CERAGON NETWORKS LTD
Form 20-F/A
July 27, 2006

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

FORM 20-F /A
(Amendment No. 1)

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, 2005

OR

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

OR

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

For the transition period from __________ to __________

Commission file number 0-30862

CERAGON NETWORKS LTD.

(Exact name of Registrant as specified in its charter)

Israel

(Jurisdiction of incorporation or organization)

24 Raoul Wallenberg Street, Tel Aviv 69719, Israel

(Address of principal executive offices)

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

None

(Title of each Class)

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

Ordinary Shares, Par Value NIS .01

(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: 26,335,003 Ordinary Shares, NIS 0.01 par value.

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

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 ¨ Accelerated filer ¨ Non-accelerated filer **x**

Indicate by check mark which financial statement item the registrant has elected to follow: Item 17 o Item 18 x

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No **x**

TABLE OF CONTENTS

EXPLANATORY NOTE

This amendment on Form 20-F/A (Amendment No. 1) amends our annual report on Form 20-F for the fiscal year ended December 31, 2005, as filed with the Securities and Exchange Commission on June 30, 2006 (the Original Report), and is being filed solely to correct a typographical error in the date of the officers certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 that was included in the Original Report. The dates of the Section 302 and Section 906 Certifications have been changed to reflect the date of filing of this Amendment No. 1, the first part of each of such Certifications has been changed to reflect the fact that they relate to an amendment of the Original Report, a typographical error in one of the Section 302 Certifications was corrected and the consent of our independent auditors was updated. No other changes have been made.

The accompanying revised certifications are dated July 27, 2006, but the statements made in these revised certifications were also true and correct as of the date of the Original Report.

Other than as expressly set forth herein, this Amendment No. 1 does not, and does not purport to, amend or restate any other information contained in the Original Report nor does this Amendment No. 1 reflect any events that have occurred after the Original Report was filed.

INTRODUCTION

Definitions

In this annual report, unless the context otherwise requires:

- references to Ceragon, the Company, us, we and our refer to Ceragon Networks Ltd. (the Registrant), an Israeli company, a consolidated subsidiaries;
- references to ordinary shares, our shares and similar expressions refer to the Registrant s Ordinary Shares, NIS 0.01 nominal (par) value per share;
- references to dollars, U.S. dollar and $ are to United States Dollars;
- references to shekels and NIS are to New Israeli Shekels, the Israeli currency;
- references to the Companies Law are to Israel s Companies Law, 5759-1999; and
- references to the SEC are to the United States Securities and Exchange Commission.

Cautionary Statement Regarding Forward-Looking Statements

This annual report includes certain statements that are intended to be, and are hereby identified as, forward looking statements for the purposes of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. We have based these forward-looking statements on our current expectations and projections about future events.

Forward-looking statements can be identified by the use of forward-looking terminology such as may, will, expect, anticipate, estimate, continue, believe or other similar words, but are not the only way these statements are identified. These statements discuss future expectations, contain projections of results of operations or of financial condition or state other forward-looking information. When considering such forward-looking statements, you should keep in mind the risk factors and other cautionary statements in this annual report. These statements may be found in Item 4: Information on the Company and Item 5: Operating and Financial Review and Prospects and in this annual report generally. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including all the risks discussed in Risk Factors and elsewhere in this annual report.

We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. In light of these risks, uncertainties, and assumptions, the forward-looking events discussed in this annual report might not occur.

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

Selected Financial Data

The selected financial data set forth in the following table are derived from our consolidated financial statements, which were prepared in U.S. dollars and in accordance with United States Generally Accepted Accounting Principles (U.S. GAAP) and cover each of the years in the five-year period ended December 31, 2005. The selected consolidated financial data set forth below should be read in conjunction with Item 5 of this annual report entitled Operating and Financial Review and Prospects and our consolidated financial statements and the notes to those financial statements included elsewhere in this annual report.

	Year ended December 31,				
	2001	2002	2003	2004	2005
	(In thousands, except share and per share data)				
Consolidated Statement of Operations Data:					
Revenues	$ 24,852	$ 18,394	$ 34,421	$ 54,831	$ 73,777
Cost of revenues	45,682	13,005	20,755	32,227	52,487
Gross profit (loss)	(20,830)	5,389	13,666	22,604	21,290
Operating expenses:					
Research and development	15,215	10,101	9,346	9,772	10,713
Less: grants and participations	2,660	1,870	1,976	2,293	1,752
Research and development, net	12,555	8,231	7,370	7,479	8,961
Selling and marketing	13,908	10,202	9,967	11,841	13,629
General and administrative	7,569	2,761	2,482	2,485	3,200
Restructuring and non-recurring income	4,750	83	(704)	--	--
Total operating expenses	38,782	21,277	19,115	21,805	25,790
Operating profit (loss)	(59,612)	(15,888)	(5,449)	799	(4,500)
Financing income, net	2,769	1,528	1,159	674	607
Other financial expenses - non-cash charge relating to puttable warrant	--	--	(3,432)	--	--
Other income	--	--	--	141	66
Net income (loss)	(56,843)	(14,360)	(7,722)	1,614	(3,827)
Basic net earnings (loss) per share	$ (2.69)	$ (0.64)	$ (0.33)	$ 0.06	(0.15)
Diluted net earnings (loss) per share	$ (2.69)	$ (0.64)	$ (0.33)	$ 0.06	(0.15)
Weighted average number of shares used in computing basic earnings (loss) per share	21,099,336	22,375,939	23,063,160	25,066,937	26,137,121
Weighted average number of shares used in computing diluted earnings (loss) per share	21,099,336	22,375,939	23,063,160	28,069,844	26,137,121

Amortization of deferred stock compensation presented in previous years was reclassified in the relevant expense line.

All outstanding share options have been excluded from the calculation of diluted net loss per share because all these securities are antidilutive for the periods presented.

	At December 31,				
	2001	2002	2003	2004	2005
	(In thousands)				
Consolidated Balance Sheet Data:					
Cash and cash equivalents, short and long term bank deposits, short and long term marketable securities	$ 53,721	$ 43,173	$ 39,046	$ 37,801	33,022
Working capital	55,361	30,386	30,481	38,827	34,871
Total assets	72,086	61,640	62,428	73,111	73,992
Total long term debt	1,511	1,825	2,451	2,986	3,424
Shareholders equity	60,619	49,266	48,683	52,187	49,189

Risk Factors

Risks Relating to Our Business

We have a history of operating and net losses. We may not operate profitably in the future.

Although we reported a profit in 2004, we incurred operating and net losses in every fiscal year from our inception through 2003 and in 2005, and we may incur losses in the future. We reported net losses of $56.8 million for 2001, $14.4 million for 2002, $7.7 million for 2003 and $3.8 million for 2005. As of December 31, 2005, our accumulated deficit was $128.2 million. In order to meet expanding sales and operations requirements, our expenses may increase. As a result, net cash outflows may continue for the near term, and we may again incur net operating losses. If our sales do not increase or if our expenses increase at a greater pace than our revenues, continuing profitability may not be achieved. We may not be able to sustain or increase profitability on a quarterly or annual basis.

Our quarterly financial performance is likely to vary significantly in the future. Our revenues and operating results in any quarter may not be indicative of our future performance. It may therefore be difficult for investors to evaluate our prospects.

Our quarterly revenues and operating results have varied significantly in the past and are likely to continue to vary significantly in the future. Fluctuations in our quarterly financial performance may result from the fact that we may receive a small number of relatively large orders in any quarter. The deferral or loss of one or more significant sales could materially affect our operating results in any fiscal quarter, especially if there are significant sales and marketing expenses associated with the deferred or lost sales. Since large orders generate disproportionately large revenues, our revenues and the rate of growth of our revenues for a particular quarter may reach levels that may not be sustained in subsequent quarters. Thus, our revenues and operating results in any quarter may not be indicative of future performance and it may be difficult for investors to evaluate our prospects.

Our products have lengthy sales cycles. This adds cost to our sales efforts and uncertainty as to their results.

Our products have lengthy sales cycles. For example, it typically takes from six to twelve months after we first begin discussions with a prospective customer before we receive an order from that customer. Because of this, we are often required to devote more time to, and spend more money on, marketing our products than would be necessary if sales were made more quickly. In some instances, we participate in competitive bids in tenders issued by existing or prospective customers. A tender process can continue for many months until a decision is made.

The loss of one or more of our key customers would result in a loss of revenues.

In certain fiscal quarters, relatively few customers have accounted for a large percentage of our revenues. Our business may be seriously harmed if we experience a loss of any of our significant customers, or we suffer a substantial reduction in orders from these customers. The worldwide telecommunications industry is dominated by a small number of large corporations, and we expect that a significant portion of our future product sales per quarter will continue to be concentrated in a limited number of customers. In addition, our customers typically are not contractually obligated to purchase any quantity of products in any particular period and product sales to major customers have varied widely from period to period. The loss of any existing customer, a significant reduction in the level of sales to any existing customer, or our inability to gain additional customers could result in further declines in our revenues. If these revenue declines occur, our business, financial condition, and results of operations could be harmed.

We are dependent upon sales of our FibeAir® family of products. Any reduction in demand for these products would cause our revenues to decrease.

All of our revenues are generated from sales of a single family of products, known as FibeAir®. We expect sales of our FibeAir family of products to continue to account for all of our revenues for the foreseeable future. As a result, we are more likely to be adversely affected by a reduction in demand for these products than companies that sell multiple product families. We also may not succeed in reducing the risk associated with any slowdown in demand for our FibeAir products.

We rely on a limited number of contract manufacturers to manufacture our products. This could result in a disruption in supply of these products.

We outsource the majority of our manufacturing processes to contract manufacturers. We do not have long-term contracts with all of these contract manufacturers. We have experienced and may in the future experience delays in shipments from these manufacturers. This could delay product shipments to our customers. Our manufacturers may themselves in the future experience other manufacturing problems, including inferior quality and insufficient quantities of components. These delays, quality problems and shortages could result in delayed deliveries, penalties, equipment replacement costs and possible cancellation of orders. If our manufacturers experience financial, operational, manufacturing capacity or other difficulties, our supply may be disrupted and we may be required to seek alternate manufacturers. We may be unable to secure alternate manufacturers that meet our needs. Moreover, qualifying new manufacturers and commencing volume production is expensive and time consuming. If we are required or choose to change manufacturers, our sales and our customer relationships may suffer.

Our contract manufacturers obtain some of the components included in our products from a single source or a limited group of suppliers. If they lose any of these suppliers, we may experience production delays and a substantial loss of revenue.

Our contract manufacturers currently obtain key components from a limited number of suppliers. Some of these components are obtained from a single source supplier. Their dependence on a limited number of suppliers subjects us to the following risks:

The component suppliers could increase component prices significantly at any time and with immediate effect. This would increase component procurement costs and could result in reduced gross margins for us.

The component suppliers may themselves experience shortages in components and interrupt or delay their shipments to our manufacturers. This may delay our product shipments to our customers and result in penalties and/or cancellation of orders for our products.

The component suppliers could discontinue the manufacture or supply of components used in our systems. If this occurs and we or our manufacturers are unable to develop alternative sources for components, we might need to modify our products. This would likely interrupt the manufacturing process and could cause delays in our product shipments. Moreover, a significant modification in our product design may increase our manufacturing costs and force us to accept lower gross margins.

Our manufacturers may purchase more inventory than is immediately required to compensate for potential component shortages or discontinuation. Such inventory can become obsolete.

Our business depends in part on original equipment manufacturers.

The success of the sales of our products currently depends in part on existing relationships with original equipment manufacturers. A portion of our systems is sold to and through such OEMs rather than directly to carriers. The sale of our products depends in part on the OEMs active marketing and sales efforts as well as the quality of their post-sales support. Sales through the OEMs channels expose our business to a number of risks, each of which could result in a reduction in the sales of our wireless products. We face the risks of termination of these relationships, or consolidation of some of these OEMs, or financial problems they might face, as well as the promotion of competing products or emphasis on alternative technologies by these OEMs, turning them into competitors rather than our partners. Any of the foregoing may result in decline in the purchase of our products. In addition, our efforts to increase sales may suffer from the lack of brand visibility resulting from OEMs sale of these products with their own brand names, or from our inability to enter into relationships with additional OEMs that would give us better penetration to existing and potential markets. If any of these risks materialize, we will need to develop alternative methods of marketing these products. Until we do so, sales of our products may decline.

If sufficient demand for our wireless products does not develop, we will not be able to generate significant revenues and we may not be profitable on an annual basis.

The acceptance of the wireless equipment which we and our competitors sell as a means of delivering data, video and voice traffic will depend upon numerous factors, including:

- its capacity to handle growing volumes of traffic;
- its cost effectiveness;
- its reliability and security;
- the availability of sufficient equipment, frequency bands and installation sites; and
- its performance in extreme weather conditions.

If our products do not address these factors in a manner which satisfies the requirements of prospective customers and end-users, the demand for our products may be adversely affected and we may not be able to generate significant revenues or operate profitably.

If we do not succeed in developing and marketing new and enhanced wireless products that keep pace with technological developments and our customers needs, our revenues may not increase.

The market for our products is new and emerging. It is characterized by rapid technological advances, changing customer needs and evolving industry standards. Accordingly, our success will depend on our ability to:

- develop and market new products in a timely manner to keep pace with developments in technology;
- meet evolving customer requirements;
- enhance our current product offerings; and
- deliver products through appropriate distribution channels.

We are continuously seeking to develop new products and enhance our existing products. Developing new products and product enhancements requires significant capital expenditures and research and development resources and we are therefore being much more selective in these investments. We may not be successful in enhancing our existing products or developing new products in response to technological advances or to satisfy increasingly sophisticated customer needs in a timely and cost-effective manner.

We face intense competition from other wireless equipment providers. Our failure to compete effectively could hurt our sales.

The market for wireless equipment is rapidly evolving, fragmented, highly competitive and subject to rapid technological change. Increased competition could result in reduced demand for our products, price reductions and reduced gross margins, any of which could seriously harm our business. A number of communications equipment suppliers, including (in alphabetical order) Alcatel, Dragonwave, Harris Corporation, Huawei Technologies, L.M. Ericsson, Motorola NEC, Nera, Stratex Networks, SIAE, Siemens and ZTE, as well as other companies offer or are developing products that may compete with our products.

5

Some of our competitors are substantially larger than we are and have longer operating histories and greater financial, sales, marketing, distribution, technical, manufacturing and other resources than we have. Some also have greater name recognition and a larger customer base than we have. Many of our competitors have well-established relationships with our current and potential customers and have extensive knowledge of our target markets. Some of our competitors have product lines that compete with ours, and are also through which we market and sell our products on an original equipment manufacturer (OEM) basis. As a result, our competitors may be able to respond more quickly to evolving industry standards and changes in customer requirements, or to devote greater resources to the development, promotion and sale of their products than we can. We expect to face increasing competitive pressures from both current and future competitors. In addition, current and potential competitors may make strategic acquisitions or establish cooperative relationships among themselves or with third parties to increase their ability to gain market share rapidly. We also expect that industry consolidation will increase competition.

We believe that our ability to compete successfully will depend on a number of factors both within and outside our control, including price, quality, availability, manufacture by contract manufacturers, customer service and support, breadth of product line, product performance and features, rapid time-to-market delivery capabilities, reliability, timing of new product introductions by us, our customers and our competitors, and the ability of our customers to obtain financing. We cannot assure you that we will have the financial resources, technical expertise, or marketing, sales, distribution and customer service and support capabilities to compete successfully.

Competition and current market conditions have resulted in downward pressure on the prices for our products, which could result in decreased revenues.

We participate in a highly volatile industry that is characterized by vigorous competition for market share and rapid technological development. These factors have resulted in aggressive pricing practices and growing competition both from start-up companies and from well-capitalized telecommunication systems providers. Manufacturers of digital microwave telecommunications equipment are experiencing price pressure, which has resulted in downward pricing pressure on our products. Our future profitability is dependent upon our ability to improve manufacturing efficiencies, reduce costs of materials used in our products, and to continue to introduce new products and product enhancements. Pricing is affected by other factors as well, including but not limited to the size of a given transaction, the geographic location of the customer, the specific application for which products are sold, the channel through which products are sold, the competitive environment and the results of negotiation. Any inability by us to effectively respond to price pressures may harm our business, financial condition and results of operations.

We also face intense competition from broadband technologies that compete with wireless transmission which could hurt our sales.

Our products also compete to a certain extent with other high-speed communications solutions, including fiber optic lines, free space optics, low to medium capacity point-to-point radios and other wireless technologies. Some of these technologies utilize existing installed infrastructure and have achieved significantly greater market acceptance and penetration than high-capacity broadband wireless technologies. In addition, customers may wish to use transmission frequencies for which we do not offer products and therefore such customers turn to our competitors to fulfill such needs. We expect to face increasing competitive pressures from both current and future technologies in the broadband access market.

Consolidation within the telecommunications industry and among suppliers could decrease our revenues.

The telecommunications industry has experienced significant consolidation among its participants, and we expect this trend to continue. Other operators may merge and one or more of our competitors may supply products to such companies that have merged or will merge. This consolidation could result in purchasing decision delays by the merged companies and decrease opportunities for us to supply our products to the merged companies. We may also see similar consolidation among suppliers which may further decrease our opportunity to market and sell our products.

Our products may contain defects that could harm our reputation, be costly to correct, expose us to litigation and harm our operating results.

We and our customers have from time to time discovered defects in our products and additional defects may be found in the future. If defects are discovered, we may not be able to correct them in a timely manner or at all. Defects and failures in our products could result in a loss of, or a delay in, market acceptance of our products. In addition, defects in our products could cause adverse publicity, damage our reputation and impair our ability to acquire new customers. In addition, we may need to make significant capital expenditures to eliminate defects from our products or to replace defective equipment.

Moreover, because our products are used in critical communications networks, we may be subject to significant liability claims if our products do not work properly. The provisions in our agreements with customers that are intended to limit our exposure to liability claims may not preclude all potential claims. In addition, any insurance policies we have may not adequately limit our exposure with respect to such claims. We warrant to our current customers that our products will operate in accordance with our product specifications. If our products fail to conform to these specifications, our customers could require us to remedy the failure or could assert claims for damages. Liability claims could require us to spend significant time and money in litigation or to pay significant damages. Any such claims, whether or not successful, would be costly and time-consuming to defend and could seriously damage our reputation and our business.

Line-of-sight limitations inherent in wireless products may limit deployment options and have an adverse affect on our sales.

Our wireless products require a direct line-of-sight between antennas, potentially limiting the ability of our customers to deploy them in a cost-effective manner. Because of line-of-sight limitations, service providers often install wireless equipment on the rooftops of buildings and on other tall structures. Communications service providers must generally secure roof rights from the owners of each building or other structure on which our products are installed. Any inability to obtain roof rights easily and cost effectively may cause a delay in deployment and increase the installation cost of our products or may cause customers not to choose to install wireless equipment.

Due to uncertainty and possible delays in deployment of advanced cellular and other networks, our revenues could be lower than expected due to delayed purchasing decisions by cellular and other customers for our products.

We have significantly increased sales to customers in the cellular market to support wireless requirements for third generation cellular networks. For sales in the cellular market, any delays by cellular providers in their third generation network deployment schedules could result in lower than expected revenues for us, since any such deployment schedule delays could result in delayed purchasing decisions by such customers.

Due to our significant volume of international sales and our rapid expansion into new markets, we are susceptible to a number of political, economic and geographic risks that could harm our business if they occur.

We are highly dependent on sales to customers outside the United States. We expect that international sales will continue to account for the majority of our sales for the foreseeable future. As a result, the occurrence of any international, political, economic or geographic events that adversely affects our business could result in significant revenue shortfalls.

Any such revenue shortfalls could cause our business, financial condition and results of operations to be harmed. Some of the risks and challenges of doing business internationally include:

- unexpected changes in regulatory requirements;
- fluctuations in foreign currency exchange rates;
- imposition of tariffs and other barriers and restrictions;
- management and operation of an enterprise spread over various countries;

burden of complying with a variety of foreign laws;

general economic and geopolitical conditions, including inflation and trade relationships; and

payment delays and uncertainties.

war and acts of terrorism

The unpredictability of our quarter-to-quarter results may harm the trading price of our ordinary shares.

Our quarterly operating results may vary significantly in the future for a variety of reasons, many of which are outside of our control, and any of which may harm our business. These factors include:

volume and timing of product orders received and delivered during the quarter;

our ability, and the ability of our contract manufacturers, to manufacture products on time;

our ability and the ability of our key suppliers to respond to changes made by customers in their orders;

timing of new product introductions by us or our competitors;

changes in the mix of products sold by us;

cost and availability of components and subsystems;

downward pricing pressure on our products;

adoption of new technologies and industry standards;

competitive factors, including pricing, availability and demand for competing products;

ability of our customers to obtain financing to enable their purchase of our products;

fluctuations in foreign currency exchange rates;

regulatory developments; and

general economic conditions in the United States and internationally.

Our quarterly results are difficult to predict and delays in product delivery or closing of a sale can cause revenues and net income to fluctuate significantly from anticipated levels. In addition, we may increase spending in response to competition or to pursue new market opportunities. Accordingly, we cannot assure you that we will be able to sustain profitability in the future, particularly on a quarter-to-quarter basis.

Our stock price may be volatile, which may lead to losses by investors.

Announcements of developments related to our business, announcements by competitors, quarterly fluctuations in our financial results and general conditions in the telecommunications industry in which we compete, or the economies of the countries in which we do business and other factors could cause the price of our ordinary shares to fluctuate, perhaps substantially. In addition, recently, the stock market has experienced extreme price fluctuations, which have often been unrelated to the operating performance of affected companies. These factors and fluctuations could lower the market price of our ordinary shares.

Following the implementation of SFAS No. 123R, we are required to record a compensation expense in connection with share based compensation, and, as a result, our profitability may be reduced significantly.

On December 16, 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (SFAS 123R), which is a revision of SFAS No. 123 originally issued in 1995 (SFAS 123). Generally, the approach in SFAS 123R is similar to the approach described in SFAS 123. However, SFAS 123 permitted, but did not require, share-based payments to employees to be recognized as an expense while SFAS 123R requires, as of the first quarter of 2006, all share-based payments to employees to be recognized as a compensation expense based on their fair values. SFAS 123R also revises, clarifies and expands guidance in several areas, including measuring fair value, classifying an award as equity or as a liability and attributing compensation cost to reporting periods. The impact of adoption of Statement 123(R) cannot be predicted because it will depend on levels of share-based payments granted in the future. However, had we adopted this standard in prior periods, we may have recorded a material amount as compensation expense, which would have had a material adverse effect on our profitability. In addition, if as a result of SFAS 123R we would stop or limit the use of stock options as an incentive and retention tool, it could have a negative effect on our ability to recruit and retain employees.

We are exposed to additional costs associated with complying with increasing and new regulation of corporate governance and disclosure standards.

As a public company, we will be spending an increased amount of management time and resources to comply with changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new Securities and Exchange Commission regulations and Nasdaq National Market rules. Particularly, as a foreign private issuer, we will need to comply with the provisions of Section 404 of the Sarbanes-Oxley Act no later than the filing of our annual report on Form 20-F for the fiscal year ending December 31, 2006. Section 404 requires management s annual review and evaluation of our internal controls over financial reporting, and possibly attestation of the effectiveness of our internal controls over financial reporting by management and our independent public accounting firm in connection with the filing of our annual report on Form 20-F for the fiscal year ending December 31, 2006, and with each subsequently filed annual report on Form 20-F. As part of this process, we will need to document and test our internal control systems and procedures and make improvements in order for us to comply with the requirements of Section 404. This process will result in additional accounting and legal expenses. In addition, if we are unable to implement required changes within the time limit imposed by Section 404, it could result in our being unable to obtain an unqualified report on internal controls from our independent auditors.

If sufficient radio frequency spectrum is not allocated for use by our products, and we fail to obtain regulatory approval for our products, our ability to market our products may be restricted.

Radio communications are subject to regulation by United States and foreign laws and international treaties. Generally, our products must conform to a variety of United States and international requirements established to avoid interference among users of transmission frequencies and to permit interconnection of telecommunications equipment. Any delays in compliance with respect to our future products could delay the introduction of such products.

In addition, both in the United States and internationally, we are affected by the allocation and auction of the radio frequency spectrum by governmental authorities. Such governmental authorities may not allocate sufficient radio frequency spectrum for use by our products or we may not be successful in obtaining regulatory approval for our products from these authorities. Historically, in many developed countries, the unavailability of frequency spectrum has inhibited the growth of wireless telecommunications networks. In addition, to operate in a jurisdiction, we must obtain regulatory approval for our products. Each jurisdiction in which we market our products has its own regulations governing radio communications. Products that support emerging wireless telecommunications services can be marketed in a jurisdiction only if permitted by suitable frequency allocations and regulations, and the process of establishing new regulations is complex and lengthy. If we are unable to obtain sufficient allocation of radio frequency spectrum by the appropriate governmental authority or obtain the proper regulatory approval for our products, our business, financial condition or results of operations may be harmed.

We are increasingly engaged in supplying post-delivery services to our customers, often in developing nations, which are subject to acceptance testing procedures. Any loss of products and delay or failure in such acceptance tests would significantly affect our revenues and operating expenses. In addition, we face intense competition from other equipment and services providers in supplying such services. Our failure to compete effectively could adversely affect our revenues.

As we continue to expand our geographic footprint, we are increasingly engaged in supplying post delivery services for our customers, often in developing nations. We may act as prime contractor and equipment supplier for network build-out projects and provide installation, supervision and testing services required for these projects or we may provide such services and equipment for projects handled by system integrators. We typically bear the risks of loss and damage and title to our products until the customer has issued an acceptance certificate upon successful completion of acceptance tests. If our products are damaged or stolen, or if the products do not pass the acceptance tests, the end user or the system integrator, as the case may be, could refuse to pay us and we would incur substantial costs, including fees owed to our subcontractors, increased insurance premiums, transportation costs, and expenses related to repairing manufacturing the products. Moreover, in such a case, we may not be able to repossess the equipment, thus suffering additional losses.

The competition for providing the services described above to end users and system integrators is intense and is subject to factors similar to those described in the section above regarding competition from wireless equipment providers. We cannot assure you that we will have the financial resources, technical expertise, or marketing, sales, distribution and customer service and support capabilities to compete successfully.

Our products operate primarily on government-licensed radiospectrum frequencies. If a customer or end-user of our products is unable to secure such a license, or if a holder of a license files for bankruptcy and its license is unavailable, such customer or end-user of our products may be unable to provide wireless communications services in the optimal transmission frequency and may not deploy a wireless network using our products.

Our products operate primarily on government-licensed radiospectrum frequencies. Users of our products must either have a license to operate and provide communications services in the applicable frequency or must acquire the right to do so from another license holder. If unable to secure such a license, a customer or end-user may not deploy a wireless network using our products. If a license holder of such radiospectrum frequency files for liquidation, dissolution or bankruptcy, substantial time could pass before those licenses are transferred, canceled, reissued or made available by the applicable government licensing authority. Until the licenses are transferred, canceled, reissued or otherwise made available, other operators may be precluded from operating in such licensed frequencies, which could decrease demand for our products. In addition, if the authorities choose to revoke licenses for certain frequencies, demand for our products may decrease as well.

If there is a change in government regulation, or if industry standards change, the potential markets for our products may become limited and we may need to modify our products. This may increase our product costs and adversely affect our ability to become profitable.

The emergence or evolution of regulations and industry standards for wireless products, through official standards committees or widespread use by operators, could require us to modify our systems. This may be expensive and time-consuming. Radio frequencies are subject to extensive regulation under the laws of the United States, foreign laws and international treaties. Each country has different regulations and regulatory processes for wireless communications equipment and uses of radio frequencies. Any failure by regulatory authorities to allocate suitable, sufficient radio frequencies to potential customers in a timely manner could negatively impact demand for our products and may result in the delay or loss of potential orders for our products. In addition, if new industry standards emerge that we do not anticipate, our products could be rendered obsolete. There may be regulatory restrictions imposed due to environmental or health concerns, such as restrictions imposed on the location and number of outdoor antennas.

There may be health and safety risks relating to wireless products.

In recent years, there has been publicity regarding the potentially negative direct and indirect health and safety effects of electromagnetic emissions from cellular telephones and other wireless equipment sources, including allegations that these emissions may cause cancer. Our wireless communications products emit electromagnetic radiation. Health and safety issues related to our products may arise that could lead to litigation or other actions against us or to additional regulation of our products. We may be required to modify our technology and may not be able to do so. We may also be required to pay damages that may reduce our profitability and adversely affect our financial condition. Even if these concerns prove to be baseless, the resulting negative publicity could affect our ability to market these products and, in turn, could harm our business and results of operations.

Our products may not meet the new European governmental regulations, including environmental standards, required for their sale, which may negatively affect our sales.

Our activities in Europe require that we comply with European Union Directives with respect to product quality assurance standards and environmental standards. Directive 2002/95/EC on Restriction of the Use of Certain Hazardous Substances in Electrical and Electronic Equipment (known as the RoHS Directive), requires products sold in Europe to meet certain design specifications, which exclude the use of hazardous substances, will take effect on July 1, 2006 and requires that certain of our products be modified to meet this regulation. Directive 2002/96/EC on Waste Electrical and Electronic Equipment (known as the WEEE Directive) requires produces of electrical and electronic equipment to register in different European countries and provide collection and recycling facilities for used products. If we fail to achieve compliance, we may be restricted from selling our products in the European Union and this could adversely affect our results of operations.

If we are unable to continue to license technology from third parties on reasonable terms, we may be precluded from selling products derived from licensed technology and we may be required to reduce the functionality of our products. This may adversely affect our sales.

We rely on technology that we license from third parties, including software that is integrated with internally developed software and used in our products to perform key functions. If we are unable to continue to license any of this software on commercially reasonable terms, we will face delays in releases of our products and may be required to reduce the operating capabilities of our products, for example, by reducing the number of operating systems on which our products operate, until equivalent technology can be identified, licensed or developed, and integrated into our current products.

If we are unable to protect our intellectual property rights adequately, we may be deprived of legal recourse against those who misappropriate our intellectual property.

Our ability to compete will depend, in part, on our ability to obtain and enforce intellectual property protection for our technology in the United States and internationally. We currently rely upon a combination of trade secrets, trademark, copyright and contractual rights to protect our intellectual property. In addition, we enter into confidentiality and invention assignment agreements with our employees, and enter into non-disclosure agreements with our suppliers and appropriate customers so as to limit access to and disclosure of our proprietary information. We cannot assure you that any steps taken by us will be adequate to deter misappropriation or impede independent third party development of similar technologies. In the event that such intellectual property arrangements are insufficient, our business, financial condition and results of operations could be harmed. We cannot assure you that the protection provided to our intellectual property by the laws and courts of foreign nations will be substantially similar to the remedies available under United States law. Furthermore, we cannot assure you that third parties will not assert infringement claims against us based on foreign intellectual property rights and laws that are different from those established in the United States.

Defending against intellectual property infringement claims could be expensive and could disrupt our business.

The wireless telecommunications industry is characterized by vigorous protection and pursuit of intellectual property rights, which has resulted in often protracted and expensive litigation. We are involved in discussions regarding the licensing of the intellectual property of another party, but we are not able to estimate the outcome of such discussions. We may in the future be notified that we are infringing certain patent or other intellectual property rights of others. Such litigation or claim could result in substantial costs and diversion of resources. In the event of an adverse result of any such litigation, we could be required to pay substantial damages, cease the licensing of allegedly infringing technology or the sale of allegedly infringing products and expend significant resources to develop non-infringing technology or to obtain licenses for the infringing technology. We cannot assure you that we would be successful in developing such non-infringing technology or that any license for the infringing technology would be available to us on commercially reasonable terms, if at all.

Our non-competition agreements with employees may not be enforceable. If any of our employees leaves us and joins a competitor, our competitor could benefit from the expertise our former employee gained while working for us.

Our non-competition agreements with permanent employees prohibit these employees from directly competing with us or working for our competitors. However, under current law or possible changes in the law, we may not be able to enforce these agreements to their fullest extent. If we are unable to enforce any of these agreements, our competitors may employ our former employees and benefit from the expertise our former employees gained while working for us.

Due to the size of their shareholdings, some of our shareholders, including Yehuda and Zohar Zisapel, have significant influence over matters requiring shareholder approval. This could delay or prevent actions that require shareholder approval.

As of March 31, 2006, Yehuda and Zohar Zisapel, who are brothers that do not vote as a group and who do not have a voting agreement, beneficially owned, directly or through entities they control, 23.2% of the outstanding ordinary shares. As a result, these shareholders may control the outcome of various actions that require shareholder approval. For example, they may be able to elect our directors, delay or prevent a transaction in which shareholders might receive a premium over the prevailing market price for their shares or prevent changes in control or management.

If we are characterized as a passive foreign investment company, our U.S. shareholders may suffer adverse tax consequences, including higher tax rates and potentially punitive interest charges on the proceeds of share sales.

We do not believe that during 2005 we were a passive foreign investment company. Foreign companies may be characterized as a passive foreign investment company for U.S. federal income tax purposes if for any taxable year 75% or more of such company s gross income is passive income, or at least 50% of the average value of all such company s assets are held for the production of, or produce, passive income. If we are characterized as a passive foreign investment company, our U.S. shareholders may suffer adverse tax consequences. These consequences may include having gains realized on the sale of our ordinary shares treated as ordinary income, rather than capital gain income, and having potentially punitive interest charges apply to the proceeds of share sales.

Risks Relating to Our Location in Israel

Conditions in Israel may limit our ability to produce and sell our products. This could result in a decrease of our revenues.

Our principal offices, manufacturing facilities, subcontractors and research and development facilities are located in Israel. Political, economic and military conditions in Israel could directly affect our operations. We could be adversely affected by any major hostilities involving Israel, including acts of terrorism or any other hostilities involving or threatening Israel, the interruption or curtailment of trade between Israel and its trading partners, a significant increase in inflation or a significant downturn in the economic or financial condition of Israel. Since October 2000, there has been an increase in hostilities between Israel and the Palestinians, which has strained Israel s relationship with its Arab citizens, Arab countries and, to some extent, with other countries around the world. Such ongoing hostilities may hinder Israel s international trade relations and may limit the geographic markets where we can sell our products. Such events could have a material adverse effect on our operations and business.

Certain countries, as well as certain companies and organizations, continue to participate in a boycott of Israeli firms and others doing business with Israel and Israeli companies. Thus there have been sales opportunities that we could not pursue and there may be such opportunities in the future from which we will be precluded. We are also precluded from marketing our products to certain of these countries due to U.S. and Israeli regulatory restrictions. We believe that the boycott has not had a material adverse effect on us. However, the boycott, restrictive laws, policies or practices directed towards Israel or Israeli businesses could adversely affect us.

Some of our executive officers and employees in Israel are, unless exempt, obligated to perform annual military reserve duty, depending on their age and position in the army. Additionally, they may be called to active duty at any time under emergency circumstances. Our operations could be disrupted by the absence for a significant period of one or more of our executive officers or key employees due to military service, and any significant disruption in our operations could harm our business. We believe that we have operated effectively given these requirements since we began operations. Nevertheless, the full impact on our workforce or business if some of our executive officers and employees will be called upon to perform military service, especially in times of national emergency, is difficult to predict.

We do not believe that the political and security situation in Israel has had any material impact on our business to date. However, we can give no assurance that it will not have such effect in the future.

Since a majority of our revenues is generated in U.S. dollars while a portion of our expenses is incurred in new Israeli shekels, our results of operations would be adversely affected if inflation in Israel is not offset on a timely basis by a devaluation of the new Israeli shekel against the U.S. dollar.

A majority of our revenues are in U.S. dollars, while a portion of our expenses, principally salaries and the related personnel expenses for Israeli employees and consultants, local vendors and subcontractors, are in NIS. As a result, we are exposed to the risk that the rate of inflation in Israel will exceed the rate of devaluation of the NIS in relation to the dollar or that the timing of this devaluation lags behind inflation in Israel. This would have the effect of increasing the dollar cost of our operations and would therefore have an adverse effect on our dollar-measured results of operations.

Since we receive Israeli government grants for research and development expenditures, we are subject to ongoing restrictions and conditions, including restrictions on our ability to manufacture products and transfer technologies outside of Israel.

We currently receive grants from the Government of Israel through the Office of the Chief Scientist of the Ministry of Industry, Trade and Labor (the OCS) for the financing of a significant portion of our research and development expenditures in Israel. In 2003, 2004 and 2005, we received or accrued OCS grants totaling approximately $2.0 million, $2.3 million and $1.8 million, representing approximately 22%, 24% and 16%, respectively, of our total research and development expenditures in these periods. To maintain our eligibility for these grants we must continue to meet several conditions under the grant programs, including paying royalties with respect to the grants received. If we fail to comply with any of the conditions imposed by the OCS, we may be required to refund any payments previously received, together with interest and penalties.

In addition, the terms of the OCS grants limit our ability to manufacture products or transfer technologies outside of Israel, if such products or technologies were developed using know-how developed with or based upon OCS grants. If we elect to transfer more than an insubstantial portion of our manufacturing processes to contractors outside of Israel, we may be required to pay higher royalties to the OCS. Any non-Israeli who becomes a direct holder of 5% or more of our share capital is generally required to notify the OCS and to undertake to observe the law governing the grant programs of the OCS, the principal restrictions of which are the transferability limits described above in this paragraph.

The tax benefits to which we are currently entitled from our approved enterprise program require us to satisfy specified conditions. If we fail to satisfy these conditions, we may be required to pay increased taxes and would likely be denied these benefits in the future.

The Investment Center of the Ministry of Industry, Trade and Labor has granted approved enterprise status to investment programs at our manufacturing facility in Tel Aviv. When we begin to generate taxable income from these approved enterprise programs, the portion of our income derived from these programs will be exempt from tax for a period of two years and will be subject to a reduced tax for an additional five to eight years thereafter, depending on the percentage of our share capital held by non-Israelis. The benefits available to an approved enterprise program are dependent upon the fulfillment of conditions stipulated under applicable law and in the certificate of approval. If we fail to comply with these conditions, in whole or in part, or fail to get approval in whole or in part, we may be required to pay additional taxes for the period in which we benefited from the tax exemption or reduced tax rates and would likely be denied these benefits in the future. The amount by which our taxes would increase will depend on the difference between the then applicable tax rate for non-approved enterprises and the rate of tax, if any, that we would otherwise pay as an approved enterprise, and the amount of any taxable income that we may earn in the future.

The tax benefits available to approved enterprise programs may be reduced or eliminated in the future. This would likely increase our tax liability.

The Israeli government may reduce or eliminate in the future tax benefits available to approved enterprise programs. Our approved program and tax benefits thereunder may not continue in the future at their current levels or at any level. The termination or reduction of these tax benefits would likely increase our tax liability.The amount, if any, by which our tax liability would increase will depend upon the rate of any tax increase, the amount of any tax benefit reduction, and the amount of any taxable income that we may earn in the future.

We may be required to pay stamp duty on agreements executed by us on or after June 1, 2003 and until January 1, 2006. This would increase our expenses.

The Israeli Stamp Duty on Documents Law, 1961 (the Stamp Duty Law), provides that most documents signed by Israeli companies are subject to a stamp duty, generally at a rate of between 0.4% and 1.0% of the value of the subject matter of such document. De facto, it has been common practice in Israel not to pay such stamp duty unless a document is filed with a governmental authority or with the courts. As a result of an amendment to the Stamp Duty Law that came into effect on June 1, 2003, the Israeli tax authorities have approached many companies in Israel, including Ceragon, and requested the disclosure of all agreements signed by such companies after June 1, 2003 with the aim of collecting stamp duty on such agreements. Based on advice from Israeli counsel, we believe that we may only be required to pay stamp duty on documents signed on or after August 2004. However, we cannot provide any assurance that the tax authorities or the courts will accept such view. Although at this stage it is not yet possible to evaluate the effect, if any, on our business operations of the amendment to the Stamp Duty Law, it could adversely affect our results of operations.

Under an order published in December 2005, the said requirement to pay stamp duty was cancelled with respect to documents signed on or after January 1, 2006.

It may be difficult to enforce a U.S. judgment against us, and our officers and directors named in this annual report, to assert U.S. securities laws claims in Israel and to serve process on substantially all of our officers and directors.

We are incorporated in Israel. Substantially all of our executive officers and directors named in this annual report are nonresidents of the United States, and a substantial portion of the assets of these persons are located outside the United States, although a significant portion of our assets are located in the U.S. It may be difficult for an investor, or any other person or entity, to enforce a U.S. court judgment based upon the civil liability provisions of U.S. federal securities laws in an Israeli court or to effect service of process upon these persons.

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

The Companies Law generally provides that a merger be approved by the board of directors and by the shareholders by means of a majority of the shares present and voting on the proposed merger. The Companies Law has specific provisions for determining the majority of the shareholder vote. Upon the request of any creditor of a party to the proposed merger, a court may delay or prevent the merger if it concludes that there is a reasonable concern that, as a result of the merger, the surviving company will be unable to satisfy its obligations to creditors. In general, a merger may not be completed until the passage of certain time periods. In certain circumstances an acquisition of shares in a public company must be made by means of a tender offer. Lastly, Israeli tax law treats some acquisitions, such as stock-for-stock exchanges between an Israeli company and a foreign company, less favorably than U.S. tax laws. These provisions of Israeli corporate and tax law may have the effect of delaying, preventing or making more difficult an acquisition of or merger with us, which could depress our share price.

ITEM 4. INFORMATION ON THE COMPANY

A. History and Development of the Company

We were incorporated under the laws of the State of Israel on July 23, 1996 as Giganet Ltd. We changed our name to Ceragon Networks Ltd. on September 6, 2000, as part of the resolution of a dispute concerning the use of the word Giganet. We operate under the Israeli Companies Law. Our registered office is located at 24 Raoul Wallenberg Street, Tel Aviv 69719, Israel and the telephone number is 011-972-3-645-5733. Our world wide web address is www.ceragon.com. Our agent for service of process in the United States is Ceragon Networks, Inc., our wholly owned U.S. subsidiary and North American headquarters, located at 10 Forest Avenue, Paramus, New Jersey 07652.

In the years ending December 31, 2005, 2004 and 2003, our capital expenditures were $0.9 million, $0.7 million and $0.4 million, respectively, and were spent primarily on production equipment and leasehold improvements. These capital expenditures were financed by the proceeds from our initial public offering and our financings. We have no current commitments for capital expenditures.

B. Business Overview

We design, develop, manufacture and sell high-capacity, point-to-point wireless backhaul solutions for cellular operators, fixed operators and private networks and enterprises. Our products provide high-speed, fiber-like transmission quality and can be deployed more rapidly and cost effectively than fiber optic lines. Our products operate over multiple frequency bands of up to 60 GHz, including frequencies that are licensed by various countries in North America, Europe, Middle East, Africa, Latin America and the Asia-Pacific region for use by the end customer and some that are unlicensed.

We primarily target fixed and mobile communications service providers and private networks and enterprises that require high capacity connectivity. To date, our products have been commercially deployed in approximately 70 countries by service providers and private customers, including local telephone companies and cellular telephone service operators, and large and medium corporate organizations. Cellular operators use our products to connect their cell sites or switch locations and to provide backhaul. Fixed operators use our products as an integral part of their high-capacity metropolitan ring and access networks. Private networks and enterprise customers, which include universities, financial institutions, corporate campuses, governments, and hospitals, use our equipment for their internal data and telecommunications needs. We sell our products through a direct sales force, systems integrators, distributors and original equipment manufacturers.

In general, the telecommunications equipment business is seasonal to the extent that sales or order intake in the first quarter of each calendar year are typically lower than in other quarters. Nevertheless, our historical results of operations do not reflect such seasonality.

Products

Our product consists of an outdoor unit, an indoor unit, a compact high-performance antenna and our network management system. The antenna transmits and receives microwave radio signals. The outdoor unit controls the power transmission, converts IF signals to RF signals and vice versa, and provides an interface between the antenna and the indoor unit. The outdoor unit is enclosed in a compact weather-proof enclosure, which is fastened to the antenna. The antenna is mounted on a pole which is typically mounted on a rooftop, tower or the side of a building. The indoor unit is connected to the outdoor unit by a standard coaxial cable. The indoor unit:

- converts the transmission signals from digital to IF/radio and vice versa;
- processes and manages information transmitted to and from the outdoor unit;
- aggregates multiple transmission signals; and
- provides the physical interfaces to the wireline network.

An antenna, an outdoor unit and an indoor unit comprise a terminal. Two terminals are required to form a radio link, which may extend across a distance of 40 miles and more. The specific distance depends upon the customer s requirements, the modulation scheme chosen, the frequency utilized, the available line of sight, local rain patterns and antenna size. Each link can be controlled by our network management software or can be interfaced to the management network system of the service provider. The systems are available in both split-mount and all-indoor installations

We market our products under the trademark FibeAir®. The FibeAir products utilize multiple modulation schemes, which increase the flexibility of our products by giving service providers the ability to choose between increased range and increased spectral efficiency. The FibeAir family includes the following products:

FibeAir 1500P. The FibeAir 1500P system provides from 155 to 622 Mbps of transmission capacity for SDH/SONET interfaces. The 1500P transmits over a 28/50/56 MHz channel using single or dual independent, hot swappable carriers with optional cross-polar interference canceller (XPIC) mechanism. Each carrier is equipped with a built-in software configurable modem, allowing16, 32, 64, 128 or 256 QAM modulation schemes for improved spectrum utilization.

FibeAir IP-Max. The FibeAir IP-Max is the Company s new wireless Native Ethernet solution. The system provides from 50 to 800 Mbps of transmission capacity for Fast Ethernet and Gigabit-Ethernet interfaces combined with scalable and dynamic bandwidth allocation of TDM interfaces. The FibeAir IP-Max answers the need of operators for the higher capacities required for providing enhanced IP-based services. It operates in the frequency range of 6-38 GHz and is equipped with built-in XPIC and software configurable modulation allowing QPSK and 16 to 256 QAM. The FibeAir IP-MAX is available with optional AES encryption capability.

FibeAir 1500HP. The FibeAir 1500HP is the Company s long haul wireless system.The system offers embedded space diversity with dual receiver architecture, extremely high transmit power and IF combining algorithm intended to provide superior performance and errorless transmission. For operators this means a reliable, easily deployed solution that can use less equipment and smaller antennas, providing substantial savings on initial investments and operational expenditures. The system operates in the frequency range of 6-11 GHz and is equipped with built-in XPIC, software configurable modulation allowing QPSK and 32 to 256 QAM, and configurable bandwidth from 10 to 40 MHz.

FibeAir 3200T. The FibeAir 3200T provides wireless high capacity data transmission over long distances, in a wide variety of network capacities, frequencies and configurations. FibeAir 3200T operates in the frequency range of 6-11 GHz and can be easily upgraded from 45 Mbps up to N+N x 155 Mbps. The system components are all indoor and installed in ETSI or standard 19 inch rack.

FibeAir 10060. The FibeAir 10060 system provides full rate Gigabit Ethernet (1.25 Gps) transmission capacity over a license-exempt, 60 GHz channel. This system allows low-cost installation by avoiding spectrum licensing processes and may be used for transmission over short distances of up to 5000 feet

FibeAir 4800. The FibeAir 4800 system is designed to provide up to 48 Mbps of aggregate capacity over license-exempt channels in the 2.4GHz to 5.85 GHz range. This system may be used for transmission over distances up to 50 miles and offers integrated Fast Ethernet and N x E1/T1 interfaces.

End-to-End Network Management. Ceragon provides state-of-the-art management based on SNMP. Our management applications are written in Java code and enable management functions at both the element and network levels. The applications run on Windows 2000/2003/XP and Sun Solaris.

CeraView® is Ceragon s SNMP-based EMS (Element Management System) that enables the operator to perform element configuration, RF and SDH performance monitoring, remote diagnostics, alarm reports and more. CeraView integrates with different 3rd party NMS (Network Management System) platforms to provide end-to-end system management.

PolyView is Ceragon s NMS server that includes CeraMap , its friendly yet powerful client graphical interface. PolyView can be used to update and monitor network topology status, provide statistical and inventory reports, define end-to-end traffic trails, download software and configure elements in the network. In addition, it can integrate with Northbound NMS platforms, to provide enhanced network management.

Our Solutions

Our wireless solutions possess the following capabilities:

High-Speed Communications. Our products enable the delivery of full-duplex, high-speed Internet access and integrated data, video and voice communications at transmission speeds of 50-800 Mbps with the licensed bands and speed of up to 1.25 Gbps with the unlicensed frequency bands. Our products deliver fiber-like transmission quality with error rates of less than one error per ten trillion bits transmitted.

Cost Effectiveness. Our products avoid the high costs associated with the deployment of fiber optic networks, including the cost of digging up streets, and obtaining municipal permits and rights of way to lay fiber optic lines. It has been estimated that digging costs for laying fiber optic lines in metropolitan areas are approximately $130 thousand per mile. Our wireless products further reduce costs because, unlike fiber optic lines, our products can be redeployed and reused at a negligible cost if the customer needs a change.

Rapid Deployment and Time to Market. Service providers can deploy our products and provide their business subscribers with broadband access within a matter of hours. Our products are light-weight, compact and easy to install and maintain. Our product set-up and configuration, including operating frequency channel, is determined by our management software. This feature simplifies the installation process and reduces installation time. Our products can be installed on rooftops, towers, or on the sides of buildings more quickly than fiber optic networks (the latter may require months or years to deploy). Rapid deployment enables service providers to roll out service to subscribers and generate revenues quickly.

Spectral efficiency. With FibeAir platforms, traffic capacity throughput and spectral efficiency are optimized for the desired channel bandwidth. For maximum flexibility on the part of the user, channel bandwidths can be selected together with a wide range of modulations. High spectral efficiency is ensured by choosing the same bandwidth for double the capacity, via two carriers with vertical and horizontal polarizations. This feature is implemented by a built-in XPIC mechanism.

Optimization for high capacity and long haul. Ceragon s innovative long-haul products were designed as a wireless networking solution for end-to end, long distance connectivity allowing the deployment of voice and data services for fixed and mobile backhaul networks. Our long-haul products can be installed as split-mount radio to be truly or all-indoor radio installation. Ceragon s unique embedded space diversity with dual receiver architecture, extremely high transmit power and IF combining algorithm guarantee superior performance and errorless transmission. For operators this means a reliable solution that can use less equipment and smaller antennas, providing substantial savings on initial investments and operating expenses.

Multi-Protocol Options. Our products work with the most common transmission standards used in communications networks around the world, including Ethernet, IP, SONET/SDH and ATM protocols.

Variety of Frequency Bands. Service providers select the optimal available transmission frequency based on the rainfall intensity in the transmission area and the desired transmission range. Regulators grant licenses to operate and provide communication services in various frequency bands in each region, although in some cases, a customer may be able to operate in a band which is exempt from licensing processes. The regulated bands are allocated by government licensing authorities for high-capacity transmissions in the metropolitan area. Our products operate in the 6, 7, 8, 11, 13, 15, 18, 23, 26, 28, 29, 31, 32 and 38 GHz frequency bands, the principal licensed bands currently available for commercial use throughout the world. In addition, some of our products are designed to operate in the 2.4 - 5.85 GHz and 60 GHz unlicensed frequency bands.

Meet Multiple Regulatory Standards. We design our products to meet North American and European standards. The European standards have been developed by the European Telecommunications Standards Institute, commonly referred to as ETSI, and have been adopted in most countries excluding those in North America. With some minor modular modifications, any of our products originally assembled to comply with North American standards may be easily adapted by service providers for compliance with European standards and vice versa. The international compatibility of our products makes them attractive to global service providers and equipment vendors that deploy communications networks in North American and international markets. Global service providers and equipment vendors that invest significant time and effort in studying, testing and approving our products prior to their deployment in communications networks in North American or international markets may deploy our products on a more expedited basis in communications networks in the other markets as well.

Modular Architecture. Our products contain plug-in hot swappable units that can easily be replaced or exchanged in the field. Our modular product design enables us to standardize our manufacturing process cost efficiently and concurrently manufacture each product to satisfy the individual requirements of each service provider on an expedited basis. It also enables service providers to easily adapt our products for use in different network environments. For example, modularity enables service providers to easily change our products to support different communications protocols by simply replacing the relevant modular components.

Integrated Multiple Access Design. By replacing a module in our basic product, a service provider can allocate the transmission capacity and physical interfaces over multiple transmission lines. This unique feature substantially reduces the service provider s costs by eliminating the need to purchase external equipment that would otherwise be needed for this purpose.

Scalability and Flexibility. We design our products to enable service providers to deploy them incrementally as demand for their services increases. This allows the service providers to match capital outlays with subscriber growth. Our customers can establish a wireless broadband network with a relatively low initial investment, in comparison with fiber optic lines, and later expand the geographic coverage area of their networks and increase the number of points that can be served on their networks as subscriber demand increases.

High Reliability and Availability. We design our products to match the reliability standard required by service providers, including 99.999% availability. This means that our products maintain connectivity 99.999% of the time, corresponding to approximately five minutes of down time per year, even under adverse weather conditions. This enables our customers to provide their subscribers with the same high availability as is offered by incumbent carriers using fiber optic networks. In addition, our products can be configured to provide full redundancy by connecting two radio links over the same frequency channel. This feature minimizes service interruptions.

Encryption. In the security area, we offer a built-in, AES-based encryption solution. Our user-friendly EncryptAir solution has been validated by the National Institute of Standards and Technology (NIST).

Multiple Modulation Schemes. The FibeAir product family utilizes multiple modulation schemes, including QPSK, 16, 32, 64, 128, and 256 QAM enabling broadband wireless service providers to choose between increased range and increased spectral efficiency.

These benefits may be offset by the following disadvantages and limitations of our wireless solutions, which are common to competing wireless point-to-point telecommunications products. Such disadvantages include:

Extreme Weather Conditions. Our products may not operate optimally in certain extreme weather conditions, including severe rainfalls or hurricanes.

Line-of-Sight Limitations. Since our products require a direct line-of-sight between antennas, service providers often install our products on cellular antenna towers, rooftops of buildings and on other tall structures. As a result, service providers must generally secure roof or other property rights from the owners of each building or other structure on which our products are installed. This may delay deployment and increase the installation cost of our products or cause service providers not to install broadband wireless equipment.

Frequency Bands. To operate our products, service providers must either have a license to operate and provide communications services in the optimal available transmission frequency, or acquire the right to do so from a licensee. If a service provider is unable to secure such a license, it will not be able to operate and provide wireless communications services in the optimal transmission frequency. This may deter a service provider from deploying a wireless network.

Network Applications

Our FibeAir products are deployed in various network applications, based on the network architecture and communications transmission requirements of our customers. These networks include:

IP/Fast Ethernet/Gigabit Ethernet Networks. Internet protocol, or IP, is the transmission standard designed for use in interconnected systems of packet-switched communication systems and in use for private data and Metro Ethernet networks for a variety of applications. Our products offer a native Fast and Gigabit Ethernet wireless transmission with fiber-like quality. With the highest available throughput on the market, this native Ethernet solution with ultra-low latency is optimized for IP-based applications including IP-DSLAM connectivity for voice over IP, Internet and video services, WiMAX backhauling and any delay-sensitive application. Our carrier class products are upgradeable, with capacities starting from 50 to 800 Mbps. Our products deliver Gigabit Ethernet for ultra-high capacity IP connections in metropolitan rings, high-speed access connections and private networks over 800 Mbps system and deliver two Fast Ethernet channels over a single 200 Mbps system where dynamic bandwidth allocation is used to share the overall capacity between the two Fast Ethernet channels. Each Fast Ethernet channel can provide a separate, secure connection to a business subscriber. With a built-in Layer 2 switch to provide Fast Ethernet traffic aggregation, Quality of Service and multi-service transport of data and voice interfaces over a single radio carrier, we substantially reduce the service provider s costs by eliminating the need to purchase external equipment or double the links.

SONET/SDH Networks. Synchronous optical network, or SONET, and its European counterpart, synchronous digital hierarchy, or SDH, are the basic network communications protocols, or standards, that exist today for intercity and international connectivity. These standards are generally utilized in a fiber optic network organized in a ring formation. The ring formation uses at least two transmission paths, or links, to each point so that traffic is rerouted in the other direction if a link in the ring formation fails.

Customer Service and Support

We are committed to providing our customers with high levels of service and support. We support our products with documentation and training courses tailored to our customers various needs. Our sales and network field engineering services personnel work closely with customers, third party integrators and others to coordinate network design, ensure successful installation and provide continuous customer support. We are increasingly engaged in projects in which we supply, either directly or through subcontractors, the required installation, supervision and testing services. We provide technical assistance and customer support 24 hours a day, 7 days a week. We have the capability to remotely monitor the in-network performance of our products and diagnose and address problems that may arise. We assist our customers in utilizing our network management software within their own internal network operations control centers.

Customers and Markets

We began selling our products commercially during the second half of 1998. Our products are currently used by more than 150 customers in approximately 70 countries.

Our sales to customers are based on written purchase agreements or purchase orders.

Our principal end-user customers are cellular operators, fixed operators, and private networks and enterprises, such as financial institutions, hospitals, universities, corporations and governments. We target three principal applications for our products:

providing cellular operators with flexible, high-capacity backhaul solutions that enable operators to expand their networks and offer advanced services;

providing independent local exchange carriers (ILECs) the means for providing voice over IP, Internet and video services and enabling fixed wireless operators to meet the demand for advanced IP solutions such as WiMAX/WiFi for mesh area networks; and

providing the private networks market with systems that meet the high-capacity needs of data-rich applications and that can be rapidly deployed in a wide range of public and enterprise environments for public safety, disaster recovery and business continuity.

The following table summarizes the distribution of our revenues by geographic market, stated as a percentage of total revenues for the periods indicated:

Region	**2003**	**2004**	**2005**
	(%)	(%)	(%)
North America	27	30	27
EMEA*	59	40	49
Asia-Pacific	9	26	13
Latin America	4	4	11

** Europe, Middle East, and Africa*

Distribution Channels

In 2005, as in previous years, we sold our products through direct sales, distributors, third-party integrators and original equipment manufacturers.

Our international direct sales force is located in our offices around the world. Our sales efforts are augmented in many cases by local agents and distributors. We entered into a strategic alliance with Nokia Corporation as an OEM distributor of our equipment, and we plan to invest additional efforts in the development of such alliances in order to provide greater access to our target markets.

The principal goal of our marketing program is to educate existing and potential customers about the capabilities and benefits of our products. We are also committed to developing and enhancing the awareness of our company and our products. Our marketing efforts include advertising, public relations and participation in industry trade shows and conferences.

Manufacturing and Assembly

Our manufacturing process consists of materials planning and procurement, assembly of indoor units and outdoor units, final product assurance testing, quality control and packaging and shipping. We employ an outsourced manufacturing strategy that relies on contract manufacturers to manufacture and assemble circuit boards and other components used in our products and to assemble and test indoor units and outdoor units for us. We have outsourced the majority of our manufacturing operations to contract manufacturers in Israel and the Philippines. We have retained some manufacturing operations at our facilities in Tel Aviv. During the second half of 2006, we expect to cease our manufacturing operations in Tel Aviv together with the phase-out of our legacy FibeAir 1500 products.

The raw materials for our products come primarily from the United States, Europe and Asia. At the beginning of 2006, we and our contract manufacturers experienced delays in manufacturing products due to worldwide shortages of certain components. We cannot assure you that such shortages will not occur again in the future.

We comply with standards promulgated by the International Organization for Standardization and have received certification under the ISO 9001, ISO 9002, and ISO 14000 standards. These standards define the procedures required for the manufacture of products with predictable and stable performance and quality, as well as environmental guidelines for our operations.

Our activities in Europe require that we comply with European Union Directives with respect to product quality assurance standards and environmental standards. The RoHS Directive will take effect on July 1, 2006 and requires that certain of our products be modified to meet this regulation. The WEEE Directive requires produces of electrical and electronic equipment to register in different European countries and provide collection and recycling facilities for used products. If we fail to achieve compliance, we may be restricted from selling our products in the European Union and this could adversely affect our results of operations.

Competition

The market for wireless equipment is rapidly evolving, fragmented, highly competitive and subject to rapid technological change. We expect competition to persist, intensify and increase in the future, especially if rapid technological developments occur in the broadband wireless equipment industry or in other competing high-speed access technologies.

We compete with a number of wireless equipment providers in the U.S. and other countries that vary in size and in the types of products and solutions they offer. Our primary competitors are companies that offer point-to-point wireless network solutions, including Alcatel, Harris Corporation, L.M. Ericsson, NEC, Nera, Stratex Networks, SIAE and Siemens, as well as a number of other companies, such as Huawei Technologies, Motorola and ZTE, that offer or are developing products that compete with ours. We believe we compete principally on the basis of:

- product performance, design, features and interoperability;
- product quality and reliability;
- price;
- ability to deliver products on a timely basis; and
- technical support and customer service.
- ability to carry out installation projects
- ability to offer or participate in offering complete solutions

Our products also compete with other high-speed communications solutions, including fiber optic lines, free space optics (to a limited extent) and other wireless technologies.

Intellectual Property

To safeguard our proprietary technology, we rely on a combination of copyright, trademark and trade secret laws, confidentiality agreements and other contractual arrangements with our customers, third-party distributors, consultants and employees, each of which affords only limited protection. We have a policy which requires all of our employees to execute employment agreements which contain confidentiality provisions.

The protective steps we have taken may be inadequate to deter misappropriation of our technology and information. We may be unable to detect the unauthorized use of, or take appropriate steps to enforce, our intellectual property rights. Some of the countries in which we sell our products do not protect a company s intellectual property to the same extent as the United States and Israel. In addition, our competitors may independently develop technologies that are substantially equivalent or superior to our technology. Any licenses for intellectual property that might be required for our services or products may not be available on reasonable terms.

We have registered trademarks for the standard character mark Ceragon Networks and our logo in the United States, Israel, and the European Union, and for the standard character mark Ceragon Networks in Canada. We have registered trademarks for our design mark for FibeAir in the United States, Israel and the European Union. In addition, we have a registered trademark in the United States for the standard character mark FibeAir. We also have registered trademarks for the standard character mark CeraView in the United States, Israel and the European Union.

Conditions in Israel

We are incorporated under the laws of, and our principal offices and manufacturing and research and development facilities are located in, the State of Israel. Therefore, we are directly affected by political and military conditions which are discussed in the Risks Relating to our Location in Israel in Item 3 above, and economic conditions in Israel, which could affect our U.S. shareholders.

Economic Conditions

Israel s economy has been subject to numerous destabilizing factors, including a period of rampant inflation in the early to mid-1980s, low foreign exchange reserves, fluctuations in world commodity prices, military conflicts and civil unrest. The Israeli government has intervened in various sectors of the economy by utilizing fiscal and monetary policies, import duties, foreign currency restrictions and control of wages, prices and foreign currency exchange rates. In 1998, the Israeli currency control regulations were liberalized significantly to allow Israeli residents to deal in foreign currency and non-residents of Israel to purchase and sell Israeli currency and assets. The Israeli government has periodically changed its policies in these areas. There are currently no Israeli currency control restrictions on remittances of dividends on the ordinary shares or the proceeds from the sale of the shares. However, legislation remains in effect under which currency controls can be imposed by administrative action at any time.

The Israeli government s monetary policy contributed to relative price and exchange rate stability in recent years, despite fluctuating rates of economic growth and an increasingly high rate of unemployment. We cannot assure you that the Israeli government will be successful in its attempts to keep prices and exchange rates stable. Price and exchange rate instability may have a material adverse effect on us.

Trade Relations

Israel is a member of the United Nations, the International Monetary Fund, the International Bank for Reconstruction and Development and the International Finance Corporation. Israel is a member of the World Trade Organization and is a signatory to the General Agreement on Trade in Services. In addition, Israel has been granted preferences under the Generalized System of Preferences from several countries, among them Japan. These preferences allow Israel to export products covered by these programs either duty-free or at reduced tariffs.

Israel and the European Union concluded a free trade agreement in 1975 which confers various advantages on Israeli exports to most European countries and obligates Israel to lower its tariffs on imports from these countries over a number of years. In 1985, Israel and the United States entered into an agreement to establish a free trade area. The free trade area has eliminated all tariff and specified non-tariff barriers on most trade between the two countries. In January 1993, an agreement was entered into between Israel and the European Free Trade Association, known as the EFTA, establishing a free-trade zone between Israel and EFTA nations. In 1995, Israel entered into a new agreement with the European Union, which includes modified rules of origin and other improvements, including providing for Israel to become a member of the research and technology programs of the European Union. In recent years, Israel has established commercial and trade relations with a number of other nations, including Russia, China, India, Turkey and other nations in Eastern Europe and Asia.

Israeli Tax Considerations and Government Programs

The following is a summary of the current tax structure applicable to companies in Israel, with special reference to its effect on us. The following also contains a discussion of the Israeli government programs benefiting us. To the extent that the discussion is based on new tax legislation which has not been subject to judicial or administrative interpretation, we cannot assure you that the tax authorities or the courts will accept the views expressed in this discussion. The discussion is not intended, and should not be taken, as legal or professional tax advice and is not exhaustive of all possible tax considerations.

General Corporate Tax Structure in Israel

Until December 31, 2003, the regular tax rate applicable to income of companies (which are not entitled to benefits due to investments in approved enterprise , as described below) was 36%. In June 2004 and in July 2005, the Knesset (Israeli parliament) passed amendments to the Income Tax Ordinance (No. 140 and Temporary Provision), 2004 and (No. 147), 2005 respectively, which determine, among other things, that the corporate tax rate is to be gradually reduced to the following tax rates: 2004 - 35%, 2005 - 34%, 2006 - 31%, 2007 - 29%, 2008 - 27%, 2009 - 26% and 2010 and thereafter - 25%.

However, the effective tax rate payable by a company that derives income from an approved enterprise, discussed further below, may be considerably less. See The Law for the Encouragement of Capital Investments, 1959 below.

The Law for the Encouragement of Capital Investments, 1959

Tax Benefits before the 2005 amendment

The Law for the Encouragement of Capital Investments, 1959, commonly referred to as the Investments Law, provides that a proposed capital investment in eligible facilities may be designated as an approved enterprise. See Tax Benefits under the 2005 Amendment below regarding an amendment to the Investments Law that came into effect in 2005.

Each certificate of approval for an approved enterprise, received upon application to the Investment Center of the Ministry of Industry, Trade and Labor of the State of Israel, or the Investment Center, relates to a specific investment program delineated both by its financial scope, including its capital sources, and by its physical characteristics, for example, the equipment to be purchased and utilized under the program. The tax benefits derived from any certificate of approval relate only to taxable income attributable to the specific approved enterprise. If a company has more than one approval or only a portion of its capital investments is approved, its effective tax rate is the result of a weighted average of the applicable rates.

Taxable income of a company derived from an approved enterprise is subject to corporate tax at the maximum rate of 25%, rather than the regular corporate tax rates, for the benefit period. This period is ordinarily seven or ten years depending upon the geographic location of the approved enterprise within Israel, and whether the company qualifies as a foreign investors company as described below, commencing with the year in which the approved enterprise first generates taxable income after the commencement of production. Tax benefits under the Investments Law may also apply to income generated by a company from the grant of a usage right with respect to know-how developed by the Approved Enterprise, income generated from royalties, and income derived from a service which is auxiliary to such usage right or royalties, provided that such income is generated within the Approved Enterprise s ordinary course of business.

A company owning an approved enterprise may elect to forego certain government grants extended to an Approved Enterprise in return for an alternative package of benefits. Under the alternative package of benefits, a company s undistributed income derived from an approved enterprise will be exempt from company tax for a period of between two and ten years from the first year of taxable income after the commencement of production, depending on the geographic location of the approved enterprise within Israel, and the company will be eligible for a reduced tax rate for the remainder of the benefits period. However, this period is limited to twelve years from commencement of production or fourteen years from the date of approval, whichever is earlier. This limitation does not apply to the exemption period.

A company that has an approved enterprise program is eligible for further tax benefits if it qualifies as a foreign investors company. A foreign investors company is a company in which more than 25% of its share capital and combined share and loan capital is owned by non-Israeli residents. A company that qualifies as a foreign investors company and has an approved enterprise program is eligible for tax benefits for a ten-year benefit period (instead of seven). Depending on the geographic location of the approved enterprise within Israel, income derived from the approved enterprise program may be exempt from tax on its undistributed income for a period of between two and ten years and will be subject to a reduced tax rate for rest of the benefits period (up to eight years). The tax rate for the additional benefits period is 25%, unless the level of foreign investment exceeds 49%, in which case the tax rate is 20% if the foreign investment is 49% or more and less than 74%; 15% if 74% or more and less than 90%; and 10% if 90% or more. A company that has elected the alternative package of benefits and that subsequently pays a dividend out of income derived from the approved enterprise during the tax exemption period will be subject to tax on the gross amount distributed. The tax rate will be the rate which would have been applicable had the company not elected the alternative package of benefits. This rate is generally 10%-25%, depending on the percentage of the company s shares held by foreign shareholders. The dividend recipient is subject to withholdings of tax at the source by the company at the rate applicable to dividends from approved enterprises, which is 15% if the dividend is distributed during the tax exemption period or within 12 years after the period. This limitation does not apply to a foreign investors company.

The benefits available to an approved enterprise are conditional upon the fulfillment of conditions stipulated in the Investments Law and its regulations and the criteria in the specific certificate of approval, as described above. If a company does not meet these conditions, in whole or in part, it would be required to refund the amount of tax benefits, with the addition of the consumer price index linkage adjustment and interest.

The Investment Center has granted approved enterprise status to three investment programs at our manufacturing facility in Tel Aviv and we have derived and expect to continue to derive a substantial portion of our income from these programs. We have elected the alternative package of benefits under these approved enterprise programs. The portion of our income derived from these approved enterprise programs will be exempt from tax for a period of two years commencing in the first year in which there is taxable income after the commencement of production and will be subject to a reduced company tax of up to 25% for the subsequent period of five years, or up to eight years if the percentage of non-Israeli investors who hold our ordinary shares exceeds 25%. The period of tax benefits for our approved enterprise programs has not yet commenced, because we have yet to realize taxable income.

Tax Benefits under the 2005 Amendment

On April 1, 2005, an amendment to the Investments Law (the Amendment) came into force. The Amendment includes revisions to the criteria for investments qualified to receive tax benefits as an Approved Enterprise. The Amendment applies to new investment programs and investment programs commencing after 2004, and does not apply to investment programs approved prior to December 31, 2004, whose benefits will remain as they were on the date of such approval. However, a company that was granted benefits according to section 51 of the Investment Law would not be allowed to commence production for a period of 3 years from the company s previous year of commencement of benefits under the Investment Law (prior to the Amendment).

The Company will continue to enjoy its current tax benefits in accordance with the provisions of the Investment Law prior to its revision. However, if the Company is granted any new benefits in the future, they will be subject to the provisions of the amended Investment Law. Therefore, the following discussion is a summary of the Investment Law prior to its amendment as well as the relevant changes contained in the new legislation.

The amendment simplifies the approval process: according the amendment, only Approved Enterprises receiving cash grants require the approval of the Investment Center. The Investment Center will be entitled to approve such programs only until December 31, 2007.

Tax benefits are available under the Amendment to production facilities (or other eligible facilities), which are generally required to derive more than 25% of their business income from export (referred to as a Benefited Enterprise). In order to receive the tax benefits, the Amendment states that the company must make an investment in the Benefited Enterprise exceeding a certain percentage or a minimum amount specified in the Law. Such investment may be made over a period of no more than three years ending at the end of the year in which the company requested to have the tax benefits apply to the Benefited Enterprise (the Year of Election). A company wishing to receive the tax benefits afforded to a Benefited Enterprise is required to select the tax year from which the period of benefits under the Investment Law are to commence by notifying the Israeli Tax Authority within 12 months of the end of that year. Where the company requests to have the tax benefits apply to an expansion of existing facilities, then only the expansion will be considered a Benefited Enterprise and the company s effective tax rate will be the result of a weighted combination of the applicable rates. In this case, the minimum investment required in order to qualify as a Benefited Enterprise is required to exceed a certain percentage or a minimum amount of the company s production assets before the expansion.

The duration of tax benefits is subject to a limitation of the earlier of 7 to 10 years from the Commencement Year, or 12 years from the first day of the Year of Election. The tax benefits granted to a Benefited Enterprise are determined, as applicable to its geographic location within Israel, according to one of the following new tax routes, which may be applicable to us:

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

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

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

The Amendment changes the definition of foreign investment in the Investments Law so that the definition now requires a minimal investment of NIS 5 million by foreign investors. Furthermore, such definition now also includes the purchase of shares of a company from another shareholder, provided that the company s outstanding and paid-up share capital exceeds NIS 5 million. Such changes to the definition of foreign investment will take effect retroactively from 2003.

Grants under the Law for the Encouragement of Industrial Research and Development, 1984

The Government of Israel encourages research and development projects through the Office of the Chief Scientist of the Israeli Ministry of Industry, Trade and Labor (the OCS), pursuant to the Law for the Encouragement of Industrial Research and Development, 1984, and the regulations promulgated thereunder, commonly referred to as the R&D Law.

Under the R&D Law, research and development programs that meet specified criteria and are approved by the research committee of the OCS are eligible for grants of up to 50% of certain approved expenditures of such programs, as determined by the research committee of the Chief Scientist.

In exchange, the recipient of such grants is required to pay the OCS royalties from the revenues derived from products incorporating know-how developed within the framework of each such program or derived from such program (including ancillary services in connection with such program), usually up to an aggregate of 100% of the dollar-linked value of the total grants received in respect of such program, plus interest. The royalty rates applicable to our programs range from 3% to 3.5%.

In June 2005, an amendment to the R&D Law came into effect, which intends to make the R&D Law more compatible with the global business environment by, among other things, relaxing restrictions on the transfer of manufacturing rights outside Israel and on the transfer of OCS-funded know-how outside of Israel, as further described below.

The Israeli government is currently in the process of formulating a proposed amendment to the royalty regulations promulgated under the R&D Law. The amendment is expected to include changes to the royalty rates, which would vary from company to company based on the amount of its revenues and approval date of its program, up to a rate of 6%, and, as of 2006, to increase the rate of interest accruing on grants by 1% per year. The amendment is expected to have retroactive effect from January 1, 2006, although there is no assurance as to whether and when it will be adopted.

The R&D Law generally requires that the product developed under a program be manufactured in Israel. However, upon the approval of the Chief Scientist, some of the manufacturing volume may be performed outside of Israel, provided that the grant recipient pays royalties at an increased rate, which may be substantial, and the aggregate repayment amount is increased up to 300% of the grant, depending on the portion of the total manufacturing volume that is performed outside of Israel. The recent amendment to the R&D Law further permits the OCS, among other things, to approve the transfer of manufacturing rights outside Israel in exchange for an import of different manufacturing into Israel as a substitute, in lieu of the increased royalties. The R&D Law also allows for the approval of grants in cases in which the applicant declares that part of the manufacturing will be performed outside of Israel or by non-Israeli residents and the research committee is convinced that doing so is essential for the execution of the program. This declaration will be a significant factor in the determination of the OCS whether to approve a program and the amount and other terms of benefits to be granted. For example, the increased royalty rate and repayment amount will be required in such cases. If we elect to transfer more than an insubstantial portion of our manufacturing processes to contractors outside of Israel, we may be required to pay higher royalties to the OCS.

The R&D Law also provides that know-how developed under an approved research and development program may not be transferred to third parties in Israel without the approval of the research committee. Such approval is not required for the sale or export of any products resulting from such research or development. The R&D Law further provides that the know-how developed under an approved research and development program may not be transferred to any third parties outside Israel, except in certain circumstances and subject to prior OCS approval. The OCS may approve the transfer of OCS-funded know-how outside Israel, in the following cases: (a) the grant recipient pays to the OCS a portion of the sale price paid in consideration for such OCS-funded know-how (according to certain formulas); or (b) the grant recipient receives know-how from a third party in exchange for its OCS-funded know-how; or (c) such transfer of OCS-funded know-how arises in connection with certain types of cooperation in research and development activities.

The R&D Law imposes reporting requirements with respect to certain changes in the ownership of a grant recipient. The law requires the grant recipient and its controlling shareholders and foreign interested parties to notify the OCS of any change in control of the recipient or a change in the holdings of the means of control of the recipient that results in a non-Israeli becoming an interested party directly in the recipient and requires the new interested party to undertake to the OCS to comply with the R&D Law. In addition, the rules of the OCS may require additional information or representations in respect of certain of such events. For this purpose, control is defined as the ability to direct the activities of a company other than any ability arising solely from serving as an officer or director of the company. A person is presumed to have control if such person holds 50% or more of the means of control of a company. Means of control refers to voting rights or the right to appoint directors or the chief executive officer. An interested party of a company includes a holder of 5% or more of its outstanding share capital or voting rights, its chief executive officer and directors, someone who has the right to appoint its chief executive officer or at least one director, and a company with respect to which any of the foregoing interested parties owns 25% or more of the outstanding share capital or voting rights or has the right to appoint 25% or more of the directors. Accordingly, any non-Israeli who acquires 5% or more of our ordinary shares will be required to notify the OCS that it has become an interested party and to sign an undertaking to comply with the R&D Law.

The funds available for OCS grants out of the annual budget of the State of Israel have been reduced in the past and may be further reduced in the future. We cannot predict whether, if at all, we would be entitled to any future grants or the amounts of any such grants.

Tax Benefits and Grants for Research and Development

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

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

However, the amount of such deductible expenses shall be reduced by the sum of any funds received through government grants for the finance of such scientific research and development projects. Expenditures not so approved are deductible over a three-year period if the R&D is for the promotion or development of the company.

Tax Benefits under the Law for the Encouragement of Industry (Taxes), 1969

According to the Law for the Encouragement of Industry (Taxes), 1969, generally referred to as the Industry Encouragement Law, an industrial company is a company resident in Israel, at least 90% of the income of which, in a given tax year, determined in Israeli currency exclusive of income from specified government loans, capital gains, interest and dividends, is derived from an industrial enterprise owned by it. An industrial enterprise is defined as an enterprise whose major activity in a given tax year is industrial production activity.

Under the Industry Encouragement Law, industrial companies are entitled to the following preferred corporate tax benefits, among others:

- deduction of purchases of know-how, patents and the right to use a patent over an eight-year period for tax purposes;
- deduction over a three-year period of specified expenses incurred with the issuance and listing of shares on the Tel Aviv Stock Exchange or, on or after January 1, 2003, on a recognized stock exchange outside of Israel;
- the right to elect, under specified conditions, to file a consolidated tax return with additional related Israeli industrial companies; and
- accelerated depreciation rates on equipment and buildings.

Eligibility for benefits under the Industry Encouragement Law is not subject to receipt of prior approval from any governmental authority.

We believe that we currently qualify as an industrial company within the definition of the Industry Encouragement Law. We cannot assure you that we will continue to qualify as an industrial company or that the benefits described above will be available to us in the future.

Special Provisions Relating to Taxation under Inflationary Conditions

The Income Tax Law (Inflationary Adjustments), 1985, generally referred to as the Inflationary Adjustments Law, represents an attempt to overcome the problems presented to a traditional tax system by an economy undergoing rapid inflation. The Inflationary Adjustments Law is highly complex. The features that are material to us can be described as follows:

- When the value of a company s equity, as calculated under the Inflationary Adjustments Law, exceeds the depreciated cost of Fixed Assets (as defined in the Inflationary Adjustments Law), a deduction from taxable income is permitted equal to the excess multiplied by the applicable annual rate of inflation. The maximum deduction permitted in any single tax year is 70% of taxable income, with the unused portion permitted to be carried forward, linked to the Israeli consumer price index. The unused portion that was carried forward may be deductible in full in the following year.
- If the company s depreciated cost of Fixed Assets exceeds its equity, then the excess multiplied by the applicable annual rate of inflation is added to taxable income (termed the inflation supplement). The inflation supplement will only be added to the corporate income but not to other types of income such as capital gains.
- Subject to specified limitations, depreciation deductions on Fixed Assets and losses carried forward are adjusted for inflation based on the increase in the consumer price index.
- Capital gains on certain traded securities, which are generally taxed at a reduced tax rates for individuals and are taxable at the corporate tax rate in specified circumstances. As of January 1, 2006, the relevant provisions governing taxation of companies on capital gains derived from the sale of traded securities are included in the Tax Ordinance, and the Adjustments Law no longer includes provisions in this regard.

The Israeli Income Tax Ordinance and regulations promulgated thereunder allow Foreign-Invested Companies, which maintain their accounts in U.S. dollars in compliance with the regulations published by the Israeli Minister of Finance, to base their tax returns on their operating results as reflected in the dollar financial statements or to adjust their tax returns based on exchange rate changes rather than changes in the Israeli CPI, in lieu of the principles set forth by the Inflationary Adjustments Law. For these purposes, a Foreign-Invested Company is a company, more than 25% of whose share capital, in terms of rights to profits, voting and appointment of directors, and of whose combined share and loan capital is held by persons who are not residents of Israel. A company that elects to measure its results for tax purposes based on the dollar exchange rate cannot change that election for a period of three years following the election. We believe that we qualify as a Foreign Investment Company within the meaning of the Inflationary Adjustments Law. We have elected to base our tax returns on our operating results in U.S. dollars as reflected in our financial statements.

Stamp Duty

The Israeli Stamp Duty on Documents Law, 1961, or the Stamp Duty Law, provides that any document (or part thereof) that is signed in Israel or that is signed outside of Israel and refers to an asset or other thing in Israel or to an action that is executed or will be executed in Israel, is subject to a stamp duty, generally at a rate of between 0.4% and 1% of the value of the subject matter of such document. De facto, it has been common practice in Israel not to pay such stamp duty unless a document is filed with a governmental authority. An amendment to the Stamp Duty Law that came into effect on June 1, 2003, determines, among other things, that stamp duty on most agreements shall be paid by the parties that signed such agreement, jointly or severally, or by the party that undertook under such agreement to pay the stamp duty. As a result of the aforementioned amendment to the Stamp Duty Law, the Israeli tax authorities have approached many companies in Israel and requested disclosure of all agreements signed by such companies after June 1, 2003, with the aim of collecting stamp duty on such agreements.

Based on advice from Israeli counsel, we believe that we may only be required to pay stamp duty on documents signed on or after August 2004. However, we cannot provide any assurance that the tax authorities or the courts will accept such view.

Under an order published in December 2005, the said requirement to pay stamp duty was cancelled with respect to documents signed on or after January 1, 2006.

C. Organizational Structure

We are an Israeli company that commenced operations in 1996. The following is a list of our subsidiaries:

Company	Place of Incorporation	Ownership Interest
Ceragon Networks (Aus) Pty Ltd	Australia	100%
Ceragon Networks do Brasil Limitada	Brazil	100%
Ceragon Networks (UK) Limited	England	100%
Ceragon Networks SARL	France	100%
Ceragon Networks (HK) Limited	Hong Kong	100%
Ceragon Networks (India) Private Limited	India	100%
Ceragon Networks, S.A. de C.V.	Mexico	100%
Ceragon Networks, Inc.	New Jersey	100%
Ceragon Networks (Philippines), Inc.	Philippines	100%

D. Property, Plants and Equipment

Our corporate headquarters and principal administrative, finance, sales and marketing, R&D and operations departments are located at a leased facility of approximately 55,000 square feet in Tel Aviv, Israel. The leases for this space are valid until May 2007, with an option to renew for an additional one-year period.

In the United States, we lease approximately 5,100 square feet in Paramus, New Jersey, for our North American headquarters. The lease in Paramus is valid until September 2008. In the United Kingdom, we lease approximately 2,560 square feet in Birmingham expiring in March 2015. We also lease space for our local subsidiaries to conduct sales and marketing activities in in their respective regions.

ITEM 4A UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The following discussion and analysis should be read in conjunction with our consolidated financial statements and the notes to those financial statements that appear elsewhere in this annual report. Our consolidated financial statements are prepared in conformity with U.S. GAAP.

Overview

We design, develop, manufacture and sell high-capacity wireless backhaul solutions for cellular operators, fixed operators and private networks and enterprises.

A majority of the revenues of the Company and certain of its subsidiaries are generated in U.S. dollars. In addition, a substantial portion of the Company s and certain of its subsidiaries costs is incurred in dollars. We use the dollar as our functional currency. Transactions and balances in other currencies are remeasured into dollars according to the principles in Financial Accounting Standards Board Statement No. 52. Gains and losses arising from conversion are recorded as financial income or expense, as applicable. Our consolidated financial statements are prepared in dollars.

We expect our operating results to fluctuate in the future as a result of various factors, many of which are outside our control. Consequently, we believe that period-to-period comparisons of our operating results may not necessarily be meaningful and, as a result, you should not rely on them as an indication of future performance.

Revenues. We generate revenues from the sale of our products, those of other parties and services. We recognize revenues from the sale of our products in accordance with SEC Staff Accounting Bulletin No. 104 and FASB s Emerging Issue Task Force (EITF) Issue No. 00-21, Revenue Arrangements with Multiple Elements. We price our products on a per unit basis according to a price list. However, the final price to the customer may vary according to various factors, including but not limited to the size of a given transaction, the geographic location of the customer, the specific application for which products are sold, the channel through which products are sold, the competitive environment and the results of negotiation. We sell our products directly and through distribution channels worldwide. In 2005, approximately 27% of our revenues were generated in North America, 49% were generated in Europe, Middle East, and Africa, 13% were generated in the Asia-Pacific region and 11% were generated in Latin America.

Cost of Revenues. Our cost of revenues consists of the prices we pay contract manufacturers for the products they manufacture for us, component and material costs, labor costs, subcontractor fees, royalties, estimated warranty costs, overhead related to manufacturing and depreciation of manufacturing equipment, shipping and royalties to the Government of Israel in connection with grants we received from the Chief Scientist. Our gross profit is affected by the selling prices for our products and the cost of revenues.

Research and Development Expenses. Our research and development expenses consist primarily of compensation and related costs for research and development personnel, subcontractors costs, costs of materials and depreciation of equipment. All of our research and development costs are expensed as incurred. Research and development expenses are offset by royalty-bearing grants from the Chief Scientist. We believe continued investment in research and development is essential to attaining our strategic objectives.

Selling and Marketing Expenses. Our selling and marketing expenses consist primarily of compensation and related costs for sales and marketing personnel, trade show and exhibit expenses, travel expenses, commissions, and promotional materials.

General and Administrative Expenses. Our general and administrative expenses consist primarily of compensation and related costs for executive, finance and human resources personnel, professional fees, insurance, provisions for doubtful accounts and other general corporate expenses.

Financial Income, Net. Our financial income, net, consists primarily of: interest earned on bank deposits and marketable securities; gains and losses arising from the translation of monetary balance sheet items denominated in non-dollar currencies into dollars; gains and losses from our currency hedging activity; and fees and commissions paid to banks.

Taxes. See Israeli Tax Considerations and Government Programs in Item 4 for a discussion of tax and other laws applicable to the Company. We have accumulated operating loss carry-forwards and therefore we have no tax expense.

Results of Operations

The following table presents consolidated statement of operations data for the periods indicated as a percentage of total revenues.*

	2003	2004	2005
Revenues	100.0%	100.0%	100.0%
Cost of revenues	60.3	58.8	71.1
Gross profit (loss)	39.7	41.2	28.9
Operating expenses			
Research and development	27.2	17.8	14.5
Less: Grants and participations	5.7	4.2	2.4
Research and development, net	21.4	13.6	12.1
Selling and marketing	29.0	21.6	18.5
General and administrative	7.2	4.5	4.3
Restructuring and non-recurring expenses (income), net	(2.0)	--	--
Total operating expenses	55.5	39.8	35.0
Operating income (loss)	(15.8)	1.5	-6.1
Financial income, net	3.4	1.2	0.8
Other financial expenses - non-cash charge relating to puttable warrant	(10.0)	--	--
Other Income	--	0.3	0.1
Net income (loss)	(22.4)	2.9	(5.2)

*The amortization of deferred stock compensation was reclassified in the relevant expense line.

Years Ended December 31, 2004 and 2005

Revenues. Revenues increased from $54.8 million for the year ended December 31, 2004 to $73.8 million for the year ended December 31, 2005, an increase of $19.0 million, or 34.6%. Quarterly revenues increased sequentially during 2005 from $16.8 million in the first quarter to $20.1 million in the fourth quarter. This increase was attributable, as in previous years, primarily to increased sales to cellular and fixed operators and private networks and enterprises in a growing number of countries.

Cost of Revenues. Cost of revenues increased from $32.2 million for the year ended December 31, 2004 to $52.5 million for the year ended December 31, 2005, an increase of $20.3 million, or 62.9%. This increase was attributable to two factors: (a) increased materials consumed in connection with our increased revenues; and (b) a write-off of inventories and a long-term receivable in the amount of $7.1 million and $390 thousand, respectively, in the last quarter of 2005. During the fourth quarter of 2005, the Company adopted a plan to terminate its legacy product line, close its in-house production facilities and transfer production activities to its contract manufacturers. Therefore, it estimated the expected sales from such product line and the expected use of associated inventory, and as a consequence it wrote off excess inventory. The Company has been utilizing part of the products related to components which it wrote off in 2001. In 2004 and 2005, approximately $1.2 million and $954 thousand, respectively, of inventory previously written-off were used as components for products manufactured in the Company s ordinary course of production and were sold as finished goods to customers. The sales of these related manufactured products were reflected in the Company s revenues without additional cost to the cost of revenues in the period in which the inventory was utilized.

Gross profit as a percentage of revenues decreased from 41.2% for the year ended December 31, 2004 to 28.9% for the year ended December 31, 2005.

Research and Development Expenses, Net. Our gross research and development expenses increased from $9.8 million for the year ended December 31, 2004 to $10.7 million for the year ended December 31, 2005, an increase of $0.9 million, or 9.6%. The increase in our gross research and development expenses was attributable primarily to the hiring of additional personnel as we developed new products and enhanced existing ones. During the year ended December 31, 2005, we recognized $1.8 million in research and development grants from the OCS, compared to $2.3 million during the year ended December 31, 2004. Our net research and development expenses increased from $7.5 million for the year ended December 31, 2004 to $9.0 million for the year ended December 31, 2005, an increase of $1.5 million or 19.8%.

Selling and Marketing Expenses. Selling and marketing expenses increased from $11.8 million for the year ended December 31, 2004 to $13.6 million for the year ended December 31, 2005, an increase of $1.8 million, or 15.1%. This increase was attributable primarily to the hiring of additional personnel and an increase in sales commissions.

General and Administrative Expenses. General and administrative expenses increased from $2.5 million for the year ended December 31, 2004 to $3.2 million for the year ended December 31, 2005, an increase of $0.7 million, or 28.8%. This increase was attributable primarily to the overall increase in the scope of our activities.

Financial Income, Net. Financial income, net decreased from $674 thousand for the year ended December 31, 2004 to $607 thousand for the year ended December 31, 2005, a decrease of $67 thousand or 10%. This decrease was attributable primarily to a higher level of gains from exchange rate differences in 2004 as compared with 2005 and to a decrease in interest income resulting from a decrease in the Company s bank deposits and marketable securities.

Net Income. The Company recorded a net loss in 2005 of $3.8 million as compared with net income in 2004 of $1.6 million, primarily due to a write-off of inventories and a long-term receivable in the amount of $7.1 million and $390 thousand, respectively, in the last quarter of 2005.

Years Ended December 31, 2003 and 2004

Revenues. Revenues increased from $34.4 million for the year ended December 31, 2003 to $54.8 million for the year ended December 31, 2004, an increase of $20.4 million, or 59.3%. Quarterly revenues increased sequentially during 2004 from $11.4 million in the first quarter to $15.9 million in the fourth quarter. This increase was attributable primarily to increased sales to cellular and fixed operators and private networks and enterprises in a growing number of countries.

Cost of Revenues. Cost of revenues increased from $20.8 million for the year ended December 31, 2003 to $32.2 million for the year ended December 31, 2004, an increase of $11.4 million, or 55.3%. This increase was attributable primarily to increased materials consumed in connection with our increased revenues. The Company has been utilizing part of the products related to components which it wrote off in 2001. In 2003 and 2004, approximately $1.5 million and $1.2 million, respectively, of inventory previously written-off were used as components for products manufactured in the Company s ordinary course of production and were sold as finished goods to customers. The sales of these related manufactured products were reflected in the Company s revenues without additional cost to the cost of revenues in the period in which the inventory was utilized.

Gross profit as a percentage of revenues increased from 39.7% for the year ended December 31, 2003 to 41.2% for the year ended December 31, 2004.

Research and Development Expenses, Net. Our gross research and development expenses increased from $9.3 million for the year ended December 31, 2003 to $9.8 million for the year ended December 31, 2004, an increase of $0.5 million, or 4.6%. The increase in our gross research and development expenses was attributable primarily to the hiring of additional personnel. During the year ended December 31, 2004, we recognized $2.3 million in research and development grants from the OCS, compared to $2.0 million during the year ended December 31, 2003. Our net research and development expenses increased from $7.4 million for the year ended December 31, 2003 to $7.5 million for the year ended December 31, 2004, an increase of $0.1 million or 1.5%.

Selling and Marketing Expenses. Selling and marketing expenses increased from $10.0 million for the year ended December 31, 2003 to $11.8 million for the year ended December 31, 2004, an increase of $1.8 million, or 18.8%. This increase was attributable primarily to the hiring of additional personnel.

General and Administrative Expenses. General and administrative expenses remained the same at $2.5 million for the years ended December 31, 2003 and 2004.

Financial Income, Net. Financial income, net decreased from $1.2 million for the year ended December 31, 2003 to $0.7 million for the year ended December 31, 2004, a decrease of $0.5 million or 41.8%. This decrease was attributable primarily to the decrease of the interest income on marketable securities and on bank deposits that in turn resulted from a shift of the Company s funds to shorter-term investments.

Other Financial Expenses - Non-Cash Charge Relating to Puttable Warrant. In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity (FAS 150), which established standards for how an issuer of financial instruments classifies and measures certain financial instruments with characteristics of both liability and equity. The Company adopted FAS 150 and as a result recorded in 2003 a non-cash charge relating to a puttable warrant.

Net Income. The Company recorded net income in 2004 of $1.6 million as compared with a net loss of $7.7 million in 2003. The Company s profitability in 2004 resulted from an increase of 64% in gross profit accompanied by lower rates of increase in operating expenses and because net income for 2003 included a non-cash charge for a puttable warrant in the amount of $3.4 million.

Impact of Inflation and Currency Fluctuations

The dollar cost of our operations is influenced by the extent that any inflation in Israel is or is not offset, or is offset on a lagging basis, by the devaluation of the NIS in relation to the dollar. When the rate of inflation in Israel exceeds the rate of devaluation of the NIS against the dollar, companies experience increases in the dollar cost of their operations in Israel. Unless offset by a devaluation of the NIS, inflation in Israel will have a negative effect on our results.

The following table presents information about the rate of inflation in Israel and the rate of devaluation (or in 2003 and 2004, appreciation) of the NIS against the dollar:

Year ended December 31,	Israeli inflation rate %	NIS devaluation (appreciation)%
2001	1.4	9.3
2002	6.5	7.3
2003	(1.9)	(7.6)
2004	1.2	(1.6)
2005	2.4	6.8

A devaluation of the NIS in relation to the dollar has the effect of reducing the dollar amount of our expenses that are payable in NIS, unless those expenses or payables are linked to the dollar. Conversely, any increase in the value of the NIS in relation to the dollar has the effect of increasing the dollar value of our unlinked NIS expenses. Part of our revenues and expenses in Europe are received or incurred in Euros. We are exposed to the risk of an appreciation of the Euro if our expenses in Euros exceed our sales in Euros. In addition, if the Euro devaluates relative to the dollar and sales in Euros exceed expenses incurred in Euros, our operating profit may be negatively affected as a result of a decrease in the dollar value of our sales.

Since exchange rates between the NIS and the dollar, and between the Euro and the dollar, fluctuate continuously, exchange rate fluctuations would have an impact on our results and period-to-period comparisons of our results. We reduce this currency exposure by entering into hedging transactions. The effects of foreign currency re-measurements are reported in our consolidated financial statements of operations. For a discussion of our hedging transactions, please see Item 11. Quantitative and Qualitative Disclosures about Market Risk.

Effects of Government Regulations and Location on the Company s Business

For a discussion of the effects of Israeli governmental regulation and our location in Israel on our business, see Information on the Company Business Overview - Conditions in Israel in Item 4 and the Risks Relating to our Location in Israel in Item 3, above.

Liquidity and Capital Resources

Since our initial public offering on the Nasdaq National Market in August 2000, we have financed our operations primarily through the proceeds of that initial public offering and through royalty-bearing grants from the Chief Scientist. In the initial public offering, we raised $97.8 million; and through December 31, 2005, we received a total of $18.3 million from the Chief Scientist.

As of December 31, 2005, we had approximately $33.0 million in cash and cash equivalents, short and long-term bank deposits, and short and long-term marketable securities.

Net cash used in operating activities was approximately $4.3 million for the year ended December 31, 2005, $1.7 million for the year ended December 31, 2004 and $4.9 million for the year ended December 31, 2003.

Net cash provided by investing activities was approximately $2.7 million for the year ended December 31, 2005, $4.2 million for the year ended December 31, 2004 and $6.4 million for the year ended December 31, 2003.

Net cash provided by financing activities was approximately $678 thousand for the year ended December 31, 2005, $1.5 million for the year ended December 31, 2004 and $1.2 million for the year ended December 31, 2003.

As of December 31, 2005, our principal commitments consisted of $3.0 million for obligations outstanding under non-cancelable operating leases and $10.0 million of royalties payable to the Government of Israel on revenues from product sales and other related revenues generated from projects for which we received grants from the OCS. The Company was committed to pay royalties to a subcontractor for the development of a component and its integration into certain of the Company s products. The agreed royalty rates were 4%, 3%, 2% and 1% for the first, second, third and fourth years of revenues, respectively, and 1% for the fifth to seventh year of revenues. The first year of such revenues was 1998. As of December 31, 2005, the Company completed its seventh year of obligation under the above-mentioned plan. The royalties were calculated as a rate of specific sales collection of a specific product.

In 2001, we entered into an agreement with a supplier pursuant to which the Company was initially committed to purchase certain products. In 2002, we entered into a supplementary arrangement with this supplier (the 2002 Agreement) in which all minimum purchase commitments of the prior agreement were mutually rescinded. As a further part of this arrangement, we issued a puttable warrant to this supplier to purchase an aggregate of 700,000 restricted Ordinary Shares with an exercise price per ordinary share of $0.003, subject to standard adjustments, with a cash conversion alternative (instead of the exercise for shares) for $875,000.

Beginning as of April 30, 2003 and expiring on October 31, 2004, the puttable warrant was exercisable for cash (in whole but not in part) payable in 6 equal monthly payments of $145,833.33. Beginning as of September 30, 2003, the puttable warrant was exercisable (in whole but not in part) together with a cash payment of $0.003 per share, or by a cashless exercise purchase, for 700,000 restricted ordinary shares. Resale of ordinary shares by the supplier issued upon exercise of the puttable warrant were subject to Rule 144 under the Securities Act of 1933, as amended. The puttable warrant was exercised by a cashless exercise into 699,624 shares in 2003 and the supplier subsequently sold the shares.

As part of the 2002 Agreement, the Company agreed to a new minimum annual purchase commitment. As of December 31, 2005, the remaining amount of the commitment is approximately $ 1.5 million for 2006.

As of December 31, 2005, our cash investments are comprised of the following: 31% consist of short term, highly liquid investments with original maturities of less than three months, and 29% consist of short term deposits and marketable securities with original maturities of up to 1 year, with a minimum credit rating of at least A1/P1. The remaining balance of our assets are invested in corporate debt securities and in bank deposits with maturities of up to 3 years, carrying a minimum rating of AA-/AA3. Substantially all of these investments are in US dollars.

Our capital requirements are dependent on many factors, including working capital requirements to finance the growth of the Company, the level of our gross profit and the allocation of resources to our research and development efforts, as well as our marketing and sales activities.

We believe that current cash and cash equivalent balances will be sufficient for our requirements through at least the next 12 months.

Capital Expenditures

We have no current material commitments for capital expenditures.

Research and Development

We place considerable emphasis on research and development to expand the capabilities of our existing products, to develop new products and to improve our existing technologies and capabilities. We believe that our future success will depend upon our ability to maintain technological leadership, to enhance existing products and to introduce on a timely basis new commercially viable products and technology addressing the needs of our customers. We intend to continue to devote a significant portion of our personnel and financial resources to research and development. As part of our product development process, we seek to maintain close relationships with our customers to identify market needs and to define appropriate product specifications. In addition, we intend to continue to comply with industry standards and, in order to participate in the formulation of European standards, we are full members of the European Telecommunications Standards Institute.

Our research and development activities are conducted at our facilities in Tel Aviv, Israel. As of December 31, 2005, our research and development staff consisted of 105 employees. Our research and development team includes highly specialized engineers and technicians with expertise in the fields of millimeter wave design, modem and signal processing, data communications, system management and networking solutions. Our technical expertise in these fields results in a highly-optimized system design and a strong and reliable system solution. Our extensive protocol knowledge and expertise has resulted in highly-optimized solutions for various communications protocols.

Intellectual Property

See: Item 4. History and Development of the Company Intellectual Property.

Trend Information

Beginning in the second half of 2003, the telecommunications industry began to recover from the downturn it experienced in the previous two years, and has shown signs of moderate growth throughout 2004 and 2005. Growth in the cellular market has created demand for high-capacity cellular backhaul infrastructure. In Europe, this demand primarily comes from the buildup of 3-G (third generation) networks which employ data-rich applications; in developing areas, it results from increases in the number of subscribers and from the establishment of new networks where none existed before (referred to as greenfield networks).

At the same time, we are seeing pressure on our resale prices in light of increased competition and an increase in the size of the transactions in which we are involved, together with an enhanced focus by our customers on reducing their capital expenditures. Such price pressure may have an impact on our results of operations. Although our revenues increased sequentially quarter by quarter during 2004 and 2005, we cannot be certain that the level of sequential quarterly revenue growth will continue.

The fixed wireless market is experiencing a strong demand for IP-based backhaul solutions. This demand is due to several factors: (a) new wireless deployments such as WiFi and WiMAX; (b) the lack of copper wire infrastructure or the cost of expanding such infrastructure; and (c) the limited connection of office buildings to fiber networks. New types of operators such as wireless Internet service providers (WISP s) are emerging to fill this demand, and Ceragon provides its IP solutions to these operators.

In the U.S., demand for Ceragon s solutions is being driven by the emergence of new wholesale carriers that are introducing a viable, cost-effective alternative to leased lines. These carriers base their business model on shared backhaul where one tower serves several operators at the same time. These wholesale providers carry the cost involved in building the backhaul infrastructure which is then used by operators on a monthly fee basis. Ceragon benefits from this emerging trend by providing the backhaul solution for these carriers.

As we continue to expand our geographic footprint, we are increasingly engaged in supplying post-delivery services for our customers, often in developing nations. We act as prime contractor and equipment supplier for these projects and provide installation, supervision and testing services required for these projects. We typically bear the risks of loss and damage and title to our products until the customer has issued an acceptance certificate upon successful completion of acceptance tests. If our products are damaged or stolen, or if the products do not pass the acceptance tests, the customer could refuse to pay us and we would incur substantial costs, including fees owed to our subcontractors, increased insurance premiums, transportation costs, and expenses related to repairing or manufacturing the products. Moreover, in such a case, we may not be able to repossess the equipment, thus suffering additional losses.

Off Balance Sheet Arrangements

Not applicable.

Tabular Disclosure of Contractual Obligations

	Payments due by period				
Contractual Obligations	***Total***	***less than 1 year***	***1-3 years***	***3-5 years***	***more than 5 years***
Operating Lease Obligations	$ 3,046,000	$ 1,666,000	$ 988,000	$ 128,000	$ 264,000
Purchase Obligations	$ 18,093,045	$ 17,549,173	$ 543,872	0	0
Total	$ 21,139,045	$ 19,215,173	$ 1,531,872	$ 64,000	$ 328,000

Critical Accounting Policies

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

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

Our management believes the significant accounting policies which affect its more significant judgments and estimates used in the preparation of its consolidated financial statements and which are the most critical to aid in fully understanding and evaluating our reported financial results include the following:

- Revenue recognition;
- Provision for doubtful accounts; and
- Inventory valuation

Revenue recognition. We recognize revenue in accordance with SEC Staff Accounting Bulletin No. 104, which is commonly referred to as SAB 104, when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable and collectibility is probable. When a right of return exists, we create a provision for returns in accordance with Statement of Financial Accounting Standards No. 48, Revenue Recognition when Right of Return Exists . When sale arrangements include a customer acceptance provision with respect to products, we do not recognize revenues before we have demonstrated that the criteria specified in the acceptance provisions have been satisfied or that the acceptance provision has lapsed. When we provide both products and post-delivery installation services which are not essential to the functionality of the equipment, we defer recognition of the fair value of the installation services (but not less than the amount contingent upon completion of installation or acceptance, if any) to the period in which such installation occurs. Our typical product warranty is between 12 to 36 months at no extra charge. We accrue for provision for warranty costs based on our historical experience. To assess the probability of collection for revenue recognition purposes, we determine whether a customer meets any of the conditions set forth in Company guidelines. On the basis of these criteria, we decide whether revenue recognition should be deferred.

Revenue from certain arrangements includes multiple elements which are sale of products and post delivery installation services that are not essential to the functionality of the equipment, within a single contract. The Company s accounting policy complies with the revenue determination requirements in EITF 00-21, (which was issued during 2003), relating to the separation of multiple deliverables into individual accounting units with determinable fair values. When such arrangements exist, the Company considers the sale of equipment and its installation to be two separate accounting units of the arrangement, since installation is not essential to the functionality of the equipment, and only defers the fair value of the installation services (but not less than the amount contingent upon completion of installation/acceptance, if any) to the period in which such installation occurs.

Provision for doubtful accounts. We perform regular credit evaluations of our customers financial condition. Allowance for doubtful accounts is computed for specific debts, the collectibility of which is doubtful, based on the company s experience. In addition, we include a general provision for doubtful debts based on the age of the debts and on management s past experience in collecting such receivables. We insure certain trade receivables under credit insurance policies.

Inventory valuation. At each balance sheet date, we evaluate our inventory balance for excess quantities and obsolescence. This evaluation includes an analysis of slow-moving items and sales levels by product and projections of future demand. If needed, we write off inventories that are considered obsolete or excessive. Remaining inventory balances are adjusted to the lower of cost or market value. If future demand or market conditions are less favorable than our projections, additional inventory write-downs may be required and would be reflected in cost of revenues in the period the revision is made.

Recently Issued Accounting Standards

On December 16, 2004, the FASB issued Statement of Financial Accounting Standard No. 123 (revised 2004), Share-Based Payment (SFAS 123R), which is a revision of FASB Statement No. 123, Accounting for Stock-Based Compensation (SFAS 123). SFAS 123R supersedes Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25), and amends FASB Statement No. 95, Statement of Cash Flows . Generally, the approach in SFAS 123R is similar to the approach described in SFAS 123. However, SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. Early adoption will be permitted in periods in which financial statements have not yet been issued. The new standard will be effective for the Company in the first interim period beginning after January 1, 2006.

SFAS 123R permits public companies to adopt its requirements using one of two methods, a modified prospective method or a modified retrospective method. We adopted SFAS 123R using the modified prospective method.

As permitted by SFAS 123, we currently account for share-based payments to employees using Opinion 25 s intrinsic value method and, as such, generally recognize no compensation cost for employee stock options. In addition, non-compensatory plans under APB 25 will be considered compensatory for SFAS 123R purposes. Accordingly, the adoption of SFAS 123R s fair value method will have a significant impact on the Company s results of operations, although it will have no impact on the Company s overall financial position. The impact of adoption of Statement 123(R) cannot be predicted because it will depend on levels of share-based payments granted in the future. However, had we adopted SFAS 123R in prior periods, the impact of that standard would have approximated the impact of SFAS 123. For further information regarding this impact, see Note 2(q) to the consolidated financial statements under Item 18.

In March 2005, the SEC released SEC Staff Accounting Bulletin No. 107, Share-Based Payment (SAB 107). SAB 107 provides the SEC s staff position regarding the application of SFAS 123R and contains interpretive guidance relating to the interaction between SFAS 123R and certain SEC rules and regulations, and also provides the SEC staff s view regarding the valuation of share-based payment arrangements for public companies. SAB 107 highlights the importance of disclosures made relating to the accounting for share-based payment transactions.We intend to follow the interpretive guidance set forth in SAB 107 during the adoption of SFAS 123R.

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES
Directors and Senior Management

The following table lists our current directors and senior management:

Name	Age	Position
Zohar Zisapel	57	Chairman of the Board of Directors
Ira Palti	48	President and Chief Executive Officer
Naftali Idan	54	Executive Vice President and Chief Financial Officer
Shlomo Tenenberg	51	Executive Vice President, Worldwide Marketing and Sales
Hillik Rave	54	Executive Vice President, Worldwide Operations
Sharon Ganot	37	Vice President, Human Resources
Udi Gordon	39	Vice President, Research and Development
Yuval Ronen	35	Vice President, Finance
Norman Kotler	54	General Counsel and Corporate Secretary
Scott Sweetland	44	President of our U.S. subsidiary
Joseph Atsmon	57	Director
Zohar Gilon	59	Director
Yael Langer	41	Director
Shmuel Levy	52	Director

Zohar Zisapel has served as the Chairman of our board of directors since we were incorporated in 1996. 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 since 1998. Mr. Zisapel serves as a director of several private companies, and as chairman of RADVision Ltd. and RADCOM Ltd. and of several private companies. Mr. Zisapel previously served as head of the electronics research and development department in the Israeli Ministry of Defense. Mr. Zisapel received a B.Sc. and an M.Sc. in electrical engineering from the Technion, Israel Institute of Technology and an M.B.A. from Tel Aviv University.

Ira Palti has been the Company s President and Chief Executive Officer since August 2005. From January 2003 to August 2005, Mr. Palti was Chief Executive Officer of Seabridge Ltd., a Siemens company that is a global leader in the area of broadband services and networks. Prior to joining Seabridge, he was the Chief Operating Officer of VocalTec Communications Ltd., responsible for sales, marketing, customer support and product development. Among the positions he held before joining VocalTec was founder of Rosh Intelligent Systems, a company providing software maintenance and AI diagnostic solutions and one of the first startups in Israel. Mr. Palti received a B.Sc. in mathematics and computer science (magna cum laude) from Tel Aviv University.

Naftali Idan has served as our Executive Vice President and Chief Financial Officer since August 2004. Prior to joining Ceragon, Mr. Idan was Senior Vice President, Chief Financial Officer in Floware Wireless Systems Ltd. from 2000 to 2001. From 1993 to 1999, he was the Executive Vice President and Chief Financial Officer of Tecnomatix Technologies Ltd. Prior to joining Tecnomatix, Mr. Idan was with Optrotech Ltd. from 1985 to 1992, where he held several positions in finance, the last one being Vice President, Finance & Administration of its US subsidiary. Prior to that, Mr. Idan served in various financial roles in both US and Israeli firms. Mr. Idan received a B.A. in accounting and economics from Tel Aviv University in Israel and an M.B.A. from De Paul University in Chicago, and is a certified public accountant in Israel.

Shlomo Tenenberg has served as our Executive Vice President, Worldwide Marketing and Sales since October 2002. From July 1998 until October 2002, he served as our Vice President of Marketing and Sales. From March 1994 to July 1998, Mr. Tenenberg served as the Vice President of Nexus Telocation Systems Ltd. From October 1989 until March 1994, Mr. Tenenberg was the Marketing Manager at ECI Telecom Ltd. Mr. Tenenberg received a B.Sc. in electrical engineering and electronics from Ben Gurion University and an M.B.A. from Tel Aviv University.

Hillik Rave has served as our Executive Vice President, Operations & Engineering since December 2005. Prior to joining the Company, Mr. Rave served as Vice President of Operations & Engineering at ECI Telecom Ltd. in its Optical Networks Division from 2000 to 2005. From 1996 to 2000 he served as Associate Vice President Commercial at ECI Telecom. Prior to joining ECI Telecom, he held management positions at Telrad, Rabintex, Scitex and ATA from 1985 to 1996. Mr. Rave received a B.A. in industrial engineering and an M.B.A. in Business and Industrial Management from Ben-Gurion University.

Udi Gordon has served as our Vice President, Research and Development since July 2003. From 1997 until June 2003, he served as a senior manager in our research and development department. From 1990 until 1997, Mr. Gordon served in the electronic research and development department in the Israeli Ministry of Defense. Mr. Gordon received a B.Sc. in electrical engineering from the Technion, Israel Institute of Technology (cum laude), and an M.B.A. from Bar-Ilan University.

Sharon Ganot has served as our Vice President, Human Resources since March 2000. From December 1999 until March 2000, Ms. Ganot was the manager of our human resources department. From April 1994 until December 1999, she was a personnel recruiter and training manager with RAD Data Communications Ltd. Ms. Ganot received a B.A. in psychology and an M.A. in industrial studies from Tel Aviv University.

Yuval Ronen has served as our Vice President, Finance since October 2005. From 2000 to 2005, Mr. Ronen served as Corporate Controller for the Company. Prior to joining Ceragon, Mr. Ronen was employed by the public accounting firm of Strauss Lazar, specializing in publicly traded companies. Mr. Ronen holds a B.A in accounting and economics and an M.B.A. (both cum laude) from Tel Aviv University in Israel, and is a certified accountant in Israel.

Norman Kotler has served as our General Counsel and Corporate Secretary since August 2004. Prior to joining Ceragon, Mr. Kotler was General Counsel and Corporate Secretary at Sapiens International Corporation (2003-2004) and Aprion Digital Ltd. (2001-2003). From 1989 to 2001, Mr. Kotler was the chief legal advisor at ECI Telecom Ltd., his last position there being Associate Vice President, Legal Affairs and Corporate Secretary. Before joining ECI Telecom, Mr. Kotler was associated with law firms in Israel and in Phoenix, Arizona. Mr. Kotler received a J.D. from University of Arizona, an M.A. in history from University of Toronto and a B.A. in history from York University (Toronto).

Scott Sweetland has served as the President of Ceragon Networks, Inc. since January 2006. From February 2000 through December 2005, Mr. Sweetland was Vice President, Sales, US and Canada for our U.S. subsidiary. Prior to joining Ceragon, Mr. Sweetland held senior sales, product marketing or microwave systems engineering positions for DMC Stratex, Innova, California Microwave/Microwave Radio Corporation, M/A-COM and Lockheed Sanders. Mr. Sweetland received a B.Sc. in electrical engineering from the University of Massachusetts and an M.B.A. from New Hampshire College.

Joseph Atsmon has served as a director since July 2001. Mr. Atsmon has also served as a director of Nice Systems Ltd. since July 2001, of RADVision Ltd. since June 2003 and of VocalTec Communications Ltd. since December 2005. From April 2001 until October 2002, he served as Chairman of Discretix Ltd. From 1995 until 2000, he served as chief executive officer of Teledata Communications Ltd., a public company acquired by ADC Telecommunications Inc. in 1998. From 1986 until 1995, Mr. Atsmon served in various positions at Tadiran Ltd., among them a division president and corporate vice president for business development. Mr. Atsmon received a B.Sc. in electrical engineering (summa cum laude) from the Technion, Israel Institute of Technology. Mr. Atsmon is one of our independent directors NASD Marketplace Rules (the Nasdaq Rules) and is our audit committee chairman and financial expert.

Zohar Gilon has served as a director since June 1999. Mr. Gilon is a general partner and managing director of Tamar Technologies L.P., a venture capital fund based in Israel, which was founded in 1998 together with C.E. Unterberg, Towbin. Mr. Gilon is a private entrepreneur and has served as a director of AVT-Advanced Vision Technology Ltd. since 1998, as well for companies in the RAD-BYNET group, including RADCOM Ltd. since September 1995 and RIT Technologies Ltd. since September 1995. Between November 1993 and June 1995, Mr. Gilon served as president of W.S.P. Capital Holdings, an investment firm traded on the Tel Aviv Stock Exchange. Mr. Gilon received a B.S.E.E. from the Technion, Israel Institute of Technology, and an M.B.A. from Tel Aviv University. Mr. Gilon is one of our external directors under Israeli law and is one of our independent directors under the Nasdaq Rules.

Yael Langer has served as a director since December 2000. Ms. Langer served as our general counsel from July 1998 until December 2000. Ms. Langer is general counsel and secretary of RAD and other companies in the RAD-BYNET group. From December 1995 to July 1998, Ms. Langer served as assistant general counsel to companies in the RAD-BYNET group. From September 1993 until July 1995, Ms. Langer was a member of the legal department of Poalim Capital Markets and Investments Ltd. Ms. Langer received an LL.B. from the Hebrew University in Jerusalem.

Shmuel Levy has served as a director since June 2000. From December 2000, Mr. Levy has been a partner at Sequoia Capital. From August 1998 until July 2000, Mr. Levy was employed by Lucent Technologies Inc., where he was president, enterprise internetworking systems. From June 1997 to July 1998, Mr. Levy was the president and chief executive officer of Lannet Data Communications Ltd. From July 1992 to June 1997, Mr. Levy held various executive positions with Madge Networks Ltd. and Lannet Data Communications. Mr. Levy received a B.S. degree in electrical engineering from Ben Gurion University. Mr. Levy is one of our external directors under Israeli law and is one of our independent directors under the Nasdaq Rules.

Compensation of Directors and Senior Management

The following table presents all compensation we paid to all of our directors and senior management as a group for the year ended December 31, 2005. The table does not include any amounts we paid to reimburse any of such persons for costs incurred in providing us with services during this period.

	Salaries, fees, commissions and bonuses	Pension, retirement and other similar benefits
All directors and executive officers as a group, consisting of eighteen persons	$ 1,550,000	$250,000

During 2005, we granted to our directors and senior management options to purchase 869,000 ordinary shares, in the aggregate, range of exercise prices of $3.70 to 4.49 per share. The options expire 10 years after grant.

Other than reimbursement for expenses, and the award of stock options, we do not compensate our directors for serving on our board of directors. For more information, please see Affiliate Employees Option Plan below and Note 9 to our Consolidated Financial Statements included as Item 18 in this annual report.

Board Practices

Board of Directors

Our articles of association authorize our board of directors to consist of a minimum of five and a maximum of nine members. Our board of directors presently consists of five members. The board retains all the powers in running our company that are not specifically granted to the shareholders. The board may make decisions to borrow money for our company, and may set aside reserves out of our profits, for whatever purposes it thinks fit.

The board may make a resolution when a quorum is present, and each resolution must be passed by a vote of at least a majority of the directors present at the meeting. A quorum of directors is at least a majority of the directors then in office. The board may elect one director to serve as the chairman of the board of directors to preside at the meetings of the board of directors, and may also remove such director as chairman. Minutes of the meetings are recorded and kept at our offices.

Terms of Directors

Our articles of association provide that directors, other than our external directors described below, are elected at our annual general meeting of shareholders by a vote of the holders of a majority of the voting power represented at that meeting. Our external directors, as further described below, each serve a three-year term. At the annual general meeting of shareholders in September 2004 (the 2004 AGM), our articles of association were amended to provide for a classified board of directors. The board of directors is now divided into two classes: Class I and Class II. Each director (other than an external director), when and however elected, will be designated as a member of a certain class of directors. The director (other than a director elected to fill a vacancy in accordance with Article 41 of the Company s Articles of Association) will serve for a term ending on the date of the third annual general meeting following the annual general meeting at which such director was elected, provided, that each initial director in Class I will serve for a term ending on the date of the annual general meeting in 2005, and each initial director in Class II will serve for a term ending on the date of the annual general meeting in 2006.

As a result of the foregoing amendment and of the election of directors at the 2004 AGM, Ms. Langer was elected to serve as a Class I director for an initial term ending at the 2005 annual general meeting of shareholders and until their respective successors are duly elected and qualified; and that Messrs. Zisapel and Atsmon were elected to serve as Class II Directors for an initial term ending at the 2006 annual general meeting of the shareholders and until their respective successors are duly elected and qualified.

If any directors are appointed by the board of directors, their appointment must be ratified by the shareholders at the next shareholders meeting following the appointment. Our shareholders may remove a director from office, in certain circumstances. There is no requirement that a director own shares of our company. Directors may appoint alternative directors in their stead.

As a company organized in Israel whose ordinary shares are listed for quotation on the Nasdaq National Market, we are required to comply with the rules of the U.S. Securities and Exchange Commission and the Nasdaq Rules applicable to listed companies, as well as with the Companies Law applicable to Israeli companies. Under the Nasdaq Rules, a majority of our directors are required to be independent and, under the Israeli Compant-size:10.0pt;">

Fair Value Measurements - Effective March 1, 2008, the Fund adopted Financial Accounting Standards Board Statement of Financial Accounting Standards No. 157 (SFAS 157), Fair Value Measurements. This new accounting statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. The three levels of the fair value hierarchy are as follows:

- Level 1 - quoted prices in active markets for identical investments
- Level 2 - other significant observable inputs (including quoted prices for similar investments, interest rates, prepayment speeds, credit risk, etc.)
- Level 3 - significant unobservable inputs (including the Fund s own assumption in determining the fair value of investments)

The inputs or methodology used in valuing securities are not necessarily an indication of the risk associated with investing in those securities.

The following is a summary of the inputs used as of May 31, 2009 in determining the Fund s investments at fair value for purposes of SFAS 157:

		Quoted Prices in Active Markets for Identical Investments (Level 1)		**Significant Other Observable Inputs (Level 2)**		**Significant Unobservable Inputs (Level 3)**
Common Stock	$	486,167,632	$	546,993,365	$	
Real Estate Investment Trusts		7,611,880		14,723,277		
Warrants				82,803		
Positions In Purchased Options				3,796,834		
Total	$	493,779,512	$	565,596,279	$	
Other Financial Instruments**	$		$	(27,317,250)		
Total	$		$	(27,317,250)	$	

Fair value for purposes of SFAS 157 is different from fair value as used in the 1940 Act. The former generally implies market value, and can include market quotations as a source of value, and the latter refers to determinations of value in absence of available market quotations.

** Other financial instruments may include open forward foreign currency contracts, futures, swaps, and written options. Forward foreign currency contracts and futures are reported at their unrealized gain/loss at period end. Swaps, purchased options and written options are reported at their market value at period end.

ING Global Equity Dividend and Premium Opportunity Fund | **PORTFOLIO OF INVESTMENTS as of May 31, 2009 (Unaudited) (continued)**

On March 19, 2008, the FASB issued Statement of Financial Accounting Standards No. 161 (SFAS No. 161), Disclosure about Derivative Instruments and Hedging Activities. This new accounting statement requires enhanced disclosures about an entity s derivative and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why an entity invests in derivatives, (b) how derivatives are accounted for under SFAS No. 133, and (c) how derivatives affect an entity s financial position, financial performance, and cash flows. SFAS No. 161 also requires enhanced disclosures regarding credit-risk related contingent features of derivative instruments.

The following is a summary of the fair valuations of the Funds derivative instruments categorized by risk exposure as of May 31, 2009:

Asset Derivatives as of May 31, 2009			Liability Derivatives as of May 31, 2009		
Risk Exposure Category		**Fair Value***	**Risk Exposure Category**		**Fair Value***
Equity Contracts	$	3,478,233	Equity Contracts	$	27,317,250
Foreign Exchange Contracts		318,601	Foreign Exchange Contracts		
Total	$	3,796,834		$	27,317,250

* Forward foreign currency contracts and futures are reported at their unrealized appreciation/depreciation at period end. Swaps, purchased and written options are reported at their market value at period end.

ING Global Equity Dividend and Premium Opportunity Fund

PORTFOLIO OF INVESTMENTS
as of May 31, 2009 (Unaudited) (continued)

Written OTC Call Options

# of Contracts	Counterparty	Description	Expiration Date	Strike	Premiums Received	Value
Options on Securities						
48,000	Morgan Stanley	Abbott Laboratories	06/24/09	44.9929USD	$ 80,880	$ (54,236)
81,000	Merrill Lynch	Altria Group, Inc.	06/24/09	17.0100USD	43,578	(24,665)
82,000	Morgan Stanley	American Electric Power Company, Inc.	06/24/09	25.5193USD	81,188	(83,378)
127,000	ABN AMRO	AT&T Inc.	06/24/09	25.1219USD	132,715	(73,429)
58,000	ABN AMRO	Automatic Data Processing, Inc.	06/24/09	35.9180USD	78,822	(105,759)
158,000	ABN AMRO	Bristol-Myers Squibb Co.	06/24/09	20.2657USD	133,194	(68,100)
53,000	Citigroup	Campbell Soup Co.	06/24/09	26.8800USD	48,442	(59,642)
30,000	Merrill Lynch	Chevron Corp.	06/24/09	66.9200USD	87,030	(58,912)
43,000	Citigroup	China Mobile Ltd.	06/24/09	46.7761USD	118,250	(150,912)
75,000	UBS AG	Coca-Cola Co.	06/24/09	43.8096USD	95,512	(378,535)
46,000	Morgan Stanley	ConocoPhillips	06/24/09	44.0552USD	102,980	(126,971)
57,000	Morgan Stanley	Consolidated Edison, Inc.	06/24/09	34.8206USD	56,886	(72,942)
122,000	Merrill Lynch	Dow Chemical Co.	06/24/09	16.0100USD	177,632	(262,811)
76,000	Merrill Lynch	Du Pont (E.I.) de Nemours and Co.	06/24/09	26.9400USD	122,892	(163,254)
76,000	ABN AMRO	Duke Energy Corp.	06/24/09	13.6086USD	34,732	(55,444)
59,000	Morgan Stanley	Emerson Electric Co.	06/24/09	33.9000USD	109,150	(31,255)
28,000	Deutsche Bank, AG	Exelon Corp.	06/24/09	48.5100USD	59,080	(38,393)
147,000	ABN AMRO	General Electric Co.	06/24/09	12.8674USD	140,385	(153,467)
55,000	Merrill Lynch	Home Depot, Inc.	06/24/09	24.9100USD	78,100	(12,531)
62,000	ABN AMRO	Honeywell International Inc.	06/24/09	31.4361USD	112,158	(147,581)
140,000	ABN AMRO	Intel Corp.	06/24/09	15.3779USD	122,780	(84,879)
41,000	UBS AG	Kimberly-Clark Corp.	06/24/09	50.4478USD	63,415	(55,036)
126,000	ABN AMRO	Kraft Foods Inc.	06/24/09	24.8475USD	115,542	(191,418)
89,000	UBS AG	Leggett & Platt, Inc.	06/24/09	14.6266USD	77,323	(51,380)
33,000	Merrill Lynch	Lorillard, Inc.	06/24/09	66.9250USD	109,065	(104,748)
138,000	Citigroup	Mattel, Inc.	06/24/09	14.1600USD	111,366	(229,376)
39,000	Merrill Lynch	McDonald s Corp.	06/24/09	53.9400USD	73,632	(166,351)
129,000	UBS AG	Merck & Co. Inc.	06/24/09	26.0976USD	147,460	(204,323)
56,000	Morgan Stanley	Novartis A.G.	06/24/09	40.1386USD	79,615	(61,096)
83,000	ABN AMRO	NYSE Euronext	06/24/09	23.8323USD	163,261	(505,482)
223,000	Morgan Stanley	Pfizer Inc.	06/24/09	15.3224USD	157,973	(94,917)
52,000	Barclays Bank PLC	Philip Morris Intl. Inc.	06/24/09	41.9945USD	80,142	(66,331)
42,000	Goldman Sachs	Procter & Gamble Co.	06/24/09	51.1600USD	70,909	(67,892)
35,000	Morgan Stanley	Rayonier Inc.	06/24/09	36.7946USD	95,942	(126,436)
233,000	UBS AG	Sara Lee Corp.	06/24/09	9.1078USD	96,229	(93,229)
75,000	Barclays Bank PLC	Southern Co.	06/24/09	28.4675USD	65,760	(47,639)

ING Global Equity Dividend and Premium Opportunity Fund

PORTFOLIO OF INVESTMENTS
as of May 31, 2009 (Unaudited) (continued)

Written OTC Call Options (continued)

# of Contracts	Counterparty	Description	Expiration Date	Strike	Premiums Received	Value
86,000	Goldman Sachs	Spectra Energy Corp.	06/24/09	14.9700USD	$ 66,306	$ (111,055)
205,000	Citigroup	Taiwan Semiconductor Manufacturing Co. Ltd.	06/24/09	10.0800USD	118,695	(196,979)
136,000	ABN AMRO	Vale S.A.	06/24/09	14.8876USD	166,464	(254,488)
354,000	Morgan Stanley	Foster s Group Ltd.	06/24/09	5.1295AUD	55,244	(14,073)
22,000	Goldman Sachs	Accor S.A.	06/24/09	30.1400EUR	57,795	(63,419)
177,000	Barclays Bank PLC	Banco Bilbao Vizcaya Argentaria, S.A.	06/24/09	8.1700EUR	134,199	(156,150)
321,000	BNP Paribas	Banco Santander S.A.	06/24/09	6.8323EUR	189,012	(353,695)
52,000	Barclays Bank PLC	Carrefour S.A.	06/24/09	29.0850EUR	109,342	(207,658)
19,000	BNP Paribas	Deutsche Boerse A.G.	06/24/09	52.3118EUR	88,814	(258,970)
95,000	UBS AG	E.ON A.G.	06/24/09	24.0000EUR	151,569	(191,961)
182,000	Barclays Bank PLC	Eni S.p.A	06/24/09	15.9900EUR	177,575	(368,123)
175,000	Citigroup	Koninklijke KPN NV	06/24/09	9.6400EUR	81,375	(33,977)
27,000	Merrill Lynch	Linde A.G.	06/24/09	57.2300EUR	94,623	(100,974)
15,000	ABN AMRO	MunichRe	06/24/09	96.6200EUR	115,221	(105,425)
145,000	Citigroup	Nokia	06/24/09	10.0790EUR	150,867	(213,814)
173,000	Goldman Sachs	Royal Dutch Shell PLC	06/24/09	17.9539EUR	174,503	(306,109)
53,000	ABN AMRO	Sanofi-Aventis	06/24/09	44.7500EUR	133,561	(105,804)
30,000	Barclays Bank PLC	Siemens A.G.	06/24/09	49.4828EUR	119,251	(142,432)
156,000	Merrill Lynch	Telefonica S.A.	06/24/09	14.6700EUR	97,855	(157,608)
77,000	ABN AMRO	Total S.A.	06/24/09	39.2600EUR	174,301	(235,818)
45,000	Goldman Sachs	Vinci S.A.	06/24/09	32.0938EUR	121,605	(161,611)
112,000	Barclays Bank PLC	Vivendi	06/24/09	19.0860EUR	124,779	(55,171)
88,000	Barclays Bank PLC	AstraZeneca PLC	06/24/09	25.8171GBP	142,171	(95,795)
406,000	Citigroup	BP PLC	06/24/09	5.0400GBP	127,970	(124,866)
206,000	Goldman Sachs	GlaxoSmithKline PLC	06/24/09	10.5568GBP	131,116	(71,876)
159,000	Merrill Lynch	HSBC Hldgs. PLC	06/24/09	5.3670GBP	89,096	(97,852)
1,764,000	Barclays Bank PLC	Vodafone Group PLC	06/24/09	1.2540GBP	164,923	(12,533)
160,000	Barclays Bank PLC	Hang Seng Bank Ltd.	06/24/09	98.3800HKD	105,767	(282,235)
648,000	Goldman Sachs	Telecom Corp. of New Zealand	06/24/09	2.5340NZD	49,182	(44,943)
405,000	Goldman Sachs	TeliaSonera A.B.	06/24/09	38.8100SEK	94,429	(66,244)
171,000	Barclays Bank PLC	DBS Group Hldgs. Ltd.	06/24/09	10.8700SGD	76,890	(132,686)
					$ 7,208,520	$ (8,997,094)
Options on Indexes						
84,000	Barclays Bank PLC	S&P 500® Index	06/12/09	887.9000USD	$ 2,932,944	$ (3,242,624)

87,000	Merrill Lynch	S&P 500® Index	06/26/09	901.1700USD	2,507,340	(3,136,412)
94,500	Barclays Bank PLC	S&P 500® Index	07/10/09	909.9300USD	2,903,418	(2,903,418)
8,600	Citigroup	Dow Jones Euro Stoxx 50 Index	06/12/09	2,325.6100EUR	1,295,120	(1,636,226)
8,700	Merrill Lynch	Dow Jones Euro Stoxx 50 Index	06/26/09	2,344.8700EUR	1,073,883	(1,669,209)
8,650	Barclays Bank PLC	Dow Jones Euro Stoxx 50 Index	07/10/09	2,442.4400EUR	1,121,898	(1,121,898)
2,200	UBS AG	FTSE 100 Index	06/12/09	4,266.4166GBP	482,611	(641,237)
2,300	ABN AMRO	FTSE 100 Index	06/26/09	4,327.5400GBP	537,824	(622,940)
2,550	Morgan Stanley	FTSE 100 Index	07/10/09	4,396.7800GBP	587,773	(587,773)
182,000	Goldman Sachs	Nikkei-225 Stock Average	06/12/09	9,020.2700JPY	649,660	(1,087,519)

ING Global Equity Dividend and Premium Opportunity Fund

PORTFOLIO OF INVESTMENTS
as of May 31, 2009 (Unaudited) (continued)

Written OTC Call Options (continued)

# of Contracts	Counterparty	Description	Expiration Date	Strike		Premiums Received		Value
190,000	Merrill Lynch	Nikkei-225 Stock Average	06/26/09	9,266.5100JPY	$	679,905	$	(921,015)
204,500	Barclays Bank PLC	Nikkei-225 Stock Average	07/10/09	9,562.8400JPY		749,885		(749,885)
					$	15,522,261	$	(18,320,156)
					$	22,730,781	$	(27,317,250)

Total Premiums Received:	$	22,730,781
Total Liabilities for Call Options Written:	$	27,317,250

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

(Registrant): ING Global Equity Dividend and Premium Opportunity Fund

By /s/ Shaun P. Mathews
Shaun P. Mathews
President and Chief Executive Officer

Date: July 28, 2009

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By /s/ Shaun P. Mathews
Shaun P. Mathews
President and Chief Executive Officer

Date: July 28, 2009

By /s/ Todd Modic
Todd Modic
Senior Vice President and Chief Financial Officer

Date: July 28, 2009