
- the use of a substantial portion of our cash resources and incurrence of significant amounts of debt;
- significantly increase our interest expense, leverage and debt service requirements as a result of incurring debt;
- the impact of any such acquisition on our financial results;
- internal controls may become more complex and may require significantly more resources to ensure they remain effective;
- negative customer reaction to any such acquisition; and
- assuming the liabilities of the acquired company.

Acquisitions present a number of other potential risks and challenges that could disrupt our business operations. For example, we may not be able to successfully negotiate or finance the acquisition on favorable terms. If an acquired company also has inventory that we assume, we will be required to write up the carrying value of that inventory to its fair value. When that inventory is sold, the gross margins for those products are reduced and our gross margins for that period are negatively affected. Furthermore, the purchase price of any acquired businesses may exceed the current fair values of the net tangible assets of such acquired businesses. As a result, we would be required to record material amounts of goodwill, acquired in-process research and development and other intangible assets, which could result in significant impairment and acquired in-process research and development charges and amortization expense in future periods. These charges, in addition to the results of operations of such acquired businesses and potential restructuring costs associated with an acquisition, could have a material adverse effect on our business, financial condition and results of operations. We cannot forecast the number, timing or size of future acquisitions, or the effect that any such acquisitions might have on our operating or financial results. Furthermore, potential acquisitions, whether or not consummated, will divert our management's attention and may 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.

We have made and may in the future pursue investments in other companies, which could harm our operating results. We have made, and could make in the future, investments in technology companies, including privately-held companies in the development stage. Many of these private equity investments are inherently risky because these businesses may never develop, and we may incur losses related to these investments. In addition, we have written down the carrying value of these investments in the past and may be required to write down the carrying value of these investments in the future to reflect other-than-temporary declines in their value, which could have a material adverse effect on our business, financial position and results of operations.

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

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 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 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 affected 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 customer and end-user demand for our products and generally have short inventory cycles, which introduce uncertainty into our revenue and 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

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directly to end users. In addition, the majority of our adapter card, switch system and cable businesses are 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 demand. 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-burden our 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.

In addition, the majority of our revenues are derived from customer orders received and fulfilled in the same quarterly period. If we overestimate customer demand, we could miss our quarterly revenue targets, which could have a material adverse effect on our financial results.

We depend on a small number of customers for a significant portion of our sales, and the loss of any one 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 September 30, 2018, sales to Dell accounted for 11.4% of our total revenues. Sales to our top ten customers represented 50.6% and 57.1% of our total revenues for the three months ended September 30, 2018 and 2017, respectively. Because the majority of servers, storage, communications infrastructure equipment and embedded systems are 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.

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 fluctuating average selling prices. We may not be able to compete successfully against current or potential competitors.

Some of our customers are also IC and switch suppliers and already have in-house expertise and internal development capabilities similar to ours. Licensing our technology and supporting such customers entails the transfer of intellectual property rights that may enable such customers to develop their own products and solutions to replace those we are currently providing to them. Consequently, these customers may become competitors to us. Further, each new design by a customer presents a competitive situation. In the past, we have lost design wins to divisions within our customers and this may occur again in the future. We cannot predict whether these customers will continue to compete with us, whether they will continue to be our customers or whether they will continue to buy products from us at the same volumes. Competition could increase pressure on us to lower our prices and could negatively affect our profit margins. 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 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.

There has been a trend toward industry consolidation in our markets for several years, as companies attempt to improve the leverage of growing research and development costs, strengthen or hold their market positions in an evolving industry or are unable to continue operations. Companies that are strategic alliance partners in some areas of our business may acquire or form alliances with our competitors, thereby reducing their business with us. We believe that industry consolidation may result in stronger competitors that are better able to compete as sole-source vendors for customers. This could lead to more variability in our operating results and could have a material adverse effect on our business, financial condition and results of operations.

Winning business is subject to lengthy, competitive selection processes that often require us to incur significant expense, from which we may ultimately generate no revenues.

Our business is dependent on us winning competitive bid selection processes, known as "design wins," to develop semiconductors for use in our customers' products. These selection processes are typically lengthy and can require us to incur significant design and development expenditures and to dedicate scarce engineering resources in pursuit of a single customer opportunity. We may not win the competitive selection process and may never generate any revenue despite incurring such expenditures.

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Furthermore, winning a product design does not guarantee sales to a customer. We may experience delays in generating revenue as a result of the lengthy development cycle typically required, or we may not realize as much revenue as anticipated. In addition, a delay or cancellation of a customer's plans could materially and adversely affect our financial results, as we may have incurred significant expense in the design process and generated little or no revenue. Customers could choose at any time to stop using our products or may fail to successfully market and sell their products, which could reduce the demand for our products and cause us to hold excess inventory, thereby materially adversely affecting our business, financial condition and results of operations.

The timing of design wins is unpredictable and implementing production for a major design win, or multiple design wins occurring at or around the same time, may strain our resources and those of our contract manufacturers. In such instances, we may be forced to dedicate significant additional resources and incur additional, unanticipated costs and expenses, which may have a material adverse effect on our results of operations.

Finally, some customers will not purchase any products from us, other than limited numbers of evaluation units, until they qualify the products and/or the manufacturing line for the products. The qualification process can take significant time and resources and we may not always be able to satisfy the qualification requirements of these customers. Delays in qualification or failure to qualify our products may cause a customer to discontinue use of our products and result in a significant loss of revenue.

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 our next generation of products in order to meet the demands of our 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.

We may be unable to successfully develop additional next generation products, new products or product enhancements. There is a risk that these developments or enhancements will be late, have technical problems, fail to meet customer or market specifications or otherwise be uncompetitive with other products using alternative technologies that offer comparable performance and functionality. Our next generation products or any new products or product enhancements may not be accepted in new or existing markets. Our business, financial condition and results of operations may be adversely affected if we fail 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 the vast majority of our products, and we must rely on third-party subcontractors to perform these services. 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.

In addition, the consolidation of foundry subcontractors, as well as the increasing capital intensity and complexity associated with fabrication in smaller process geometries has limited the diversity of our suppliers and increased our risk of a "single point of failure." Specifically, as we move to smaller geometries, we have become increasingly reliant on IC manufacturers. The lack of diversity of suppliers could also drive increased prices and adversely affect our results of operations, including our product gross margins.

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.

If we fail to carefully manage the use of "open source" software in our products, we may be required to license key portions of our products on a royalty-free basis or expose key parts of source code.

Some portion of our software may be derived from "open source" software that is generally made available to the public by its authors and/or other third parties. Such open source software is often made available to us under licenses, such as the GNU General Public License, which impose certain obligations on us in the event we were to create and distribute derivative works of the open source software. These obligations may require us to make source code for the derivative works available to the public and/or license such derivative works under a particular type of license, rather than the forms of licenses customarily used to protect our intellectual property. In the event that we inadvertently use open source software without the correct license form or a copyright holder of any open source software were to successfully establish in court that we had not complied with the terms of a license for a particular work, we could be required to release the source code of that work to the public and/or stop distribution of that work.

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 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. If we are unable to reduce our associated manufacturing costs this reduction in average selling prices 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 margins. We expect gross margin to vary over time, and our recent level of product gross margin may not be sustainable. Our product gross margins vary from quarter to quarter, and our recent level of gross margins may not be sustainable and may be adversely affected in the future by numerous factors, including product mix shifts, product transitions, increased price competition in one or more of the markets in which we compete, increases in material or labor costs, excess product component or obsolescence charges from our contract manufacturers, warranty related issues, or the introduction of new products or entry into new markets with different pricing and cost structures.

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;

changes in the relative sales mix of our products;

decreases in the overall average selling prices of our products;

changes in the cost of our 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 may be 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 may not be able to proportionately reduce our operating expenses.

We rely on our ecosystem partners to enhance and drive demand for our product offerings. Our inability to continue to develop or maintain such relationships in the future or our partners' inability to timely deliver technology or product offerings to the market may harm our revenues and ability to remain competitive.

We have developed relationships with third parties, which we refer to as ecosystem partners. Such partners provide their technology products, operating systems, tool support, reference designs and other elements necessary for the sale of our products into our markets. In addition, introduction of new products into the market by these partners may increase demand for our products. If we are unable to continue to develop or maintain these relationships, or if our ecosystem partners delay or fail to timely deliver their technology or products or other elements to the market, our revenues may be adversely impacted and we might not be able to enhance our customers' ability to commercialize their products in a timely manner and our ability to remain competitive may be harmed.

We rely primarily upon trade secret, patent, trademark 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, trademark 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. Patents that we currently own do not cover all of the products that we presently sell as we have patent applications pending with respect to certain products, while we have not been able to obtain, or choose not to



seek, patent protection for other products. 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. Furthermore, any issued patents may be challenged, invalidated or declared unenforceable. Whether or not these patents are issued, the applications may become publicly available and the proprietary information disclosed in the applications will become available to others. The lives of acquired patents may also be of a shorter term depending upon their acquisition dates and the issue dates. The term of any issued patent in the United States and Israel is typically 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, financial condition and results of operations. In addition, given the costs of obtaining patent protection, we may choose not to protect certain innovations that later on turn out to be important. In such cases, our lack of intellectual property rights may have a material adverse impact on our business, financial condition and results of operations. 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. From time to time, we receive notices from competitors and other third parties that claim we have infringed upon, misappropriated or misused other parties' proprietary rights. We may also be required to indemnify some customers and strategic partners under our agreements if a third party alleges or if a court finds that our products or activities have infringed upon, misappropriated or misused another party's proprietary rights. We have received requests from certain customers and strategic partners to include increasingly broad indemnification provisions in our agreements with them. Additionally, our products may contain technology provided to us by other parties such as contractors, suppliers or customers. We may have little or no ability to determine in advance whether such technology infringes upon the intellectual property rights of a third party. Our contractors, suppliers and licensors may not be required to indemnify us in the event that a claim of infringement is asserted against us, or they may be required to indemnify us only up to a maximum amount, above which we would be responsible for any further costs or damages. Questions of infringement in the markets we serve involve highly technical and subjective analysis. We are involved in intellectual property litigation today and 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, and 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.

In the normal course of business, we enter into agreements with terms and conditions that require us to indemnify the other party against third-party claims alleging that one of our products infringes or misappropriates intellectual property rights, as well as against certain claims relating to property damage, personal injury or acts or omissions relating to supplied products or technologies, or acts or omissions made by us or our agents or representatives. In addition, we are obligated pursuant to indemnification undertakings with our officers and directors to indemnify them to the fullest extent permitted by law and to indemnify venture capital funds that were affiliated with or represented by such officers or directors. If we receive demands for indemnification under these agreements and terms and conditions, they will likely be very expensive to settle or defend, and we may incur substantial legal fees in connection with any indemnity demands. Our indemnification obligations under these agreements and terms and conditions may be unlimited in duration and amount, and could have an adverse effect on our business, financial condition and results of operations.

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 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 our president and CEO and other senior executives. We do not have long-term employment contracts with our president and CEO or any other key personnel, and their knowledge of our business and industry would be extremely difficult to replace. On May 4, 2018, Jacob Shulman, stepped down as our CFO, following the announcement of his resignation on February 21, 2018. We are actively searching for a new CFO. If there is a significant delay in the hiring or the transition of a new CFO, there could be an adverse impact on our business, financial condition and results of operations.

In an effort to retain key employees, we may modify our compensation policies by, for example, increasing cash compensation to certain employees and/or modifying existing share options. These modifications of our compensation policies and the requirement to expense the fair value of share options and RSUs awarded to employees and officers may increase our operating expenses and result in the dilution of the holders of our ordinary shares. We cannot be certain that these and any other changes in our compensation policies will or would improve our ability to attract, retain and motivate employees. Our inability to attract and retain additional key employees and the increase in share-based compensation expense could each have an adverse effect on our business, financial condition and results of operations.

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 company 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 and strengthen our sales and marketing and general and administrative efforts. To successfully manage our growth, we believe we must effectively:

- manage and enhance our relationships with customers, distributors, suppliers, end users and other third parties;
- implement additional, and enhance existing, administrative, financial and operations systems, procedures and controls;

- address capacity shortages;

- manage inventory levels;

- expand and upgrade our technological capabilities;

- manage the challenges of having U.S., Israeli and other foreign operations; and

- hire, train, integrate and manage additional qualified engineers for research and development activities as well as additional personnel to strengthen our sales and marketing, financial and IT functions.

Managing our growth 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, in which case our business, financial conditions and results of operations may be adversely affected.

We are subject to risks associated with our distributors' product inventories.

We sell many of our products to customers through distributors who maintain their own inventory of our products for sale to dealers and end customers. We allow limited price adjustments on sales to distributors. Prior to January 1, 2018, we recognized revenues for sales to distributors upon sell through by the distributors, net of estimated allowances for price adjustments. Upon the adoption of the new revenue standards effective January 1, 2018, we began recognizing revenue on sales to distributors upon shipment and transfer of control (known as "sell-in" revenue recognition), net of the estimated allowances for price adjustments. We have extended these programs to certain distributors in the United States, Asia and Europe and may extend them on a selective basis to some of our other distributors in these geographies. The allowances for distributor price adjustments are based on judgments and estimates, using historical experience rates, inventory levels in distribution, current trends and other factors, and there could be material differences between actual amounts and our estimates.

If our distributors are unable to sell an adequate amount of their inventory of our products in a given quarter to dealers and end customers or if they decide to decrease their inventories for any reason, such as adverse global economic conditions or a downturn in technology spending, our sales to these distributors and our revenues may decline. We

also face the risk that our distributors may purchase, or for other reasons accumulate, inventory levels of our products in any particular quarter in excess of future anticipated sales to end customers. If such sales do not occur in the time frame anticipated by these distributors for any reason, these distributors may substantially decrease the amount of product they order from us in subsequent periods until

their inventory levels realign with end-customer demand, which would harm our business and could adversely affect our revenues in such subsequent periods.

We do not always have a direct relationship with the end customers of our products sold through distributors. As a result, our products may be used in applications for which they were not necessarily designed or tested, and they may not perform as anticipated in such applications. In such event, failure of even a small number of parts could result in significant liabilities to us, damage our reputation and harm our business and results of operations.

Certain of our customers and suppliers require us to comply with their codes of conduct, which may include certain restrictions that may substantially increase our cost of doing business as well as have an adverse effect on our operating efficiencies, operating results and financial condition.

Certain of our customers and suppliers require us to agree to comply with the Electronic Industry Code of Conduct ("EICC") or their own codes of conduct, which may include detailed provisions on labor, human rights, health and safety, environment, corporate ethics and management systems. Certain of these provisions are not requirements under the laws of the countries in which we operate and may be burdensome to comply with on a regular basis. Moreover, new provisions may be added or material changes may be made to any these codes of conduct, and we may have to promptly implement such new provisions or changes, which may substantially further increase the cost of our business, be burdensome to implement and adversely affect our operational efficiencies and operating results. If we violate any such codes of conduct, we may lose further business with the customer or supplier and, in addition, we may be subject to fines from the customer or supplier. While we believe that we are currently in compliance with our customers and suppliers' codes of conduct, there can be no assurance that, from time to time, if any one of our customers and suppliers audits our compliance with such code of conduct, we would be found to be in full compliance. A loss of business from these customers or suppliers could have a material adverse effect on our business, financial condition and results of operations.

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

Our products may contain defects and errors. Product defects and errors could result in additional development costs, diversion of technical resources, delayed product shipments, increased warranty-related returns, including wide-scale product recalls, warranty expenses and product liability claims against us which may not be fully covered by insurance. Our products are complex and our quality control tests and procedures may fail to detect any such defects or errors. 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. As a result, defects in our products could have an adverse effect on our business, financial condition and results of operations.

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 a limited number of third parties to manufacture our products. Our ability to offer new products depends on our manufacturers' ability to implement our revised product specifications, which is costly, time-consuming and complex.

We have significant intangible assets and goodwill. Consequently, the future impairment of our intangible assets and goodwill, if any, may significantly impact our profitability.

Our intangible assets and goodwill are significant. As of September 30, 2018, we had recorded \$668.5 million of intangible assets, net and goodwill primarily related to our past acquisitions. Intangible assets and goodwill are subject to an impairment analysis whenever events or changes in circumstances indicate the carrying amount of the asset may not be recoverable. Additionally, goodwill and indefinite-lived assets are subject to an impairment test at least annually. The impairment of any goodwill and other intangible assets may have a negative impact on our consolidated results of operations.

Unanticipated changes in our tax provisions or adverse outcomes resulting from examination of our income tax returns could adversely affect our results of operations.

We are subject to income taxes in Israel, the United States and various foreign jurisdictions. Our effective income tax rate could be adversely affected by changes in tax laws or interpretations of those tax laws, by changes in the mix of



earnings in countries with differing statutory tax rates, or by changes in the valuation of our deferred tax assets and liabilities. The U.S. recently enacted significant tax reform, and certain provisions of the new law may adversely affect us. See Note 11, "Income Taxes" in the notes to the unaudited condensed consolidated financial statements for more details about the U.S. tax reform and its effects.

Our effective income tax rates are also affected by intercompany transactions for sales, services, funding and other items. Given the increased global scope of our operations, and the complexity of global tax and transfer pricing rules and regulations, it has become increasingly difficult to estimate earnings within each tax jurisdiction. If actual earnings within a tax jurisdiction differ materially from our estimates or new information is discovered in the course of our tax return preparation process, we may not achieve our expected effective tax rate. Additionally, our effective tax rate may be affected by the tax effects of acquisitions, restructuring activities, newly enacted tax legislation, share-based compensation and uncertain tax positions. Finally, we are subject to the examination of our income tax returns by the Internal Revenue Service and other tax authorities which may result in the assessment of additional income taxes. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. However, unanticipated outcomes from these examinations could have a material adverse effect on our business, financial condition and results of operations.

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 to GAAP in the United States. These accounting principles are subject to interpretation by the FASB, the American Institute of Certified Public Accountants, 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.

We may be subject to disruptions or failures in information technology systems and network infrastructures, including theft, misuse of our electronic data or cyber-attacks that could have a material adverse effect on us.

We rely on the efficient and uninterrupted operation of complex information technology systems and network infrastructures to operate our business. We also hold large amounts of data in various data center facilities upon which our business depends. A disruption, infiltration or failure of our information technology systems or any of our data centers as a result of software or hardware malfunctions, system implementations or upgrades, computer viruses, third-party security breaches, attempts by others that try to gain unauthorized access through the Internet to our information technology systems, employee error, theft or misuse, malfeasance, power disruptions, natural disasters or accidents could cause breaches of data security, loss of intellectual property and critical data and the release and misappropriation of sensitive competitive information and partner, customer and employee personal data. These attempts may be the result of industrial or other espionage, or actions by hackers seeking to harm us, our products, or our end users. Any of these events could harm our competitive position, result in a loss of customer confidence, cause us to incur significant costs to remedy any damages and ultimately materially adversely affect our business, financial condition and results of operations.

While we have implemented a number of protective measures, including firewalls, antivirus, patches, log monitors, routine back-ups, system audits, routine password modifications and disaster recovery procedures, such measures may not be adequate or implemented properly to prevent or fully address the adverse effect of such events, and in some cases we may be unaware of an incident or its magnitude and effects.

In addition, our third-party subcontractors, including our foundries, test and assembly houses and distributors, have access to certain portions of our sensitive data. In the event that these subcontractors do not properly safeguard our data that they hold, security breaches and loss of our data could result. Any such loss of data by our third-party service providers, or theft, unauthorized use or publication of our trade secrets and other confidential business information as a result of such cyber threats, could adversely affect our competitive position and reduce marketplace acceptance of our products; the value of our investment in research and development and marketing could be reduced; and third parties may assert against us or our customers claims related to resulting losses of confidential or proprietary information or end-user data, or system reliability. Any such event could have a material adverse effect on our business, financial condition and results of operations.

Our business is subject to the risks of earthquakes, fires, floods and other natural catastrophic events.

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 or tsunami, could have a material adverse impact on our business, financial condition and results of operations. To the extent that such disruptions result in delays or

cancellations of customer orders, or the deployment of our products, our business, financial condition and results of operations would be adversely affected.

We must comply with a variety of existing and future laws and regulations that could impose substantial costs on us and may adversely affect our business.

We are subject to various state, federal and international laws and regulations governing the environment, including restricting the presence of certain substances in electronic products and making producers of those products financially

responsible for the collection, treatment, recycling and disposal of those products. In addition, we are also subject to various industry requirements restricting the presence of certain substances in electronic products. Although our management systems are designed to maintain compliance, we cannot assure you that we have been or will be at all times in complete compliance with such laws and regulations. If we violate or fail to comply with any of them, a range of consequences could result, including fines, import/export restrictions, sales limitations, criminal and civil liabilities or other sanctions.

We and our customers are also subject to various import and export laws and regulations. Government export regulations apply to the encryption or other features contained in some of our products. If we fail to continue to receive licenses or otherwise comply with these regulations, we may be unable to manufacture the affected products or ship these products to certain customers, or we may incur penalties or fines.

We are also subject to regulations concerning the supply of certain minerals coming from the conflict zones in and around the Democratic Republic of Congo ("DRC"). The Dodd-Frank Wall Street Reform and Consumer Protection Act includes disclosure requirements regarding the use of certain minerals mined from the DRC and adjoining countries and procedures regarding a manufacturer's efforts to identify sourcing of such conflict minerals. The implementation of these requirements could affect the sourcing and availability of minerals used in the manufacture of semiconductor devices.

As a result, this could limit the pool of suppliers who can provide us confirmation that the components and parts we source are considered DRC "conflict free," and we may not be able to confirm that we have obtained products or supplies that can be confirmed as DRC "conflict free" in sufficient quantities for our operations. Also, because our supply chain is complex, we may face reputational challenges with our customers, shareholders and other stakeholders if we are unable to sufficiently verify the origins for the minerals used in our products.

The costs of complying with these laws could adversely affect our current or future business. In addition, future regulations may become more stringent or costly and our compliance costs and potential liabilities could increase, which may harm our current or future business.

If we fail to maintain an effective system of internal controls, we may not be able to report accurately our financial results or prevent material 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 material fraud. We have in the past discovered, and may in the future discover, areas of our internal controls that need improvement. Section 404 of the Sarbanes-Oxley Act of 2002 requires our management to report on, and our independent registered public accounting firm to attest to, the effectiveness of our internal control structure and procedures for financial reporting. We have an ongoing program to perform the system and process evaluation and testing necessary to comply with these requirements. We have incurred, and expect to continue to incur significant expenses and to devote significant management resources to Section 404 compliance. Furthermore, as we grow our business or acquire businesses, our internal controls may become more complex and we may require significantly more resources to ensure they remain effective. Failure to implement required new or improved controls, or difficulties encountered in their implementation, either in our existing business or in businesses that we may acquire could harm our operating results or cause us to fail to meet our reporting obligations. In the event that our CEO, V.P., Corporate Controller or independent registered public accounting firm determine that our internal controls over financial reporting are not effective as defined under Section 404, investor perceptions of our company may be adversely affected and may cause a decline in the market price of our ordinary shares.

#### 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, corporate and sales support operations located in Israel. A significant number of our employees and a material amount of 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. These conflicts 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. In addition, there has been recent civil unrest in certain

areas in the Middle East, including Egypt, Jordan, Iraq, Syria and Libya. 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.

The security and political conditions may have an 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. Our Israeli operations are within range of Hezbollah or Hamas 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 as a result of such events could have a material adverse effect on our business, financial condition and results of operations.

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 employees, are obligated to perform military reserve duty for Israel 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 some of our employees, including those in key positions, have been called upon 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 labor unrest in Israel.

In the past, there have been several general strikes and work stoppages in Israel affecting all banks, airports and ports. These strikes 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 derived 63.5% and 61.9% of our revenues in the nine months ended September 30, 2018 and 2017, respectively, from sales outside of the United States. As a result, we face additional risks from doing business internationally, including:

- reduced protection of intellectual property rights in some countries;
- difficulties in staffing and managing foreign operations;
- longer sales and payment cycles;
- greater difficulties in collecting accounts receivable;
- adverse economic conditions;
- 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;
- compliance with the United States' Foreign Corrupt Practices Act and similar anti-bribery laws in other jurisdictions;
- compliance with export control and regulations;
- licenses, tariffs, other trade barriers, transit restrictions and other regulatory or contractual limitations on our ability to sell or develop our products in certain foreign markets, including the tariffs recently enacted and proposed by the U.S. government on various imports from China and by the Chinese government on certain U.S. goods, the scope and duration of which remain uncertain;
- restrictive governmental actions, such as restrictions on the transfer or repatriation of funds and foreign investments;

foreign currency exchange risks;  
fluctuations in freight rates and transportation disruptions;  
political and economic instability;  
variance and unexpected changes in local laws and regulations;  
natural disasters and public health emergencies; and  
trade and travel restrictions.

We sell our products into many countries and we also source many components and materials for our products from various countries. Such global resourcing enables us to minimize or mitigate the impact of tariffs and other regulatory taxes or duties. Nonetheless, the recently imposed U.S. tariffs could have a negative impact on our business, financial condition or results of operations. Further, an increase in tariffs or the imposition of additional tariffs and the potential escalation of a trade war and retaliatory measures could adversely affect our business, financial condition or results of operations.

A significant legal risk associated with conducting business internationally is compliance with various and differing anti-corruption and anti-bribery laws and regulations of the countries in which we do business, including the U.S. Foreign Corrupt Practices Act, the U.K. Bribery Act and similar laws in China. In addition, the anti-corruption laws in various countries are constantly evolving and may, in some cases, conflict with each other. Our Code of Ethics and Business Conduct and other policies prohibit us and our employees from offering or giving anything of value to a government official for the purpose of obtaining or retaining business and from engaging in unethical business practices, including kick-backs to or from purely private parties. However, there can be no assurance that all of our employees or agents will refrain from acting in violation of such laws and our related anti-corruption policies and procedures. Any violations of these anti-corruption or trade control laws, or even allegations of such violations, can lead to an investigation, which could disrupt our operations, involve significant management distraction, and lead to significant costs and expenses, including legal fees. If we, or our employees or agents acting on our behalf, are found to have engaged in practices that violate these laws and regulations, we could suffer severe fines and penalties, profit disgorgement, injunctions on future conduct, securities litigation, and other consequences that may have a material adverse effect on our business, financial condition and results of operations. In addition, our reputation, sales activities or stock price could be adversely affected if we become the subject of any negative publicity related to actual or potential violations of anti-corruption, anti-bribery, or trade control 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 any of the above risks 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 or to assert U.S. securities law claims in Israel.

We are incorporated in Israel. Two of our executive officers and two of our directors, one of whom is also an executive officer, are non-residents of the United States and are located in Israel, and a significant amount of our assets and the assets of these persons are located outside the United States. Therefore, it may be difficult to enforce a judgment obtained in the United States against us or any of the above persons in Israel.

In addition, 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. If U.S. law is found to be applicable, the content of applicable U.S. law must be proved in an Israeli court as a fact, which can be a time-consuming and costly process. Certain matters of procedure will also be governed by Israeli law.

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

The Israeli Companies Law, 1999 (the "Companies Law") generally requires that a merger be approved by the board of directors and by the general meeting of the shareholders. Upon the request of any creditor of a merging company, a court may delay or prevent the merger if it concludes that there is a reasonable concern that, as a result of the merger, the surviving company will be unable to satisfy its obligations. In addition, a merger may generally not be completed

unless at least (i) 50 days have passed since the filing of the merger proposal with the Israeli Registrar of Companies and (ii) 30 days have passed since the merger was approved by the shareholders of each of the merging companies.



Also, in certain circumstances, an acquisition of shares in a public company must be made by means of a tender offer if, as a result of the acquisition, the purchaser would hold 25% or more of the voting rights in the company (unless there is already a 25% or greater shareholder of the company) or more than 45% of the voting rights in the company (unless there is already a shareholder that holds more than 45% of the voting rights in the company). If, as a result of an acquisition, the acquirer would hold more than 90% of a company's shares or voting rights, the acquisition must be made by means of a tender offer for all of the shares.

In addition, the Companies 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.

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

We derive all of our revenues in U.S. dollars. The U.S. dollar is our functional and reporting currency in all of our foreign locations. However, a significant portion of our liabilities, as well as our operating expenses, consisting principally of salaries and related personnel costs and facilities expenses, are denominated in NIS. This foreign currency exposure gives rise to market risk associated with exchange rate movements of the U.S. dollar against the NIS. To the extent that the value of the NIS increases against the U.S. dollar, our expenses on a U.S. dollar cost basis will increase. We cannot predict any future trends in the rate of appreciation of the NIS against the U.S. dollar. If the U.S. dollar cost of our salaries and related personnel costs and facilities expenses 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 hedge against currency fluctuations in the future. Further, because all 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 the collection of our receivables more difficult. To help manage this risk we have been engaged in foreign currency hedging activities, comprised of currency derivative instruments and natural hedges. Our cost in Israel in U.S. dollar terms will also 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.

The results of the United Kingdom's referendum on withdrawal from the European Union may have a negative effect on global economic conditions, financial markets and our business.

The United Kingdom ("U.K.") held a referendum in June 2016 in which a majority of voters approved an exit from the European Union ("Brexit"). In March 2017, the U.K. began the process to exit the European Union. Negotiations are in progress to determine the future terms of the U.K.'s relationship with the European Union, including, among other things, the terms of trade between the U.K. and the European Union. The effects of Brexit will depend on any agreements the U.K. reaches to retain access to European Union markets either during a transitional period or more permanently. In addition, the exit of the U.K. from the European Union could lead to legal and regulatory uncertainty and potentially divergent treaties, laws and regulations as the U.K. determines which European Union treaties, laws and regulations to replace or replicate, including those governing manufacturing, labor, environmental, data protection/privacy, competition and other matters applicable to the semiconductor industry. The referendum has also given rise to calls for the governments of other European Union member states to consider withdrawal. These developments, or the perception that any of them could occur, may have a material adverse effect on global economic conditions and the stability of global financial markets, and may significantly reduce global market liquidity and restrict the ability of key market participants to operate in certain financial markets. Any of these factors could depress economic activity and restrict our access to capital, which could have a material adverse effect on our business, financial condition and results of operations and reduce the price of our ordinary shares.

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.

According to the Encouragement Law, the Company's operations in Israel were granted "Approved Enterprise" status by the Investment Center in the Israeli Ministry of Economy and Industry and "Beneficiary Enterprise" status by the Israeli Income Tax Authority. The Company is eligible for tax benefits under the Encouragement Law with respect to

its income derived from its Approved and Beneficiary Enterprises. 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, limiting manufacturing outside of Israel 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

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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" and "Beneficiary 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.

If we elect to distribute dividends out of exempt income derived from "Approved/Beneficiary Enterprise" income, we will be subject to tax on the gross amount distributed. The tax rate will be the rate which would have been applicable had we not been granted the beneficial status. This rate is generally between 10% and the corporate tax rate in Israel, depending on the percentage of our shares held by foreign shareholders. The dividend recipient is subject to withholding tax at the source at the reduced rate applicable to dividends from Approved Enterprises, which is 15% if the dividend is distributed during the tax exemption period (subject to the applicable double tax treaty) or within 12 years after the period. This 12-year limitation does not apply to foreign investment companies. The Encouragement Law has defined certain actions that are deemed as dividend distributions and would trigger the recapture of tax benefits.

The Israeli government grants that we received require us to meet various conditions and 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 grants from the IIA for the financing of a portion of our research and development expenditures in Israel. When know-how is developed using or in connection with IIA grants, we are subject to restrictions on transfer of the know-how, including outside of Israel. Transfer of know-how outside of Israel requires pre-approval by the IIA which may at its sole discretion grant such approval and impose certain conditions, and is subject to the payment to IIA of a transfer fee or license fees, calculated according to the formulas provided in the R&D Law which takes into account, inter alia, the consideration for such know-how paid to us in the transaction in which the technology is transferred. In general, transfer fees are no less than the funding received plus interest less the royalties already paid for the transferred know-how and are not higher than six times the amount of the grants received by the company. In addition, any decrease of the percentage of manufacturing performed in Israel, as originally declared in the application to the IIA, requires us to obtain the approval of the IIA and may result in increased amounts to be paid to the IIA as well as in increased royalty rate. Transfer of know-how to another Israeli entity requires the approval of IIA as well as full or partial assumption of the liabilities to IIA by the other entity. These restrictions may impair our ability to enter into agreements for those products or technologies without the approval of the IIA. We cannot be certain that any approval of the IIA 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 IIA 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 IIA. Any approval, if given, will generally be subject to additional financial obligations. If we fail to comply with the conditions imposed by the IIA, we may be required to refund any payments previously received, together with interest and penalties as well as tax benefits. Also, failure to meet the restrictions concerning transfer of know-how outside of Israel may trigger criminal liability. The restrictions regarding the use and transfer of know-how (including for the purpose of manufacturing) apply also to any IIA programs that are under a royalty payments agreement and to non-royalty-bearing programs.

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.

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, our competitors, our customers or rumors from sources other than our company related to acquisitions, new products, significant contracts, commercial relationships, capital commitments or changes in the competitive landscape;
- 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;
- anticompetitive practices of our competitors;
- commencement of, or our involvement in, litigation;
- whether our operating results meet our guidance or the expectations of investors or securities analysts;
- continuing international conflicts and acts of terrorism; and
- changes in accounting rules.

We may need to raise additional capital, which might not be available or which, if available, may be on terms that are not favorable to us.

We may need to raise additional funds, and we cannot be certain that we will be able to obtain additional financing on favorable terms, if at all. If we issue equity securities to raise additional funds, the ownership percentage of our shareholders would be diluted, and the new equity securities may have rights, preferences or privileges senior to those of existing holders of our ordinary shares. If we borrow money, we may incur significant interest charges, which could harm our profitability. Holders of debt may also have certain rights, preferences or privileges senior to those of existing holders of our ordinary shares. If we cannot raise needed funds on acceptable terms, we may not be able to develop or enhance our products, take advantage of future opportunities or respond to competitive pressures or unanticipated requirements, which could harm our business, financial condition and results of operations.

If we sell our ordinary shares in future financings, ordinary shareholders could experience immediate dilution and, as a result, the market price of our ordinary shares may decline.

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 or debt financings or similar arrangements in the future, including the issuance of convertible debt securities, preferred shares or ordinary shares. If we issue ordinary shares or securities convertible into ordinary shares, holders of our ordinary shares could experience dilution.

The ownership of our ordinary shares may continue to be concentrated, and certain shareholders may have significant influence over the outcome of corporate actions requiring shareholder approval.

As of September 30, 2018, based on information filed with the SEC or reported to us, Starboard Value LP and certain of its affiliates ("Starboard") beneficially owned an aggregate of approximately 8.6% of our outstanding ordinary shares. Starboard and any other shareholders acquiring beneficial ownership of a significant amount of our outstanding ordinary shares may 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.

If securities or industry analysts do not publish research or reports about our business, if they adversely change their recommendations regarding our ordinary shares or if our operating results do not meet their expectations, the market price of our ordinary shares could decline.

The trading market for our ordinary shares could be influenced by the research and reports that industry or securities analysts publish about us or our business. If one or more of these analysts cease coverage of our company or fail to publish reports on us regularly, we could lose visibility in the financial markets, which in turn could cause the price of our ordinary shares or trading volume in our ordinary shares to decline. Moreover, if one or more of the analysts who cover our company downgrades our ordinary shares or if our operating results do not meet their expectations, the market price of our ordinary shares could decline.

Provisions of our articles of association 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;

- a requirement for the approval of the shareholders of at least a majority of the voting power of the Company for any merger involving the Company;

- a requirement for the approval of at least 75% of the voting power represented at the general meeting of the shareholders for the removal of any director from office, and election of any director instead of the director so removed; and

- an advance notice requirement for shareholder proposals and nominations.

Furthermore, Israeli tax law treats some acquisitions, particularly share-for-share swaps between an Israeli company and a foreign company, less favorably than U.S. tax law. Under certain circumstances and subject to receiving a ruling from the Israeli Income Tax Authority, Israeli tax law generally provides that a shareholder who exchanges our shares for shares that are listed for trading on a securities exchange 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, resulting in taxation before disposition of the investment in the foreign corporation. For a further discussion of Israeli laws relating to mergers and acquisitions, please see "Risk Factors - Risks Related to Operations in Israel and Other Foreign Countries - Provisions of Israeli law may delay, prevent or make difficult an acquisition of our company, which could prevent a change of control and therefore depress the price of our shares." 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, while the Board regularly reviews our cash position and uses for cash, we do not anticipate paying any cash dividends 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 Israeli laws, rules adopted by the SEC, the Nasdaq Stock Market, the FASB and the Public Company Accounting Oversight Board, may 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

Not applicable.

ITEM 3 — DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4 — MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5 — OTHER INFORMATION

Not applicable.



ITEM 6 — EXHIBITS

3.1	(1)	<u>Amended and Restated Articles of Association of Mellanox Technologies, Ltd. (as amended on May 24, 2018)</u>
10.1	(2)	<u>Form of Mellanox Technologies, Ltd. Executive Severance Benefits Agreement for U.S. Executives</u>
10.2	(3)	<u>Form of Mellanox Technologies, Ltd. Executive Severance Benefits Agreement for Israel Executives</u>
10.3	(4)	<u>Form of Restricted Share Unit Award Grant Notice and Restricted Share Unit Award Agreement For All Participants (Other than Participants in Israel) under the Third Amended and Restated Global Share Incentive Plan (2006)</u>
10.4	(5)	<u>Form of Restricted Share Unit Award Grant Notice and Restricted Share Unit Award Agreement For Participants in Israel under the Third Amended and Restated Global Share Incentive Plan (2006)</u>
10.5	(6)	<u>Form of Performance Share Unit Award Grant Notice and Performance Share Unit Award Agreement for Participants in the United States under the Third Amended and Restated Global Share Incentive Plan (2006)</u>
10.6	(7)	<u>Form of Performance Share Unit Award Grant Notice and Performance Share Unit Award Agreement for Participants in Israel under the Third Amended and Restated Global Share Incentive Plan (2006)</u>
10.7	(8)	<u>Third Amended and Restated Global Share Incentive Plan (2006)</u>
31.1		<u>Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
31.2		<u>Certification of Interim Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
32.1		<u>Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>
32.2		<u>Certification of Interim Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>
101.INS		XBRL Instance Document
101.SCH		XBRL Taxonomy Extension Schema Document
101.CAL		XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB		XBRL Taxonomy Extension Label Linkbase Document
101.PRE		XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF		XBRL Taxonomy Extension Definition Linkbase Document

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- (1) Incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q (SEC File No. 001-33299) filed on August 3, 2018.
- (2) Incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q (SEC File No. 001-33299) filed on August 3, 2018.
- (3) Incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q (SEC File No. 001-33299) filed on August 3, 2018.
- (4) Incorporated by reference to Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q (SEC File No. 001-33299) filed on August 3, 2018.
- (5) Incorporated by reference to Exhibit 10.5 to the Company's Quarterly Report on Form 10-Q (SEC File No. 001-33299) filed on August 3, 2018.
- (6) Incorporated by reference to Exhibit 10.6 to the Company's Quarterly Report on Form 10-Q (SEC File No. 001-33299) filed on August 3, 2018.
- (7) Incorporated by reference to Exhibit 10.7 to the Company's Quarterly Report on Form 10-Q (SEC File No. 001-33299) filed on August 3, 2018.
- (8) Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K (SEC File No. 001-33299) filed on July 25, 2018.



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.

Date: November 2, 2018 Mellanox Technologies, Ltd.

/s/ Eric Johnson  
Eric Johnson  
V.P., Corporate Controller  
(Interim Principal Financial and Accounting Officer)