CERAGON NETWORKS LTD
Form 20-F
March 26, 2008
As filed with the Securities and Exchange Commission on March 26, 2008

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 20-F

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

OR

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

For the fiscal year ended December 31, 2007

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)

Norman Kotler, (+972) 3-645-5733(tel.), (+972) 3-645-5499 (fax), 24 Raoul Wallenberg Street, Tel Aviv 69719, Israel

(Name, Telephone, E-mail and/or Facsimile Number and Address of Company Contact Person)

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

Title of Each Class	Name of Exchange of Which Registered
Ordinary Shares, Par Value NIS 0.01	Nasdaq Global Market

Securities registered or to be registered pursuant to Section 12(g) of the Act: None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: None

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: 36,918,196 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 o Accelerated filer x Non-accelerated filer o

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

U.S. GAAP x
International Financial Reporting Standards as issued by the International Accounting Standards Board o
Other o

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

Item 17 o Item 18 o

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

Yes o No x

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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. dollars 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 expressions, but are not the only way these statements are identified. These statements discuss future expectations, plans and events, contain projections of results of operations or of financial condition or state other forward-looking information. When a forward-looking statement includes an underlying assumption, we caution that, while we believe the assumption to be reasonable and make it in good faith, assumed facts almost always vary from actual results, and the difference between a forward-looking statement and actual results can be material. Forward-looking 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 statements as a result of various factors, including all the risks discussed in Risk Factors and other cautionary statements in this annual report. All of our forward-looking statements are qualified by and should be read in conjunction with those disclosures. Except as may be required by applicable law, 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, 2007. 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,				
	2003	2004	2005[1]	2006	2007
	(In thousands, except share and per share data)				
Consolidated Statement of Operations Data:					

	Year ended December 31,				
Revenues	$ 34,421	$ 54,831	$ 73,777	$ 108,415	$ 161,888
Cost of revenues [2,3]	20,755	32,227	52,487	80,776	103,406
Gross profit	13,666	22,604	21,290	27,639	58,482
Operating expenses:					
Research and development	9,346	9,772	10,713	13,336	15,457
Less: grants and participations	1,976	2,293	1,752	1,543	--
Research and development, net	7,370	7,479	8,961	11,793	15,457
Selling and marketing	9,967	11,841	13,629	17,420	25,344
General and administrative	2,482	2,485	3,134	5,170	5,277
Restructuring and non-recurring income	(704)	--	--	--	--
Expense in respect of settlement reserve	--	--	--	--	450
Total operating expenses	19,115	21,805	25,724	34,383	46,528
Operating income (loss)	(5,449)	799	(4,434)	(6,744)	11,954
Financing income, net	1,159	674	607	1,284	1,182
Other financial expenses - non-cash charge relating to puttable warrant	(3,432)	--	--	--	--
Other income	--	141	--	--	--
Net income (loss)	(7,722)	1,614	(3,827)	(5,460)	13,136
Basic net earnings (loss) per share	$ (0.33)	$ 0.06	$ (0.15)	$ (0.20)	$ 0.44
Diluted net earnings (loss) per share	$ (0.33)	$ 0.06	$ (0.15)	$ (0.20)	$ 0.41
Weighted average number of shares used in computing basic earnings (loss) per share	23,063,160	25,066,937	26,137,121	26,728,053	29,692,670
Weighted average number of shares used in computing diluted earnings (loss) per share[4]	23,063,160	28,069,844	26,137,121	26,728,053	32,101,394

(1) The deferred stock-based compensation expenses presented for the years 2003-2005 in a separate line item were reclassified in the relevant expense line.

(2) In 2005, the amount includes $7,082 related to a write-off of inventories and $390 related to long-term receivables.

(3) In 2006, the amount includes a one-time charge of $10,444 related to an agreement with the Office of the Chief Scientist to terminate our grant program.

(4) Except for 2004 and 2007, 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,				
	2003	2004	2005	2006	2007
	(In thousands)				
Consolidated Balance Sheet Data:					
Cash and cash equivalents, short and long term bank deposits, short and long term marketable securities	$ 39,046	$ 37,801	$ 33,022	$ 29,485	$ 121,741
Working capital	30,481	38,827	34,871	47,268	132,420
Total assets	62,428	73,111	73,992	96,351	217,640
Total long term liabilities	2,451	2,986	3,424	12,277	9,936
Shareholders' equity	48,683	52,187	49,189	47,561	160,894

Risk Factors

The following risk factors, among others, could affect our actual results of operations and cause our actual results to differ materially from those expressed in forward-looking statements made by us. These forward-looking statements are based on current expectations and we assume no obligation to update this information. You should carefully consider the risks described below, in addition to the other information contained elsewhere in this annual report. The following risk factors are not the only risk factors facing our company. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also affect our business. Our business, financial condition and results of operations could be seriously harmed if any of the events underlying any of these risks or uncertainties actually occur. In that event, the market price for our ordinary shares could decline.

Risks Relating to Our Business

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

We have incurred operating and net losses in every fiscal year from our inception, other than 2004 and 2007, and we may incur losses in the future. For the years ended 2003, 2005 and 2006, we reported net losses of $7.7 million, $3.8 million and $5.5 million, respectively. As of December 31, 2007, our accumulated deficit was $120.6 million. While we achieved net income of approximately $13.1 million in the year ended December 31, 2007, we cannot assure you that we will operate profitably in the future or that our profitability will not decline. If we do not sustain our profitability, our share price could decline and the viability of our company will be in question.

Global competition and current market conditions in India and other parts of Asia have resulted in downward pressure on the prices for our products, which could result in reduced revenues, gross margins and profitability.

We operate in the wireless equipment market, which is characterized by vigorous, worldwide competition for market share and by rapid technological development. These factors have resulted in aggressive pricing practices and downward pricing pressures, as well as growing competition from both start-up companies and well-capitalized telecommunication systems providers. Moreover, competition for larger equipment orders is particularly intense since the number of large equipment orders in any year is limited. Consequently, we generally experience greater pricing pressure when we compete for larger orders as a result of this increased competition and demand from purchasers for greater volume discounts. As an increasing portion of our revenues is derived from large orders, we believe that our business will be more susceptible to these pressures.

Also, in recent years we have increased sales of our products in India and other parts of Asia in response to the rapid build-out of cellular networks in those regions. For the year ended December 31, 2007, 42% of our revenues were earned in the Asia/Pacific region. Sales of our products in these markets are generally at lower gross margins in comparison to other regions.

If we are unable to effectively respond to these pricing pressures, our revenues, gross margins and profitability could be materially reduced.

Consolidation of our potential customer base could harm our business.

The ongoing trend toward mergers in the telecommunications industry has resulted in the consolidation of our potential customer base. In situations where an existing customer consolidates with another industry participant which uses a competitor s products, our sales to that existing customer could be reduced or eliminated completely to the extent that the consolidated entity decides to adopt the competing products. Further, consolidation of our potential customer base could result in purchasing decision delays as consolidating customers integrate their operations and could generally reduce our opportunities to win new customers to the extent that the number of potential customers decreases. Finally, as our customers become larger they may have more leverage to negotiate better pricing which could harm our revenues and gross margins.

We face intense competition from other wireless equipment providers. If we fail to compete effectively, our business, financial condition and results of operations would be materially adversely affected.

The market for wireless equipment is rapidly evolving, fragmented, highly competitive and subject to rapid technological change. Increased competition in the wireless equipment market could result in reduced demand for our products, price reductions and reduced gross margins, any of which could seriously harm our business and results of operations. In the area of high-capacity circuit-switched wireless network solutions, our primary competitors include Harris Stratex Networks, Inc., L.M. Ericsson Telephone Company, NEC Corporation (NEC) and Nokia Siemens Networks B.V. (NSN). In the area of IP-based wireless solutions, our primary competitors are Dragonwave, Inc. and Harris Stratex Networks, Inc. In addition to these primary competitors, a number of other communications equipment suppliers, including Alcatel-Lucent, Nera Networks AS, SIAE Microelectronica S.p.A. and ZTE Corporation, as well as other companies, offer or are developing products that compete with our products.

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. 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.

Additionally, the telecommunications equipment industry has experienced significant consolidation among its participants, and we expect this trend to continue. In mid-2006, Nokia and Siemens formed a joint venture to merge the Networks Business Group of Nokia and the carrier-related operations of Siemens into NSN. NSN began operations in April 2007. Other examples are the recent mergers of Alcatel and Lucent and of the wireless divisions of Harris and Stratex Networks, and the acquisition by Ericsson of Marconi. These consolidations have increased the size and thus the competitive resources of these companies. In the future, current and potential competitors may make strategic acquisitions or establish cooperative relationships among themselves or with third parties that may allow them to increase their market share and competitive position.

We expect to face increasing competitive pressures in the future. If we are unable to compete effectively, our business, financial condition and results of operations would be materially adversely affected.

We face intense competition from other high-speed communications solutions that compete with our high-capacity point-to-point wireless products, which could reduce demand for our products and have a material adverse effect on our business and results of operations.

Our products compete with other high-speed communications solutions, including fiber optic lines, leased copper lines and other wireless technologies. Some of these technologies utilize existing installed infrastructure and have achieved significantly greater market acceptance and penetration than high-capacity point-to-point wireless technologies.

Some of the disadvantages of high capacity, point-to-point wireless technologies that may make other technologies more appealing include:

Extreme Weather Conditions: wireless backhaul solutions may not operate optimally in certain extreme weather conditions, including severe rainfalls or hurricanes; and

Line-of-Sight Limitations: wireless backhaul solutions generally require a direct line-of-sight between antennas. Consequently, service providers often install these solutions on wireless 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 costs. Some base stations cannot be linked by line-of-sight solutions.

In addition, customers may decide to use transmission frequencies for which we do not offer products. To the extent that these competing communications solutions reduce demand for high-capacity point-to-point wireless transmission products, this reduction could have a materially adverse effect our business and results of operations.

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

We design, develop, manufacture and sell nearly all of our products to meet high-capacity point-to-point wireless backhaul needs. Nearly all of our revenues are generated from sales of our FibeAir® portfolio of products. We expect sales of our FibeAir® portfolio of products to continue to account for nearly 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 point-to-point wireless backhaul products than companies that sell multiple and diversified product lines or into multiple markets.

We sell a significant portion of our products through a small number of strategic relationships with OEMs at gross margins that are lower than the gross margins for our sales directly to customers, which lowers our overall gross margin. In addition, the loss of one or more of these key OEM relationships would result in a significant loss of revenues.

We market and sell our products to customers increasingly through three OEMs who integrate our solutions into their product offerings. We anticipate that sales to our three OEMs will constitute an increasing portion our business in the future. For the year ended December 31, 2007, sales to NSN, our largest OEM, represented approximately 10.0% of our revenues.

Our sales to our OEMs are made on the basis of purchase orders rather than long-term purchase commitments. Our relationships with our OEMs are generally governed by non-exclusive agreements that require us to competitively price our products, have no minimum sales commitments and do not prohibit our OEMs from offering products that compete with our solutions. The size of purchases by our OEMs typically fluctuates from quarter-to-quarter and year-to-year, and may continue to fluctuate in the future, which may affect our quarterly and annual results of operations.

Our OEM agreements typically have an initial term between one and five years and automatically renew for successive one year terms. Our agreement with NSN expires on November 1, 2008, unless terminated by either party upon a three months notice prior to such automatic renewal. Under certain customary circumstances, including failure to remedy a breach within 30 days of receiving written notice, either we or NSN may terminate the agreement. In addition, NSN has the right to terminate the agreement in the event we sell all or substantially all of our assets, merge or consolidate with a third party, or suffer a material change of ownership.

Some of our OEMs also possess significant resources and advanced technical capabilities and may, either independently or jointly with our competitors, develop and market products and related services that compete with our solutions. If either of these were to occur, our OEMs may discontinue marketing, distributing and supporting our solutions.

Furthermore, sales to our OEMs result in lower gross margins than sales directly to end-users through distributors and re-sellers and expose our business to a number of risks, each of which could result in a reduction in the revenues for our products. By selling our products to OEMs, we rely in part on the sales and marketing efforts of the OEMs, as well as on their post-sale support. These OEMs may decide to promote competing products or alternative technologies. If our OEMs fail to effectively market and support our products, or if we experience a loss or a substantial reduction in orders from these OEMs, or one of our OEMs terminates its relationship with us, our revenues may decline, and our business, financial condition, and results of operations would be materially adversely affected.

The creation of NSN may lead to fewer purchases of our products by NSN, which would significantly reduce our revenues.

As of November 2005, we entered into an OEM Purchase and Distribution Agreement, which we refer to as the Nokia OEM Agreement, with Nokia Corporation. Under the Nokia OEM Agreement, Nokia agreed to include our products with its microwave radio product portfolio as Nokia PowerHopper Vario to provide complete wireless transmission networking solutions. After the creation of NSN by Nokia and Siemens in mid-2006, Nokia assigned the Nokia OEM Agreement to NSN. During 2007, sales to NSN accounted for approximately 10% of our revenues. Siemens has products and capabilities to develop products that compete with some of ours, and we cannot assure you that NSN will continue to make substantial purchases of our products under the Nokia OEM Agreement. These purchasing decisions can be made by NSN on a regional basis, product basis or customer basis. If NSN decides to promote Siemens current or future products rather than ours, NSN could become a competitor of ours in addition to, or instead of, being a strategic partner, which could decrease our sales to NSN and significantly reduce our revenues.

We cannot assure you that we will be able to sustain our recent revenue growth rate which may reduce our share price.

Our revenues have grown rapidly over the last several years. Our revenues for the years ended December 31, 2005, 2006 and 2007 were $73.8 million, $108.4 million and $161.9 million, respectively. We cannot assure you that we will be able to sustain our recent growth rate in future periods. You should not rely on our revenue growth in any prior quarterly or annual period as an indication of our future revenue growth. If we are unable to maintain adequate revenue growth, our share price may decline. You must consider our business and prospects in light of the risks and difficulties we encounter as a rapidly growing technology company.

We rely on a limited number of contract manufacturers to manufacture our products and if they experience delays, disruptions, quality control problems or a loss in capacity, it could materially adversely affect our operating results.

We outsource all of our manufacturing processes to a limited number of contract manufacturers that are located in Israel and the Philippines. We do not have long-term contracts with any of these contract manufacturers. We have experienced and may in the future experience delays in shipments from these contract manufacturers.

Our contract manufacturers may themselves in the future experience manufacturing problems, including inferior quality and insufficient quantities of components. These delays, disruptions, quality control problems and loss in capacity could result in delays in deliveries of our product to our customers, which could subject us to penalties payable to our customers, increased warranty costs and possible cancellation of orders. If our contract manufacturers experience financial, operational, manufacturing capacity or other difficulties, or shortages in components required for manufacturing, 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 in a timely and cost-effective manner. In addition, some of our contract manufacturers have granted us licenses with respect to certain technology that is used in a number of our products. If we change contract manufacturers, we may be required to renegotiate such licenses or re-design some of our products, either of which could increase our cost of revenues and cause product delivery delays. If we change manufacturers, during such a transition period, we may be more likely to face delays, disruptions, quality control problems and loss in capacity, and our sales, profits and customer relationships may suffer.

We may face problems in managing the growth of our business.

Our revenues grew from $54.8 million in 2004 to $161.9 million in 2007. The number of products manufactured by us through our contract manufacturers in these periods has grown significantly as well. If our growth continues at similar rates, we may face difficulties in managing such growth. Our success in handling rapid growth will depend on our ability to:

- manufacture (through our contract manufacturers) and deliver our products to our customers in a timely manner;
- develop efficient forecast methods for evaluating the prospective quantity of products that will be ordered by our customers;
- control inventories of components ordered by our contract manufacturers required to meet actual demand;
- streamline and automate processes in order to manufacture, ship and deliver on time larger quantities of equipment than in previous years;
- reduce the costs of manufacturing our products; and
- balance the need to hire and train new employees with the need to minimize costs.

If we are unable to manage our growth, we could lose sales or fail to manage costs associated with our sales, either of which would have a material adverse effect on our business and results of operations.

Our contract manufacturers obtain some of the components included in our products from a limited group of suppliers and, in some cases, single or sole source suppliers. The loss of any of these suppliers could cause us to experience production and shipment 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 or sole source supplier. Our contract manufacturers dependence on a single or sole source supplier or on a limited number of suppliers subjects us to the following risks:

The component suppliers may experience shortages in components and interrupt or delay their shipments to our contract manufacturers. Consequently, these shortages could delay the manufacture of our products and shipments to our customers which could 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. In such an event, our contract manufacturers or we may be unable to develop alternative sources for the components necessary to manufacture our products, which could force us to redesign our products. Any such redesign of our products 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 bring about lower gross margins.

The component suppliers may increase component prices significantly at any time and with immediate effect, particularly if demand for certain components increases dramatically in the global market. These price increases would increase component procurement costs and could significantly reduce our gross margins and profitability.

Our ability to grow depends on acceptance by our customers of IP-based solutions and our ability to develop and introduce IP-based products.

The market for IP-based backhaul equipment for mobile networks is just beginning to evolve. Our future success depends in part on the acceptance by customers of IP-based networks, IP-based or hybrid backhaul solutions and IP-based or hybrid products that we are developing. We cannot control third-party adoption of IP-based backhaul over competing backhaul solutions such as fiber optic lines. Moreover, our future success depends on our ability to design and manufacture IP-related products that satisfy our customers evolving and changing needs for IP-based networks and for IP-based backhaul. If the IP-based backhaul for mobile networks market does not develop at the rate we expect as a result of alternative or changing technologies, changes in product standards and regulation, inability to gain customer acceptance or for any other reason, our future growth, business, financial condition, and results of operations may be materially adversely affected.

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If we do not succeed in developing and marketing new products that keep pace with technological developments, changing industry standards and our customers needs, we may not be able to grow our business.

The market for our products is characterized by rapid technological advances, changing customer needs and evolving industry standards, as well as increasing pressures to make existing products more cost efficient. 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, including technological improvements which reduce the cost and manufacturing time; and

deliver products through appropriate distribution channels.

In addition, the wireless equipment industry is subject to evolving industry standards. The emergence or evolution of new industry standards for wireless products, through official standards committees or widespread use by operators, could require us to modify our products. Any such modifications may be expensive and time-consuming or we may not be able to meet these standards at all. If new industry standards emerge that we do not anticipate, our products could be rendered obsolete and we may be required to modify our products in ways that could increase our product costs and adversely affect our profitability.

We are continuously seeking to develop new products and enhance our existing products. Developing new products and product enhancements requires research and development resources and cooperation with subcontractors. 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 which would have a material adverse effect on our ability to grow our business.

We rely on a limited number of contractors as part of our research and development efforts.

We conduct a part of our research and development activities through outside contractors. We depend on our contractors ability to achieve stated milestones and commercialize our products, and on their ability to cooperate and overcome design difficulties. Our contractors may experience problems, including the inability to recruit professional personnel, which could delay our research and development process. These delays could:

- increase our research and development expenses;
- delay the introduction of our upgraded and new products to current and prospective customers and our penetration into new markets; and
- adversely affect our ability to compete.

If our contractors fail to perform, we may be unable to secure alternative contractors that meet our needs. Moreover, qualifying new contractors may also increase our research and development expenses.

Our sales cycles in connection with competitive bids or to prospective customers are lengthy.

It typically takes from three to twelve months after we first begin discussions with a prospective customer before we receive an order from that customer. In some instances, we participate in competitive bids in tenders issued by our customers or prospective customers. These tender processes can continue for many months before a decision is made by the customer. As a result, we are required to devote a substantial amount of time and resources to secure sales. In addition, the lengthy sales cycle results in greater uncertainty with respect to any particular sale, as events may occur during the sales cycle that impact customers decisions which, in turn, increases the difficulty of forecasting our results of operations.

We sell other manufacturers products as an OEM, which subjects us to various risks that may cause our revenues to decline.

We sell a limited number