SILICOM LTD.
Form 20-F
April 26, 2016

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

FORM 20-F

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

Or

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

For the fiscal year ended December 31, 2015

Or

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

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

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

For the transition period from to

Commission File number: 000-23288

SILICOM LTD.
(Exact name of Registrant as specified in its charter and as translated into English)

ISRAEL
(Jurisdiction of incorporation or organization)

14 Atir Yeda Street,
Kfar Sava 4464323, Israel
(Address of principal executive offices)

Mr. Eran Gilad, CFO and Company Secretary

Telephone: +972-9-764-4555
E-mail: erang@silicom.co.il
14 Atir Yeda Street,
Kfar Sava 4464323, Israel
(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

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

None	None
Title of each class	Name of each exchange on which registered
Ordinary Shares, NIS 0.01 nominal value per share	NASDAQ GLOBAL SELECT MARKET

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

None
(Title of Class)

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

None
(Title of Class)

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

7,311,563

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

Yes o No x

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

Yes o No x

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

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

Yes x No o

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

Large accelerated filer o Accelerated filer x Non-accelerated filer o

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

US GAAP x International Financial Reporting Standards as issued by the International Accounting Standards Board o Other o

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 o Item 18 o

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

Yes o No x

(APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PAST FIVE YEARS)

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

Yes o No o

This annual report on Form 20-F includes certain “forward-looking” statements within the meaning of Section 21E of the Securities Exchange Act of 1934. The use of the words “projects,” “expects,” “may,” “plans” or “intends”, or words similar import, identifies a statement as “forward-looking.” There can be no assurance, however, that actual results will not differ materially from our expectations or projections. Factors that could cause actual results to differ from our expectations or projections include the risks and uncertainties relating to our business described in this report at Item 3 titled “Risk Factors.”

As used herein or in any document incorporated by reference hereto, the “Company”, “Silicom Ltd.”, “Silicom”, “Registrant” “we”, “us”, or “our” refers to Silicom Ltd. and its subsidiaries. We have prepared our consolidated financial statements in United States dollars and in accordance with accounting principles generally accepted in the United States. All references herein to “dollars” or “$” are to United States dollars, and all references to “Shekels” or “NIS” are to New Israel Shekels.

Table of Contents

PART I. 6

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS 6

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE 7

ITEM 3. KEY INFORMATION 7
A. Selected Financial Data 7
B. Capitalization and indebtedness 11
C. Reason for the offer and use of proceeds 11
D. Risk Factors 11

ITEM 4. INFORMATION ON THE COMPANY. 27
A. History and Development of the Company 27
B. Business Overview 29
Principal Markets 32
Manufacturing and Suppliers 32
Marketing Channels 35
Patents and Licenses 37
Competition 38
Governmental Regulation Affecting the Company 39
C. Organizational Structure 40
D. Property, Plant and Equipment 40

ITEM 4A. UNRESOLVED STAFF COMMENTS 41

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS 41
Critical Accounting Policies 42
A. Operating Results 45
Impact of Inflation and Currency Fluctuations on Results of Operations, Liabilities and Assets 49
B. Liquidity and Capital Resources 49
C. Research and development, patents and licenses, etc. 51
D. Trend Information 53
E. Off-Balance Sheet Arrangements 54
F. Tabular disclosure of contractual obligations 55

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES 56
A. Directors and Senior Management 56
B. Compensation 59
C. Board Practices 62
Board of Directors 64
External Directors 64
Audit Committee 68
Compensation Committee 70
Internal Auditor 75
D. Employees 75

E.	Share Ownership	77

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS 78
A. Major Shareholders 78
B. Related Party Transactions 79

ITEM 9. THE OFFER AND LISTING 84
A. Offer and listing details 84
Markets and Share Price History 84

ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK 115
Interest Rate Risk 115
Foreign Currency Exchange Risk 116

ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES 118

PART II. 118

ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES 118

ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS 118

ITEM 15. CONTROLS AND PROCEDURES 118
Disclosure Controls and Procedures 118
Management's Annual Report on Internal Control over Financial Reporting 118
Inherent Limitations on Effectiveness of Controls 119
Changes in Internal Control over Financial Reporting 119

ITEM 15T. CONTROLS AND PROCEDURES 119

ITEM 16. RESERVED 119

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT 119

ITEM 16B. CODE OF ETHICS	120
ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES	120
ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES	120
ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS	121
ITEM 16F. CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANT	121
ITEM 16G. CORPORATE GOVERNANCE	121
ITEM 16H. MINE SAFETY DISCLOSURE	123
PART III.	123
ITEM 17. FINANCIAL STATEMENTS	123
ITEM 18. FINANCIAL STATEMENTS	123
ITEM 19. EXHIBITS	123

Part I.

Item 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not Applicable.

Item 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not Applicable.

Item 3. KEY INFORMATION

A. Selected Financial Data

The selected data presented below under the captions “Consolidated Statements of Operations Data” and “Consolidated Balance Sheets Data” for and as of the end of each of the years in the five-year period ended December 31, 2015, are derived from our audited consolidated financial statements. The consolidated financial statements as of December 31, 2015, and for each of the years in the three-year period ended December 31, 2015, and the report thereon, are included elsewhere in this annual report. The selected data set forth below should be read in conjunction with our consolidated financial statements and the notes thereto, which are set forth in Item 18 – “Financial Statements” and the other financial information appearing elsewhere in this annual report.

CONSOLIDATED STATEMENTS OF OPERATIONS DATA:

	2011	2012	2013	2014	2015
Sales	$39,633	$48,729	$73,298	$75,622	$82,738
Cost of sales	22,430	28,849	43,865	44,835	48,659
Gross profit	17,203	19,880	29,433	30,787	34,079
Research and development costs	4,165	4,401	5,465	6,480	9,702
Sales and marketing expenses	2,677	3,081	3,818	4,418	5,651
General and administrative expenses	1,890	2,369	2,572	2,798	3,611
Contingent consideration expense (benefit)	0	0	0	45	(3,090)
Total operating expenses	8,732	9,851	11,855	13,741	15,874
Operating income	8,471	10,029	17,578	17,046	18,205
Financial income, net	439	752	404	263	220
Income before income taxes	8,910	10,781	17,982	17,309	18,425
Income tax expenses	667	910	905	2,704	1,905
Net income(1)	8,243	9,871	17,077	14,605	16,520
Net income per share					
Basic income per ordinary share	$1.195	$1.424	$2.404	$2.033	$2.273
Diluted income per ordinary share	$1.178	$1.417	$2.357	$1.996	$2.242
Weighted average number of ordinary shares used to compute basic income per share (in thousands)	6,896	6,934	7,103	7,184	7,269
Weighted average number of ordinary shares used to compute diluted income per share (in thousands)	6,995	6,968	7,246	7,319	7,368

(1) Net income is after deduction of taxes on income, which have been reduced by virtue of tax benefits to which the Company is entitled in its capacity as an "Approved Enterprise, "Benefited Enterprise" or "Preferred Enterprise", as applicable with respect to each of the years indicated above, under Israeli law. As such, the Company was required to pay taxes at a reduced effective rate. The Company selected the 2004 tax year (for which the tax benefits ended at the end of 2013), the 2006 tax year, the 2009 tax year and the 2012 tax year as its Year of Election under its capacity as Approved Enterprise or Benefited Enterprise for each of the Years of Election. In 2014 the Company elected to be taxed under its capacity as a Preferred Enterprise, following which its benefits under the Investment Law under its capacities as Approved Enterprise or Benefited Enterprise, as applicable, were ceased. As of 2014, the benefits under the Investment Law under the Company's capacity as a Preferred Enterprise commenced. See Note 14C to the Financial Statements and “Item 10” - Additional Information - Taxation.”

CONSOLIDATED BALANCE SHEET DATA

	2011	2012	2013	2014	2015
Total assets	$72,865	$89,033	$105,257	$122,436	$139,998
Total current liabilities	$6,438	$11,789	$11,948	$19,006	$19,814
Long-term liability	$2,153	$2,278	$2,618	$2,698	$7,350
Shareholders' equity	$64,274	$74,966	$90,691	$100,732	$112,834
Capital stock	$20	$21	$21	$21	$21
Number of ordinary shares issued(1)	6,940,059	7,022,397	7,154,984	7,233,604	7,299,315

(1) Including 14,971 held by one of our subsidiaries - Silicom Connectivity Solutions, Inc. Under the Israeli Companies Law 5759-1999 (the "Companies Law") these shares held by such subsidiary are non-voting shares.

The following table sets forth information regarding the exchange rates of U.S. dollars per NIS for the periods indicated. Average rates are calculated by using the daily representative rates as reported by the Bank of Israel on the last day of each month during the periods presented.

	NIS per U.S. $			
Year Ended December 31,	High	Low	Average	Period End
2015	4.053	3.761	3.887	3.902
2014	3.994	3.402	3.577	3.889
2013	3.728	3.471	3.601	3.471
2012	4.028	3.715	3.844	3.733
2011	3.821	3.395	3.582	3.821

9

The following table sets forth the high and low daily representative rates for the NIS as reported by the Bank of Israel for each of the prior six months.

	NIS per U.S. $			
Month	High	Low	Average	Period End
March 2016	3.912	3.766	3.868	3.766
February 2016	3.964	3.871	3.908	3.91
January 2016	3.983	3.913	3.950	3.951
December 2015	3.905	3.855	3.881	3.902
November 2015	3.921	3.868	3.889	3.877
October 2015	3.923	3.816	3.863	3.867

The NIS to U.S. Dollar exchange rate on March 31, 2016, as published by the Bank of Israel, was NIS 3.766.

Dividends

Prior to 2013, we had not paid dividends to our shareholders. On January 14, 2013, we announced that our Board of Directors adopted a policy for distributing dividends, subject to all applicable laws. According to this policy, each year we will distribute a dividend of up to 50% of our annual distributable profits. As part of the stated policy, the Company's Board of Directors reserves the right to declare additional dividend distributions, to change the rate of dividend distributions (either as a policy or on a one-time basis), to cancel a specific distribution or to cancel the policy as a whole at any time, at its sole discretion. The actual distribution of a dividend will be subject to meeting the conditions required by applicable law, including the distribution tests set forth in Section 302 of the Companies Law, and to the specific decision of the Company's Board of Directors for each distribution. Future dividend policies will be reviewed by the Board of Directors based upon conditions then existing, including our earnings, financial condition, capital requirements and other factors. Our ability to pay cash dividends may be restricted by instruments governing any of our obligations.

Dividends paid by an Israeli resident company to non-Israeli shareholders are generally subject to withholding tax in Israel at a rate of up to 25% (or 30% if such non-Israeli shareholder is a “substantial shareholder”), but the actual withholding rate may be lower or higher than 25% depending upon the type of shareholder. In our case, the applicable withholding tax rate will also depend on the particular Israeli production facilities that have generated the earnings that are the source of the specific dividend and, accordingly, the applicable withholding rate may change from time to time.

On March 18, 2013 our Board of Directors declared a dividend of US $0.55 (NIS 2.03 according to the NIS-USD exchange rate as of March 18, 2013, as reported by the Bank of Israel) per share payable on April 17, 2013 to shareholders of record as of April 4, 2013, and in the aggregate amount of approximately US $3.9 million (approximately NIS 14.4 million according to the NIS-USD exchange rate as of March 18, 2013, as reported by the Bank of Israel) for 2012. Taxes were withheld at source by the Company as required pursuant to Israeli law.

On March 18, 2014 our Board of Directors declared a continuing dividend for 2013 of US $1.00 (NIS 3.462 according to the NIS-USD exchange rate as of March 18, 2014, as reported by the Bank of Israel) per share payable on April 17, 2014 to shareholders of record at the close of the NASDAQ Global Select Market on April 3, 2014, and in the aggregate amount of approximately US $7.2 million (approximately 24.9 million according to the NIS-USD exchange rate as of March 18, 2014, as reported by the Bank of Israel) for 2013. Taxes were withheld at source by the Company as required pursuant to Israeli law.

On March 23, 2015 our Board of Directors declared a continuing dividend for 2014 of US $1.00 (NIS 4.018 according to the NIS-USD exchange rate as of March 23, 2015, as reported by the Bank of Israel) per share payable on April 21, 2015 to shareholders of record at the close of the NASDAQ Global Select Market on April 6, 2015, and in the aggregate amount of approximately US $7.3 million (approximately 29.3 million according to the NIS-USD exchange rate as of March 23, 2015, as reported by the Bank of Israel) for 2014. Taxes were withheld at source by the Company as required pursuant to Israeli law.

On March 21, 2016 our Board of Directors declared a continuing dividend for 2015 of US $1.00 (NIS 3.855 according to the NIS-USD exchange rate as of March 21, 2016, as reported by the Bank of Israel) per share payable on April 14, 2016 to shareholders of record at the close of the NASDAQ Global Select Market on April 4, 2016, and in the aggregate amount of approximately US $7.3 million (approximately 28.1 million according to the NIS-USD exchange rate as of March 21, 2016, as reported by the Bank of Israel) for 2015. Taxes were withheld at source by the Company as required pursuant to Israeli law.

For more information on the taxation of dividends generally, and for our calculation of the tax withheld on the dividends paid as detailed above, see the section entitled “Taxation of Dividends” in Section 10.E “Taxation”.

Holders of our ordinary shares should consult their own tax advisors as to the United States, Israeli or other tax consequences of the receipt of any dividend distributions made to our shareholders, including, in particular, the effect of any foreign, state or local taxes, and of any taxes withheld at source by the Company.

B. Capitalization and indebtedness

Not Applicable

C. Reason for the offer and use of proceeds

Not Applicable

D. Risk Factors

This annual report and statements that we may make from time to time may contain forward-looking information. There can be no assurance that actual results will not differ materially from our expectations, statements or projections. Factors that could cause actual results to differ from our expectations, statements or projections include the risks and uncertainties relating to our business described below.

Risks Relating to Our Business

The markets for our products change rapidly and demand for new products is difficult to predict.

The markets for our products are characterized by rapidly changing technology and evolving industry standards. For example, the migration to higher line rate Ethernet solutions, the adaptation of new bus interfaces and increased use of emerging technologies such as Cloud, Virtualization and SDN, cause our OEM customers to demand such new products and technologies. In the event that our OEM customers decide to begin using new technologies, we may not be able to develop products for the new technologies in a timely manner. Our OEM customers may also select competing products despite our ability to develop products incorporating new technologies. For Example, with the shift towards running applications in the Cloud we anticipate that the demand will grow for add-on adapters and products which address the challenges presented by the Cloud, such as power, heat and space limitations in such environments which increase the need for essential building blocks in generic servers, which can be potentially served by our products. However there is no assurance that our OEM customers will buy such products from us or that we will continue to generate significant sales in this area or other areas in which we operate. Consequently, we may suffer from reduced sales to such OEMs and accumulate unusable inventory which can be used only with older technologies. We intend to continue investing in product and technology development. Although we have recorded growing sales of our line of products (to which the majority of our revenues are attributable), there can be no assurance that we will continue to be successful in the marketing of our current products and in developing, manufacturing and marketing enhanced and new products in a timely manner.

The market for cloud-based and cloud-focused solutions is at a relatively early stage of development, and if it develops in ways that are different from what we anticipate or expect, our business could be harmed.

The market for cloud-based solutions is at an early stage relative to physical appliances and on-premise networking solutions, and these types of deployments may not achieve or sustain high levels of demand and market acceptance, or may end up being implemented differently than current expectations in the market place.

In view of an anticipated increase in Cloud-based data centers utilizing virtualization and SDN, the systems are expected to be increasingly based on generic server platforms. These platforms will all need offload capabilities in order to address the performance challenges realized due to the huge amount of traffic, the high volume of data, the need to encrypt such data, the need to run in virtualized environment, which by itself is a challenge for the server CPU, and the need to include switching within the server for high efficiency SDN. We anticipate that consequently the demand for add-on adapters which address these challenges will grow. Power, heat and space limitations in such environments increase the need for hardware accelerators. Such systems will require essential building blocks in their own generic severs, which can be served by our products.

While we believe that we address the above needs with a comprehensive suite of products, many factors may affect the market acceptance of cloud-based and cloud-focused solutions, and/or the acceptance of add-on products incorporated into such solutions. Some of these factors include the possibility of seeing a reduction in the number of physical servers and appliances required by the providers of cloud based or virtualized solutions, or the evolving of different architecture designs which provide for functionality our products offer without the need for add on adapters.

If significant organizations providing Cloud based solutions or other virtualized networks do not perceive the benefits of our cloud-focused and virtualized network based solutions, or if our competitors or new market entrants are able to develop solutions for this sector that do not require add on products such as ours, or offer features that are, or are perceived to be, more effective than ours, this trend of moving towards the cloud but without needing our products for use in such virtualization environments would have a material adverse effect on our business, results of operations and financial condition.

The market for our products is highly competitive and some of our competitors may be better positioned than we are.

The market for our products is highly competitive. We face competition from numerous companies, some of which are more established, benefit from greater market recognition and have greater financial, production and marketing resources than we do. For example, in the network interface cards for which we have developed our Server Adapters, our main competitor is Intel, which may offer solutions competing with our developed products. In addition, Caswell, Lanner and Napatech are the main competitors of some of our Smart Cards products. There may be other solutions which might also compete with our other products. We cannot guarantee that our present or contemplated products will continue to be distinguishable from those of our competitors or that the marketplace will find our products preferable to those of our competitors. Furthermore, there can be no assurance that competitive pressures will not result in price reductions that could materially adversely affect our business and financial condition and the results of our operations. For more information regarding our competitors see "Item 4B. – Information on the Company – Business Overview – Competition".

We may need to invest significantly in research and development and business development in order to diversify our product offering and enter new markets.

Most of our revenues are generated from the sale of our networking and data infrastructure solution products. The technology industry in which we operate is characterized by rapid technological change, frequent new product introductions, changes in customer requirements and evolving industry standards. While these changes could lead to a reduction in the demand for our existing products, they could also create an opportunity for us to expand our product offering to our existing customers and to new customers. Accordingly, our future success may depend on our ability to diversify our product offering and enter new markets, which could involve numerous risks, including:

- Substantial research and development and business development expenditures, which could divert funds from other corporate uses and/or have a significant negative effect on our short-term results;
- Diversion of management’s attention from our core business; and
- Entering markets in which we have little or no experience.

There can be no assurance that we will be able to successfully complete the development and market introduction of new products and no assurance that we will be able to successfully enter new markets. This could have a material adverse effect on our business, results of operations and financial condition.

We may experience difficulty in developing new, commercially successful products at acceptable release times.

We conduct extensive research, development and engineering activities. Our efforts emphasize the development of new products, cost reduction of current products, and the enhancement of existing products, generally in response to rapidly changing customer preferences, technologies and industry standards. We cannot guarantee the continued success of our latest lines of products, which include Bypass Switches, Intelligent Bypass Switches, the SETAC product family, the CPE/Edge/Appliance Units and Low End Appliances, nor that they will continue to be widely accepted by the marketplace or that any of our ongoing development efforts will result in other commercially successful products, that such products will be released in a timely manner or that we will be able to respond effectively to technological changes or new product announcements by others.

Significant growth in markets demanding functionality similar to the functionality offered by certain of our products may cause manufacturers to integrate such characteristics into server motherboards or increase the market share of appliances that already have such functionality in-built, eliminating the need for our add-on products.

A significant portion of our products sold are add-on adapters that are added to existing servers in order to improve their functionality. If demand for improved functionality similar to the functionality of our add-on adapters increases significantly, server manufacturers may begin incorporating such functionality as a part of the basic design of their servers, thereby eliminating the need to achieve such functionality through add-on adapters. Furthermore, the market share of special purpose appliances that already have such functionality built-in may increase, consequently reducing the market share of solutions based on servers with add-on adapters. We cannot assure you that such a trend will not occur in connection with our add-on adapters or any of our other products. Such a trend would have a material adverse effect on our business, results of operations and financial condition.

Our OEM customers may replace the appliances they currently use with appliances that do not require our cards or incorporate cards other than ours.

Many of the OEMs that use appliances which include our cards do so for a few years, and then consider migration to newer generations of appliances. We cannot guarantee that our cards will be needed or selected for such new appliances or compatible with them. A decision by a current OEM customer or customers to select a new appliance without including our cards in such new appliance may have a significant adverse effect on our results of operations.

We may experience difficulty in developing solutions for appliances with proprietary interfaces which may be used by some of our potential customers.

The market for networking appliances includes appliances that make use of proprietary interfaces. These appliances are offered to our potential customers in addition to the customary server-based appliances which use standard interfaces. Our potential customers may decide to use appliances with proprietary interfaces instead of the customary server-based appliances for which several manufacturers may provide add-on cards. There could be no assurance that we would be able to develop non-standard add-on cards for appliances with proprietary interfaces or, if we are successful in developing such cards, that manufacturers of the proprietary interfaces or the customers electing to use these interfaces will make use of our cards in such non-standard environments.

Our ability to accurately forecast future sales is severely limited due to the short lead time of customer orders.

As a result of the short lead time for firm purchase orders, we are unable to accurately forecast future revenues from product sales. As a result, even dramatic fluctuation in revenue (whether increase or decrease) might not be detected until the very end of a financial quarter, which may not enable us to monitor costs in a timely manner to compensate for such fluctuation.

The short lead time of customer orders combined with the long lead time of our suppliers when ordering certain components for our products could result in either a surplus or lack of sufficient supplies, and impact negatively on our finances.

While we are generally required to fill orders for our products within one or two weeks following the receipt of a firm purchase order, we must place orders of certain components for our products between sixteen and twenty weeks prior to delivery. As a result, we must have a significant amount of components in our inventory to be able to meet our best forecasts of projected purchase orders as opposed to on the basis of firm purchase orders. In the event that firm purchase orders are significantly lower than such forecasts, a significant part of our inventory will not be used and we may be unable to adjust costs in a timely manner to compensate for revenue shortfalls and in the event that firm purchase orders exceed such forecasts, we will not be able to fill such purchase orders which may lead to the loss of business from a customer.

The loss of a significant customer may have a material adverse effect on us.

We depend on a small amount of customers for our products. Our top three customers accounted for approximately 35% of our revenues in 2015 (out of which our top customer accounted for approximately 20% of our revenues in 2015). We expect that a small number of customers will continue to account for a significant portion of our revenues for the foreseeable future. Loss or cancellation of business from, significant changes in deliveries to, or decreases in the prices of products sold to, one or more of our key customers has, in the past, significantly reduced our revenues for a reporting period and could, in the future, harm our margins, financial condition and business.

The loss or ineffectiveness of any of our original equipment manufacturer relationships or a reduction of purchase orders or sales efforts by such original equipment manufacturers may have a material adverse effect on our operations and financial results.

Our sales and marketing strategy is to develop and maintain strategic relationships with leading original equipment manufacturers ("OEMs") in the servers industry and server-based systems industry, which integrate our products into their systems. These OEMs are not within our control, are not obligated to purchase our products, and may select other products that may compete with our lines of products. A reduction in their sales efforts or discontinuance of sales of our products by our OEMs could lead to reduced sales and could materially adversely affect our operating results. Use of OEMs also entails the risk that they will build up inventories in anticipation of a growth in sales. If such growth does not occur as anticipated, such OEMs may substantially decrease the amount of products ordered in subsequent quarters or discontinue product orders. The termination or loss of either one of our key OEM relationships or several OEM relationships at approximately the same time, without being able to compensate this loss with sales to other OEM customers might have a material adverse effect on our operations and financial results.

We are dependent on key personnel.

Our success has been, and will be, dependent to a large degree on our ability to retain the services of key personnel and to attract additional qualified personnel in the future. Competition for such personnel is intense. There can be no assurance that we will be able to attract, assimilate or retain key personnel in the future and our failure to do so would have a material adverse effect on our business, financial condition and results of operations.

We may not be able to prevent others from claiming that we have infringed their proprietary rights.

We cannot guarantee that one or more parties will not assert infringement claims against us. The cost of responding to claims could be significant, regardless of whether the claims have merit. Significant and protracted litigation may be necessary to determine the scope of the proprietary rights of others or to defend against claims of infringement, regardless of whether the claims have merit. Although we believe that all our products use only our intellectual property, or intellectual property which is properly licensed to us, in the event that any infringement claim is brought against us and infringement is proven, we could be required to discontinue the use of the relevant technology, to cease the manufacture, use and sale of infringing products, to incur significant litigation damages, costs and expenses, to develop non-infringing technology or to obtain licenses to the alleged infringing technology and to pay royalties to use such licenses. There can be no assurance that we would be able to develop any such alternative technologies or obtain any such licenses on terms commercially acceptable to us.

On March 2, 2012 Internet Machines LLC, a Texas limited liability company filed a patent infringement lawsuit in the United States District Court for the Eastern District of Texas (the “Court”) against numerous defendants (including many switch manufacturers) with respect to certain patents for switches, and included our US subsidiary amongst the list of defendants named in such lawsuit. The lawsuit claims that the defendants have infringed certain patents purported to be owned by Internet Machines LLC and seeks unspecified compensation for damages as well as injunctive relief. The defendants filed answers and counterclaims to the complaint asserting that they do not infringe any claims of the asserted patents and the claims of the patents are invalid and/or unenforceable. On April 28, 2015, the lawsuit was dismissed with prejudice by the Court.

Although in the past we have resolved a claim of infringement through a license agreement, the terms of which did not have a material effect on our business, any infringement claim or other litigation against us, could seriously harm our business, operating results and financial condition. While there are no other lawsuits or other claims currently pending against us or our subsidiaries regarding the infringement of patents or intellectual property rights of others, except for any such claims or legal proceedings that, if adversely determined, would not adversely affect the use or exploitation of such intellectual property right by the Company or by (i) any of our subsidiaries; (ii) our recently acquired assets from ADI Engineering, Inc.; or (iii) the creation, development, manufacturing, marketing, provision, distribution, licensing, or sale of any product or service created, developed, manufactured or otherwise provided by any of the Company, any or our subsidiaries or in relation to the assets recently acquired by us from ADI under the assets purchase agreement dated October 28, 2015, we have been a party to such claims in the past and may be party to such claims in the future.

We may not be able to protect our intellectual proprietary rights.

Our success, ability to compete, and future revenue growth are dependent and will depend, in part, on our ability to protect our intellectual property. It is possible that competitors or other unauthorized third parties may obtain, copy, use or disclose our technologies and processes. Any of our existing, acquired, or future patents or other rights to our intellectual property may be challenged, invalidated or circumvented. If our intellectual property rights do not adequately protect our technology, our competitors may be able to offer products similar to ours.

In order to establish and protect the technology we use in our products, we primarily rely on a combination of non-disclosure agreements and technical measures, and to a lesser degree on patents. We enter into confidentiality arrangements with our employees, key consultants and other third parties with whom we conduct business. In addition, our employees and key consultants involved in the development of our technologies are required to sign non-compete and invention assignment agreements. We also control access to and distribution of our technologies, documentation and other proprietary information. Despite these efforts, internal or external parties may attempt to copy, disclose, obtain or use our products, services or technology without our authorization.

Despite perceived exclusive access to any intellectual property rights obtained via acquisition, and our best efforts during any such acquisition process to secure such rights, internal or external parties may attempt to copy, disclose, obtain or use our products, services or technology without our authorization, or others may assert infringement claims against us with respect to a product of ours which utilizes such acquired intellectual property rights.

We believe that the measures we take afford only limited protection, and accordingly, there can be no assurance that the steps we take will be adequate to prevent misappropriation of our technology or the independent development of similar technologies by others. The process of seeking patent protection may take a long time and be expensive. We cannot assure you that patents will be issued from pending or future applications or that, if patents are issued, they will not be challenged, invalidated or circumvented or that the rights granted under the patents will provide us with meaningful protection or any commercial advantage. In addition, we cannot assure you that other countries in which we market our services and products will protect our intellectual property rights to the same extent as the United States. Effective intellectual property enforcement may be unavailable or limited in some countries. It may be difficult for us to protect our intellectual property from misuse or infringement by other companies in these countries. Our inability to enforce our intellectual property rights in some countries may harm our business and results of operations. Litigation, which could result in substantial costs to us and diversion of our resources, may also be necessary to enforce our patents or other intellectual property rights.

Further, we cannot assure you that we will at all times enforce our patents or other intellectual property rights or that courts will uphold our intellectual property rights, or enforce the contractual arrangements that we have entered into to protect our proprietary technology, which could reduce our opportunities to generate revenues. Our confidentiality and non-competition agreements may not be enforceable and our proprietary technology may not remain a secret. Others may develop similar technology and use this technology to compete with us. Despite our efforts to protect our proprietary rights, former employees and other unauthorized parties may attempt to copy aspects of our products or obtain and use information that we regard as proprietary.

Loss of our sources for certain key components could harm our operations.

Although we generally use standard parts and components for our products, certain key components used in our products are currently available from only one source, and others are available from a limited number of sources, on which we depend. Nevertheless, we believe that we maintain a sufficient inventory of these components to protect against delays in deliveries. However, we cannot guarantee that we will not experience delays in the supply of critical components in the future or that we will have a sufficient inventory of critical components at such time to produce products at full capacity. For example, a key component in many of our cards is manufactured by Intel, one of our competitors. While we have not encountered difficulties in purchasing such components from Intel's distributors, we cannot guarantee that we will continue to be able to purchase such components without delays or at reasonable prices. In the event that we are not able to purchase key components of our products from our limited sources, or are able to purchase these key components only under unreasonable terms, we may need to redesign certain products. We cannot guarantee that we will have adequate resources for such a redesign or that such a redesign will be successful. Such inability to obtain alternative resources or to successfully redesign our products could have a material adverse effect on our business, results of operations and financial condition.

Inability to receive information from our key component manufacturers could affect our ability to develop new products required by our OEM customers and by the industry in which we operate.

Our products are based on networking controllers which are manufactured by eitherBroadcom, Cavium or Intel. In order to design our products, we need to receive information that enables us to design products with the use of such controllers. There can be no assurance that we will continue to receive all the information required for designing products with the use of new controllers continuously released by the above mentioned companies. Intel and Cavium are our competitors and Broadcom may also compete with our products. Such competition may also affect their decisions regarding the sharing of information with us. The inability to obtain such information may adversely affect our ability to develop new products required by our OEM customers and by the industry in which we operate.

Our networking and data infrastructure solution products which are sold by us mainly to OEMs, are characterized by long sales cycles.

We sell our networking and data infrastructure solution products mainly to original equipment manufacturers, or OEMs. The decision making process of our OEM customers includes several time consuming processes, resulting from the critical importance of our products in their systems. They need to define the required configuration of their server system/appliance, derive the need and type of adapters or other add-on products, evaluate our products, intensively test and qualify our products and then (or in parallel) negotiate the terms for a purchase. It may therefore take 12 months or more from the time we first contact a prospective customer before such customer implements our cards in its system constituting what is known as a Design Win. Additionally, once a Design Win for one of our products is secured, our sales of these products typically involve significant capital investment decisions by prospective end customers, as well as a significant amount of time to educate such end customers as to the benefits of systems and appliances that include our products. As a result, before purchasing systems and appliances which include our products (and consequently facilitating sales of our products), companies spend a substantial amount of time performing internal reviews and obtaining capital expenditure approvals, consequently lengthening the period of time required for a Design Win to mature into consistent sales. These long sales cycles make it difficult to predict when and to what extent discussions with potential customers will materialize into sales and could cause our revenue and operating results to fluctuate widely from period to period. In addition, our allocation of significant resources to potential sales opportunities that do not materialize into sales could have a material adverse effect on our business, results of operations and financial condition.

We may make acquisitions or pursue mergers that could disrupt our business and harm our financial condition.

As part of our business strategy, we have sought and may continue to seek to invest in or acquire other businesses, technologies or assets, and we may enter into joint ventures or other strategic relationships with third parties.

We may assume liabilities, incur amortization expenses related to intangible assets or realize large and immediate write-offs in connection with future acquisitions. In addition, the future valuation of these acquisitions may decrease from the market price paid by us, which may result in the writing-off, or impairment, of the relevant assets. In addition, our operation of any acquired or merged businesses, technologies or assets could involve numerous risks, including:

- Post-merger integration problems resulting from the combination of any acquired operations with our own operations or from the combination of two or more operations into a new merged entity;
- Diversion of management's attention from our core business;
- Substantial expenditures, which could divert funds from other corporate uses;
- Entering markets in which we have little or no experience; and
- Loss of key employees of the acquired operations.

We cannot be certain that any acquisition or merger will be successful. If the operation of the business of any acquisition or merger disrupts our operations, our business may suffer. In addition, even if we successfully integrate the acquired business with our own, we may not receive the intended benefits of the acquisition.

We may be subject to risks associated with laws, regulations and customer initiatives relating to the environment, conflict minerals or other social responsibility issues, which may force us to incur additional expenses, may make our supply chain more complex and may result in damage to our reputation with customers.

The Dodd-Frank Wall Street Reform and Consumer Protection Act included disclosure requirements regarding the use of "conflict" minerals mined from the Democratic Republic of Congo and adjoining countries ("DRC") and procedures regarding a manufacturer's efforts to prevent the sourcing of such "conflict" minerals. These requirements will require companies to diligence, disclose and report whether or not such "conflict" minerals originate from the DRC. The implementation of these requirements could adversely affect the sourcing, availability and pricing of minerals such as cassiterite, wolframite, coltan, and gold which are used in the manufacture of certain components used in our products. As a result, this could limit the pool of suppliers who can provide us DRC "conflict free" components and parts, and we may not be able to obtain DRC "conflict free" products or supplies 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. In such event, we may also face difficulties in satisfying customers who require that all of the components of our products are certified as conflict mineral free. In addition, we will incur additional costs to comply with the disclosure requirements, including costs related to determining the source of any of the relevant minerals and metals used in our products. For additional information see "Item 4 Information on the Company – Business Overview."

Risks Relating to Operations in Israel and Internationally

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

Our production facilities have been granted "Approved Enterprise" or "Benefited Enterprise" status in past years and currently hold a "Preferred Enterprise" status and since and as such, we are entitled to certain tax benefits. To be eligible for these tax benefits, we must meet certain conditions. If we fail to meet these conditions in the future, the tax benefits could be reduced or canceled and we could be required to refund any tax benefits we might already have received. These tax benefits may not be continued in the future at their current levels, or at any level. In recent years, the Israeli government has reduced the benefits available and has indicated that it may further reduce or eliminate some of these benefits in the future. The termination or reduction of these benefits may increase our income tax expense in the future. To the best of our knowledge, to date we have met the conditions for benefits under each of our "Approved Enterprise" and "Benefited Enterprise" plans and under our "Preferred Enterprise" status in all material respects. There can be no assurance, however, that we will continue to meet such conditions in the future. If these tax benefits are reduced, cancelled or discontinued, our Israeli taxable income would be subject to regular Israeli corporate tax rates. The standard corporate tax rate for Israeli companies in 2013 was 25.0%, was increased to 26.5% for 2014 and 2015 and reduced to 25% in 2016 and thereafter. See Item 10 "Additional Information – Taxation – Law for the Encouragement of Capital Investments, 1959" for more information about our "Benefited Enterprise" status.

The recent Amendment Number 7 to the Israeli Encouragement of Industrial Research and Development Law, 1984 may cause ambiguity regarding its implementation and have an adverse effect on the Company

On July 29, 2015, the Israeli Parliament, the Knesset, enacted Amendment Number 7 to the Israeli Encouragement of Industrial Research and Development Law, 1984 (the "R&D Law" and the "R&D Amendment", respectively). The R&D Amendment, effective as of January 1, 2016 amends material provisions of the R&D Law, such as royalty rates, changes to royalty rates upon transfer of manufacturing rights abroad etc., leaves substantial discretion with a new authority which shall be established to replace the current Office of the Chief Scientist of Israel (the "OCS") and includes only guidelines to some of the core issues of the R&A Law, thus currently causing much ambiguity as to the implementation of the R&D Amendment and its effect on companies which developed know-how using funds received from the OCS. In addition, it is still not clear if the R&D Amendment will have a retroactive effect, which may change the terms of grants previously received from the OCS.

The political environment and hostilities in Israel could harm our business.

Since the establishment of the State of Israel in 1948, a state of hostility has existed between Israel and the Arab countries in the region. This state of hostility has varied in degree and intensity over time. There has also been conflict and unrest between Israel, the Palestinian Authority and certain terrorist groups operating within the Palestinian Authority and Lebanon. In addition, internal conflicts within neighboring counties such as Egypt and Syria also affect Israel, both directly and indirectly. A significant increase in violence began in September 2000 and has continued with varying levels of severity through 2013, such as Israel's war with the Hezbollah militant group in July and August of 2006. In December 2008 and January 2009 there was an escalation in violence among Israel, Hamas, the Palestinian Authority and other groups, as well as extensive hostilities along Israel's border with the Gaza Strip, which resulted in missiles being fired from the Gaza Strip into Southern Israel. Similar hostilities accompanied by missiles being fired from the Gaza Strip into Southern Israel, as well at areas more centrally located near Tel Aviv and at areas surrounding Jerusalem, occurred during November 2012. During the summer of 2014, another escalation in violence among Israel, Hamas, the Palestinian Authority and other groups took place. This escalation became known as "Operation Protective Edge", which resulted in missiles being fired from the Gaza Strip into Southern and Central Israel, as well as civil insurrection of Palestinians in the West Bank. In October 2015, Israel encountered another escalation in violence with the Palestinian population, which resulted in clashes between Israel and armed Palestinians on the border with Gaza, in the West Bank and in Israeli cities. Since February 2011, Egypt has experienced political turbulence and an increase in terrorist activity in the Sinai Peninsula, following the resignation of Hosni Mubarak as president. This included protests throughout Egypt, and the appointment of a military regime in his stead, followed by the elections to parliament which brought groups affiliated with the Muslim Brotherhood (which had been previously outlawed by Egypt), and the subsequent overthrow of this elected government by a military regime instead. Such political turbulence and violence may damage peaceful and diplomatic relations between Israel and Egypt, and could affect the region as a whole. Similar civil unrest and political turbulence has occurred in other countries in the region, including Syria which shares a common border with Israel, and is affecting the political stability of those countries. Since April 2011, internal conflict in Syria has escalated, and evidence indicates that chemical weapons have been used in the region. Intervention may be contemplated by outside parties in order to prevent further chemical weapon use. This instability and any intervention may lead to deterioration of the political and economic relationships that exist between the State of Israel and some of these countries, and may have the potential for additional conflicts in the region. In addition, Iran has threatened to attack Israel and is widely believed to be developing nuclear weapons. Iran is also believed to have a strong influence among extremist groups in the region, such as Hamas in Gaza, Hezbollah in Lebanon. Iran is known to support the government of Syria in its battles against various rebel militia groups in Syria. Furthermore, 2014 saw the rise of an Islamic fundamentalist group, known as ISIS. Following swift conquering operations, ISIS gained control of vast areas in the Middle East, including in Iraq and Syria, which contributed to the turmoil experienced in these areas. As a result, the United States armed forces have engaged in limited operations to eradicate ISIS and recently, Russia's armed forces have also engaged in limited operations to defeat ISIS and other rebel groups operating in Syria. These situations may potentially escalate in the future to more violent events which may affect Israel and us. Furthermore, several countries still restrict trade with Israeli companies and additional countries may impose such restrictions as a result of changes in the military and/or political conditions in Israel and/or the surrounding countries, which may limit our ability to make sales in, or purchase components from, those countries. Any future armed conflict, political instability, continued violence in the region or restrictions could have a material adverse effect on our business, operating results and financial condition. While such hostilities did not in the past have a material adverse impact on our business, we cannot guarantee that hostilities will not be renewed and have such an effect in the future. The political and security situation in Israel may result in parties with whom we have contracts claiming that they are not obligated to perform their commitments under those agreements pursuant to force majeure provisions. Any 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 or obtain components used in our products. Since many of our facilities are located in Israel, we could experience serious disruptions if acts associated with this conflict result in any serious damage to our facilities. Any insurance coverage

we may have may not adequately compensate us for losses that may occur and any losses or damages incurred by us could have a material adverse effect on our business. Any future armed conflict or political instability in the region would likely negatively affect business conditions and harm our results of operations.

Many of our employees in Israel are required to perform military reserve duty.

All non-exempt male adult citizens and permanent residents of Israel under the age of 40, or older for reserves officers or citizens with certain occupations, as well as certain female adult citizens and permanent residents of Israel, are obligated to perform military reserve duty and may be called to active duty under emergency circumstances. In recent years, there have been significant call-ups of military reservists, and it is possible that there will be additional call-ups in the future. While we have operated effectively despite these conditions in the past, we cannot assess what impact these conditions may have in the future, particularly if emergency circumstances arise. Our operations could be disrupted by the absence for a significant period of one or more of our executive officers or key employees or a significant number of our other employees due to military service. Any disruption in our operations would harm our business.

Exchange rate fluctuations and international risks could increase the cost of our operations.

Approximately 97% of our international sales are denominated in U.S. dollars and may be subject to government controls and other risks, including, in some cases, export licenses, federal restrictions on export, currency fluctuations, political instability, trade restrictions, and changes in tariffs and freight rates. Our U.S. dollar costs in Israel and Denmark will increase further to the extent that inflation in Israel and Denmark exceeds the devaluation of the NIS and Danish Krone ("DKK"), respectively, against the dollar, if the timing of such devaluation lags behind inflation in Israel or Denmark, or if the dollar devalues against the NIS or DKK.

We are affected by worldwide downturns in industries based on technology.

The volatility in the securities markets discussed above and its effect on high-technology companies may have a ripple effect on our performance. In the downturn which the markets experienced beginning in 2001, technology companies dealing in communications and computers were severely affected and some were forced to cease operations. We felt the effects of this downturn in 2001 through 2003. We were also affected by the downturn in the economic markets which began in 2008, posing a risk to industries based on technology as well as the overall economy. We can give no assurance that our results will not be affected on a going forward basis by any economic downturns.

General economic conditions may adversely affect the Company’s results.

Uncertainty in global economic conditions, including any disruption in financial and credit markets, pose a risk to the overall economy that could impact demand for our and our customers’ products, as well as our ability to manage commercial relationships with our customers, suppliers and creditors. If the global economic situation worsens, our business could be negatively impacted, including such areas as reduced demand for our products and services, or supplier or customer disruptions, which could reduce our revenues or our ability to collect our accounts receivable and have a material adverse effect on our financial condition and results of operations.

Risks Related to our Ordinary Shares

We are affected by volatility in the securities markets.

The securities markets in general have experienced volatility which has particularly affected the securities of many high-technology companies and particularly those in the fields of communications, software and internet, including companies that have a significant presence in Israel. This volatility has often been unrelated to the operating performance of these companies and may cause difficulties in raising additional financing required to effectively operate and develop their businesses. Such difficulties and the volatility of the securities markets in general may affect our financial condition and results.

We may experience a decline in our share price and there is no guarantee that our share price will rise at all.

Our share price fell during recent periods of uncertainty in global economic conditions and we expect it to continue to be affected by such uncertainty to the extent that it continues. We cannot assure you that our share price will stabilize, or not decline, in the coming fiscal year.

We may not be able to fulfill our dividend policy in the future.

We have announced a dividend policy for distributing up to 50% of our annual distributable profits as a dividend. Our Board of Directors declared a dividend for 2012 which was distributed in April 2013, for 2013 which was distributed in April 2014, for 2014 which was distributed in April 2015 and for 2015 which was distributed in April 2016. Our ability to distribute dividends in the future may be adversely affected by the risk factors described in this report. As part of the stated dividend policy the Company's Board of Directors reserves the right to declare additional dividend distributions, to change the rate of dividend distributions (either as a policy or on a one-time basis), to cancel a specific distribution or to cancel the policy as a whole at any time, at its sole discretion. Any dividend will depend on our earnings, capital requirements, financial condition and other business and economic factors affecting us at the time as our board of directors may consider relevant. Our ability to pay cash dividends may be restricted by instruments governing any of our obligations. We are restricted by Israeli law to pay dividends in any fiscal year only out of “profits,” as defined by the Israeli Companies Law, unless otherwise authorized by an Israeli court, and provided that the distribution is not reasonably expected to impair our ability to fulfill our outstanding and expected obligations. There

is no assurance that we will be able to continue paying dividends or increase our payment of dividends in the future, nor is there any assurance that our Board of Directors will not change our dividend policy in the future. If we are unable to fulfill our stated dividend policy, or pay dividends at levels anticipated by investors in our shares, the market price of our shares may be negatively affected and the value of our shareholders' investment may be reduced. See "Item 8.A Consolidated Statements and Other Financial Information", under the caption "8A – Dividend Policy" for additional information regarding the payment of dividends.

If we fail to meet continued listing standards of NASDAQ, our shares may be delisted, which could have a material adverse effect on the liquidity of our shares

Our ordinary shares are currently traded on the Nasdaq Global Select Market. The NASDAQ has requirements that a company must meet in order to remain listed on NASDAQ. In particular, NASDAQ rules require us to maintain a minimum bid price of $1.00 per share of our ordinary shares. If the closing bid price of our common stock were to fall below $1.00 per share for 30 consecutive trading days or we do not meet other listing requirements, we would fail to be in compliance with NASDAQ's listing standards. There can be no assurance that we will continue to meet the minimum bid price requirement, or any other requirement in the future. If we fail to meet the minimum bid price requirement, The NASDAQ Stock Market may initiate the delisting process with a notification letter. If we were to receive such a notification, we would be afforded a grace period of 180 calendar days to regain compliance with the minimum bid price requirement. In order to regain compliance, our ordinary shares would need to maintain a minimum closing bid price of at least $1.00 per share for a minimum of 10 consecutive trading days. If our ordinary shares were to be delisted, our liquidity would be adversely affected and our market price could decrease.

The trading volume of our shares has been low in the past and may be low in the future, resulting in lower than expected market prices for our shares.

Our shares have been traded at low volumes in the past and may be traded at low volumes in the future for reasons related or unrelated to our performance. This low trading volume may result in lower than expected market prices for our ordinary shares and our shareholders may not be able to resell their shares for more than they paid for them.

Israeli courts might not enforce judgments rendered outside of Israel.

We are incorporated in Israel. All of our executive officers and all of our directors are non-residents of the United States, and a substantial portion of our assets and the assets of these persons are located outside the United States. Therefore, it may be difficult to enforce a judgment obtained in the United States against us or any such persons. It may also be difficult to enforce civil liabilities under U.S. federal securities laws in original actions instituted in Israel. However, subject to certain time limitations, Israeli courts may enforce U.S. final executory judgments for liquidated amounts in civil matters obtained after due trial before a court of competent jurisdiction (according to the rules of private international law currently prevailing in Israel) which enforces similar Israeli judgments, provided that the requisite procedural and legal requirements are adhered to. If a foreign judgment is enforced by an Israeli court, it generally will be payable in NIS, which can then be converted into foreign currency at the rate of exchange of such foreign currency on the date of payment. Pending collection, the amount of the judgment of an Israeli court stated in NIS (without any linkage to a foreign currency) ordinarily will be linked to the Israeli consumer price index plus interest at the annual statutory rate prevailing at such time. Judgment creditors bear the risk of unfavorable exchange rates.

If we are characterized as a passive foreign investment company for U.S. federal income tax purposes, our U.S. shareholders may suffer adverse tax consequences.

We will be a passive foreign investment company, or PFIC, if 75% or more of our gross income in a taxable year, including our pro-rata share of the gross income of any company, U.S. or foreign, in which we are considered to own, directly or indirectly, 25% or more of the shares by value, is passive income. Alternatively, we will be considered to be a PFIC if at least 50% of our assets in a taxable year, averaged over the year and ordinarily determined based on fair market value and including our pro-rata share of the assets of any company in which we are considered to own, directly or indirectly, 25% or more of the shares by value, are held for the production of, or produce, passive income. If we were to be a PFIC, and a U.S. Holder does not make an election to treat us as a “qualified electing fund,” or QEF, or a “mark-to-market” election, “excess distributions” to a U.S. Holder, and any gain recognized by a U.S. Holder on a disposition or our ordinary shares, would be taxed in an unfavorable way. Among other consequences, our dividends, to the extent that they constituted excess distributions, would be taxed at the regular rates applicable to ordinary income, rather than the 15% maximum rate applicable to certain dividends received by an individual from a qualified foreign corporation, and certain "interest" charges may apply. In addition, gains on the sale of our shares would be treated in the same way as excess distributions. The tests for determining PFIC status are applied annually and it is difficult to make accurate predictions of future income and assets, which are relevant to the determination of PFIC status. In addition, under the applicable statutory and regulatory provisions, it is unclear whether we would be permitted to use a gross loss from sales (sales less cost of goods sold) to offset our passive income in the calculation of gross income. As a result of our substantial cash position, if the value of our shares declines, there is a substantial risk that we will be classified as a PFIC under the asset test described above. There can be no assurance that we will not be classified as a PFIC by the U.S. Internal Revenue Service. In light of the uncertainties described above, no assurance can be given that we will not be a PFIC in any year. A U.S. Holder who makes a QEF election is taxed currently on such holder's proportionate share of our earnings. If the IRS determines that we are a PFIC for a year with respect to which we have determined that we were not a PFIC, however, it might be too late for a U.S. Holder to make a timely QEF election, unless the U.S. Holder qualifies under the applicable Treasury regulations to make a retroactive (late) election. U.S. Holders who hold ordinary shares during a period when we are a PFIC will be subject to the foregoing rules, even if we cease to be a PFIC, subject to exceptions for U.S. Holders who made a timely QEF or mark-to-market election, or certain other elections. We do not currently intend to prepare or provide the information that would enable you to make a Qualified Election Fund election. Accordingly, our shareholders are urged to consult their tax advisors regarding the application of PFIC rules.

26

Our investment portfolio may be impaired by disruptions in the financial and credit markets.

Our investment portfolio currently consists of corporate debt securities which the Company classified at December 31, 2015 as "held-to-maturity". As of December 31, 2015, we hold approximately US$ 32.9 million in corporate debt securities.

Due to possible significant disruptions in the financial and credit markets, the corporate debt securities in our portfolio are subject to a possible increased risk of default due to bankruptcy, lack of liquidity, operational failure or other factors affecting the issuers of those securities. In addition, securities in our portfolio are subject to other risks, such as credit, liquidity, market and interest rate risks, which may be exacerbated by market disruptions, and which may impair the assets. We may be required to adjust the carrying value of our investment securities due to a default, lack of liquidity or other event, if the event constitutes an impairment which is considered to be other-than-temporary. As of December 31, 2015, we were not required to adjust the carrying value of our investment securities since there were no other-than-temporary impairments.

This loss would be recorded in our consolidated statement of operations which could materially adversely impact our consolidated results of operations and financial condition.

Item 4. INFORMATION ON THE COMPANY.

A. History and Development of the Company

Our legal and commercial name is Silicom Ltd. We were incorporated under the laws of the State of Israel in 1987, and we operate under Israeli law and legislation. Our registered and principal executive offices are located in Israel at 14 Atir Yeda Street, Kfar Sava, Israel 4464323, and our telephone number is +972-(0)9-764-4555.

Our shares have been listed on the NASDAQ Global Select Market since January 2, 2014 under the ticker symbol “SILC”. Prior thereto our shares were listed on the NASDAQ Global Market (previously known as the NASDAQ National Market) under the ticker symbol “SILC” (and previously “SILCF”) from February 11, 2008. Prior thereto, our shares were listed on the NASDAQ Capital Mark.et (previously known as the NASDAQ Small-Cap). On December 20, 2005, we obtained the approval of the Tel Aviv Stock Exchange, or TASE, for the listing of our shares on TASE. Trading of our shares on TASE commenced on December 27, 2005. On October 26, 2015, our Board of Directors resolved to act to delist the Company’s shares from trading on the TASE. Consequently, we applied to the TASE and requested that TASE initiate the delisting process. On October 29, 2015, the TASE announced to the TASE members on the TASE electronic filing site, the MAYA, and on the ISA electronic filing site, the MAGNA, that the last trading day in the Company's shares on the TASE shall be January 26, 2016 and that on January 28, 2016, the Company's shares shall be delisted from trading on the TASE. Accordingly, the last trading day in our shares on the TASE was January 26, 2016, and on January 28, 2016, our shares were delisted from trading on the TASE. Our shares are currently listed only on the NASDAQ Global Select Market. See Item 9. “The Offer and Listing - Markets and Share Price History”.

In March 2014, we filed a "shelf" registration statement with the Securities and Exchange Commission, or SEC. We may sell up to $80,000,000 of our ordinary shares in one or more offerings pursuant to this registration statement.

In December 2014, we entered into a share purchase agreement with Fiberblaze, a provider of high performance application acceleration solutions for the mobile, telecommunication, network monitoring, cyber security, financial and related industries, Nikolaj Herman, Fiberblaze Holding APS, a Danish company, Hilmer APS, a Danish company, and Jakob Hilmer, for the purchase of the entire share capital of Fiberblaze and Fiberblaze US (the "Fiberblaze SPA") in consideration for an amount of approximately $10 million, plus such additional amounts in the event Fiberblaze meets pre-determined criteria. For additional information regarding the Fiberblaze SPA, see "Item 10 – Additional Information – Material Contracts" and Note 3B to our financial statements included elsewhere in this annual report.

In September 2015, we, together with our wholly owned subsidiary, Silicom Connectivity Solutions, Inc., entered into an asset purchase agreement with ADI Engineering, Inc. ("ADI"), a US company which provides Intel-based products targeted at SDN, NFV, IoT ("Internet of Things"), Cloud computing and Virtualization, Steve Yates and Patricia Yates (the "ADI APA") for the purchase of ADI's assets in consideration for an amount equal to $10 million in cash at closing, and an additional consideration subject to the attainment of certain future performance milestones. For additional information regarding the ADI APA, see "Item 10 – Additional Information – Material Contracts" And Note 3A to our financial statements included elsewhere in this annual report.

Principal capital expenditures and divestitures

From January 1, 2015 to December 31, 2015, our capital expenditures totaled to approximately $20,771 thousand (compared to $16,682 thousand during 2014 and $929 thousand during 2013), of which approximately $1,608 thousand (compared to $1,179 thousand during 2014 and $788 thousand during 2013) can be attributed to machinery and equipment, approximately $1,374 thousand (compared to $659 thousand during 2014 and $141 thousand during 2013) can be attributed to office furniture and equipment and leasehold improvements, and approximately $17,802 thousand can be attributed to the ADI APA. We have financed our capital expenditures from our available internal resources, and expect to continue to finance our capital expenditures in a similar manner in 2016.

B. Business Overview

We are currently engaged in the design, manufacture, marketing and support of high performance networking and data infrastructure solutions for a broad range of servers, server based systems and communications devices. Our products are sold to OEM customers who offer networking appliances, servers and storage devices. As the market moves to utilize applications within virtualization based Cloud Data Centers, our products are now offered in this market as well.

Products

Our products are comprised of:

(i) Server network interface cards with and without bypass (Server Adapters);
(ii) Intelligent and programmable cards, with features such as encryption, acceleration, data compression, redirection, time stamping, network capture solutions, FPGA based ultra-low latency solutions, other offload features and/or compute blades (Smart Cards); and
(iii) Stand-alone Products (including Bypass Switches, Intelligent Bypass Switches, the patented SETAC (Server To Appliance Converter) product family and the CPE/Edge/Low End Appliance Units.

Server Adapters

We have developed a line of products for the server networking industry which facilitates interaction between servers and switches, allowing them to communicate with each other through a larger number of ports and with higher performance than their original manufacturer designed capabilities. Our designs have resulted in powerful products that allow server-based systems to fully exploit the high speed potential of 1/10/25/40/100 Gigabit Ethernet. The products have either one, two, four, six or eight ports, which plug into the servers which need to have such capabilities.

Following demands from customers and potential customers, we also designed some of these same server adapter products with a bypass feature. Intended for mission-critical environments, Silicom's Gigabit Ethernet Bypass Networking Cards feature innovative bypass circuitry to maintain continuity of network connectivity in the event of an appliance failure. Upon the occurrence of an appliance failure, the card's bypass mechanism automatically reroutes traffic to bypass faulty components, enabling customers to have reliable and always available network accessibility. As with all of Silicom's Multiport Gigabit Ethernet Networking Cards, the Bypass Cards also improve server throughput and performance during normal operations by introducing more ports and better throughput while reducing network congestion, simplifying network management, and minimizing CPU utilization.

Smart Cards

Our Smart Card products include server adapters such as: (a) redirector cards, (b) encryption and data compression hardware acceleration cards, (c) time stamping and full FPGA based network capture and mobile OSS distribution solutions, (d) Network processor acceleration cards, (e) VHIO – a product off-loading virtualization switching from the CPU, (f) FPGA based ultra-low latency solutions, and (g) compute blades which offer general compute capability in networking intensive environment.

Our redirector cards improve performance by: (a) enabling traffic filtering in order to reduce the amount of traffic received by the server, limiting it to only essential traffic for the server CPU, and consequently improving server performance, and (b) load-balancing between external servers and/or CPUs and/or CPU cores increasing the efficiency of the server.

Our product line of high-performance encryption cards is designed to improve the throughput of internet security appliances and other networking appliances. The products improve the performance of networking appliances by independently executing encryption tasks, thereby accelerating the encryption process and freeing the CPUs of such appliances for other activities. In 2013 we announced the launch of a new high-performance PCI Express Server encryption and compression card family based on the Intel® Communications Chipset 89xx series. During 2014 we achieved our first design win of our Coleto Creek encryption and compression card, from one of our existing customers, a market-leading provider of smart network solutions, who will use the Coleto Creek and Quad-Port 10G Networking cards in one of its next-generation network appliances, and during 2015 we achieved additional design wins for this solution. This product line can off-load not only encryption functionality, but compression functionality as well. The market need for compression off-load was previously limited to some content delivery and WAN optimization networking appliances; however, such compression off-load is now becoming more and more important in the storage market especially within the Big-Data area, which is the market sector that is the primary target of this functionality.

Our 1G/10G/40G/100G Nano-Second Time-Stamping/Full Capturing adapters, are based either on a combined Intel networking silicon and our proprietary time-stamping FPGA (field programmable gate array), or on a pure FPGA based solution, working at wire speed to time-imprint packets at high resolutions and accuracy, process packet, load balance between packets and provide full capturing solutions in a variety of scenarios. Our PCI-E Network processor based Smart Cards are targeted for server acceleration by providing a packet processing platform which can be used to off-load packet processing applications from the main CPU onto a processor card, and consequently freeing CPU cycles for the main application and improving server performance.

In 2014 we launched a new Cloud Virtualization Off-Loading solution with open stack support – the SmartSilc VHIO 1.0, which is our first product utilizing a Virtualization Off-Load Engine. As a network processor blade incorporated within cloud compute nodes and network nodes, SmartSilc VHIO 1.0 offloads all network and storage I/O tasks from the Hypervisor, significantly reducing CPU utilization and consequently improving the performance of any compute node in which it is installed. In addition, its implementation of NAT, firewall and other tasks previously carried out in the network node frees the network node to become an additional compute node.

Our FPGA based ultra-low latency solutions are used for the programming process needed to achieve line-speed data processing with ultra-low latency. These features are required in Network Monitoring/Capture/Analysis solutions for telecommunications, Lawful Interception, data centers and the Algorithmic HFT (High Frequency Trading) niche of the financial service market, as well as the emerging mobile OSS/BSS markets.

Our compute blades offer general compute capability in networking intensive environment. These compute blades could be integrated in an appliance, micro server, CPE equipment and alike. In addition, we use our low end compute blades for IoT. The growing IoT market requires compute nodes for an unlimited number of applications. Such compute nodes are required to be low-cost, and we are addressing such need by basing our compute blades mostly on using Intel’s low-end compute silicon and optimizing it for high performance at the low-cost.

Stand-alone Products

Our Stand-alone Products include (i) Bypass Switches and Intelligent Bypass Switches which allow the use of our solutions even where the networking component of the solution is already present, (ii) the patented SETAC product family, a unique solution that enables standard servers to be configured as network appliances with high-density front networking ports and easy port modularity, including Switched SETAC which adds the functionality of a switch to such a solution, (iii) CPE/Edge/Low End Appliance Units, which integrate our compute blades and enable us to offer a stand-alone solution with general compute capability in networking intensive environment to the customer.

We developed stand-alone bypass solutions which allow the use of our solutions even where the networking component of the solution is already present. We market stand-alone bypass units for: (a) entry level bypass switch 1/10Gbps, directed at power failure bypass; and (b) high end 1G/10G/40G/100Gbps Intelligent Bypass Solution which includes switch with self-generating heartbeat and versatile monitoring and control options.

Our SETAC products convert standard servers to network appliances. The SETAC product line includes SETAC converters (comprised of PCI-Express G2 and G3 adapters, cables and Silicom’s backplane), which interface with Silicom’s front loading I/O Express Modules adapters. SETAC products are installed by a simple process of placing Silicom’s I/O Express Modules adapters into a server’s hard drive slots. This combination enables standard servers to be configured as network appliances with server-grade reliability, front-end access, field replaceable architecture and a stable technology environment, thus creating a complete network appliance platform solution that provides us with a competitive edge. To the best of our knowledge we are currently the only company offering such a unique solution in the hardware networking appliance industry.

In December 2014, we announced the achievement of our first design win of our Switched SETAC solution, a new cloud platform designated to save space, energy and costs in cloud and data center services by integrating x86 standard motherboards, switching capability utilizing commercial off-the-shelf switching silicon, our Redirector features and potential support for SDN/NFV protocols from a provider of cloud based cyber security and application delivery solutions. Pursuant to this announcement, we announced in December 2014 the achievement of another design win of our Switched SETAC (the accelerated version), from a European provider of PDI solutions. This unique product adds Network Processor acceleration to the many additional features and benefits of the Switched SETAC, by allowing applications to be offloaded from the main CPU to the Network Processor modules, thus resulting in high performance while maintaining all Switched SETAC capabilities. During 2015 we announced an additional design win achievement of our Switched SETAC solution.

In addition, we are now offering to the market full computing platforms in a networking intensive environment. Such platforms are based on compute blades, integrating such blades into a full CPE/EDGE/Appliance Units. Such units offer a stand-alone solution with general compute capability in networking intensive environment. These units are also offered as CPE or edge equipment required as a part of a Cloud solution and also as low-end branch office appliances carrying mostly networking applications.

We cannot assure that any of our products will be commercially successful, that our development efforts will result in commercially successful products, that such products will be released in a timely manner or that we will be able to respond effectively to technological changes or new product announcements by our competitors.

We cannot assure you that revenue generated from our current suite of products and solutions will reach or exceed historical levels in any future period. A decrease in the price of, or demand for, any of these products or solutions, or a significant increase in our costs of manufacturing could have a material adverse effect on our business, results of operations and financial condition.

Principal Markets

The principal markets in which we compete are set forth more particularly in, and are incorporated by reference to Note 12A to the consolidated financial statements set forth in Item 18 of this annual report. In 2013, 2014 and 2015 approximately 76%, 71% and 66% respectively, were in North America 13%, 15% and 20% respectively, of our sales were in Europe, and 11%, 14% and 14% respectively, were in Asia-Pacific. Our main business is not seasonal, and we believe that there are sufficient sources and raw materials available to sustain it.

Manufacturing and Suppliers

Our manufacturing operations consist primarily of producing finished goods from (i) components purchased from third parties, (ii) sub-assemblies manufactured by sub-contractors, and (iii) turnkey manufacturers. In addition, we perform testing and quality assurance procedures with respect to the components and sub-assemblies which are incorporated into our final products and the final products themselves.

We seek to monitor quality with respect to each stage of the production process including, but not limited to, the selection of component suppliers, warehouse procedures and final testing, packaging and shipping. We have been certified as complying with "ISO 9001:2008" and "ISO 14001:2004", which are the quality control standard used in our industry. We believe that our quality assurance procedures have been instrumental in achieving a high degree of reliability for our products. We intend to continue to maintain and improve the efficiency of such procedures.

Although we generally use standard parts and components for our products, certain key components used in our products are currently available from only one source, and others are available from a limited number of sources. Components currently available from one source include proprietary Gigabit Ethernet chipsets and other components, including other semiconductor devices and transformers, as well as plastic and metal product housings. We believe that we maintain a sufficient inventory of these components to protect against delays in deliveries. The Dodd-Frank Wall Street Reform and Consumer Protection Act included disclosure requirements regarding the use of "conflict" minerals mined from the Democratic Republic of Congo and adjoining countries (“DRC”) and procedures regarding a manufacturer's efforts to prevent the sourcing of such "conflict" minerals. These requirements will require companies to diligence, disclose and report whether or not such “conflict” minerals originate from the DRC. This implementation of these requirements could adversely affect the sourcing, availability and pricing of minerals such as cassiterite, wolframite, coltan, gold and their derivatives (tantalum, tin, and tungsten) which are used in the manufacture of certain components used in our products, as well as affect the companies we use to manufacture components of our products. As a result, this could limit the pool of suppliers who can provide us DRC "conflict free" components and parts, and we may not be able to obtain DRC "conflict free" products or supplies in sufficient quantities for our operations. In circumstances where conflict minerals in our products are found to be sourced from the DRC, we may take actions to change materials or designs to reduce the possibility that our purchase of conflict minerals may fund armed groups in the region. These actions could add engineering and other costs to the manufacture of our products, and we may not be able to obtain "conflict free" products or supplies in sufficient quantities for our operations. In addition, we incur additional costs to comply with the disclosure requirements, including costs related to determining the source of any of the relevant minerals and metals used in our products, as further elaborated below. 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. In such event, we may also face difficulties in satisfying customers who require that all of the components of our products are certified as conflict mineral free. There can be no assurance that we will not experience delays in the supply of critical components in the future or that we will have a sufficient inventory of critical components at such time to produce products at full capacity. If we do experience such delays and there is an insufficient inventory of critical components at that time, our operations and financial results would be adversely affected.

In June 2014 and May 2015, we issued our Specialized Disclosure Report for the years ended December 31, 2013 and December 31, 2014, respectively, in compliance with Rule 13p-1 under the Exchange Act, according to which, some conflict minerals (gold, tantalum, tin, and tungsten) are necessary to the functionality or production of certain of our products. Conflict minerals are obtained, via our direct suppliers, from sources worldwide, and our desire is not to eliminate those originating in the DRC and adjourning countries but rather to obtain conflict minerals from sources that do not directly or indirectly finance or benefit armed groups in the DRC and adjourning countries.

We have also adopted a policy with respect to the sourcing of conflict minerals, according to which as part of our commitment to corporate responsibility and respecting human rights in our own operations and in our global supply chain, it is our goal to seek to use tantalum, tin, tungsten and gold in our products that are "DRC conflict free", while continuing to support responsible in-region mineral sourcing from the DRC and adjoining countries.

Furthermore, since the origin of conflict minerals cannot be determined with any certainty once the ores are smelted, refined and converted to ingots, bullion or other conflict minerals containing derivatives, we rely on our direct suppliers to assist with our reasonable country of origin inquiry and due diligence efforts, including the identification of smelters and refiners, for the conflict minerals contained in the materials which they supply to us.

Based on our reasonable country of origin inquiry and due diligence process, we concluded that during 2013 and 2014 (i) we manufactured and contracted to manufacture products as to which conflict minerals are necessary to the functionality or production of our products and (ii) as a result of the reasonable country of origin inquiry and due diligence measures, we determined that our products to which conflict minerals are necessary to the functionality or production of our products are “DRC Conflict Undeterminable” (as defined in Rule 13p-1 under the Exchange Act). We made this determination due to insufficient information provided by some of its active suppliers and manufacturers who supplied it with some of the necessary conflict minerals, which originated in the DRC and adjoining countries, but who were unable to indicate whether such necessary conflict minerals were from recycle or scrap sources, were DRC conflict free or were not found to be DRC conflict free.

Firm purchase orders for our products generally include an agreed supply date for the supply of our products. In addition, we may agree to fill orders for our products within short periods of time after receipt of a firm purchase order based on the immediate availability of our products and/or components in our inventory. Consequently, we need to maintain inventory at levels that are in accordance with our forecasts and those of our customers. There can be no assurance that such forecasts will indeed materialize into firm purchase orders and consequently we cannot guarantee that the full volume of such inventory will be delivered against firm purchase orders and not remain unused.

Marketing Channels

The principal market sectors for our products are:

(i) Network appliances, including WAN Optimization, Internet Security, Cyber Security, Application Delivery, Traffic Management, Network Monitoring and Analytics, High Frequency Trading (HFT) for the financial service market and other mission-critical sectors;

(ii) Servers;

(iii) Data storage including Big Data;

(iv) The "Cloud" (virtualized data centers with and without SDN); and

(v) Network CPE/EDGE/Low End appliances; and

(vi) IOT.

Our main business model for our line of products is called the Design Win Model. The following are the main aspects of this model:

- We approach a potential customer or are approached by such customer.

- If the customer shows interest in the products and we believe that achievement of a business relationship with the customer is possible, we ship products for such customer's evaluation.

- During the evaluation process the customer receives a few units of the relevant product for initial basic testing. If the evaluation process is successful, we ship products for qualification.

- During the qualification process the customer receives a larger amount of our products for more specific testing, which may include certain adaptations of our products to its specific needs.

- If the qualification process is successful, we enter into negotiations regarding the terms of a business relationship.

- In some cases, typically with the larger customers, the evaluation and qualification process may take 12 months or more.

Once all phases mentioned above are concluded, the customer will purchase products from us in order to incorporate such products within its server based systems, and then sell such systems with our cards embedded in them. The sale of our products within such systems is the objective of our Design Win Model. In most cases once we secure a Design Win our customer will continue to buy our cards for as long as it continues to sell its server based system.

Over the last few years, our sales and marketing has been carried out through a network of strategic relationships with leading original equipment manufacturers which sell our products, generally as a part of their systems and sometimes under their own private labels. Our current original equipment manufacturer customers are mostly active in the Internet Security market, Application Delivery market, Traffic management market, Network Monitoring market, data storage market, general servers market, WAN optimization market and other server based applications. Our customers sell their products, to the Governments, Enterprise (headquarter and branch) and to Data Centers (regular and virtualized, including to the Cloud). They are referred to in this report as OEMs, or OEM customers. Our strategy of carrying out strategic relationships with OEM customers continues to be the strategy under which we operate. We believe that these relationships enable us to take advantage of the superior financial resources and market presence of these companies to increase our sales and establish, maintain and strengthen our position and reputation in the market. In addition, we believe that relationships with OEMs improve access to new technologies developed by such OEMs, thereby ensuring smooth integration of our products and technology with those of the OEMs. In furtherance of this strategy, during the last few years we entered into strategic arrangements with OEMs and continued securing successful Design Wins with OEMs who purchase our products. Revenues from sales of our products to OEM customers in 2015 constituted substantially all of our revenues. We expect the percentage of our revenues that is derived from sales to OEM customers to continue at similar percentage levels, though we believe that within our group of OEM customers we will gradually increase the proportion of our sales to Cloud/Virtualized data Center/SDN customers. This is due to the fact that: (a) the market is moving towards running applications in the Cloud; and, (b) Cloud and web 2.0 companies are typically either using standard servers or design their own “white boxes” into both of which we offer our solutions. While there are no assurances that such solutions will be accepted by such Cloud and Web 2.0 players, we believe that this trend represents significant potential for us.

The loss of some of our OEM customers, or any single key OEM customer, may have a material adverse effect on our operations and financial results and we cannot assure you that we will be able to enter into strategic relationships with OEMs in the future. Normal payment terms of our OEM customers are up to 90 days net. Approximately 95% of our international sales are denominated in U.S. dollars and may be subject to government controls and other risks, including, in some cases, export licenses, federal restrictions on export, currency fluctuations, political instability, trade restrictions and changes in tariffs and freight rates. We have experienced no material difficulties to date as a result of these factors.

Our arrangements with our OEM customers (and distributors and resellers when applicable) are generally non-exclusive. We have generally experienced good relations with our customers and are not aware of any pending terminations other than with respect to products that newer technologies have eliminated the need for.

Our OEM customers, distributors and resellers are not within our control. They are not obligated to purchase products from us and may represent other lines of products. A reduction in sales effort or discontinuance of sales of our products by our OEM customers could lead to reduced sales and could materially adversely affect our operating results, as we experienced during the second quarter of 2015, during which we updated our revenue projections for such quarter due to a softening of demand from some of our customers, due to longer-than-expected decision making processes together with the slower market deployment of our high-potential design wins and our new solutions for upcoming industry trends. Use of OEMs also entails the risk that OEMs will build up inventories in anticipation of a growth in sales. If such growth does not occur as anticipated, these OEMs may substantially decrease the amount of products ordered from us in subsequent quarters, discontinue product orders or even attempt to return unsold products. The loss or ineffectiveness of several of our OEM relationships at approximately the same time, or the loss of any key OEM customer, might have a material adverse effect on us.

Patents and Licenses

Our success and ability to compete are dependent to a significant degree on our technology. In order to establish and protect the technology we develop and/or acquire to use in our products, we primarily rely on a combination of non-disclosure agreements and technical measures, and to a lesser degree on patent. These measures afford only limited protection, and accordingly, there can be no assurance that the steps we take will be adequate to prevent misappropriation of our technology or the independent development of similar technologies by others. Despite our efforts to protect our technology, unauthorized parties may attempt to copy aspects of our products and develop similar hardware or software or to obtain and use information that we regard as proprietary. In addition, there can be no assurance that one or more parties will not assert infringement claims against us. The cost of responding to claims could be significant, regardless of whether the claims are valid. We cannot assure that the scope of any issued patent will adequately protect our intellectual property rights, or that patents will not be challenged, invalidated or circumvented or that the rights granted under the patents will provide us with meaningful protection or any commercial advantage.

On April 8, 2010, we filed a patent application in the United States in the United States Patents and Trademarks Office, or the USPTO, for the "Server-Based Network Appliance", to protect our proprietary intellectual property with respect to SETAC products. On June 12, 2012 we were issued patent No. 8,199,523 entitled ‘Server-Based Network Appliance’ from the United States Patent and Trademark Office with respect to our SETAC product. The patent will expire in October, 2030. The patent covers a server-based network appliance in which a computer motherboard is mounted in a case with the bus slots of the motherboard adjacent to the rear side of the case. Communication adapter cards are mounted in the case so that the ports of these cards are accessible at the front panel. Bus extension circuitry inside the case connects the bus slots on the motherboard with the communication adapter cards, as though the cards were plugged into the motherboard. This configuration, which is used in the our SETAC product, gives the convenience of connecting and replacing modules via the front panel while using standard motherboards, which are not normally designed for front-panel access.

During 2012-2013, we developed a Nano-Second Time-Stamping NIC. The NIC combines Intel’s networking silicon and the Company’s time-stamping FPGA (field programmable gate array), working at wire speed to time-imprint packets.

On September 16, 2013, we acquired all of the intellectual property related to the unique Virtualization Off-Load Engine developed during the last two years by Net Perform Technology, Ltd., a privately held company registered in Hong Kong, China. The Virtualization Off-Load Engine is able to off-load CPU tasks onto a separate intelligent add-on card, thereby freeing up server cycles and improving the server’s Networking and Storage I/O. Through the acquisition, we secured exclusive access to this important technology, which we anticipate will provide us with a significant competitive advantage. We intend to continue developing, improving and utilizing this technology, as we did through the SmartSilc VHIO 1.0. Despite perceived exclusive access to this product, and our best efforts during the acquisition process to secure same, internal or external parties may attempt to copy, disclose, obtain or use our products, services or technology without our authorization, or may assert a claim of infringement regarding the product.

On February 8, 2015 we filed a patent application (14/616,718) in the USPTO with respect to Hybrid Networking Application Switch.

For additional information regarding the risks to the Company with respect to patents and other intellectual property rights see the risk factor entitled “We may not be able to protect our intellectual proprietary rights” under Item 3.D - “Risk Factors”.

Competition

The networking and data infrastructure solutions industry is highly competitive. We face competition from numerous companies, some of which are more established, benefit from greater market recognition and have greater financial, production and marketing resources than we do. We cannot guarantee that our present or any contemplated products will continue to be distinguishable from those of our competitors or that the marketplace will find our products preferable to those of our competitors. Furthermore, there can be no assurance that competitive pressures will not result in price reductions that could materially adversely affect our business and financial condition and the results of our operations.

We believe that our expanded feature set coupled with the general wide spectrum of solutions we offer gives us a competitive edge.

With respect to Server Adapters, our main competitor is Intel. In the Server Adapter product line, our competition is not as significant. To the best of our knowledge, our only significant competitors in this industry are Interface Masters, Portwell, Caswell, Lanner and Adlink. In addition, there may be other local solutions which might also compete with our products. Although the situation may change in the future, we believe that our competition in the bypass card market is less significant than our competition in the non-bypass card market.

In the Smart Cards products sector, our competition is fragmented, and differs with respect to the specific solution being offered by us. In this sector, Cavium, Tilera (now a part of Mellanox), Netronome, Napatech, Solarflare Myricom (a subsidiary of CSP), Lanner and Caswell compete with certain of our Smart Cards. With respect to the encryption products of our Smart Cards sector, our main competitor is Cavium. With respect to the compression products of our Smart Cards sector, our main competitors are Cavium and Exar. In addition, Lanner, Portwell and Nexcom compete with our compute blades and network processor based cards.

In the Stand-alone Products sector, our competition is fragmented, and differs with respect to the specific solution being offered by us. With respect to the Bypass Switches and Intelligent Bypass Switches solutions (in which solutions are offered in the form of an external box instead of an embedded card), to the best of our knowledge our main competitors are Net Optics (subsidiary of IXIA), Gigamon, and Interface Masters. With respect to our unique SETAC solution, to the best of our knowledge, there is no direct competition to our products. As network appliances may be built based on either standard servers or special hardware appliances, our SETAC products are designed to improve and enhance the competitive positioning of standard servers in the network appliance industry compared to the special hardware appliances alternative. We believe that the products offered by suppliers of special hardware appliances such as Portwell, Caswell, Nexcom, Lanner and Advantech do not provide similar solutions as the SETAC solution and therefore constitute only non-direct competition. With respect to our CPE/Edge/Low End Appliance products, to the best of our knowledge our main competitors are Portwell, Caswell, Lanner and Nexcom.

Governmental Regulation Affecting the Company

We are affected by the terms of research and development grants we have received from the OCS. Under the terms of Israeli Government participation, a royalty of 3% or up to 5% of the net sales of products developed from a project funded by the OCS must be paid under the terms of the pre-R&D Amendment regime, beginning with the commencement of sales of products developed with grant funds and ending when a dollar-linked amount equal to 100% of such grants plus interest at LIBOR is repaid. The terms of Israeli Government participation also impose significant restrictions on manufacturing outside Israel of products developed with government grants, in accordance with the terms and conditions of the pre-R&D Amendment regime. In addition, according to the pre-R&D Amendment regime the transfer to third parties of technologies developed through such projects is subject to approval of the OCS. Following the R&D Amendment there is currently much ambiguity regarding its implementation and its effect on research and development grants received prior thereto. For additional information see “Item 10. Additional Information – Taxation”.

In addition, we receive certain tax benefits and reduced tax rates from the Israeli government due to our status as a "Preferred Enterprise" under the Law for the Encouragement of Capital Investments-1959, as amended. See "Item 10. Additional Information – Taxation". The entitlement to these benefits is conditional upon our fulfillment of the conditions stipulated by the law and the regulations promulgated thereunder. In the event of failure to comply with these conditions, the benefits could be canceled and we would be required to refund the amount of the benefits, in whole or in part, with the addition of linkage differences and interest.

C. Organizational Structure

We have the following two wholly owned subsidiaries:

- Silicom Connectivity Solutions, Inc. – a private company incorporated in the United States.

Fiberblaze A/S – a private company incorporated in Denmark. On December 10, 2014, we entered into the Fiberblaze SPA for the purchase of the entire holdings in Fiberblaze, pursuant to which we became its sole shareholder. As part of the Fiberblaze SPA, we have also purchased Fiberblaze US LLC, a private company incorporated in the United States, being a 100% owned subsidiary of Fiberblaze. See "Item 10. Additional Information – C. Material Contracts" for additional information on the Fiberblaze SPA.

In addition, two of our founders, Messrs. Yehuda and Zohar Zisapel, are also founders of, and in certain instances still directors and/or material shareholders of some of the corporations within the "Rad Group". See Item 7. "Major Shareholders and Related Party Transactions" for additional information on our relationships with members of this group of companies.

D. Property, Plant and Equipment

We do not own any real property, but we lease property at five locations. Our executive offices are located in Kfar Sava, Israel and our research and development facilities are located in Kfar Sava, Israel, in Søborg, Denmark and in Charlottesville, Virginia, the United States.

In November 2007, we renewed the term of the lease for our Kfar Sava offices until December 31, 2008, and have been extending such lease each year. During 2013 we extended the lease further until April, 2015, when the lease terminated in accordance with its terms. This facility was approximately 1,050 square meters in size, and we paid a monthly rent of approximately $16,000. In April 2015, following the termination of our lease due to our election not to renew it, we moved to our new offices in Kfar Sava, which we lease for a period of five years, ending in February 28, 2020, with an option to renew the term for an additional five years period. This facility is approximately 1,500 square meters in size and the monthly payments (which include various management services) are approximately $32,000.

We have conducted our manufacturing in Yokneam, Israel since 2000. In January 2014, following the termination our lease (which was in effect since January 2009) due to our election not to exercise our option to renew it, we moved to a new facility in Yokneam, which we lease pursuant to a sub-lease for a period of three years, ending in December 31, 2016, with an option to renew the term for an additional period of three years. This facility is approximately 2,400 square meters in size plus additional warehouse areas of approximately 250 meters in size and the monthly payments (which include rental payments, as well as fees for various management and upkeep services) are approximately $45,000.

We lease office space in Charlottesville, Virginia, the United States. The lease is for a period of 26 months ending in December 31, 2017. This facility is approximately 929 square meters in size and the monthly payments are approximately $11,000.

As of February 2004, we sub-lease office space in Paramus, New Jersey, from our affiliate, Radcom Equipment, Inc. Our current sub-lease extends until December 31, 2016. Currently, the monthly rent payments for this space are approximately $2,000. See “Item 7 – Major Shareholders and Related Party Transactions.”

We lease office space in Søborg, Denmark of approximately 472 square meters, until September 2016. If we will choose not to extend our current lease pass such date, we will seek to lease a new facility for its office space. The monthly rent payments for this space are approximately $8,000.

We believe that our facilities in Israel, the United States and Denmark are suitable and adequate for our operations as currently conducted. In the event that additional facilities are required or we need to seek alternative rental properties, we believe that we could obtain such additional or alternative facilities at commercially reasonable prices.

Item 4A. UNRESOLVED STAFF COMMENTS

There are no unresolved staff comments.

Item 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

General

Silicom was incorporated in Israel and commenced operations in 1987. We have traditionally been engaged in the design, manufacture, marketing and support of connectivity solutions for computers. We are currently engaged in the design, manufacture, marketing and support of high performance networking and data infrastructure solutions for a broad range of servers, server based systems and communications devices. Our products are sold to OEM customers who offer networking appliances, servers and storage devices. As the market moves to utilize applications within virtualization based Cloud Data Centers, our products are now offered in this market sector as well. In 2013, 2014 and 2015 we recorded sales from all of our networking and data infrastructure solutions of approximately $73.3 million, $75.6 million and $82.7 million, respectively. We primarily sell our products through original equipment manufacturers and, to a lesser extent, through independent distributors (on a non-exclusive basis).

Critical Accounting Policies

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amount of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities at the date of our financial statements. Actual results may differ from these estimates under different assumptions or conditions.

Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and could potentially result in materially different results under different assumptions and conditions. We believe that our critical accounting policies are limited to those described below.

- Goodwill and other intangible assets - Goodwill reflects the excess of the purchase price of business acquired over the fair value of net assets acquired. Goodwill is not amortized but instead is tested for impairment at least annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

The Company operates in one operating segment and this segment comprises one reporting unit.

Goodwill is reviewed for impairment at least annually in accordance with ASU 2011-08, Testing Goodwill for Impairment. ASU 2011-08 provides an entity the option to perform a qualitative assessment to determine whether it is more likely than-not that the fair value of a reporting unit is less than its carrying amount prior to performing the two-step goodwill impairment test. If this is the case, the two-step goodwill impairment test is required. If it is more likely than-not that the fair value of a reporting is greater than its carrying amount, the two-step goodwill impairment test is not required.

If the two-step goodwill impairment test is required, first, the fair value of the reporting unit is compared with its carrying amount (including goodwill). If the fair value of the reporting unit is less than its carrying amount, an indication of goodwill impairment exists for the reporting unit and the entity must perform step two of the impairment test (measurement). Under step two, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation and the residual fair value after this allocation is the implied fair value of the reporting unit goodwill. If the fair value of the reporting unit exceeds its carrying amount, step two does not need to be performed. During the year ended December 31, 2015, no impairments were found and therefore no impairment losses were recorded.

Intangible assets that are not considered to have an indefinite useful life are amortized over their estimated useful lives of up to 3 years. The acquired customer relationships, current technology, intellectual property and backlog are amortized over their estimated useful lives in proportion to the economic benefits realized. This accounting policy results in amortization of such intangible assets in the straight-line method.

- Inventories – Inventories are stated at the lower of cost or market. Cost is determined using the "weighted average-cost" method. We write down obsolete or slow moving inventory to its market value.

- Marketable securities – We account for investments which we intend and are able to hold to maturity, that are classified as held-to-maturity investments as defined in ASC 320-10, “Accounting for Certain Investments in Debt and Equity Securities”.

Whenother-than-temporary impairment has occurred, the amount of the other-than-temporary impairment recognized in earnings depends on whether we intend to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss. If we intend to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary impairment is recognized in earnings equal to the entire difference between the amortized cost basis of the investment and its fair value at the balance sheet date. If we do not intend to sell the security and it is not more likely than not that we will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary impairment is separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings.

Income Taxes – We account for income taxes under ASC 740-10, "Accounting for Income taxes". Under ASC 740-10, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation allowances are established when necessary to reduce deferred taxes assets to the amount expected to be realized. Valuation allowances in respect of deferred taxes were recorded in respect of the following matter:

Deferred tax assets that, as we believe, are more likely than not to be realized. In assessing the potential of realization of deferred tax assets, we consider projected future taxable income and tax planning strategies.

Deferred tax assets and liabilities are classified as current or non-current items in accordance with the nature of the assets or liabilities to which they relate. When there are no underlying assets or liabilities the deferred tax assets and liabilities are classified in accordance with the period of expected reversal. Income tax expenses represent the tax payable for the period and the changes during the period in deferred tax assets and liabilities. In 2012, Silicom Connectivity Solutions, Inc. utilized all of its loss carry-forward (in 2011, all of the valuation allowance referred to loss carry-forward related to Silicom Connectivity Solutions, Inc.) and therefore all related deferred tax assets and valuation allowance were derecognized. As of December 31, 2015, the deferred tax assets were $1,545 thousand and the deferred tax liabilities were $268 thousand, whereas in 2014, the deferred tax assets were to $913 thousand and the deferred tax liabilities were $543 thousand.

We recognize the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs.

ASC 740, "Accounting for Uncertainty in Income Taxes" clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements. This interpretation prescribes a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. ASC 740 also provides guidance on de-recognition of tax positions, classification on the balance sheet, interest and penalties, accounting in interim periods, disclosure, and transition. ASC 740 requires significant judgment in determining what constitutes an individual tax position as well as assessing the outcome of each tax position.

As of January 1, 2015 and for the twelve months ended December 31, 2015, we did not have any significant unrecognized tax benefits. In addition, we do not expect that the amount of unrecognized tax benefits will change significantly within the next 12 months.

- Accounting for Stock-Based Compensation – The Company recognizes compensation expense in accordance with ASC topic 718, "Compensation – stock compensation" based on estimated grant date fair value using an option-pricing model. Some of our share-based awards granted after January 1, 2008 include features that are not supported by the Black and Scholes valuation model, such as an expiration date to occur if the closing price of the Shares falls below 50% of the grant date share price. Therefore for such share-based awards granted after January 1, 2008, the Company recognizes compensation expense based on estimated grant date fair value using the Monte Carlo option-pricing model or the Binomial option-pricing model, while for the remaining share-based awards granted after January 1, 2008 the Company recognizes compensation expense based on estimated grant date fair value using the Black and Scholes model.

A. Operating Results

You should read the following management's discussion and analysis of our financial condition and operating results in conjunction with the consolidated financial statements and the related notes thereto included in this annual report. The following table sets forth, for the periods indicated, the relationship (in percentages) of items from our Consolidated Statement of Operations Data to our total sales:

Year Ended December 31,

	2013		2014		2015	
Sales	100	%	100	%	100	%
Cost of sales	59.8		59.3		58.8	
Gross profit	40.2		40.7		41.2	
Research and development costs	7.5		8.6		11.7	
Sales and marketing expenses	5.2		5.8		6.8	
General and administrative expenses	3.5		3.7		4.4	
Contingent consideration expense (benefit)	0.0		0.1		(3.7	)
Operating Income	24.0		22.5		22.0	
Financial income, net	0.5		0.4		0.3	
Income before income taxes	24.5		22.9		22.3	
Income tax expenses	1.2		3.6		2.3	
Net Income	23.3		19.3		20.0	

Sales in 2015 increased by 9.4% to 82,738 thousand compared to $75,622 thousand in 2014. The increase in sales was mainly attributed to our continued success in our target markets including those driven by trends like Cyber security, Cloud Computing, SDN, NFV, Virtualization and other trends, and to our continued success in expanding our product offering and customer base.

Sales in 2014 increased moderately by 3.2% to $75,622 thousand compared to $73,298 thousand in 2013. Our modest growth in 2014 was mainly attributed to the following overlapping factors - continued increase of ongoing orders from existing customers, continued integration of our products into some of our larger customers' product lines and the continued expansion of our customer base, offset by a lower demand for our products from our largest customer (who is not a competitor of the Company) in the total amount of approximately $6.4 million during 2014, representing approximately 8.5% of our sales in 2014. Such lower demand was attributed to the customer's typical refresh and upgrade cycle, which occurs every few years and during which our sales to customers undergoing such cycle may either decline, increase or remain steady. During 2014, the customer replaced one of its appliances which embedded Silicom cards with cards of another company. All of the above, coupled with a sharp growth of 50.4% in 2013 which created high comparable sales number for 2014, lead to our modest growth in 2014.

Gross profit in 2015 was $34,079 thousand compared to $30,787 thousand in 2014. Gross profit as a percentage of sales in 2015 was 41.2%, compared to 40.7% in 2014. Our gross profit is largely dependent on the mix of products we sell during a specific year. The higher gross profit percentage in 2015 compared to 2014 was primarily a result of changes to the mix of products we sold in 2015. Gross profit is also affected, among other factors, by amortization of acquired intangible assets in the amount of $655 thousand, compared with $40 thousand in 2014 as well as by write-downs of inventory made with respect to any obsolete or slow moving inventory we can no longer use. The inventory write-downs as a percentage of sales in 2015 decreased to 0.3%, compared to 1.4% in 2014.

Gross profit in 2014 was $30,787 thousand compared to $29,433 thousand in 2013. Gross profit as a percentage of sales in 2014 was 40.7%, compared to 40.2% in 2013. Our gross profit is largely dependent on the mix of products we sell during a specific year. The higher gross profit percentage in 2014 compared to 2013 was primarily a result of changes to the mix of products we sold in 2014. Gross profit is also affected, among other factors, by write-downs of inventory made with respect to any obsolete or slow moving inventory we can no longer use. The inventory write-downs as a percentage of sales in 2014 decreased to 1.4%, compared to 2.6% in 2013.

Research and development costs in 2015 increased by 49.7% to $9,702 thousand compared to $6,480 thousand in 2014. This increase was mainly attributed to the increase in the number of our research and development employees required for our continued investment in new product development, enhancements to existing products and the development of new networking and connectivity technologies expanding our product offering to our target markets, which contributed approximately $2,999 thousand to such increase and to an increase in amortization of acquired intangible assets which amounted to approximately $693thousand in 2015, compared to $95 thousand in 2014, offset by a relative strengthening of the US Dollar against the New Israeli Shekel (since a significant portion of our research and development expenses are incurred in New Israeli Shekels) of approximately $470 thousand.

Research and development costs in 2014 increased by 18.6% to $6,480 thousand compared to $5,465 thousand in 2013. This increase was mainly attributed to our continued investment in new product development, enhancements to existing products and the development of new networking and connectivity technologies which contributed approximately $876 thousand to such increase, to an increase in amortization of acquired intangible assets which amounted to approximately $95 thousand in 2014, compared to $20 thousand in 2013, and to a relative weakening of the US Dollar against the New Israeli Shekel (since a significant portion of our research and development expenses are incurred in New Israeli Shekels), which contributed approximately $44 thousand to such increase.

Sales and marketing expenses in 2015 increased by 27.9% to $5,651 thousand compared to $4,418 thousand in 2014. This increase was mainly attributed to our continued investment in the promotion of our server networking products to our target markets including those driven by trends like Cyber security, Cloud Computing, SDN, NFV, Virtualization and other trends, by, among others, our continued effort to expand exposure of our product offering and expanding our customer base , which contributed approximately $1,176 thousand to such increase and to an increase in amortization of acquired intangible assets which amounted to approximately $262 thousand in 2015, compared to $10 thousand in 2014, offset by a relative strengthening of the US Dollar against the New Israeli Shekel (since a significant portion of our sales and marketing expenses are incurred in New Israeli Shekels) of approximately $205 thousand.

Sales and marketing expenses in 2014 increased by 15.7% to $4,418 thousand compared to $3,818 thousand in 2013. This increase was mainly attributed to our continued investment in the promotion of our server networking products, which contributed approximately $581 thousand to such increase, and to a relative weakening of the US Dollar against the New Israeli Shekel (since part of our selling and marketing expenses are incurred in New Israeli Shekels), which contributed approximately $ 19 thousand to such increase.

General and administrative expenses in 2015 increased by 29.1% to $3,611 thousand compared to $2,798 thousand in 2014. This increase was mainly attributed to the growth in our activity, which contributed approximately $685 thousand to such increase, and to acquisition related expenses, which contributed approximately $299 thousand to such increase, offset by a relative strengthening of the US Dollar against the New Israeli Shekel (since a significant portion of our sales and marketing expenses are incurred in New Israeli Shekels) of approximately $171 thousand.

In 2015 we had a contingent consideration benefit in the amount of $3,090 thousand compared to an expense of $45 thousand in 2014. For additional information see Note 3B to our financial statements included elsewhere in this annual report.

General and administrative expenses in 2014 increased by 10.5% to $2,843 thousand (out of which $45 thousand expenses were related to contingent consideration), compared to $2,572 thousand in 2013. This increase was mainly attributed to the growth in our activity, which contributed approximately $250 thousand to such increase, and to a relative weakening of the US Dollar against the New Israeli Shekel (since a significant portion of our general and administrative expenses are incurred in New Israeli Shekels), which contributed approximately $21 thousand to such increase.

Financial income, net in 2015 decreased by 16.3% to $220 thousand compared to $263 thousand in 2014. The decrease was primarily attributed to increase in expenses attributed to the relative strengthening of the US Dollar against the New Israeli Shekel (a significant portion of our balance sheet assets and obligations are denominated in New Israeli Shekels), and to increase in bank fees.

Financial income, net in 2014 decreased by 34.9% to $263 thousand compared to $404 thousand in 2013. The decrease was primarily caused by the relative weakening of the US dollar against the New Israeli Shekel (a significant portion of our balance sheet assets and obligations are denominated in New Israeli Shekels), which created a net financial expense in US dollars from exchange rate differences, and the decrease in yields from investments in marketable securities.

In 2015 we recorded current income tax expenses of $2,848 thousand and deferred income tax benefit of $907 thousand compared to similar current income tax expenses of $2,903 thousand and deferred income tax benefit of $219 thousand in 2014. The increase in deferred income tax benefit was mainly attributed to tax benefits relating to share based compensation provided by us to our employees and directors, which amounted to $242 thousand compared to $0 thousand in 2014, to an increase in deferred income tax benefit in relation to amortization of acquired intangible assets, which amounted to $280 thousand in 2015 compared to $19 thousand in 2014, and to tax loss carryforwards, which amounted to $179 thousand in 2015 compared to $0 thousand in 2014. In addition, in 2015 we recorded income tax benefits relating to prior years of $36 thousand, and in 2014 we recorded income tax expenses relating to prior years of $20 thousand.

In 2014 we recorded current income tax expenses of $2,903 thousand and deferred income tax benefit of $219 thousand compared to current income tax expenses of $1,428 thousand and deferred income tax benefit of $552 thousand in 2013. In addition, in 2014 we recorded income tax expenses relating to prior years of $20 thousand, and in 2013 we recorded income tax expenses relating to prior years of $29 thousand.

In 2015 we recorded net income of $16,520 thousand compared to net income of $14,605 thousand in 2014, a 13.1% increase. This increase was mainly due to the increase in our activity and sales.

In 2014 we recorded net income of $14,605 thousand compared to net income of $17,077 thousand in 2013, a 14.5% decrease. This decrease was mainly due to higher operating expenses which we incurred during 2014 and to a higher corporate income tax rate effective as of 2014, whereas our sales remained similar to previous years.

Impact of Inflation and Currency Fluctuations on Results of Operations, Liabilities and Assets

Since the majority of our revenues are denominated and paid in U.S. dollars, we believe that inflation in Israel and in Denmark and fluctuations in the U.S. dollar exchange rates do not have any material effect on our revenue. Inflation in Israel or Denmark and the Israeli and Danish currency as well as U.S. dollar exchange rate fluctuations, may however, have an effect on our expenses and, as a result, on our net income/loss. The cost of our Israeli and Danish operations, as expressed in U.S. dollars, is influenced by the extent to which any change in the rates of inflation in Israel or Denmark are not offset (or are offset on a lagging basis) by a change in valuation of the NIS or DKK in relation to the U.S. dollar.

We do not presently engage in any hedging or other transactions intended to manage the risks relating to foreign currency exchange rate or interest rate fluctuations. However, we may in the future undertake such transactions, if management determines that it is necessary to offset such risks.

B. Liquidity and Capital Resources

As of December 31, 2015, we had working capital of $59,419 thousand and our current ratio (current assets to current liabilities) was 4.00. Cash and cash equivalents as of December 31, 2015 increased by $288 thousand to $18,178 thousand, compared to $17,890 thousand as of December 31, 2014.

We did not have any short-term bank deposits in 2015, compared to $4,000 thousand short-term bank deposits as of December 31, 2014.

Short-term marketable securities decreased by $6,531 thousand to $8,636 thousand, compared to $15,167 thousand as of December 31, 2014, and long-term marketable securities increased by $3,888 thousand to $24,246 thousand, compared to $20,358 thousand as of December 31, 2014. The net decrease of $6,355 thousand in these four balance sheet items in 2015 was mainly due to acquisitions which contributed an expenditure of approximately $10,000 thousand to such changes, to payment of dividend which contributed approximately $7,300 thousand to such changes and to property, plant and equipment expenditures which contributed approximately $3,000 thousand to such changes, offset by positive cash provided by operating activities in the amount of $13,000 thousand and to consideration received in connection with exercise of options to purchase our ordinary shares in the amount of approximately $943 thousands.

Trade receivables (including trade receivable from related parties; For additional information regarding trade receivables from related parties see "Item 7B. – Major Shareholders and Related Party Transactions – Related Party Transactions.") increased to $23,768 thousand as of December 31, 2015, compared to $18,831 thousand as of December 31, 2014. This increase was mainly attributed to the increase of our activity.
Other receivables decreased to $1,380 thousand as of December 31, 2015, compared to $1,632 thousand as of December 31, 2014.

Trade payables increased to $8,556 thousand as of December 31, 2015, compared to $8,236 thousand as of December 31, 2014. Other payables and accrued liabilities increased to $11,147 thousand as of December 31, 2015, compared to $5,783 thousand as of December 31, 2014. This increase was mainly attributed to the payment of contingent consideration which the Company is obligated to pay under the Fiberblaze SPA to the Fiberblaze sellers in the amount of $1,498 thousand pursuant to achievement of certain pre-determined milestones and to the payment of the first contingent consideration which the Company is obligated to pay under the ADI APA to the ADI sellers in the amount of $3,000 thousand pursuant to the achievement of certain pre-determined first milestone.

Cash provided by operating activities in 2015 amounted to $13,287 thousand compared to $20,684 thousand in 2014. The cash provided by operating activities in 2015 was the result of our positive operating income.

Inventories increased to $26,321 thousand as of December 31, 2015, compared to $25,449 thousand as of December 31, 2014.

Capital expenditures on property and equipment for the year ended at December 31, 2015 were $2,969 thousand, compared to $1,838 thousand as of December 31, 2014. This increase was mainly attributed to investment in our leased property designated to better accommodate our needs.

We have cash and cash equivalents that we believe are sufficient for our present requirements. Furthermore, our cash resources are sufficient to fund our operating needs for at least the next twelve months.

C. Research and development, patents and licenses, etc.

Since we commenced operations, we have conducted extensive research, development and engineering activities. Our efforts emphasize the development of new products, cost reduction of current products, and the enhancement of existing products, generally in response to rapidly changing customer preferences, technologies and industry standards.

Because the market for our products is characterized by rapidly changing technology and evolving industry standards, our success depends upon our ability to select, develop, manufacture and market new and enhanced products in a timely manner to meet changing market needs. As such, we invest significant resources in research and new product development, enhancements to existing products, and the development of new networking and connectivity technologies, and we expect to continue to do so.

As of June 2012 we have a patent No. 8,199,523 entitled ‘Server-Based Network Appliance’ from the United States Patent and Trademark Office with respect to our SETAC product.

As of December 2014, we own or have licenses or similar rights with respect to Fiberblaze, including Fiberblaze's high performance OEM hardware platform for Ethernet and network interface product family, registered names and domain name.

As of September 2015, we own all intellectual property and intellectual property rights in which ADI has an ownership interest or have licenses or similar right where ADI has such licenses or rights, including with respect to custom embedded, communications and networking products based on the latest Intel silicon, registered names and domain name.

We cannot assure you that the scope of any issued patent will adequately protect our intellectual property rights, or that patents will not be challenged, invalidated or circumvented or that the rights granted under the patents will provide us with meaningful protection or any commercial advantage.

On September 16, 2013, we acquired all of the intellectual property related to the unique Virtualization Off-Load Engine developed during the last two years by Net Perform Technology, Ltd., a privately held company registered in Hong Kong, China. The Virtualization Off-Load Engine is able to off-load CPU tasks onto a separate intelligent add-on card, thereby freeing up server cycles and improving the server’s Networking and Storage I/O. Through the acquisition, we secured exclusive access to this important technology, and we intend to continue developing and improving upon this technology. Despite perceived exclusive access to this product, and our best efforts during the acquisition process to secure same, internal or external parties may attempt to copy, disclose, obtain or use our products, services or technology without our authorization, or assert a claim of infringement regarding the product.

On February 8, 2015 we filed a patent application (14/616,718) in the USPTO with respect to Hybrid Networking Application Switch.

For additional information regarding the risks to the Company with respect to patents and other intellectual property rights see the risk factor entitled "We may not be able to protect our intellectual proprietary rights" under Item 3.D - "Risk Factors".

The Government of Israel encourages research and development projects oriented towards products for export or projects which will otherwise benefit the Israeli economy. In each of the three fiscal years from 1999 to 2001, we received grants from the OCS for the development of systems and products. We have received from the OCS up to 30% of certain research and development expenditures for particular projects. Under the terms of Israeli Government participation as in effect prior to the R&D Amendment, a royalty of 2% or up to 5% of the net sales of products developed from a project funded by the OCS must be paid, beginning with the commencement of sales of products developed with grant funds and ending when a dollar-linked amount equal to 100% of such grants without interest, for projects approved prior to December 2000, and plus interest at LIBOR, for amounts received after that date, is repaid. The terms of Israeli Government participation, as in effect prior to the R&D Amendment, also place restrictions on the location of the manufacturing of products developed with government grants, which, in general, must be performed in Israel, and on the transfer to third parties of technologies developed through projects in which the government participates. The R&D Amendment amended the core terms of the Israeli Government participation and placed substantial discretion in a new authority established to replace the OCS and provided only guidelines regarding material terms such as royalty rates and transfer of know-how developed with government grants. See "Item 10. Additional Information - Taxation". We received approximately 20% of certain research and development expenditures for a particular project in 2003 and approximately 30% of such expenditures for a particular project in 2004. We did not have any new grant programs with the OCS from 2005 to 2015. In August 2005, we received approval for a $54 thousand dollar grant from the Korea-Israel Industrial Research and Development Foundation, or Koril-RDF, in connection with the joint development of a certain product with a Korean company. Under the terms of this grant we are required to repay the amounts received at a rate of 2.5% per year of our gross sales of the product developed with the grant in each such year, until 100% of the grant (and any other sums received from Koril-RDF) are repaid. The annual payment for every year following the first sale of the product will not exceed certain percentages of the amounts received from Koril-RDF. As of January 2006 and to date, our research and development activities have been sponsored and funded by us, and we did not participate in any new encouragement programs or received any additional grants from the OCS or Koril-RDF. As of December 31, 2015, we have closed all of our OCS funded programs, and do not anticipate having any sales of products funded by OCS grants or be required to pay any royalties to the OCS with respect thereto.

We expect that we will continue to commit resources to research and development in the future. As of March 31, 2016, we had 83 employees engaged primarily in research and development and design activities of which 49 employees in Israel, 20 in Denmark and 14 in the U.S.A. In 2013, 2014 and 2015, our research and development expenses were $5,465, $6,480 and $9,702 respectively, constituting approximately 7.5%, 8.6% and 11.7% respectively, of our sales. The increase in our research and development expenses in 2015 compared to 2014 was mainly attributed to the increase in the number of our research and development employees required for our continued investment in new product development, enhancements to existing products and the development of new networking and connectivity technologies expanding our product offering to our target markets, as well as to the increase in amortization of acquired intangible assets. For additional information concerning commitments to pay royalties on sales of products developed from projects funded by the OCS, see “Item 10. Additional Information - Taxation.”

D. Trend Information

In today’s network-based environment, there is a growing demand for server-based systems. We believe that the markets for such systems are continuously growing. Exploding data and internet traffic increase the need for connectivity and bandwidth, which results in the increased need of networking throughput, connectivity, compute power and storage. Such growing demand was the basis for the emerging technologies of virtualization, cloud and SDN, all of which are targeting the implementation of a more effective model for all the above mentioned tasks.

In view of such an anticipated increase in Cloud-based data centers utilizing virtualization and SDN, the systems are expected to be increasingly based on generic server platforms. These platforms will all need offload capabilities in order to address the performance challenges realized due to the huge amount of traffic, the high volume of data, the need to encrypt such data, the need to run in virtualized environment, which by itself is a challenge for the server CPU, and the need to include switching within the server for high efficiency SDN. We anticipate that consequently the demand for add-on adapters which address these challenges will grow. Power, heat and space limitations in such environments increase the need for hardware accelerators. Such systems will require essential building blocks in their own generic severs, which can be served by our products.

We address the above needs with a comprehensive suite of cards that integrate encryption and compression functionality, with the Virtualization Off-Load Engine which is able to off-load these CPU tasks onto a separate intelligent add-on card thereby freeing up server cycles and improving the server’s Networking and Storage I/O, with our generic off-loading platforms based on network processors and with our redirector cards which deal with load balancing between servers/CPUs/CPU cores and perform traffic filtering to increase the efficiency of the server. We believe that our Server network interface cards (with and without bypass), Intelligent and programmable cards, and Stand-alone products will all continue to be key driver of our growth in the coming years. A distinct advantage of these products is that the demand in the server based industry has been continuously growing, especially as our products are suited to the growth in Big Data and the Cloud (including SDN).

The sales cycles in the markets for our products are long, and continuing to achieve Design Wins according to the process described above and obtaining new customers is time consuming. However, each Design Win we have achieved and do achieve may represent an opportunity for sustained, long-term revenues once we establish a relationship with a customer.

Although we expect our business and products to further develop in the coming years, there is no assurance that we will continue to generate significant sales in the areas in which we operate.

E. Off-Balance Sheet Arrangements

On July 22, 2002, our Audit Committee and the Board of Directors approved an Indemnification Agreement with our directors and officers. Our shareholders approved the terms of this agreement in a General and Extraordinary Meeting held on January 7, 2004. In Amendment 3 to the Companies Law, the instances in which a company may indemnify its officers and directors were broadened. In December 2007 each of our Audit Committee and Board of Directors approved a new form of Indemnification Agreement with our directors and officers so as to reflect this amendment. Our shareholders approved the terms of this new Indemnification Agreement in January 2008. The Agreement provides that the directors and officers will be exempt from liability in certain circumstances. The Agreement also provides for the indemnification by us for certain obligations and expenses imposed on the officer in connection with an act performed in his or her capacity as an officer of the Company. This right to indemnification is limited, and does not cover, among other things, a breach of an officer's duty of loyalty, a willful breach of an officer's duty of care, or a reckless disregard for the circumstances or consequences of a breach of duty of care. The right to indemnification also does not cover acts that are taken intentionally to unlawfully realize personal gain. The maximum amount of our liability under these Indemnification Agreements for any monetary obligation imposed on an officer or a director in favor of another person by a judgment is currently $3,000,000 for each instance of a covered scenario. In addition we would be liable to indemnify the officer or director for all reasonable litigation expenses with respect to certain proceedings. We are not aware of any material pending action that may result in anyone claiming such indemnification.

An amendment in 2011 to the Israeli Securities Law, and a corresponding amendment to the Companies Law, authorized the Israeli Securities Authority to impose administrative sanctions against Israeli public companies and their office holders for certain violations of the Israeli Securities Law or the Companies Law. These sanctions include monetary sanctions and certain restrictions on serving as a director or senior officer of a public company for certain periods of time. The Israeli Securities Law and to the Companies Law provide that only certain types of such liabilities may be reimbursed by indemnification and insurance. Specifically, legal expenses (including attorneys' fees) incurred by an individual in the applicable administrative enforcement proceeding and certain compensation payable to injured parties for damages suffered by them are permitted to be reimbursed via indemnification or insurance, provided that such indemnification and insurance are authorized by the company's articles of association, and receive the requisite corporate approvals. In January 2012 each of our Audit Committee and Board of Directors approved a new form of Indemnification Agreement with our directors and officers serving in such capacities from time to time so as to reflect this amendment, and at the Annual General Meeting of the Shareholders held on April 11, 2012 our shareholders approved these amendments to the Articles of Association and a revised form of Indemnification Agreement for directors serving in such capacity from time to time.

As per Amendment 20 to the Companies Law, it was decided on July 31, 2013, at the Extraordinary General Meeting of the Shareholders to adopt the Executive Compensation Policy of the Company, which was recommended by our Compensation Committee and approved by our Board of Directors. The Executive Compensation Policy included the above referenced form of Indemnification Agreement to be entered into by the Company with our directors and officers serving in such capacities from time to time. The Executive Compensation Policy also noted that going forward, any change to the Indemnification Agreement, including any changes which materially depart from the key terms of the current agreement (provided that such changes apply equally to all executives of the Company, including directors) will be submitted to the Company's Compensation Committee and the Board of Directors for their approval but shall not, unless required by law or the Company's Articles of Association, be presented at a General Meeting of the shareholders. As set forth in the Companies Law, an Executive Compensation Policy for a period exceeding three years has to be re-approved once every three years. Accordingly, we intend to bring our amended Executive Compensation Policy for shareholders approval on the next annual general meeting of our shareholders.

We are not party to any other material off-balance sheet arrangements or contingent obligations.

F. Tabular disclosure of contractual obligations

The following table shows our outstanding contractual obligations by category and by payments due as of December 31, 2015:

		Payments due by period			
Contractual Obligations	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Operating Leases	$ 2,877	$ 1,434	$ 1,010	$ 433	
Purchase Obligations	$ 12,714	$ 12,714			
Total	$ 15,591	$ 14,148	$ 1,010	$ 433	

Our total outstanding contingencies in respect of OCS royalty-bearing participations received or accrued, net of royalties paid or accrued before interest, amounted to approximately $2,960 thousand as of December 31, 2015 which are attributable to sales of certain discontinued products. As of the date of this annual report, all of our OCS programs have been closed per our request, we are not anticipating any sales of our products developed with OCS funding and accordingly don't expect to be required to pay any royalties to the OCS. In the unlikely event we do sell products developed using OCS funding, we will be required to pay royalties to the OCS as set forth in the R&D Law.

Other Long-Term Liabilities Reflected on the Company's Balance Sheet:

The liability for employees' severance benefits amounted to approximately $2,251 thousand as of December 31, 2015.

The liability for employees' severance benefits is calculated on the basis of the latest monthly salary paid to each employee multiplied by the number of years of employment. The liability is covered by the amounts deposited by us into employees' managers' insurance and/or pension fund accounts in respect of severance obligations to such employees, including accumulated income thereon as well as by the unfunded provision reflected on the balance sheet. Such liability will be removed, either by termination of employment or retirement. While the timing of such obligations cannot be pre-determined (and as such were not included in the above table), such liability will be removed, either by termination of employment or retirement.

Item 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

A. Directors and Senior Management

The following table and notes thereto set forth information regarding our directors and senior management as of March 31, 2016.

Name	Age	Position with Company
Avi Eizenman(1)	58	Active Chairman of the Board
Shaike Orbach(1)	64	President, Chief Executive Officer, Director
Zohar Zisapel(2)	67	Former Director
Ayelet Aya Hayak	46	External Director
Ilan Erez	48	External Director
Eli Doron(3)	63	Director
Eran Gilad	48	Chief Financial Officer and Company Secretary

(1) Was re-elected for an additional one-year term, commencing as of July 28, 2015.
(2) Served as a Director until his cessation of service on July 28, 2015.
(3) Was elected for a one-year term, commencing as of July 28, 2015.

Avi Eizenman co-founded the Company in 1987 and has served as a Director since its inception. Mr. Eizenman also served as our President and Chief Executive Officer from the Company's inception until April 1, 2001, and on such date, he resigned from his positions as President and Chief Executive Officer and was appointed Active Chairman of the Board of Directors. Mr. Eizenman served as head of the ASIC department at Scitex Ltd. in 1986. From 1979 until 1985, Mr. Eizenman held various positions, including project manager, ASIC specialist and engineer, with the Electronic Research & Development Department of the Israeli Ministry of Defense. Mr. Eizenman holds a B.Sc. degree, with honors, in Electrical Engineering from the Technion, and an M.B.A. from Tel Aviv University.

Shaike Orbach has been our President and Chief Executive Officer since April 2001. In December 2001, Mr. Orbach was named a Director, replacing Zohar Zisapel, who resigned from the Board of Directors. Prior to that, for a period of four and a half years, Mr. Orbach was President and CEO of Opgal Ltd., a high-tech subsidiary of Israel's Rafael and El-Op corporations. Previously, he was General Manager of Edusoft, an Israeli company the shares of which were traded on the NASDAQ National Market (now, the NASDAQ Global Market), and Managing Director of Tecsys Ltd. He holds a B.Sc degree in Mechanical Engineering from the Technion.

Zohar Zisapel is a co-founder of the Company. He served as a Director from the Company's inception and until 2001. In September 2010, he was elected again as Director in the Company and served as Director until July 2015. Mr. Zisapel is also a founder and a director of RAD Data Communications Ltd., of which he served as CEO from January 1982 until January 1998 and has served as chairman from 1998 until 2013. Mr. Zisapel serves as chairman of two other public companies – Ceragon Networks Ltd. (Ticker Symbol CRNT) and RADCOM Ltd. (Ticker Symbol RDCM) – and as chairman or director of several private companies. The Company has certain dealings with members of the Rad Group (see "Item 7. Major Shareholders and Related Party Transactions" below). Since July 2008, Mr. Zisapel has been a director of Amdocs Limited (Ticker Symbol DOX). Mr. Zisapel received a B.Sc. and a M.Sc. in electrical engineering from the Technion, Israel Institute of Technology, and an M.B.A. from Tel Aviv University.

Ayelet Aya Hayak was elected by the shareholders as an external director for an initial three-year term commencing July 1, 2013 and is expected to be recommended for a second three-year term in the next annual general meeting of our shareholders. Ms. Hayak serves as a director in several public companies, among which are New Horizon Group Ltd., One Software Technologies (O.S.T.) Ltd., MYDAS Fund Investments Ltd., Danel (Adir Yehushua) Ltd., B.S.R. Projects Ltd., Financitech Ltd., and M.I. Holdings Ltd. Additionally, Ms. Hayak also serves as the chairman of the board of directors of S.D.S (Star Defense Systems) Ltd. Between 2009 and 2011 Ms. Hayak served as the CEO of Paula Ltd. Ms. Hayek holds a BA degree in accounting and business administration from the Tel Aviv College of Management and is also a Certified Public Accountant.

Ilan Erez has co-Managed the Software Business Unit of 3D Systems Corporation (NYSE: DDD) since May 2015. 3D Systems provides comprehensive 3D products and services, including 3D printers, print materials, on-demand parts services and digital design and manufacturing tools. From 2005 to 2015, Mr. Erez served as Chief Financial Officer of Cimatron Ltd. (Ticker Symbol CIMT) engaged in the design and sale of CAD/CAM software for the tool-making and discrete manufacturing industries, since July 2005. From 1998 to 2005 Mr. Erez served as the Chief Financial Officer of the Company. He also served as VP Operations of the Company from May 2001 to 2005. From 1996 to 1998 Mr. Erez served as Controller and assistant to the Chief Executive Officer at Bio-Dar Ltd. From 1994 to 1996 Mr. Erez served as an auditor at Kesselman & Kesselman, a member of Price Waterhouse Coopers. Mr. Erez is a Certified Public Accountant in Israel and holds a B.A in Accounting and Economics from the Hebrew University and an LL.M. in Business Law from Bar-Ilan University. Mr. Ilan Erez has served as an external director of the Company since 2010, was re-elected by the shareholders as an external director for a second three-year term commencing July 1, 2013 and is expected to be recommended for an third three year term in the next annual general meeting of our shareholders.

Eran Gilad was our Chief Financial Officer since May 2005 and the Secretary of the Company since 2012. From 1995 to 2005 Mr. Gilad held senior financial and operational positions in various public and private companies operating in the high-tech field. He is a Certified Public Accountant in Israel and holds an M.A in Economics from Tel-Aviv University and a B.A in Accounting and Economics from Tel-Aviv University.

Eli Doron is the founder of Connesta Ltd. ("Connesta"), an Israeli high-tech company engaged in developing and providing SaaS virtual control room solutions, founded in 2011. From inception, Mr. Doron serves as the Chief Executive Officer of Connesta. Prior thereto and during 2010, Mr. Doron was the Chief Executive Officer of Computerized Electricity Systems ("CES"). Prior to joining CES, Mr. Doron was the co-founder of Radvision Ltd. (formerly Nasdaq: RVSN. Acquired by Avaya Ltd. in 2011; "Radvision"). From 1992 and until 2009 Mr. Doron served as the Chief Technology Officer of Radvision, and from 2006 and until 2009 he served as President of Radvision. Prior to founding Radvision and from 1983, Mr. Doron served at SIMTECH Advanced Training and Simulation Systems Ltd., initially as hardware manager and from 1998 as Chief Technology Officer. Prior thereto and from 1977, Mr. Doron served as an electronic engineer at MBT Israel Aircraft Industries Ltd. Mr. Doron holds a B.Sc degree in electronics and computer science from Ben-Gurion University and an M.B.A. degree from the University of Bradford in the United Kingdom.

B. Compensation

In accordance with the Companies Law, the following table presents information regarding compensation actually received by our five most highly paid executive officers during the year ended December 31, 2015. All amounts are in USD.

Name and Position	Salary and Benefits(1)	Cash Bonus(2)	Equity-based Compensation(3)	Total
Avi Eizenman – Active Chairman	467,024	162,300	538,768	1,168,092
Yeshayahu ("Shaike") Orbach – CEO and President	318,310	162,300	538,768	1,019,378
David Castiel – VP Engineering	190,099	16,723	91,586	298,407
David Hendel – VP Research and Development	188,175	16,723	91,586	296,482
Elad Blatt – VP Business Development and Sales North America	179,938	21,867	91,586	293,391

(1) "Salary and Benefits" include annual salary or service fees paid, payments to the National Insurance Institute, manager's insurance and pension funds, severance, advanced education funds, basic health insurance, vacation pay, recuperation pay, tax gross-up payments, automobile-related expenses, telephone expenses and benefits and perquisites as mandated by Israeli or applicable law.
(2) "Cash Bonus" includes bonus payments as recorded in our financial statements for the year ended December 31, 2015.
(3) "Equity-based Compensation" includes the expense recorded in our financial statements for the year ended December 31, 2015 with respect to equity-based compensation granted to the executive offices detailed above.

The aggregate direct remuneration paid to all persons as a group who served in the capacity of director or executive officer during the year ended December 31, 2015 was $2,535 thousand. The aggregate amount accrued to provide for severance payments to all persons as a group who served in the capacity of director or executive officer as of the year ended December 31, 2015 was $921 thousand. The severance terms of our Chief Executive Officer and Chairman of the Board, as previously approved by the audit committee, board of directors and shareholders of the Company, and in accordance with the Executive Compensation Policy of the Company which was approved by the shareholders, may entitle them, in certain circumstances, to additional payments. We have not paid any compensation to Zohar Zisapel for serving on our board of directors until his cessation of service on July 2015. We do pay cash compensation to Avi Eizenman who is an active Chairman of the Board, and to Shaike Orbach, who is the President and Chief Executive Officer.

Avi Eizenman and Shaike Orbach may also be entitled to cash bonuses by meeting some pre-determined thresholds, and as calculated based on a pre-determined formulas set by our board of directors, as approved by the annual general meeting of our shareholders for the years 2013 and 2014-2016 on April 30, 2014. Mr. Eizenman and Mr. Orbach's 2014-2016 cash bonuses may not exceed the value of 18 of their monthly salaries, respectively, and their cash bonus formulas are taking into consideration the erosion rate from the 2013 annual bonus formulas, according to which their cash bonus formulas were based on achieving one or more of the following thresholds: (i) the Company's actual revenue for 2013 was 80% or more of the pre-determined budget target; and (ii) the Company's actual operating profit for 2013 was 65% or more of the pre-determined budget target, and are based on achieving one or more of the following thresholds: (i) the Company's actual revenue for any of the years 2014-2016 is 80% or more of the pre-determined budget target for the relevant year; and (ii) the Company's actual operating profit for any of the years 2014-2016 is 65% or more of the pre-determined budget target for the relevant year. The Compensation Committee may, in its sole discretion, raise or lower such annual cash bonuses by up to 20%. Furthermore, in accordance with the Company's recoupment policy, Mr. Eizenman and Mr. Orbach may be required to reimburse the Company for the cash bonuses (or any part thereof) paid in the previous 3 years, in the event such cash bonuses were based on financial data included in the Company's financial statements that were found to be inaccurate and were subsequently restated.

Non-employee directors, including External Directors within the meaning of the Companies Law, are entitled to be paid cash compensation for board and any committee member services, as applicable, in accordance with the amounts which are permitted under the Companies Regulations (Rules Regarding Compensation and Expenses of External Directors) - 2000 enacted pursuant to the Companies Law. Office holders, including External Directors or Independent Directors, may waive their entitlement to their compensation, subject to applicable law.

All our officers other than the external directors work full time for us. We do not currently grant any variable bonus or equity based compensation, nor any separation payments to our non-employee directors. Certain of the compensation previously paid to our directors was paid in the form of options under the Silicom Directors Share Incentive Option Plan (1994) (under which there are presently no options outstanding) and certain of such compensation is paid in the form of options which were granted under the Share Option Plan (2004) or RSU’s which will be granted under the Silicom Ltd - Global Share Incentive Plan (2013), described below.

On December 30, 2004, our shareholders adopted our Share Option Plan (2004). Under the original terms of the Share Option Plan (2004) up to a maximum of 282,750 of our ordinary shares are reserved for issuance, subject to certain adjustments, upon the exercise of options granted to employees, directors, officers, consultants and service providers. In December 2007, the Board of Directors increased the number of our ordinary shares available for issuance under the Share Option Plan (2004) by 300,000. In August 2012, the Board of Directors increased the number of our ordinary shares available for issuance under the Share Option Plan (2004) by an additional 500,000. The Share Option Plan (2004) is administered by the board of directors, which designates the optionees, dates of grant, vesting periods and the exercise price of options. The options are non-assignable except by the laws of descent. Certain tax advantages apply to certain of our directors, officers and employees with respect to options granted to them under the Share Option Plan (2004). As of March 31, 2016, we have granted a total of 1,036,000 options under the Share Option Plan (2004), of which (i) 200,000 options were granted to Mr. Avi Eizenman, such that: (a) 30,000 were exercised at an exercise price of $2.53 (which would have otherwise terminated on December 30, 2014); (b) 40,000 expired in July 2008, (c) 40,000 were exercised at an exercise price of $3.82 (which would have otherwise terminated on the earlier of October 15, 2016 or the closing price of our shares falling below $1.91), (d) 50,000 were exercised at an exercise price of $18.82 (which would have otherwise terminated on the earlier December 21, 2018 or the closing price of our shares falling below $9.41), and (d) 40,000 were granted with an exercise price of $15.28 and a termination date of the earlier of September 13, 2020 or the closing price of our shares falling below $7.64, of which 20,000 were exercised at an exercise price of $15.28; (ii) 30,000 options were granted to Mr. Yehuda Zisapel (who was formerly a Director of the Company) and exercised at an exercise price of $2.53 (which would have terminated on December 30, 2014); (iii) 200,000 options were granted to Mr. Shaike Orbach, of which (a) 30,000 were exercised at an exercise price of $2.53 (which would have otherwise terminated on December 30, 2014), (b) 40,000 expired in July 2008, (c) 40,000 were exercised at an exercise price of $3.82 (which would have otherwise terminated on the earlier of October 15, 2016 or the closing price of our shares falling below $1.91), (d) 50,000 were exercised at an exercise price of $18.82 (which would have otherwise terminated on the earlier of December 21, 2018 or the closing price of our shares falling below $9.41) and (e) 40,000 were exercised at an exercise price of $15.28 (which would have otherwise terminated on the earlier of September 13, 2020 or the closing price of our shares falling below $7.64); (iv) 30,000 options were granted to Ms. Einat Domb-Har (who was a former external director of the Company) and exercised at an exercise price of $2.53 (which would have terminated on December 30, 2014) ; and (v) 30,000 options were granted to Mr. Ilan Kalmanovich (who was a former external director of the Company) and exercised at an exercise price of $2.53 (which would have terminated on December 30, 2014). 36,625 of the options granted under the Share Option Plan (2004) were returned to the company due to certain employees who left their positions not exercising their options and 200,000 of the options granted under the Share Option Plan (2004) expired without exercise due to the expiration of their term. The Share Option Plan (2004) expired at the end of 2014, upon which expiration any unallocated shares under this plan have been returned to the general pool of registered but unissued share capital of the Company.

On October 21, 2013, our board of directors adopted our Global Share Incentive Plan (2013). On April 30, 2014, the annual general meeting of our shareholders approved the Global Share Incentive Plan (2013) to qualify for incentive stock options for U.S. tax purposes. The Global Share Incentive Plan (2013) is administered by the board of directors, which determines the number of our ordinary shares available for issuance under the plan, designates the award recipients and types of awards, dates of grant, vesting periods and the exercise price of awards. Under the Global Share Incentive Plan (2013) the Company may grant awards of options, restricted shares, restricted share units ("RSU's") or other equity based awards. The board of directors has determined that initially up to a maximum of 500,000 of our ordinary shares are reserved for issuance, subject to certain adjustments, upon the exercise of equity based awards granted to employees, directors, officers, consultants and service providers. The awards are non-assignable except by the laws of descent. Certain tax advantages apply to certain of our directors, officers and employees with respect to equity based awards granted to them under Global Share Incentive Plan (2013). As of March 31, 2016, we have granted a total of 82,000 RSUs under the Global Share Incentive Plan (2013), of which a total of (i) 25,000 RSUs were granted to Mr. Avi Eizenman, and (ii) 25,000 RSUs were granted to Mr. Shaike Orbach, pursuant to the approval of our compensation committee, board of directors and annual general meeting of our shareholders, which gave effect to such grants in its meeting on April 30, 2014.

In addition, in March 2015, our compensation committee and board of directors, respectively, have approved the grant of a total of 92,591 options under the Global Share Incentive Plan (2013), of which a total of (i) 13,333 options were granted to Mr. Avi Eizenman, and (ii) 13,333 options were granted to Mr. Shaike Orbach, which, pursuant to the approval of our Annual General Meeting, became effective on July 28, 2015.

C. Board Practices

Each of Avi Eizenman and Shaike Orbach was re-elected, and Eli Doron was elected, to the board of directors most recently on July 28, 2015 to serve until the next Annual General Meeting, which is currently scheduled to convene in June 2016, subject to the Companies Law and our Amended and Restated Articles of Association. Avi Eizenman is a founder of the Company and has served as a Director since our inception in 1987. On July 1, 2010 Mr. Ilan Erez was elected as an external director for an initial term of three years in accordance with Section 245(a) of the Israeli Companies Law, with such terms ending as of July 1, 2013. At the Annual General Meeting of our shareholders held on April 14, 2013, the shareholders re-elected Mr. Ilan Erez as an external director for an additional second three-year term, and elected Ms. Ayelet Aya Hayak as an external director for an initial three-year term, with such terms of office for the external directors commencing as of July 1, 2013. Mr. Ilan Erez and Ms. Ayelet Aya Hayak are expected to be brought for re-election as External Directors for a third three-year term and second three-year term, respectively, on the next Annual General Meeting of our shareholders, scheduled to convene in June, 2016.

None of the members of the board of directors is entitled to receive any severance or similar benefits upon termination of his or her service with the board of directors, except for Avi Eizenman, who also functions as the active Chairman of the Board and Shaike Orbach, who also functions as President and Chief Executive Officer (See “Item 6.B. Directors and Senior Management – Compensation” above).

In December 2007 our Audit Committee and Board of Directors approved severance arrangements for each of Mr. Avi Eizenman and Mr. Shaike Orbach, which provide for extended notice provisions and severance payments in the event of termination. The arrangements were approved by our shareholders in January 2008, and include the following main terms and conditions (identical with respect to each of Mr. Avi Eizenman and Mr. Shaike Orbach):

Notice of Termination

The termination of the executive’s employment, by him or by us, for any reason other than cause (which is generally defined as willful conduct or omission materially injurious to the company), death or disability, shall require 12 months advance written notice. If, however, following a change in control transaction, either: (i) he shall give notice of termination of his employment for good reason (which is generally defined as an adverse change to the status, responsibilities, salary or other material terms of his employment); or (ii) we shall give notice of termination of his employment for any reason other than cause or disability, 18 months advance written notice shall be required. A change in control transaction includes transactions such as sale of all or substantially all of the company’s shares or assets, or a merger, acquisition, or other reorganization in which control of our company changes following such transaction.

Severance Payments

If the executive’s employment shall be terminated for any reason other than cause, he shall be entitled to receive his last full monthly salary multiplied by the number of years (or portions thereof) that he was employed by us (i.e. the severance amount he would be entitled to receive under the Israeli law, had we terminated his employment for any reason other than cause) (the “Severance Law Amount”). If, however, his employment shall be terminated: (i) by the company for any reason other than cause or disability; or (ii) by him for a good reason following a change in control, he shall be entitled to receive one and half times the Severance Law Amount. If the executive’s employment under the arrangement is terminated by reason of death or disability, then, in addition to the above, he shall be entitled to receive a lump sum severance payment equal to his last full monthly salary multiplied by twelve 12 months.

As per Amendment 20 to the Companies Law, it was decided at the Extraordinary General Meeting of the Shareholders on July 31, 2013, to adopt the Executive Compensation Policy of the Company, which included the above referenced extended notice provisions, and severance payments in the event of termination, with respect to each of Mr. Avi Eizenman and Mr. Shaike Orbach. The Executive Compensation Policy is expected to be brought for shareholders re-approval at our next Annual General Meeting scheduled to convene in June 2016.

Board of Directors

Our Articles of Association provide for a board of directors of not less than two and not more than eight members. Each director (except external directors) is elected to serve until the next annual general meeting of shareholders and until his or her successor has been elected. Other officers serve at the discretion of the board of directors. The Articles of Association of the Company provide that any director may, subject to the provisions of the Companies Law and the approval by the Board of Directors, appoint another person to serve as a substitute director and may cancel such appointment. Under the Companies Law, a person who is already serving as a director will not be permitted to act as a substitute director. Additionally, the Companies Law prohibits a person from serving as a substitute director for more than one director. Appointment of a substitute director for a member of a board committee is only permitted if the substitute is a member of the board of directors and does not already serve as a member of such committee. If the committee member being substituted is an external director, the substitute may only be another external director who possesses the same expertise as the external director being substituted. The term of appointment of a substitute director may be for one meeting of the board of directors or for a specified period or until notice is given of the cancellation of the appointment. To our knowledge, no director currently intends to appoint any other person as a substitute director, except if the director is unable to attend a meeting of the board of directors.

External Directors

Under the Companies Law, companies registered under the laws of Israel the shares of which have been offered to the public in or outside of Israel are required to appoint no less than two external directors. No person may be appointed as an external director if such person is a relative (as defined in the Companies Law) of a controlling shareholder or if such person, or the person's relative, partner, employer or any entity under the person's control, has or had, on or within the two years preceding the date of the person's appointment to serve as external director, any affiliation with any of either the company, any entity or person controlling, controlled by or under common control with the company, or relatives of such person. The term "affiliation" includes:

- an employment relationship;
- a business or professional relationship maintained on a regular basis;
- control; and
- service as an office holder.

The Israeli Minister of Justice, in consultation with the Israeli Securities Authority, may determine that certain matters will not constitute an affiliation, and has issued certain regulations with respect thereof.

If the company does not have a controlling shareholder or a shareholder who holds company shares entitling him to vote at least 25% of the votes in a shareholders meeting, then the company may not appoint as an external director any person or such person's relative, partner, employer or any entity under the person's control, who has or had, on or within the two years preceding the date of the person's appointment to serve as external director, any affiliation with the Chairman of the Board, Chief Executive Officer, a substantial shareholder who holds at least 5% of the issued and outstanding shares of the company or voting rights which entitle him to vote at least 5% of the votes in a shareholders meeting, or the Chief Financial Officer.

A person shall be qualified to serve as an external director only if he or she possesses "expertise in finance and accounting" or "professional qualifications". At least one external director must possess expertise in finance and accounting.

A director can satisfy the requirements of having "expertise in finance and accounting" if due to his or her education, experience and qualifications he or she has acquired expertise and understanding in business and accounting matters and financial statements, in a manner that allows him or her to understand, in depth, the company's financial statements and to spur a discussion regarding the manner in which the financial data is presented.

A public company's board of directors must evaluate the proposed external director's expertise in finance and accounting, by considering, among other things, such candidate's education, experience and knowledge in the following: (i) accounting and auditing issues typical to the field in which the company operates and to companies of a size and complexity similar to such company; (ii) the company's independent public accountant's duties and obligations; (iii) preparation of the company's consolidated financial statements and their approval in accordance with the Companies Law and the Israeli Securities Law - 1961.

A director is deemed to be "professionally qualified" if he or she meets any of the following criteria: (i) has an academic degree in any of the following professions: economics, business administration, accounting, law or public administration; (ii) has a different academic degree or has completed higher education in a field that is the company's main field of operations, or a field relevant to his or her position; or (iii) has at least five years experience in any of the following, or has at least a cumulative total of at least five years experience in any two of the following: (A) a senior position in the business management of a corporation with a significant extent of business, (B) a senior public position or a senior position in public service, or (C) a senior position in the company's main field of operations. As with a candidate's expertise in finance and accounting, the board of directors here too must evaluate the proposed external director's "professional qualification" in accordance with the criteria set forth above.

The declaration required by law to be signed by a candidate to serve as an external director must include a statement by such candidate concerning his or her education and experience, if relevant, in order that the board of directors may properly evaluate whether such candidate meets the requirements of having "expertise in finance and accounting" or being "professionally qualified" as set forth in the regulations. Additionally, the candidate should submit documents and certificates that support the statements set forth in the declaration.

No person may serve as an external director if the person's position or other business activities create, or may create, a conflict of interest with the person's responsibilities as an external director or may otherwise interfere with the person's ability to serve as an external director. Additionally, no person may serve as an external director if the person, the person's relative, spouse, employer or any entity controlling or controlled by the person, has a business or professional relationship with someone with whom affiliation is prohibited, even if such relationship is not maintained on a regular basis, excepting negligible relationships, or if such person received from the company any compensation as an external director in excess of what is permitted by the Companies Law. Pursuant to the recently enacted amendment to the Companies Regulations (Matters Which do not Constitute Affiliation), 2006, effective as of April 3, 2016 (the "Amendment to the Affiliation Regulations"), business or professional relationship maintained on a regular basis between the company and the external director will not constitute affiliation if the relationship commenced after the appointment of the external director for office, the company and the external director consider the relationship to be negligible and the audit committee approved, based on information presented to it, that the relationship is negligible, and the external director declared that he did not know and could not have reasonably know about the formation of the relationship and has no control over its existence or termination. If, at the time external directors are to be appointed, all current members of the board of directors who are not controlling shareholders or relatives of such shareholders are of the same gender, then at least one external director must be of the other gender.

External directors are to be elected for a term of three years by a majority vote at a shareholders' meeting, provided that either:

- the majority includes at least a majority of the shares held by non-controlling and disinterested shareholders who are present and voting at the meeting; or
- the total number of shares held by non-controlling and disinterested shareholders that voted against the election of the director does not exceed two percent of the aggregate voting rights in the company.

External directors may be re-elected for two additional terms of three years each, provided that with respect to the appointment for each such additional three-year term, one of the following has occurred: (i) the reappointment of the external director has been proposed by one or more shareholders holding together 1% or more of the aggregate voting rights in the company and the appointment was approved at the general meeting of the shareholders by a simple majority, provided that: (1)(a) in calculating the majority, votes of controlling shareholders or shareholders having a personal interest in the appointment as a result of an affiliation with a controlling shareholder and abstentions are disregarded and (b) the total number of shares of shareholders who do not have a personal interest in the appointment as a result of an affiliation with a controlling shareholder and/or who are not controlling shareholders, present and voting in favor of the appointment exceed 2% of the aggregate voting rights in the company, and (2) pursuant to a recently enacted amendment to the Companies Law ("Amendment 22"), effective as of January 10, 2014, the external director who has been nominated in such fashion is not a linked or competing shareholder, and does not have or has not had, on or within the two years preceding the date of such person's appointment to serve as another term as external director, any affiliation with a linked or competing shareholder. The term "linked or competing shareholder" means the shareholder(s) who nominated the external director for reappointment or a material shareholder of the company holding more than 5% of the shares in the company, provided that at the time of the reappointment, such shareholder(s) of the company, the controlling shareholder of such shareholder(s) of the company, or a company under such shareholder(s) of the company's control, has a business relationship with the company or are competitors of the company; the Israeli Minister of Justice, in consultation with the Israeli Securities Authority, may determine that certain matters will not constitute a business relationship or competition with the company; (ii) the reappointment of the external director has been proposed by the board of directors and the appointment was approved by the majority of shareholders required for the initial appointment of an external director; or (iii) pursuant to a recently enacted amendment to the Companies Law ("Amendment 26"), effective as of November 25, 2014, the external director has proposed himself for reappointment and the reappointment was approved in accordance with Sub-section (i) above.

However, under regulations promulgated pursuant to the Companies Law, companies whose shares are listed for trading on specified exchanges outside of Israel, including the Nasdaq Global Select, Global and Capital Markets, may elect external directors for additional terms that do not exceed three years each, beyond the three three-year terms generally applicable, provided that, if an external director is being re-elected for an additional term or terms beyond three three-year terms: (i) the audit committee and board of directors must determine that, in light of the external director's expertise and special contribution to the board of directors and its committees, the re-election for an additional term is to the company's benefit; (ii) the external director must be re-elected by the required majority of shareholders and subject to the terms specified in the Companies Law; and (iii) the term during which the nominee has served as an external director and the reasons given by the audit committee and board of directors for extending his or her term of office must be presented to the shareholders prior to their approval.

External directors may be removed only by the same percentage of shareholders as is required for their election, or by a court, and then only if the external directors cease to meet the statutory qualifications for their appointment, violate their duty of loyalty to the company or are found by a court to be unable to perform their duties on a full time basis. External directors may also be removed by an Israeli court if they are found guilty of bribery, fraud, administrative offenses in a company or use of inside information. Each committee of a company's board of directors which has been granted any authority normally reserved for the board of directors must include at least one external director; provided, however, that the audit committee and compensation committee must each include all external directors then serving on the board of directors.

Following termination of service as an external director, a public company, a controlling shareholder thereof and any entity controlled by a controlling shareholder, may not grant any benefit, directly or indirectly, to any person who served as an external director of such public company, or to his or her spouse or child, including, not appointing such person, or his or her spouse or child, as an office holder of such public company or of any entity controlled by a controlling shareholder of such public company, not employing such person or his or her spouse or child and not receiving professional services for pay from such person, either directly or indirectly, including through a corporation controlled by such person, all until the lapse of two years from termination of office with respect to the external director, his or her spouse or child; and with respect to other relatives of the former external director - until the lapse of one year from termination of office.

An external director is entitled to compensation as provided in regulations adopted under the Companies Law and is otherwise prohibited from receiving any other compensation, directly or indirectly, in connection with service provided as an external director. At the Annual Shareholders Meeting of the Company held on April 14, 2013, the shareholders of the Company re-elected Mr. Ilan Erez as an external director for second three-year term and elected Ms. Ayelet Aya Hayak as an external director for an initial three-year term, with such terms of office for the external directors having commenced as of July 1, 2013. Mr. Ilan Erez and Ms. Ayelet Aya Hayak are expected to be brought for re-election as External Directors for a third three-year term and second three-year term, respectively, on the next Annual General Meeting of our shareholders, scheduled to convene in June, 2016.

Audit Committee

The Companies Law requires public companies to appoint an audit committee. The responsibilities of the audit committee pursuant to the Companies Law include identifying irregularities in the management of our business and approving related party transactions as required by law, classifying company transactions as extraordinary transactions or non-extraordinary transactions and as material or non-material transactions in which an officer has an interest (which will have the effect of determining the kind of corporate approvals required for such transaction), assessing the proper function of the company’s internal audit regime and determining whether its internal auditor has the requisite tools and resources required to perform his role and to regulate the company's rules on employee complaints, reviewing the scope of work of the company’s independent accountants and their fees, and implementing a whistleblower protection plan with respect to employee complaints of business irregularities. Pursuant to Amendment 22, effective as of January 10, 2014, the responsibilities of the audit committee under the Companies Law also include the following matters: (i) to establish procedures to be followed in respect of related party transactions with a controlling shareholder (where such are not extraordinary transactions), which may include, where applicable, the establishment of a competitive process for such transaction, under the supervision of the audit committee, or individual, or other committee or body selected by the audit committee, in accordance with criteria determined by the audit committee; and (ii) to determine procedures for approving certain related party transactions with a controlling shareholder, which were determined by the audit committee not to be extraordinary transactions, but which were also determined by the audit committee not to be negligible transactions.

Under the Companies Law, an audit committee must consist of at least three directors, including all the external directors of the company, and a majority of the members of the audit committee must be independent or external directors. The Companies Law defines independent directors as either external directors or directors who: (1) meet the requirements of an external director, other than the requirement to possess accounting and financial expertise or professional qualifications, with Audit Committee confirmation of such; (2) have been directors in the company for an uninterrupted duration of less than 9 years (and any interim period during which such person was not a director which is less than 2 years shall not be deemed to interrupt the duration); and, (3) were classified as such by the company.

The following persons may not be a member of the audit committee:

- The chairman of the board of directors,
- Any director employed by or otherwise providing services to the company or to the controlling shareholder or entity under such controlling shareholder's control,
- Any director who derives his salary primarily from a controlling shareholder,
- A controlling shareholder, or
- Any relative of a controlling shareholder.

According to the Companies Law, (1) the chairman of the audit committee must be an external director, (2) the required quorum for audit committee meetings and decisions is a majority of the committee members, of which the majority of members present must be independent and external directors, and (3) any person who is not eligible to serve on the audit committee is further restricted from participating in its meetings and votes, unless the chairman of the audit committee determines that such person’s presence is necessary in order to present a certain matter, provided however, that company employees who are not controlling shareholders or relatives of such shareholders may be present in the meetings but not for the actual votes, and likewise, company counsel and company secretary who are not controlling shareholders or relatives of such shareholders may be present in the meetings and for the decisions if such presence is requested by the audit committee.

Currently, Ms. Ayelet Aya Hayak, Mr. Ilan Erez and Mr. Eli Doron serve as members of our audit committee, and Mr. Ilan Erez serves as the chairperson.

Compensation Committee

On December 5, 2010, our board of directors established a compensation committee, composed of at least two directors who were initially Mr. Zohar Zisapel (a former director in the Company), as chairman, and Mr. Avi Eizenman. At the time, its sole function was to recommend, to the board of directors, certain executive compensation matters and any other matters as the board of directors decided from time to time.

In December 2012, Amendment 20 to the Companies Law ("Amendment 20") went into effect, pursuant to which, the Board of Directors of Israeli publicly traded companies are required to appoint a compensation committee comprised of at least three members, including all external directors, who must also comprise a majority of the members of the compensation committee. In addition, the chairman of the compensation committee must be an external director. Following the compensation committee's recommendations, the Board of Directors is required to establish a compensation policy, which includes a framework for establishing the terms of office and employment of the office holders and guidelines with respect to the structure of the variable pay of office holders. Such guidelines are the basis for adequate balance between the components of compensation, which exists when a linkage is maintained between compensation and performance and the creation of value for shareholders in the Company, while maintaining the Company's ability to recruit and maintain talented officeholders and incentivizing them to pursue the Company's objectives. In particular, an appropriate balance between the fixed component (base salary and additional benefits) and the variable component and capital compensation avoids placing an exaggerated emphasis on one component.

The following persons may not be a member of the compensation committee:

- The chairman of the board of directors,
- Any director employed by or otherwise providing services to the company or to the controlling shareholder or entity under such controlling shareholder's control,
- Any director who derives his salary primarily from a controlling shareholder,
- A controlling shareholder, or
- Any relative of a controlling shareholder.

The responsibilities of the compensation committee include the following:

1. To recommend to the Board of Directors as to a compensation policy for officers of the company, as well as to recommend, once every three years to extend the compensation policy subject to receipt of the required corporate approvals;
2. To recommend to the Board of Directors as to any updates to the compensation policy which may be required;
3. To review the implementation of the compensation policy by the Company;
4. To approve transactions relating to terms of office and employment of certain Company office holders, which require the approval of the compensation committee pursuant to the Companies Law; and
5. To exempt, under certain circumstances, a transaction relating to terms of office and employment from the requirement of approval of the shareholders meeting.

In December 2012, our Board of Directors changed the composition of the members of our compensation committee by removing Mr. Avi Eizenman from the compensation committee, and appointing the Company’s two external directors, Mr. Ilan Erez and Ms. Einat Domb-Har to our compensation committee, and appointing Mr. Ilan Erez as chairman of our compensation committee. On July 1, 2013, following the election of Ms. Ayelet Aya Hayak as an external director instead of Ms. Einat Domb-Har, Ms. Aya Hayak replaced Ms. Domb-Har on our compensation committee. Following the election of Mr. Eli Doron as a member of our board of directors, Mr. Eli Doron replaced Mr. Zohar Zisapel on our compensation committee. Our compensation committee has been charged by the Board of Directors to act in accordance with the powers and prerogatives delegated to it by the Companies Law and take any decisions and make any recommendations to the Board all as set forth in the Companies Law.

Pursuant to Amendment 27 to the Companies Law, effective as of April 3, 2016 ("Amendment 27"), the audit committee may serve as the company's compensation committee, provided that it meets the composition requirements of the compensation committee.

Under Section 267B(a) and Parts A and B of Annex 1A of the Companies Law, which were legislated as part of Amendment 20, a company’s compensation policy shall be determined based on, and take into account, the following parameters:

a. advancement of the goals of the Company, its working plan and its long term policy;
b. the creation of proper incentives for the office holders while taking into consideration, inter alia, the Company’s risk management policies;
c. the Company’s size and nature of its operations;
d. the contributions of the relevant office holders in achieving the goals of the Company and profit in the long term in light of their positions;
e. the education, skills, expertise and achievements of the relevant office holders;
f. the role of the office holders, areas of their responsibilities and previous agreements with them;
g. the correlation of the proposed compensation with the compensation of other employees of the Company, and the effect of such differences in compensation on the employment relations in the company; and
h. the long term performance of the office holder.

In addition, the compensation policy should take into account that in the event the compensation paid to office holders shall include variable components – it should address the ability of the board of directors to reduce the value of the variable component from time to time or to set a cap on the exercise value of convertible securities components that are not paid out in cash. Additionally, in the event that the terms of office and employment include grants or payments made upon termination – such grants should take into consideration the length of the term of office or period of employment, the terms of employment of the office holder during such period, the company's success during said period and the office holder's contribution to obtaining the company's goals and maximizing its profits as well as the circumstances and context of the termination.

In addition, the compensation policy must set forth standards and rules on the following issues: (a) with respect to variable components of compensation - basing the compensation on long term performance and measurable criteria (though a non-material portion of the variable components can be discretionary awards taking into account the contribution of the officer holder to the company. Pursuant to Amendment 27, variable components in the amount of up to a three month salary of the relevant office holder, on an annual basis, shall be considered a non-material portion of the variable components); (b) establishing the appropriate ratio between variable components and fixed components and placing a cap on such variable components (including a cap on the grant date value of convertible securities components that are not paid out in cash); (c) setting forth a rule requiring an office holder to return amounts paid, in the event that it is later revealed that such amounts were paid on the basis of data which prove to be erroneous and resulted in an amendment and restatement of the company's financial statements; (d) determining minimum holding or vesting periods for equity based variable components of compensation, while taking into consideration appropriate long term incentives; and (e) setting a cap on grants or benefits paid upon termination.

The board of directors of a company is obligated to adopt a compensation policy after considering the recommendations of the compensation committee. The final adoption of the compensation committee is subject to the approval of the shareholders of the company, which such approval is subject to certain special majority requirements, as set forth in the Israeli Companies Law, pursuant to which one of the following must be met:

(i) the majority of the votes includes at least a majority of all the votes of shareholders who are not controlling shareholders of the company or who do not have a personal interest in the compensation policy and participating in the vote; abstentions shall not be included in the total of the votes of the aforesaid shareholders; or

(ii) the total of opposing votes from among the shareholders described in subsection (i) above does not exceed 2% of all the voting rights in the company.

Nonetheless, even if the shareholders of the company do not approve the compensation policy, the board of directors of a company may approve the compensation policy, provided that the compensation committee and, thereafter, the board of directors determined, based on detailed, documented, reasons and after a second review of the compensation policy, that the approval of the compensation policy is for the benefit of the company.

Executive Compensation Policy

On July 31, 2013, an Extraordinary General Meeting of the Shareholders of the Company took place, approving the Executive Compensation Policy (the “Policy”), which had been recommended by the Compensation Committee and approved by the Board of Directors, for the Company’s directors and office holders, in accordance with the requirements of the Companies Law. The Policy is expected to be brought for re-approval of our shareholder at the next Annual General Meeting of our shareholders, scheduled to convene in June, 2016.

The Policy includes, among other issues prescribed by the Companies Law, a framework for establishing the terms of office and employment of the office holders, a recoupment policy, and guidelines with respect to the structure of the variable pay of office holders.

Each of our compensation committee and board of directors may engage compensation advisors and other professionals to assist in formulating compensation packages in line with the Policy, including, without limitation, to assist in collecting relevant data, framing the appropriate factors to be considered and evaluating the different factors being considered.

All compensation arrangements of office holders are to be approved in the manner prescribed by applicable law. Our office holders, including External Directors or Independent Directors, may waive their entitlement to their compensation, subject to applicable law.

Our recoupment policy relating to office holder compensation allows for the recovery of all or a portion of any compensation paid to our office holders that was paid during the previous three years on the basis of financial data included in our financial statements in any fiscal year that were found to be inaccurate and were subsequently restated. In such event, we will seek reimbursement from the office holders to the extent such office holders would not have been entitled to all or a portion of such compensation, based on the financial data included in the restated financial statements. Our compensation committee will be responsible for approving the amounts to be recouped and for setting terms for such recoupment from time to time. Notwithstanding the aforesaid, the recoupment policy will not be triggered in the event of a financial restatement due to changes in the applicable reporting or accounting standards. The above noted recoupment policy does not derogate from any relevant recoupment or clawback provisions under any applicable law or regulatory rules which apply to us.

All of our office holders (other than non-employee directors) may be incentivized through cash bonuses and long-term equity-based incentives to provide the office holder with a stake in our success – thus linking the office holder's long-term financial interests with the interests of our shareholders. In accordance with the Policy, the incentives are developed through a program that sets performance targets based on each office holder's role and scope. Actual payments are driven by the business and individual performance vis-à-vis the performance targets set at the beginning of the year. The formula for the performance targets and the maximum variable components payable to each office holder (other than directors) shall be presented and recommended by our Chief Executive Officer and reviewed and approved by our compensation committee and our board of directors. The formula for the performance targets and the maximum variable components payable to any employee office holders who are also directors shall be presented and recommended by our compensation committee and reviewed and approved by our board of directors and our shareholders. The maximum value of the variable compensation components for an office holder at the Company shall not exceed eighty percent of such office holder's total compensation package on an annual basis. The maximum annual value of the equity-based long-term compensation components and cash bonuses of all of our office holders shall not exceed two percent of our market cap.

Unless otherwise specified in the terms of the variable compensation of an office holder, our Policy dictates that the board of directors shall not have discretion to unilaterally reduce such office holder's variable compensation. Equity based compensation may be granted in any form permitted under our equity incentive plans, as in effect from time to time (collectively, the "Equity Incentive Plans"), including stock options, restricted share units and restricted stock. Equity grants to office holders shall be made in accordance with the terms of the Equity Incentive Plans. All equity-based incentives granted to our office holders shall be subject to vesting periods in order to promote long-term retention of the awarded office holders. Unless determined otherwise in a specific award agreement approved by the compensation committee and the board of directors, grants to our office holders other than directors shall vest gradually over a period of between two to four years. We do not have any equity ownership guidelines that require any of our office holders to hold a stated number or fixed percentage of our ordinary shares, nor do they have to continue to hold for any period of time shares in the Company which they acquired as a result of the exercise of fully vested equity grants. The value of the equity-based compensation shall be calculated on the grant date, according to acceptable valuation practices at the time of grant. The board of directors shall not have discretion to limit the value of the equity-based compensation at the time of exercise. The board of directors may, following approval by our compensation committee, extend the period of time for which an award to an office holder is to remain exercisable, or make provisions with respect to the acceleration of the vesting period of any office holder's awards, including, without limitation, in connection with a corporate transaction involving a change of control.

Our compensation committee will periodically review the Policy and monitor its implementation, and recommend to our board of directors and shareholders to amend the Policy as it deems necessary from time to time. The term of the Policy shall be three years as of the date of its adoption on July 31, 2013, during which, the Board of Directors is required to examine the Policy and revise it from time to time, if the circumstances under which it had been adopted have materially changed. Following such three year term, the Policy, including any revisions recommended by our compensation committee and approved by our board of directors, as applicable, will be brought once again to the shareholders for approval.

Internal Auditor

Under the Companies Law, the board of directors of a public company must appoint an internal auditor, who is nominated by the audit committee. The role of the internal auditor is to examine, among other matters, whether our actions comply with the law and orderly business procedure. Under the Companies Law, the internal auditor may be an employee of the company but not an office holder (as defined in Item 10 below), nor an affiliate, nor a relative of an office holder or affiliate, and he or she may not be our independent accountant or its representative. Doron Cohen of Fahn Kaneh Control Management Ltd. (a subsidiary of Fahn Kanne & Co. - Grant Thornton Israel) serves as our internal auditor.

D. Employees

The number of employees over the last three financial years is set forth in the table below.

As of December 31	2013	2014	2015
Total Employees	143	197	238
Marketing, Sales, Customer Services	17	22	26
Research & Development	41	66	81
Manufacturing	75	97	114
Corporate Operations and Administration	10	12	17

As of March 31, 2016, we had 237 employees, including 25 in marketing, sales and customer services, 83 in research and development, 113 in manufacturing, and 16 in corporate operations and administration. All such employees, except for 23 employees of our subsidiaries in the United States and 29 of our subsidiary in Denmark, are based in Israel. We consider our relations with our employees excellent and have never experienced a labor dispute, strike or work stoppage. None of our employees is represented by a labor union. We do not employ a significant number of temporary employees, but we do use temporary employees from time to time, as necessary.

In Israel we are subject to certain labor statutes and national labor court precedent rulings, as well as to certain provisions of the collective bargaining agreements between the Histadrut (General Federation of Labor in Israel) and the Coordination Bureau of Economic Organizations including the Industrialists' Associations. These provisions of collective bargaining agreements are applicable to our Israeli employees by virtue of expansion orders issued in accordance with relevant labor laws by the Israeli Ministry of Labor and Welfare, and which apply such agreement provisions to our employees even though they are not directly part of a union that has signed a collective bargaining agreement. The laws and labor court rulings that apply to our employees principally concern the minimum wage laws, procedures for dismissing employees, determination of severance pay, leaves of absence (such as annual vacation or maternity leave), sick pay and other conditions for employment. The expansion orders which apply to our employees principally concern the requirement for length of the work day and workweek, mandatory contributions to a pension fund, annual recreation allowance, travel expenses payment and other conditions of employment. We generally provide our employees with benefits and working conditions beyond the required minimums.

Israeli law generally requires severance pay, which may be funded by managers' insurance and/or a pension fund described below, upon the retirement or death of an employee or termination of employment without cause (as defined in the law). The payments to the managers’ insurance and/or pension fund in respect of severance pay amount to approximately 8.33% of an employee’s wages, in the aggregate. Furthermore, Israeli employees and employers are required to pay predetermined sums to the National Insurance Institute, which is similar to the United States Social Security Administration. Such amounts also include payments for national health insurance. The payments to the National Insurance Institute are equal to approximately 14.25% of an employee’s wages, of which the employee contributes approximately 49% and the employer contributes approximately 51%.

A general practice followed by us, is the contribution of funds on behalf of most of our employees either to a fund known as managers' insurance or to a pension fund, or to a combination of both. Such practice was further reinforced in July 1, 2008, when we entered into agreements with a majority of its employees in order to implement Section 14 to the Severance Pay Law, according to which the payment of monthly deposits by us into managers’ insurance and/or pension fund are in respect of severance obligation to such employees. See Note 9 of our consolidated financial statements. These funds provide a combination of savings plan, insurance and severance pay benefits to the employee, giving the employee a lump sum payment upon retirement and securing the severance pay or part of it, if legally entitled, upon termination of employment. Each employee contributes an aggregate amount equal to between 5% and 5.5% of his base salary to such funds, and we contribute, in the aggregate, between 13.3% and 15.8% of the employee’s base salary, with such amount including the 8.33% which is contributed as severance pay as noted above.

E. Share Ownership

The following table sets forth, as of March 31, 2016, the number of shares owned by our officers, directors and senior management. The percentages shown are based on 7,311,563 ordinary shares outstanding as of March 31, 2016:

Name and Address	Number of Shares and Options Owned[1]	Percent of Outstanding Shares	
Zohar Zisapel[2, 3]	1,511,722	20.68	%
Avi Eizenmann	247,618	3.37	%
Shaike Orbach	*	*	
Eli Doron	*	*	
Ayelet Aya Hayak	*	*	
Ilan Erez	*	*	
Eran Gilad	*	*	
All directors and officers as a group	1,759,340	23.92	%

* Denotes ownership of less than 1% of the outstanding shares.

[1] The table above includes the number of shares and options that are exercisable within 60 days of March 31, 2016. Ordinary shares subject to these options are deemed beneficially owned for the purpose of computing the ownership percentage of the person or group holding these options, but are not deemed outstanding for purposes of computing the ownership percentage of any other person. Except where otherwise indicated, and subject to applicable community property laws, based on information furnished to us by such owners or otherwise disclosed in any public filings, to our knowledge, the persons and entities named in the table have sole voting and dispositive power with respect to all shares shown as beneficially owned by them.

[2] Based on Schedule 13D/A filed on March 5, 2009.

[3] Zohar Zisapel ceased serving as a director in the Company as of July 28, 2015.

See also "Item 6. Directors and Senior Management – Compensation."

Item 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

A. Major Shareholders

The shareholders of the Company who beneficially own over 5% or more of each class of shares, as well as the number of shares owned and the percentage of outstanding shares owned by each, and additional information, is set forth below. The voting rights of our major shareholders do not differ from the voting rights of other holders of our ordinary shares. All of the information with respect to beneficial ownership of the Ordinary Shares is given to the best of our knowledge.

Name of Shareholder	Number of Shares and Options Owned1	Percentage of Outstanding Shares	
Zohar Zisapel2	1,511,722	20.68	%
Dov Yelin/Yair Lapidot/Yelin Lapidot Holdings Management Ltd.3	552,712	7.56	%
Harel Insurance Investments & Financial Services Ltd.4	415,898	5.69	%

[1] The table above includes the number of shares and options that are exercisable within 60 days of March 31, 2016. Ordinary shares subject to these options are deemed beneficially owned for the purpose of computing the ownership percentage of the person or group holding these options, but are not deemed outstanding for purposes of computing the ownership percentage of any other person. Except where otherwise indicated, and subject to applicable community property laws, based on information furnished to us by such owners or otherwise disclosed in any public filings, to our knowledge, the persons and entities named in the table have sole voting and dispositive power with respect to all shares shown as beneficially owned by them.

2 Based on Schedule 13D/A filed on March 5, 2009.

[3] As reported on the Schedules 13G/A filed by each of Dov Yelin, Yair Laipdot and Yelin Lapidot Holdings Management Ltd., an Israeli investment management firm (collectively, “Yelin Lapidot”) with the Securities and Exchange Commission on February 2, 2016, and as further updated in correspondence by Yelin Lapidot Holdings Management Ltd. with the Company, dated as of March 31, 2016, all 552,712 ordinary shares of the Company are beneficially owned by Yelin Lapidot via two of its wholly-owned subsidiaries (the “Subsidiaries”), Yelin Lapidot Provident Funds Management Ltd. which holds 248,024 Ordinary Shares of the Company, and Yelin Lapidot – Mutual Funds Management Ltd. which holds 304,688 Ordinary Shares of the Company. Yelin Lapidot has reported on the Schedules 13G/A that: (i) Messrs. Yelin and Lapidot each own 24.38% of the share capital and 25% of the voting rights, and are responsible for the day-to-day management, of Yelin Lapidot Holdings Management Ltd., (ii) the Subsidiaries operate under independent management and make their own independent voting and investment decisions, (iii) that any economic interest or beneficial ownership in any of the Ordinary Shares of the Company covered by the report on Schedule 13G is held for the benefit of the members of the provident funds or mutual funds, as the case may be, and (iv) the report on Schedule 13G/A shall not be construed as an admission by Messrs. Yelin and Lapidot, Yelin Lapidot Holdings Management Ltd. or the Subsidiaries that he or it is the beneficial owner of any of the Ordinary Shares of the Company covered by report on Schedule 13G/A, and that each of them disclaims beneficial ownership of any such ordinary shares of the Company.

[4] As reported on the Schedule 13G/A filed by Harel Insurance Investments & Financial Services Ltd. ("Harel"), an Israeli insurance company publicly traded on the TASE, with the Securities and Exchange Commission on January 28, 2016, of the 415,898 Ordinary Shares (i) 405,495 are held for members of the public through, among others, provident funds and/or pension funds and/or index-linked securities and/or insurance policies, which are managed by subsidiaries of Harel, each of which subsidiaries operates under independent management and makes independent voting and investment decisions, and (ii) 10,403 Ordinary Shares are beneficially held for Harel's own account. Harel also reported that the report on Schedule 13G/A shall not be construed as an admission by Harel that it is the

beneficial owner of more than 10,403 ordinary shares of the Company covered by the report on Schedule 13G/A.

The Company's major shareholders do not have different voting rights.

As of March 31, 2016, there were approximately 5 record holders of ordinary shares, including approximately 2 record holders in the United States. Collectively, these 2 record holders in the United States held less than 1% of the outstanding ordinary shares.

B. Related Party Transactions

Messrs. Yehuda and Zohar Zisapel are brothers and are our founders. On July 15, 2010 Mr. Yehuda Zisapel resigned from serving as director on our board of directors. On September 2, 2010, Mr. Zohar Zisapel was appointed as a director on our board until July 28, 2015, when he ceased serving as a director. Messrs. Yehuda and Zohar Zisapel are also founders, directors and principal shareholders of several other corporations within the “Rad Group”, as described in “Item 6. Directors, Senior Management and Employees”.

There are other members of the Rad Group that are actively engaged in designing, manufacturing, marketing and supporting data communications products, none of which are currently the same as our products. Certain products of members of the Rad Group are complementary to, and may be used in connection with, our products.

The Rad Group provides us with certain services, and is reimbursed by us for the costs of providing such services. During 2015, we purchased from the Rad Group internet services for an amount of up to $51,500, testing services for our products for an amount of up to $147,000, car leasing services for an amount of up to $6,000 and insurance services for an amount of up to $55,000. We also sub-lease office space in Paramus, New Jersey, for an amount of up to $24,000 (monthly rent payments of approximately $2,000) from Radcom Equipment, Inc., an affiliated company of the Rad Group. We began to sub-lease this space in February 2004; the sub-lease was in effect until January 31, 2006 and was renewed for additional one-year periods through December 31, 2014. On January 1, 2015, we extended the sub-lease for an additional two-year period until December 31, 2016.

During 2015, we sold external bypass switches and Server Adapters to members of the Rad Group for an amount of approximately $1,154,000.

The material terms of the arrangements with the Rad Group, described in the preceding paragraphs, occur within the Company's ordinary course of business, and on market terms. We believe that such arrangements are neither material to us nor unusual in their nature or conditions. We further believe that the terms of the transactions in which we have engaged and are currently engaged with other members of the Rad Group are generally no less favorable to us than terms which might be available to us from unaffiliated third parties.

Our board of directors approved a resolution under which sales to or purchases from any members of the Rad Group must meet certain criteria or otherwise be specifically approved by the relevant corporate bodies, as applicable in accordance with Israeli law. These criteria included a stipulation that transactions between us and members of the Rad Group relate to standard equipment, services and products purchased or sold by us and the Rad Group, as applicable. Our board of directors approved sales to or purchases from the Rad Group, from time to time, of standard equipment, services and products, which are (i) within our ordinary course of business and (ii) at least at market terms and at a value lower than 0.5% of our annual turnover per transaction and 2.5% of our annual turnover for all such transactions in a financial year, aggregated together. Our management is required to examine on a quarterly basis whether transactions with the Rad Group comply with such criteria. Transactions which do not meet the criteria will require specific corporate approvals in the applicable manner prescribed by Israeli law. Further, all future related party transactions and arrangements (or modifications of existing ones) with members of the Rad Group, transactions in which office holders of the Company have a personal interest, or transactions which raise issues of such office holders' fiduciary duties, could require additional corporate approvals as applicable under the Companies Law.

Except as indicated above, we do not currently directly compete with other members of the Rad Group and do not currently contemplate engaging in competition with any other member of the Rad Group in the future. However, opportunities to develop, manufacture or sell new products (or otherwise enter new fields) may arise in the future, which opportunities might be pursued by us or by one or more other members of the Rad Group to the exclusion of (or in competition with) other members of the Rad Group (including us). In the event that any such opportunity arises, the directors then in office will determine whether or not we should seek to pursue it. Any such determination will be based upon such factors as the directors then deem relevant. However, in making any such determination, the directors will be bound by their fiduciary duties to the Company (and to any other corporation or other person to whom they then owe a fiduciary duty).

On July 22, 2002, our audit committee and the Board of Directors approved an Indemnification Agreement with our directors and officers. Our shareholders approved the terms of this agreement in a General and Extraordinary Meeting held on January 7, 2004. In Amendment 3 to the Companies Law, effective as of 2005, the instances in which a company may indemnify its officers and directors were broadened. In December 2007 each of our audit committee and Board of Directors approved a new form of Indemnification Agreement with our directors and officers so as to reflect this amendment. Our shareholders approved the terms of this new Indemnification Agreement in January 2008. According to Amendment 16 to the Israeli Securities Law, 5728-1968 (the "Israeli Securities Law"), and to a corresponding amendment to the Companies Law, both effective as of 2011, the Israeli Securities Authority is authorized to impose administrative sanctions against companies like ours and their office holders for certain violations of the Israeli Securities Law or the Companies Law. These sanctions include monetary sanctions and certain restrictions on serving as a director or senior officer of a public company for certain periods of time. The Israeli Securities Law and the Companies Law provide that only certain types of such liabilities may be reimbursed by indemnification and insurance. Specifically, legal expenses (including attorneys' fees) incurred by an individual in the applicable administrative enforcement proceeding and certain compensation payable to injured parties for damages suffered by them are permitted to be reimbursed via indemnification or insurance, provided that such indemnification and insurance are authorized by the company's articles of association, and receive the requisite corporate approvals. In January 2012 each of our audit committee and Board of Directors approved a new form of Indemnification Agreement with our directors and officers so as to reflect this amendment, and our shareholders approved these amendments to the Articles of Association and a revised form of Indemnification Agreement for directors at the Annual General Meeting of the Shareholders held on April 11, 2012.

The Indemnification Agreement provides that our directors and officers will be exempt from liability in certain circumstances. The Indemnification Agreement also provides for the indemnification by the Company for certain obligations and expenses imposed on the officer in connection with act performed in his or her capacity as an officer of the Company. This right to indemnification is limited, and does not cover, among other things, a breach of an officer’s duty of loyalty, a willful breach of an officer’s duty of care, or a reckless disregard for the circumstances or consequences of a breach of a duty of care. The right to indemnification also does not cover acts that are taken intentionally to unlawfully realize personal gain. The maximum amount of our liability under these Indemnification Agreements for any monetary obligation imposed on an officer or a director in favor of another person by a judgment is currently $3,000,000 for each instance of a covered scenario. In addition we would be liable to indemnify the officer or director for all reasonable litigation expenses with respect to certain proceedings. We have maintained liability insurance for our directors and officers. On September 23, 2007 our shareholders approved the procurement of a policy, which provides for total coverage of up to $4,000,000. All of our directors are parties to our Indemnification Agreements and are covered by our directors and officers insurance policy.

As per Amendment 20, it was decided on July 31, 2013, at the Extraordinary General Meeting of the Shareholders to adopt the Executive Compensation Policy of the Company, which was recommended by our compensation committee and approved by our board of directors. Our approved Executive Compensation Policy includes the above referenced form of Indemnification Agreement to be entered into by the Company with our directors and officers serving in such capacities from time to time, as well as the above referenced directors and officers liability insurance policy. Under the Executive Compensation Policy, any change to the Indemnification Agreement or the insurance policy, including the cost and/or any changes which materially depart from the key terms of the current agreement and/or insurance policy (provided that such changes apply equally to all executives of the Company, including directors) will be submitted to the Company's compensation committee and the board of directors for their approval but shall not, unless required by law or the Company's Articles of Association, be presented at a General Meeting of the shareholders.

See also "Item 6. Directors and Senior Management – Compensation."

Item 8. FINANCIAL INFORMATION

A. Consolidated Statements and Other Financial Information

Our consolidated financial statements and other financial information are included herein on pages F-1 through F-44.

A1. See Item 18 for our consolidated financial statements.

A2. See Item 18 for our consolidated financial statements, which cover the last three financial years.

A3. See page F-3 for the audit report of our accountants, entitled "Report of Independent Registered Public Accounting Firm."

A4. Not applicable.

A5. Not applicable.

A6. See Note 12A to our audited consolidated financial statements included in Item 18 of this annual report for the geographic distribution of our sales based on the location of the customer.

A7. Litigation

On March 2, 2012 Internet Machines LLC, a Texas limited liability company filed a patent infringement lawsuit in the United States District Court for the Eastern District of Texas (the “Court”) against numerous defendants (including many switch manufacturers) with respect to certain patents for switches, and included our US subsidiary amongst the list of defendants named in such lawsuit. The lawsuit claimed that the defendants infringed certain patents purported to be owned by Internet Machines LLC and sought unspecified compensation for damages as well as injunctive relief. The defendants filed answers and counterclaims to the complaint asserting that they did not infringe any claims of the asserted patents and the claims of the patents were invalid and/or unenforceable. While one of our switch suppliers (which was also named as a defendant in the aforesaid lawsuit) agreed to indemnify us with respect to certain liabilities, there was no certainty that we would have been ultimately able to collect all or any amounts under such indemnity should we would have been found liable under the lawsuit. On September 4, 2012, the Court granted the defendants' motion to stay the pending litigation and on April 28, 2015, the lawsuit was dismissed with prejudice by the Court.

Other than the above, we are not a party to any material litigation and we are not aware of any pending or threatened litigation that would have a material adverse effect on us or our business.

A8. Dividend Policy

Prior to 2013, we had not paid dividends in the past. On January 14, 2013, we announced that our Board of Directors has adopted a policy for distributing dividends, subject to all applicable laws. According to this policy, each year we will distribute a dividend of up to 50% of our annual distributable profits. As part of the stated policy, the Company's Board of Directors reserves the right to declare additional dividend distributions, to change the rate of dividend distributions (either as a policy or on a one-time basis), to cancel a specific distribution or to cancel the policy as a whole at any time, at its sole discretion. The actual distribution of a dividend will be subject to meeting the conditions required by applicable law, including the distribution tests set forth in Section 302 of the Companies Law, and to the specific decision of the Company's Board of Directors for each distribution. Future dividend policy will be reviewed by the Board of Directors based upon conditions then existing, including our earnings, financial condition, capital requirements and other factors. Our ability to pay cash dividends may be restricted by instruments governing any of our obligations.

Dividends paid by an Israeli company to shareholders residing outside Israel are generally subject to withholding of Israeli income tax at a rate of 25-30%. Such tax rates apply unless a lower rate is provided in a treaty between Israel and the shareholder’s country of residence. In our case, the applicable withholding tax rate will also depend on the particular Israeli production facilities that have generated the earnings that are the source of the specific dividend and, accordingly, the applicable rate may change from time to time.

On March 18, 2013 our Board of Directors declared a dividend of US $0.55 per share which was paid on April 17, 2013 to shareholders of record as of April 4, 2013, and in the aggregate amount of approximately US $3.9 million for 2012.

On March 18, 2014 our Board of Directors declared a dividend of US $1.00 per share payable on April 17, 2014 to shareholders of record at the close of the NASDAQ Global Select Market on April 3, 2014, and in the aggregate amount of approximately US $7.2 million for 2013.

On March 23, 2015 our Board of Directors declared a dividend of US $1.00 per share payable on April 21, 2015 to shareholders of record at the close of the NASDAQ Global Select Market on April 6, 2015, and in the aggregate amount of approximately US $7.3 million for 2014.

On March 21, 2016 our Board of Directors declared a dividend of US $1.00 per share payable on April 14, 2016 to shareholders of record at the close of the NASDAQ Global Select Market on April 4, 2016, and in the aggregate amount of approximately US $7.3 million for 2015.

B. Significant Changes

Since the date of the annual financial statements included in this Annual Report, no significant changes have occurred.

Item 9. THE OFFER AND LISTING

A. Offer and listing details

Markets and Share Price History

Following our delisting from trading on the TASE, the only trading market for our ordinary shares is the NASDAQ Global Select Market, where our shares have been listed and traded under the symbol SILC since January 2, 2014. Prior thereto our shares were listed and traded on the NASDAQ Global Market (previously NASDAQ National Market) under the symbol SILC (previously SILCF) from February 11, 2008. Prior thereto, our shares were listed and traded on the NASDAQ Capital Market (previously known as the NASDAQ Small-Cap).

The table below sets forth the high and low reported sales prices in dollars of our ordinary shares, as reported by NASDAQ during the indicated periods:

PERIOD	LOW	HIGH
LAST 6 CALENDAR MONTHS		
March 2016	29.9	34.2
February 2016		