You can count on the benefits

NICE Systems Annual Report 2001

NICE Systems is a global leader of business interaction management with market-leading multimedia digital recording solutions, applications and related professional services. NICE's synergistic technology platforms enable customers to capture, evaluate, analyze and improve business interactions to enhance business processes and gain competitive advantages. NICE products and solutions are used in contact centers, trading floors, air traffic control (ATC) sites, closed circuit television (CCTV) security installations and government agencies.

NICE is a public company traded on NASDAQ (NICE) and on the Tel Aviv Stock Exchange (Nice).

To Our Shareholders,

We began 2001 with some very aggressive short-term objectives, and I am pleased to report that we achieved all of them. This is particularly gratifying in view of the challenging market environment, which was characterized by reductions in IT budgets, lengthening sales cycles, and intense competition.

Building on Fundamental Strengths

We ended the year with the same basic strengths with which we began: excellent technology and products, a strong blue-chip customer base, an outstanding team of people, and prestigious strategic partners. In addition, our competitive position was improved by strengthening our management team, creating a more appropriate organizational structure, leveraging our professional services capability, lowering our expense profile and improving our working capital management.

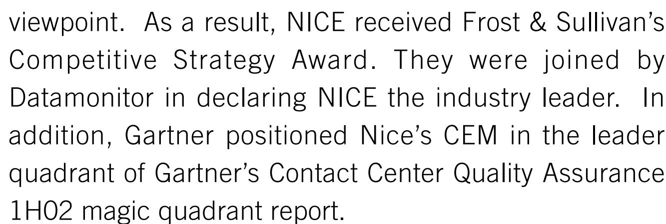
In retrospect, perhaps the most important decision was moving aggressively on all fronts to make necessary changes as quickly as possible, even though the disruption could hurt our short term results. After reporting a substantial loss in Q1, we snapped back quickly and made a significant improvement in each subsequent quarter, ending the year with higher gross margins, positive net operating cash flow and a strong balance sheet.

Validating Our Strategy

During 2001, while improving our operational efficiency, we made a comprehensive review of our business at the strategic level and concluded several things:

Our core technology and products – multimedia recording platforms– represent extremely valuable assets. The ability to capture interactions efficiently and cost-effectively is the foundation upon which many other performance-enhancing solutions must be built. What hasn't been captured can't be analyzed, evaluated, understood, or acted upon. Our strategy was validated when Frost & Sullivan, prominent industry experts, published a report in the third quarter of 2001, predicting that total recording capabilities will account for an increasing proportion of the market over the next several years.

Our vertical market expertise and ability to anticipate customers' needs is an important competitive strength. Throughout 2001, we received accolades from all the major industry analysts for our leadership and vision. Various industry groups bestowed more than a dozen product awards on us during the year, many of them "Product of the Year" designations. For example, we used our industry leadership to popularize the concept of Customer Experience Management (CEM) in the contact center market and, by yearend, over 20 competing companies and most industry commentators had adopted our terminology and market



viewpoint. As a result, NICE received Frost & Sullivan's Competitive Strategy Award. They were joined by Datamonitor in declaring NICE the industry leader. In addition, Gartner positioned Nice's CEM in the leader quadrant of Gartner's Contact Center Quality Assurance 1H02 magic quadrant report.

We have strong positions in several large, emerging market segments. We are number one or have the prospect of attaining that position in several market segments with very strong growth prospects including contact center performance and digital video security. Some of these segments are not only experiencing strong growth but are under-penetrated, particularly outside the United States. We also see excellent prospects for other, more mature segments that are growing more slowly but where competition is fragmented. We believe that introducing upgraded solutions and new applications into these markets create attractive growth opportunities. Examples of these segments include financial trading floors and public safety.

Expanding Market Boundaries

We are in the early phase of market development for value-added applications that will extend the boundaries of our current markets. There is enormous long-term potential to leverage our core recording capabilities, by introducing innovative new valued-added applications tailored to specific markets and vertical segments. Our quality monitoring and e-learning solutions for agent performance optimization have already experienced initial success. In addition, our audio and video content analysis applications will also increase the size of the overall market and afford strong growth opportunities in 2003 and beyond.

Emphasizing Product Development

One of our key goals this year was to position us for future growth by expanding the breadth of each of our major product lines. During 2001, we introduced both total recording and quality monitoring solutions tailored to the specific needs of smaller contact centers to give customers the best possible solution for each of their locations regardless of size. Our market-leading high-end suite of multimedia contact center solutions were enhanced with new features and capabilities such as capture capabilities for web chat, email and agent screen activity as well as VoIP (Voice over Internet Protocol).

Similarly, we introduced a mid-range solution in our digital video recording product line, while also improving our premium solution for applications such as real-time casino requirements and transportation security needs. In addition to superior quality images from state-of-the-art compression technology, the new solution provides seamless integration with existing security systems and enhanced storage capabilities.

Responding to worldwide emphasis on improving security, a new aviation security initiative was launched that leveraged our experience as the leading provider of solutions for air traffic control. We also introduced two new solutions for the public safety market as well as an enhanced system for monitoring and recording a wide variety of telecom media including fixed and mobile networks and voice and data communications for law enforcement purposes.

Partnering for Success

By carefully listening to our customers, we know that it is vital for our solutions to be seamlessly integrated with other systems such as CRM solutions, business intelligence systems and other enterprise applications. Therefore, we have taken a leadership role in developing important partnerships with other solution providers. During 2001, we announced specific integration projects with a roster of prominent companies including Siebel Systems, Cisco Systems, Computer Associates and Boeing Autometric. A joint development agreement with Knowlagent aimed at offering innovative e-learning solutions to the contact center market was also announced.

Haim Shani
President & CEO

During 2001, we expanded our geographic reach by augmenting our long-standing distribution partnerships with premier firms such as Avaya. For example, in May, we formed a relationship to pursue the high-growth market in India with Tata Telecom a provider of world-class contact center solutions with more than 50 service centers across India. In August, we formed a distribution partnership with ITApps, a full-service Customer Loyalty Solutions provider headquartered in Hong Kong in order to further penetrate the Asia Pacific market.

Positioning for Growth

In 2002, we combined the digital video recording and threat analysis capabilities of the VIM Division with the government, military and law enforcement communications intelligence experience of the ISS Division to create a new Security Group. The newly-formed group constitutes a second "core" business that will address a market that currently exceeds $1 billion. The Security Group will pursue a dual business strategy. In addition to selling discrete solutions through existing channels and partnerships, we will pursue much larger, more comprehensive security projects that integrate all our products and expertise. On these larger projects, we expect to work with large, diversified companies and systems integrators that specialize in security solutions.

Going forward, our goals include attaining a leading market share position in each major market and expanding our global presence. In addition, our ongoing programs to outsource most of our manufacturing and further leverage our professional services organization are aimed at improving profitability.

I want to take this opportunity to recognize our outstanding employees for the tremendous effort they put forth during 2001, a period of major change for our company, as well as the patience and support from our board of directors and shareholders. The entire organization is now united in the goal of creating sustainable competitive advantage and, in turn shareholder value. We look to the future with confidence and anticipation.

H. Shani

Haim Shani
President and CEO

You can count on the experience

It's not often that a company sees its own terminology become mainstream. In NICE's case, the term "CEM-Customer Experience Management" now defines a whole market segment, and is used freely by NICE's competitors, not only its allies. That is because in today's tough markets, the quality of personal interaction can be key to the customer's perception.

The facts speak for themselves: Gartner Group positioned NICE's CEM in the leader quadrant of Gartner's Contact Center Quality Assurance 1H02 magic quadrant report, Datamonitor reported that NICE is the worldwide recording and quality management leader, and NICE received Frost and Sullivan's Competitive Strategy Award for pioneering CEM. Since CEM was launched in June 2000, twenty competing companies have adopted the terminology and NICE's CEM solutions have won thirteen product awards.

CEM from NICE is well established in the Americas and is now vigorously establishing a strong presence in new territories. The Asia-Pacific market has been identified as one of the strongest in the world for contact centers. In 2001, NICE opened a regional office in Hong Kong. Furthermore, the largest telecommunications provider in Hong Kong successfully implemented our CEM solution in its network of six contact centers.

The Indian market is also expanding, with the relocation of several large US and UK Contact Centers. To strengthen our market position in 2001, we entered into a partnership with Tata Telecom, the leader in India's call center market.

> "Everyone wants to improve customer satisfaction. NICE CEM helped us identify how to do it by identifying new business processes that reduced the time it takes to resolve each customer request. The results have been remarkable. Just nine months after we started with NICE, we reduced complaints by 90% and increased customer satisfaction to 80%."
>
> **Rutger Pekelharing**,
> *Managing Director, Intertwine*

1 TO BENEFIT FROM AWARD-WINNING SOLUTIONS

2 TO INSTILL MEASURABLE VALUE THROUGHOUT YOUR CONTACT CENTER

3 TO CREATE THE MOST LOYAL CUSTOMERS ON EARTH

NICE, as the pioneer of CEM, is proud of the confidence customers have placed in our concept and products. Despite the difficult market, sales to over 100 new CEM customers, and repeat sales to veteran customers, demonstrated market awareness of our unique advantages.

NICE's latest product offerings, including emotion detection, word spotting and customer idea management, demonstrate NICE's ability to introduce market and product innovations. In fact, our new introductions quickly jumped on the awards bandwagon with our idea management solution awarded Best Knowledge Management Product at the Call Center and CRM Solutions show in Las Vegas. At the same show, our content analysis solution was awarded Best Voice Processing Product.

We continue to broaden our offerings with solutions for smaller businesses. NiceAdvantage™, first launched in 2000, is a quality management solution for contact centers that have up to 100 seats. NiceCall® focus is for even smaller financial institutions and Call Centers with up to 32 channels.

NICE solutions interface with an even wider range of applications. We introduced new integrations in 2001 with Siebel eBusiness software, Cisco's Customer Contact Software and Computer Associate's Unicenter TNG.

You can count on the innovation

1. TO DELIVER COMPLETE SOLUTIONS
2. TO BE AN OPEN PLATFORM FOR CHANGE AND DEVELOPMENT
3. TO SET NEW STANDARDS OF INDUSTRY PERFORMANCE

> We took an extensive look at who could provide the equipment and the know-how to help us realize our vision for future web-enabled contact centers - NICE proved itself up the challenge.
>
> ***Veronica Murdock,***
> *Executive Vice President, Earthlink*

You can count on the security by

Secutity Group

Security awareness has heightened, and NICE is a natural key player. NICE delivers a wide range of products that manage multiple communication channels and integrate with security systems including access control and intrusion detection to provide the highest level of security management.

Worldwide, sales to corporations, retail outlets, and correctional facilities grew. Major US airports selected NiceVision® in 2001, for its real time alert and proactive security management capabilities, including unattended baggage. In Europe, we established a presence in the casino and gaming market.

Our global presence is empowered by a continuous stream of enhanced and new products. NiceVision® Pro, rolled out in 2001, offers the highest frame rate for the most detailed security information for more thorough investigation debriefing. Providing real-time video content analysis, this new market entry also leads the open architecture trend for easy system integration.

NiceVision® Harmony, also introduced in 2001, is a solution for mid-range video recording applications, that can function as a standalone unit, or can work as part of a unified system with NiceVision Pro.

NICE's strategy of partnering with industry leaders and third parties continues. Our integration with Visionic's FaceIt® technology enables subjects to be repeatedly identified as they move about the secured environment.

With increasing security awareness leading to stricter demands, NICE's proven technology and open architecture have the answers here and now.

"We've been very satisfied with the features and functionality of the NiceVision system, particularly the pre- and post-alarm recording, system modularity and scalability, and NICE's customer service. The NiceVision system was an enormous improvement over the analog system we had previously."

Adam Matheson,
Project Manager, Security Access Control System/CCTV.
Sydney Airport

1 MANAGING MULTI-CHANNEL COMMUNICATIONS SIMULTANEOUSLY

2 INTEGRATING WITH A WIDE RANGE OF SYSTEMS IN YOUR SECURITY ENVIRONMENT

3 VISUALLY DETECTING AND ALARMING SUSPICIOUS EVENTS

1 ACHIEVE NEW HEIGHTS OF RELIABILITY

2 INCREASE SAFETY AND SECURITY OF AIR AND SEA PORTS

3 COMMAND AND CONTROL CRITICAL SITES

You can count on high performance

Security Group

In 2001, we launched innovative solutions to meet the demand for advanced security powered by the latest technology. NiceTrack™, a comprehensive monitoring system designed by intelligence experts, was introduced to meet the special operational needs of law enforcement agencies. CDFS-5000, a surveillance and monitoring solution that operates on both fixed and mobile platforms, was also made available to the military intelligence market .

By far the leader in the Air Traffic Control (ATC) market, with 60% market share, NICE received several repeat orders in 2001. In addition we successfully expanded into a new market segment, by making NiceFix's Radio Direction Finding (DF) and navigation capabilities available for sea vessels. Already ordered by major port authorities, this solution was welcomed for its reliability and rapid integration.

Our NiceSoft™ digital radio recorder continues to be a preferred solution for providing synchronized access to radar screens and recorded voice conversations. NiceLog® and NiceCLS™ have been adapted to serve an effective command and control center for recording trunk radio.

ATC Installations

Angola	China	Finland	Hungary	Kazakhstan	Portugal	Sri Lanka
Austria	Croatia	Germany	ICAO	Luxemburg	Romania	Sweden
Azerbaijan	Cyprus	Greece	Iceland	Maldive Islands	Slovakia	Switzerland
Canada	Denmark	Greenland	Ireland	Moldova	Slovenia	Turkey
Cape Verde	Estonia	Holland	Israel	Norway	Somalia	U.K.
Chile	Fiji Islands	Hong Kong	Japan	Poland	Spain	U.S.

> We are pleased to upgrade our system to take advantage of new product features and expand our system to meet our new requirements.

Heinz Scmid, Project Manager
Skyguide, Swiss Air Navigation Services

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Management's Discussion and Analysis

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and the related notes and other financial information included elsewhere in this annual report. The discussion and analysis contains forward-looking statements that are based on current expectations and beliefs and involve numerous risks and uncertainties that could cause our actual results to differ materially from expectations. Such statements can be identified by the use of forward-looking terminology such as "anticipate", "believe", "estimate", "expect", "intend", "may", "plan", "project", "should" or other similar words. The forward-looking statements relate to, among other things: operating results; anticipated cash flows; gross margins; adequacy of resources to fund operations; our ability to maintain our average selling prices despite the aggressive marketing and pricing strategies of our competitors; our ability to maintain and develop profitable relationships with our key channel partners, one of which constitutes more than 10% of our revenues, and the financial strength of our channel partners.

Please read the section below entitled "Factors That May Affect Future Results" to review conditions that we believe could cause actual results to differ materially from those contemplated by the forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect our view only as of the date of this report. Except as required by law, we undertake no obligation to update these forward-looking statements to reflect future events or circumstances or the occurrence of unanticipated events.

Overview

We develop, market and support integrated, scalable multimedia digital recording platforms, software applications and related professional services for business interaction management and security needs. Our products and solutions are used primarily in contact centers, trading floors, closed circuit television security installations, government programs and intelligence agencies and in the air traffic control, transportation and public safety markets.

Our audio and screen recording products interface with telephone switches, turret systems, ACD and CTI servers of the world's leading telecommunications providers and our video/audio recording platforms can be easily integrated within existing network infrastructures and security systems. The development and marketing of software applications designed to enable our customers to analyze the recordings and their content for improved business performance continues to be a focal point of our strategy. Our software is also designed to be integrated with various third party software applications.

Our products are sold primarily through a global network of telecommunications infrastructure dealers and distributors; a portion of product sales and most services are sold directly to end-users. One customer accounted for approximately 12%, 19%, and 16% of revenues in 2001, 2000 and 1999, respectively.

In early 2001, with mounting evidence of an economic slowdown in the information technology and telecommunications sectors as well as the changing business dynamics, we conducted a comprehensive review of our strategy, products, organization and infrastructure. This review culminated in the restructuring of our global operations, including a phased reduction of approximately 340 of our 1,110 employees, consolidation of our field facilities in North America, expansion our local presence in Europe and Asia, and various other actions aimed at focusing on our core markets, products and competencies. In the event that we redefine our strategic direction and/or difficult economic conditions continue to prevail, we may be required to implement further restructuring measures. We are not currently able to determine whether or to what extent such circumstances may continue or worsen.

Critical Accounting Policies

Our consolidated financial statements have been prepared in accordance with U.S. GAAP. A discussion of the significant accounting principles which we follow in preparing our financial statements is set forth in Note 2 to our consolidated financial statements included elsewhere in this annual report. While all the accounting policies impact the financial statements, certain policies may be viewed to be critical. These policies are those that are both most important to the portrayal of our financial condition and results of operations and require our management's most difficult, subjective and complex judgments and estimates. Actual results may differ from these estimates under different assumptions or conditions.

Revenue recognition. Revenue related to sales of our products is generally recognized when persuasive evidence of an agreement exists; the product has been delivered and title and risk of loss have passed to the buyer; the sales price is fixed and determinable, no further obligations exist, and collectibility is probable. Arrangements under which a distributor is obligated to pay only as and if sales are made to end-users are accounted for as consignment sales.

Revenue from services, which include installation, project management, training, and time and material support, are recognized as the services are performed. Maintenance revenue is recognized ratably over the term of the maintenance obligation.

When transactions involve multiple elements, revenue is allocated to element based on Vendor Specific Objective Evidence, or VSOE, of the relative fair values of each element in the arrangement, according to the residual method as prescribed in SOP 98-9 "Modification of SOP 97-2, Software Recognition With Respect to Certain Transactions". Our VSOE used to allocate the sales price to support services and maintenance is based on the price charged when these elements are sold separately.

We record a provision for estimated sales returns and allowances on product sales in the same period as the related revenues are recorded. We base these estimates on historical sales returns and other known factors. Actual returns could be different from our estimates and current provisions for sales returns and allowances may need to be increased.

Revenues from fixed-price contracts that require significant customization are recognized using the percentage-of-completion method generally on the basis of value added and results achieved out of the completeness of the product as a whole.

Allowance for doubtful accounts. We evaluate the collectibility of our accounts receivable based on a combination of factors. In circumstances where we are aware of a specific customer's inability to meet its financial obligations to us, we record a specific allowance against amounts due to reduce the net recognized receivable to the amount we reasonably believe will be collected. For all other customers, we recognize allowances for doubtful accounts based on the length of time the receivables are past due and our historical experience. If the financial condition of one of our significant customers or our customers in general should deteriorate, additional allowances may be required.

Inventory valuation. At each balance sheet date, we evaluate our ending inventories for excess quantities and obsolescence. This evaluation includes analyses of sales levels by product and projections of future demand. In addition, we write off inventories that are considered obsolete. 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 sales in the period the revision is made.

Impairment of long-lived assets. We routinely consider whether indicators of impairment of long-lived assets and certain identifiable intangible assets are present. If such indicators are present, an impairment loss would be recognized if the sum of the estimated future undiscounted cash flows expected to result from the use of the asset is less than its carrying amount. We use fair value in determining the amount of impairment loss that should be recorded. We may incur impairment losses in future periods if factors influencing our estimates change.

In July 2001, the Financial Accounting Standards Board issued SFAS No. 142 "Goodwill and Other Intangible Assets." Under SFAS No. 142, goodwill and intangible assets with indefinite lives will no longer be amortized, but rather reviewed for impairment on a periodic basis. We will adopt the provisions of this Statement effective January 1, 2002. This Statement is required to be applied to all goodwill and other intangible assets recognized in our financial statements at such date. Impairment losses for goodwill and certain intangible assets that arise due to the initial application of this Statement are to be reported as resulting from a change in accounting principle. We have not yet completed an analysis of the potential impact upon adoption of the impairment tests of goodwill and certain intangible assets, however, amortization of existing goodwill and certain intangibles will cease upon adoption.

Deferred income taxes. We record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. We have considered future taxable income and prudent and feasible tax planning strategies in determining the need for a valuation allowance. Our current valuation allowance covers the tax benefit from net operating losses and reserves and allowances. When these tax benefits are reasonably determined to be realizable, the valuation allowance will be reversed and credited to earnings in the period that such determination is made.

Contingencies. From time to time, we are defendant or plaintiff in various legal actions, which arise in the normal course of business. We are also a defendant in a class action and intellectual property infringement actions. We are required to assess the likelihood of any adverse judgments or outcomes to these matters as well as potential ranges of probable losses. A determination of the amount of reserves required for these contingencies, if any, which would be charged to earnings, is made after careful and considered analysis of each individual action together with our legal advisors. The required reserves may change in the future due to new developments in each matter or changes in circumstances, such as a change in settlement strategy. A change in the required reserves would effect our earnings in the period the change is made.

Operating Results

The following table sets forth for the periods indicated certain line items from our statement of operations as a percentage of our total revenues:

	Year Ended December 31,		
	1999	**2000**	**2001**
Revenues	100.0%	100.0%	100.0%
Cost of revenues	41.8	48.0	58.0
Gross profit	58.2	52.0	42.0
Operating expenses			
Research and development expenses, net	10.5	12.7	15.1
Selling and marketing expenses	22.0	23.1	27.6
General and administrative expenses	16.0	18.5	21.4
Restructuring charges	0.0	0.0	11.5
Other special charges	4.4	4.4	0.0
Amortization of acquired intangibles	0.2	0.6	2.7
Total operating expenses	53.1	59.3	78.3
Operating income (loss)	5.1	(7.3)	(36.3)
Financial income, net	4.1	4.0	3.3
Other income (expense), net	0.0	0.0	(3.8)
Income (loss) before taxes on income	9.2	(3.3)	(36.8)
Taxes on income	0.1	0.2	0.2
Net income (loss)	9.1	(3.5)	(37.0)

Year Ended December 31, 2001 Compared to Years Ended December 31, 2000 and 1999

Revenues. Our revenues decreased to $127.1 million in 2001 from $153.2 million in 2000, and $117.4 million in 1999. The 17% decrease in revenues in 2001 was due primarily to the overall slowdown in technology spending combined with the impact, particularly in North America, of internal operational changes implemented in early 2001. Sales in North America declined 26% in 2001 (after increasing 40% in 2000). Sales in Europe (including Israel) decreased 14% and sales in the rest of the world rose 2% in 2001. On a product line basis, sales of our multimedia recording and quality management (CEM) products decreased 22% to $99.8 million in 2001 and represented 79% of total revenues; sales of digital video products declined 11% to $14.1 million and represented 11% of total revenues, and revenues from sales of COMINT systems increased 52% to $13.2 million and accounted for 10% of total revenues.

The 30% increase in revenues in 2000 from the prior year was due mainly to a 25% increase in sales of our CEM products, particularly in North America, and the successful market introduction of the functionality-rich version of the NiceVision digital video recorder.

Cost of revenues. Cost of revenues was $73.8 million in 2001 compared with $73.6 million in 2000 and $49.0 million in 1999. During 2000, we more than doubled the number of customer support staff who provide installation and technical support to our customers from about 100 at the start of the year to approximately 210 at the end of December 2000. Of the total, 37 support employees joined us as part of the December 2000 acquisition of the direct sales and customer support channel and service and maintenance agreements of our then largest distributor in North America, Stevens Communications, Inc.

As a result, the increase in cost of revenues in 2001 was due primarily to the impact on an annual basis of the significant increase in the number of customer support employees and related costs without a commensurate increase in customer support revenue, which resulted in a substantial negative gross profit on customer support. This increase in customer support cost was only partly offset by lower sales volume and manufacturing labor costs. Going forward, we are focused on improving our pricing for customer support services and increasing revenue from the sale of maintenance contracts. The increase in cost of revenues in 2000, as compared with 1999, was due principally to higher sales volume, manufacturing labor costs, and inventory provisions.

Gross profit. For the reasons mentioned above, gross profit was $53.3 million in 2001 compared with $79.6 million in 2000, and $68.4 million in 1999. Gross profit margin was 42.0%, 52.0% and 58.2% in 2001, 2000 and 1999, respectively.

Research and development, net. Research and development expense, before capitalization of software development costs and grants, rose to $26.0 million in 2001 from $25.4 million in 2000, and $15.2 million in 1999 and represented 20.5%, 16.6% and 13.0% of revenues in 2001, 2000 and 1999, respectively. The level of spending reflects our efforts to continue to improve our long-term competitive position. In 2000, we increased the number of research and development staff by 24% in order to support the development of new or enhanced products for each of our product lines. In 2001, these efforts included major functionality improvements to our voice recording platforms and quality monitoring and contact center

performance applications; as well as the market introduction of the NiceVision Pro high-end video recording platform and the NiceTrack telecommunications monitoring solution. The increase in gross research and development expense in both 2001 and 2000 resulted from the overall average higher level of research and development staff.

Software development costs capitalized were $5.4 million in 2001 compared with $4.7 million in 2000, and $2.6 million in 1999. Net research and development expense decreased 2% in 2001 to $19.2 million from $19.5 million in 2000, and from $12.4 million in 1999. Amortization of capitalized software development costs, included in cost of revenues, was $2.8 million, $1.6 million and $1.1 million in 2001, 2000 and 1999, respectively.

Selling and marketing expenses. Selling and marketing expenses were $35.0 million, $35.4 million and $25.8 million in 2001, 2000, and 1999, respectively. The decrease in selling and marketing expenses in 2001 was due principally to involuntary reductions in staff, lower revenue-related expenses and lower discretionary marketing outlays only partly offset by expansion of our sales and marketing infrastructure in Europe and Asia.

The increase in selling and marketing expenses in 2000 was due mainly to the creation of separate and expanded sales and marketing infrastructures for our CEM, digital video and COMINT products and increased promotional activities related to the launch of the CEM concept.

General and administrative expenses. General and administrative expenses were $27.1 million in 2001, $28.3 million in 2000 and $18.7 million in 1999. The decrease in 2001 was due primarily to the reduction in administrative staff and cost containment efforts. The increase in general and administrative expenses in 2000 was due mainly to increased personnel and related overhead, outlays for improvements to various management information systems, and an increase in the allowance for doubtful accounts receivable.

Restructuring charges. As a result of the decline in general economic and business conditions in late 2000 and the changing competitive environment, we implemented a restructuring program in 2001 to better align our cost structure with the current business environment and to focus our resources on the highest potential growth areas of our business. As a result, we incurred a $14.6 million charge for restructuring costs in the first quarter of 2001.

Our restructuring program included a 30% reduction in force across all business functions. Approximately 60% of such employees are or were based in Israel and the remainder were based primarily in North America. The workforce reduction resulted in a charge of $9.6 million for termination benefits. We also consolidated our North American operations into two main facilities and eliminated excess field office space. The restructuring program included a charge of $1.9 million for lease terminations and estimated losses on subleases and $1.9 million for nonrecoverable investments in leasehold improvements and facility equipment. The restructuring program included exiting a product line acquired as part of the Dees transaction. As a result, a charge of $1.1 million, relating to the impairment of the associated goodwill was taken.

The restructuring program was substantially completed by December 31, 2001 with the principal exception of employee terminations related to the completion of the outsourcing of manufacturing of our products. The expected cash impact of the total charge is $11.5 million of which $9.0 million was paid in 2001. Remaining cash expenditures relating to workforce reductions are expected to be substantially paid by mid-2002. Amounts relating to the consolidation of facilities will be paid over the respective lease terms mainly through 2003.

Other special charges. In 2000, the Company recorded a charge of $6.8 million related to in-process research and development of software acquired in the CenterPoint Solutions, Inc. transaction for which technological feasibility had not yet been established and for which no alternative future use existed. In 1999, the Company recorded a charge of $5.2 million to write-off certain items, including in-process research and development of software, arising in the acquisition of STS Software Systems Ltd.

Amortization of acquired intangibles. Amortization expense was $3.4 million, $0.9 million and $0.3 million in 2001, 2000 and 1999, respectively. The increase in 2001 is due mainly to the acquisition of certain assets of SCI.

Financial income, net. Financial income, net decreased 31% to $4.3 million in 2001 after increasing 29% to $6.2 million in 2000 from $4.8 million in 1999. The decrease in 2001 reflects lower average cash balances and lower average interest rates in 2001 compared with 2000. The increase in 2000 is due primarily to higher average interest rates on investment balances. We expect that net financial income will decline in 2002 due principally to lower average market interest rates.

Other income (expense), net. Other expense, net was $4.8 million in 2001 compared with other income, net of $53 thousand in 2000 and net other expense of $4 thousand in 1999. In 2001, we recorded a one-time $4.4 million charge following the settlement of a dispute with SCI relating to certain post-closing adjustments in connection with the acquisition by NICE.

Net income (loss). Net loss was $46.8 million in 2001 compared with $5.3 million in 2000 and net income of $10.8 million in 1999. The decrease in 2001 and 2000 resulted primarily from the factors described above.

Quarterly Results

The following table presents unaudited quarterly financial information for each of the four quarters in the year ended December 31, 2001. Such information has been prepared on the same basis as our consolidated financial statements.

	Quarter Ended			
	March 31, 2001	June 30, 2001	September 30, 2001	December 31, 2001
	(in thousands of U.S. dollars)			
Revenues	$ 25.1	$ 30.5	$ 33.8	$ 37.7
Gross profit	7.2	12.2	15.5	18.3
Research and development, net	5.4	4.8	4.6	4.4
Operating loss	(29.9)	(8.8)	(5.0)	(2.3)
Net loss	(28.9)	(7.9)	(4.1)	(5.9)

Our operating results may be subject to significant fluctuations in future periods. Our operating results for any particular quarter are not necessarily indicative of any future results. Our quarterly operating results may be subject to significant fluctuations due to various factors, including the length of the sale cycles, the timing and size of orders and shipments to customers, variations in distribution channels, mix of products, new product introductions, competitive pressures and general economic conditions.

Qualitative and Quantitative Disclosure About Market Risk

Market risks relating to our operations result primarily from weak economic conditions in the markets in which we sell our products and changes in interest rates and exchange rates. To manage the volatility related to the latter exposure, we may enter into various derivative transactions. Our objective is to reduce, where it is deemed appropriate to do so, fluctuations in earnings and cash flows associated with changes in currency exchange rates. It is our policy and practice to use derivative financial instruments only to manage exposures. We do not use financial instruments for trading purposes and are not a party to any leveraged derivative.

Foreign Currency Risk. We conduct our business primarily in U.S. dollars but also in the currencies of the United Kingdom, Canada, Germany and Israel. Thus, we are exposed to foreign exchange movements, primarily in European and Israel currencies. We monitor foreign currency exposure and, from time to time, may enter into various contracts to preserve the value of sales transactions and commitments.

Interest Rate Risk. We invest in investment-grade U.S. corporate bonds and dollar deposits with FDIC-insured U.S. banks. Since these investments carry fixed interest rates and since our policy and practice is to hold these investments to maturity, interest income over the holding period is not sensitive to changes in interest rates. As of December 31, 2001, we had no other exposure to changes in interest rates and had no interest rate derivative financial instruments outstanding.

Liquidity and Capital Resources

We have historically financed our operations through cash generated from operations and sales of equity securities. Cash and cash equivalents and short and long-term investments were $89.0 million and $98.0 million at December 31, 2001 and 2000, respectively, a decrease of $9.0 million. Cash and cash equivalents increased $6.6 million and short and long-term investments decreased by $15.6 million.

For 2001, cash provided by operations was $0.8 million, compared with cash used in operations of $2.1 million in 2000 and cash provided by operations of $19.6 million in 1999. The improvement in 2001 compared with 2000 was primarily attributable to an overall improvement in working capital associated with substantial reductions in accounts receivable and inventories largely offset by the $46.8 million loss incurred in the year. The decrease in cash from operations in 2000 compared with 1999 was due primarily to the net loss and increases in accounts receivable and inventories.

Net cash provided by investing activities was $3.9 million in 2001. Net cash used in investing activities was $18.1 million and $35.1 million in 2000 and 1999, respectively. The increase in 2001 reflects lower capital expenditures and lower outlays for acquisitions. Capital expenditures were $7.6 million, $14.2 million and $10.1 million in 2001, 2000 and 1999, respectively. The capital expenditures in 2001 resulted from investment in a global ERP system and equipment for research and development purposes. As of December 31, 2001, we have no material commitment for capital expenditures.

Net cash provided by financing activities (mainly net proceeds from the issuance of shares upon the exercise of stock options) was $1.9 million, $15.0 million and $10.3 million in 2001, 2000 and 1999, respectively, primarily as a result of stock options exercised. We have available for use short-term revolving lines of credit at a number of commercial banks totaling up to $30 million. There are no financial covenants associated with these credit lines. As of December 31, 2001, we had no amount outstanding on our lines of credit.

We believe that based on our current operating forecast, the combination of existing working capital, expected cash flows from operations and available credit lines will be sufficient to finance our ongoing operations for the next twelve months. Depending upon our future growth, the success of our business initiatives and acquisition opportunities, we will consider from time to time various financing alternatives and may seek to raise additional capital to finance our strategic efforts through debt or equity financing or to enter into strategic arrangements.

Factors That May Affect Future Results

We operate globally in a dynamic and changing environment that involves numerous risks and uncertainties. The following discussion includes a discussion of some, but not all, of those risks and uncertainties that could cause actual results and outcomes to differ materially from those contained in any forward-looking statement made by us or on our behalf.

We are subject to the effects of general global economic and market conditions. Our operating results have been materially adversely affected as a result of recent unfavorable economic conditions and reduced information technology spending, particularly in the product segments in which we compete. During 2001, there was a decrease in demand for our type of products as customers delayed or reduced information technology expenditures. If economic and market conditions do not improve, our business, results of operations or financial condition could continue to be materially adversely affected.

During 2002, we plan to migrate towards the outsourcing of the manufacturing of all of our key products. We may experience delivery delays due the inability of the outsourcer to consistently meet our quality or delivery requirements. If this supplier or any other supplier were to cancel contracts or commitments with us or fail to meet the quality or delivery requirements needed to satisfy customer orders for our products, we could lose time-sensitive customer orders and have significantly decreased quarterly revenues and earnings, which would have a material adverse effect on our business, results of operations and financial condition.

We have recently established a significant sales infrastructure in Hong Kong and the United Kingdom by relocating a significant portion of our Israel-based sales operations and by recruiting new managers and sales persons in order to bring about a growth in revenue. We expect continued growth, particularly in connection with the enhancement and expansion of our operations in Europe, the Middle East and Africa (EMEA) as well as in the Asia Pacific (APAC) region. However, we cannot assure you that our revenues will increase as a result of this relocation and expansion or that we will be able to recover the expenses we incurred in effecting the relocation and expansion. Our failure to effectively manage the expansion of our manufacturing, sales, marketing, service and support organizations could have a negative impact on our business.

To accommodate our recent global expansion, we are implementing a variety of new or expanded business systems, procedures and controls. There can be no assurance that the implementation of such systems, procedures, controls and other internal systems can be completed successfully. If our growth continues, we will be required to hire and integrate new employees. There can be no assurance that we will be able to successfully recruit and integrate new employees. Competition for highly skilled employees, including sales, technical and management personnel, is high in the technology industry. Our failure to manage growth effectively, including our failure to attract talented employees or retain the services of key personnel, could have a material adverse effect on our results of operations and financial position.

The sales cycle for our solutions is variable, typically ranging between a few weeks to several months from initial contact with the potential client to the signing of a contract. Occasionally sales require substantially more time. Delays in executing client contracts may affect our revenue and cause our operating results to vary widely. Any delays in payment or on the achievement of milestones may have a material adverse impact on our financial position.

The operating results of many technology companies reflect seasonal trends, and we expect to be affected by such trends in the future. Although we have not experienced consistent seasonal fluctuations in operational results to date, we believe that it is likely that we will experience relatively higher revenues in the fourth quarter and relatively lower revenues in the first quarter due mainly to customers' annual purchasing and budgetary practices.

As a high percentage of our expenses, particularly employee compensation, is relatively fixed, a variation in the level of sales, timing of the initiation, progress or completion of projects or engagements, especially at or near the end of any quarter, may have a material adverse impact on our quarterly operating results.

The market for our products and related services, in general, is highly competitive. Additionally, some of our principal competitors have significantly greater resources than do we. Price reductions or declines in demand for our products and services, whether as a result of competition, weak economic conditions, market-related issues or technological change, would have a material adverse effect on our results of operations and financial position.

Variations in our revenue and operating results could occur as a result of a number of other factors, such as the budgeting and purchasing practices of our customers, the length of the customer product evaluation process, the timing and cost of new product introductions and product enhancements, availability of components and the timing of any acquisitions and associated costs. Variations in sales channels, product costs or mix of products sold, changes in exchange rates and general economic conditions in our geographic areas of operations could also have a material adverse impact on operations and financial results.

We have agreements in place with many distributors, dealers and resellers to market and sell our products and services in addition to our direct sales force. We may, from time to time, derive a significant percentage of our revenues from one or more of our distributor channels. Our financial results could be materially adversely affected if our contracts with channel partners were terminated, if our relationship with channel partners were to deteriorate or if the financial condition of our channel partners were to weaken. In addition, as our market opportunities change, we may have increased reliance on particular channel partners, which may negatively impact gross margins. There can be no assurance that we will be successful in maintaining or expanding these channels. If we are not successful, we may lose sales opportunities, customers and market share. In addition, there can be no assurance that our channel partners will not develop or market products or services in competition with us in the future.

Additional factors that may cause actual results to differ materially from our expectations include our ability to manage expense and inventory levels, the continued financial strength of our customers, dealers and distributors, our ability to offer financing vehicles to our customers, our ability to manage accounts receivable, our ability to continuously develop, introduce and deliver commercially viable products, solutions and technologies, the market's rate of acceptance of the solutions we offer, our ability to keep pace with market and technology changes and to compete successfully and our ability to manage the competitive risks associated with the strategic alliances that we have entered into.

As part of our growth strategy, we may, from time to time, acquire or invest in complementary businesses, products or technologies. We frequently evaluate the tactical or strategic opportunity available related to complementary businesses, products or technologies. The process of integrating an acquired company's business into our operations and/or of investing in new technologies, may result in unforeseen operating difficulties and large expenditures and may absorb significant management attention that would otherwise be available for the ongoing development of our business. Moreover, there can be no assurance that the anticipated benefits of any acquisition or investment will be realized. Future acquisitions or investments contemplated and/or consummated could result in potentially dilutive issuances of equity securities, the incurrence of debt and contingent liabilities, amortization expenses related to intangible assets, any of which could have a material adverse effect on our operating results and financial condition.

We have also invested in companies, which can still be considered in the start-up or development stages. These investments are inherently risky as the market for the technologies or products they have under development are typically in the early stages and may never materialize. We could lose our entire initial investment in these companies.

Our products focus specifically on organizations' business-critical operations. The provisions of our sales contracts limit our exposure to potential liability claims. Although we carry product liability and errors and omissions insurance against such claims, there can be no assurance that such insurance will continue to be available on acceptable terms, if at all, or that such insurance will provide us with adequate protection against any such claims. A significant liability claim against us could have a material adverse effect on our results of operations and financial position.

Our success is dependent, to a certain extent, upon our proprietary technology. We currently rely on a combination of patent, trade secret, copyright and trademark law, together with non-disclosure and non-compete agreements, to establish and protect the technology used in our systems. However, we cannot assure you that such measures will protect our proprietary technology, that competitors will not develop products with features based upon, or otherwise similar to, our systems or that we will prevail in any proceeding instituted by us in order to enjoin competitors from selling similar products. Although we believe that our products do not infringe upon the proprietary rights of third parties, we cannot assure you that one or more third parties will not make a contrary claim or that we will be successful in defending such claim.

We derive and expect to continue to derive significant benefits from various programs and laws in Israel including tax benefits relating to our "Approved Enterprise" programs and grants from the Office of the Chief Scientist, or OCS, for research and development. To be eligible for these grants, programs and tax benefits, we must continue to meet certain conditions, including making certain specified investments in fixed assets. From time to time, the Israeli Government has discussed reducing or eliminating the availability of these grants, programs and benefits. Pursuant to an amendment to Israeli regulations, income from one of our "Approved Enterprises" is exempt from income tax for only two years. Following this two year period, the "Approved Enterprise" will be subject to corporate tax at a reduced rate of 10-25% (based on the

percentage of foreign ownership in each taxable year) for the following eight years. Income from the remaining two "Approved Enterprises" are tax exempt for four years. Following this four year period, the "Approved Enterprises" are subject to corporate tax at a reduced rate of 15-25% (based on the percentage of foreign ownership in each taxable year) for the following six years. If grants, programs and benefits available to us or the laws under which they were granted are eliminated or their scope is further reduced, or if we fail to meet the conditions of existing grants, programs or benefits and are required to refund grants or tax benefits already received (together with interest and certain inflation adjustments) or fail to receive approval for its future Approved Enterprises, our business, financial condition and results of operations could be materially adversely affected.

Numerous factors, some of which are beyond our control, may cause the market price of our ordinary shares or the American Depositary Shares (ADSs) representing our ordinary shares to fluctuate significantly. These factors include, among other things, announcements of technological innovations, customer orders or new products by us or our competitors, earning releases by us or our competitors, market conditions in the industry and the general state of the securities markets (with particular emphasis on the technology and Israeli sectors of the securities markets).

REPORT OF INDEPENDENT AUDITORS

To the Shareholders of

NICE Systems Ltd.

We have audited the accompanying consolidated balance sheets of NICE Systems Ltd. ("the Company") and subsidiaries as of December 31, 2000 and 2001, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above, present fairly, in all material respects, the consolidated financial position of the Company and subsidiaries as of December 31, 2000 and 2001, and the consolidated results of their operations and cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States.

/s/ KOST FORER & GABBAY

Tel-Aviv, Israel
February 6, 2002

KOST FORER & GABBAY
A Member of Ernst & Young Global

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	December 31,	
	2000	**2001**
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 18,640	$ 25,256
Short-term bank deposits	24,371	311
Marketable securities	29,089	29,270
Trade receivables (net of allowance for doubtful accounts of - $ 3,783 and $ 3,146 in 2000 and 2001, respectively)	46,367	28,435
Unbilled receivables	1,816	6,574
Other receivables and prepaid expenses	11,994	5,465
Inventories	21,159	11,057
Total current assets	153,436	106,368
LONG-TERM INVESTMENTS:		
Long-term marketable securities	25,916	34,176
Investment in affiliates	1,429	1,429
Severance pay fund	5,011	5,357
Long-term prepaid expenses	20	471
Total long-term investments	32,376	41,433
PROPERTY AND EQUIPMENT, NET	25,896	22,111
OTHER ASSETS, NET	39,781	40,100
Total assets	$ 251,489	$ 210,012

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

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands (except share data)

	December 31,	
	2000	**2001**
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Trade payables	$ 12,650	$ 11,123
Accrued expenses and other liabilities	23,467	25,314
Total current liabilities	36,117	36,437
LONG-TERM LIABILITIES:		
Deferred lease payments	247	-
Accrued severance pay	6,527	6,543
Other long-term liabilities	21	14
Total long-term liabilities	6,795	6,557
COMMITMENTS AND CONTINGENT LIABILITIES		
SHAREHOLDERS' EQUITY:		
Share capital-		
Ordinary shares of NIS 1 par value:		
Authorized: 50,000,000 shares as of December 31, 2000 and 2001;		
Issued and outstanding: 12,914,680 and 13,273,798 shares as of December 31, 2000 and 2001, respectively	4,313	4,398
Additional paid-in capital	187,679	192,845
Deferred share compensation	(47)	(24)
Accumulated other comprehensive loss	-	(38)
Retained earnings (accumulated deficit)	16,632	(30,163)
Total shareholders' equity	208,577	167,018
Total liabilities and shareholders' equity	$ 251,489	$ 210,012

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

CONSOLIDATED STATEMENTS OF OPERATIONS

U.S. dollars in thousands (except per share data)

	Year ended December 31,		
	1999	**2000**	**2001**
Revenues	$ 117,411	$ 153,163	$ 127,108
Cost of revenues	49,020	73,554	73,767
Gross profit	68,391	79,609	53,341
Operating expenses:			
Research and development, net	12,353	19,502	19,190
Selling and marketing	25,793	35,448	35,046
General and administrative	18,734	28,300	27,143
Amortization of acquired intangible assets, restructuring expenses and in process research and development	5,415	7,646	17,967
Total operating expenses	62,295	90,896	99,346
Operating income (loss)	6,096	(11,287)	(46,005)
Financial income, net	4,809	6,188	4,254
Other income (expenses), net	(4)	53	(4,846)
Income (loss) before taxes on income	10,901	(5,046)	(46,597)
Taxes on income	74	273	198
Net income (loss)	$ 10,827	$ (5,319)	$ (46,795)
Basic net earnings (loss) per share	$ 0.94	$ (0.43)	$ (3.59)
Diluted net earnings (loss) per share	$ 0.88	$ (0.43)	$ (3.59)

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

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. dollars in thousands

	Share capital	Additional paid-in capital	Deferred share compensation	Accumulated other comprehensive loss	Retained earnings (Accumulated deficit)	Total comprehensive income (loss)	Total shareholders' equity
Balance as of January 1, 1999	$ 3,919	$ 142,474	$ (310)	$ -	$ 11,124		$ 157,207
Issuance of warrants in respect of the acquisition of STS	-	229	-	-	-		229
Amortization of deferred share compensation	-	-	207	-	-		207
Exercise of share options	143	10,457	-	-	-		10,600
Comprehensive income:							
Net income	-	-	-	-	10,827	$ 10,827	10,827
Total comprehensive income						$ 10,827	
Balance as of December 31, 1999	4,062	153,160	(103)	-	21,951		179,070
Issuance of shares in respect of the acquisition of CPS	37	9,349	-	-	-		9,386
Issuance of shares of ESPP	7	934	-	-	-		941
Deferred share compensation	-	72	(72)	-	-		-
Issuance of shares in respect of the acquisition of SCI	54	10,267	-	-	-		10,321
Amortization of deferred share compensation	-	-	128	-	-		128
Exercise of share options and warrants	153	13,897	-	-	-		14,050
Comprehensive loss:							
Net loss	-	-	-	-	(5,319)	$ (5,319)	(5,319)
Total comprehensive loss						$ (5,319)	
Balance as of December 31, 2000	4,313	187,679	(47)	-	16,632		208,577
Issuance of shares of ESPP	31	1,408	-	-	-		1,439
Issuance of shares related to a settlement agreement in respect of the acquisition of SCI	46	3,345	-	-	-		3,391
Amortization of deferred share compensation	-	-	23	-	-		23
Exercise of share options	8	413	-	-	-		421
Comprehensive loss:							
Unrealized losses on forward contracts	-	-	-	(38)	-	$ (38)	(38)
Net loss	-	-	-	-	(46,795)	(46,795)	(46,795)
Total comprehensive loss						$ (46,833)	
Balance as of December 31, 2001	$ 4,398	$ 192,845	$ (24)	$ (38)	$ (30,163)		$ 167,018

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	1999	**2000**	**2001**
Cash flows from operating activities:			
Net income (loss)	$ 10,827	$ (5,319)	$ (46,795)
Adjustments required to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	6,798	11,725	15,266
In-process research and development write-off in respect of CPS acquisition	-	6,786	-
In-process research and development write-off in respect of STS acquisition	5,155	-	-
Share compensation in respect of SCI acquisition	-	-	476
Amortization of deferred share compensation	207	128	23
Accrued severance pay, net	367	899	(330)
Loss on disposal of property and equipment and goodwill impairment in respect of restructuring	-	-	3,062
Loss (gain) on sale of available-for-sale marketable securities, amortization of (premium) discount and accrued interest on held-to-maturity marketable securities	62	(345)	183
Loss on sale of assets of Dees	-	-	281
Decrease (increase) in trade and unbilled receivables	(1,565)	(12,968)	12,459
Decrease (increase) in other receivables and prepaid expenses	(2,414)	(82)	6,512
Decrease (increase) in inventories	(2,243)	(10,006)	9,635
Increase in long-term prepaid expenses	(138)	-	(471)
Increase (decrease) in trade payables	2,730	1,438	(1,527)
Increase (decrease) in accrued expenses and other liabilities	(33)	5,729	1,956
Other	(127)	(53)	113
Net cash provided by (used in) operating activities	19,626	(2,068)	843

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	1999	**2000**	**2001**
Cash flows from investing activities:			
Purchase of property and equipment	(10,062)	(14,161)	(7,623)
Proceeds from sale of property and equipment	151	394	1,301
Purchase of other assets	(175)	-	(25)
Investment in held-to-maturity marketable securities	(22,389)	(1,467)	(15,722)
Proceeds from maturity of held-to-maturity marketable securities	17,064	38,525	39,977
Proceeds from sale of available-for-sale marketable securities	269	-	-
Investment in short-term bank deposits	(66,601)	(31,028)	(384)
Proceeds from short-term bank deposits	69,469	49,454	24,448
Investment in long-term held-to-maturity marketable securities	(13,984)	(43,671)	(32,879)
Investment in affiliates	-	(1,200)	-
Payment for the acquisition of STS (a)	(6,267)	-	-
Payment for the acquisition of CPS (b)	-	(3,189)	-
Payment for the acquisition of assets and liabilities of SCI (c)	-	(6,960)	-
Proceeds from sale of assets of Dees (d)	-	-	255
Capitalization of software development costs	(2,570)	(4,730)	(5,435)
Other	-	(80)	-
Net cash provided by (used in) investing activities	(35,095)	(18,113)	3,913
Cash flows from financing activities:			
Proceeds from issuance of shares and exercise of share options and warrants, net	10,600	14,991	1,860
Short-term bank credit, net	(303)	(3)	-
Net cash provided by financing activities	10,297	14,988	1,860
Increase (decrease) in cash and cash equivalents	(5,172)	(5,193)	6,616
Cash and cash equivalents at the beginning of the year	29,005	23,833	18,640
Cash and cash equivalents at the end of the year	$ 23,833	$ 18,640	$ 25,256

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	1999	**2000**	**2001**
Supplemental disclosure of cash flows activities:			
Cash paid during the year for:			
Income taxes	$ 58	$ 105	$ 257
(a) Payment for the acquisition of STS:			
Estimated fair value of assets acquired and liabilities assumed at the date of acquisition:			
Working capital deficiency (excluding cash and cash equivalents)	$ (875)		
Property and equipment	90		
In-process research and development	5,155		
Assembled work-force	287		
Other long-term liabilities	(152)		
Goodwill	1,991		
	6,496		
Less - amount acquired by issuance of warrants	(229)		
	$ 6,267		
(b) Payment for the acquisition of CPS:			
Estimated fair value of assets acquired and liabilities assumed at the date of acquisition:			
Working capital (excluding cash and cash equivalents)		$ 158	
Property and equipment		185	
Long-term investments		93	
Long-term liabilities		(42)	
In-process research and development		6,786	
Core technology		2,189	
Assembled work-force		409	
Goodwill		2,797	
		12,575	
Less - amount acquired by issuance of shares		(9,386)	
		$ 3,189	

CONSOLIDATED STATEMENTS OF CASH FLOWS
U.S. dollars in thousands

	Year ended December 31,		
	1999	**2000**	**2001**
(c) Payment for the acquisition of certain assets and liabilities of SCI:			
Estimated fair value of assets acquired and liabilities assumed at the date of acquisition:			
Working capital deficiency		$ (6,881)	
Assembled work-force		523	
Goodwill		23,639	
		17,281	
Less - amount acquired by issuance of shares		(10,321)	
		$ 6,960	
(d) Proceeds from sale of assets of Dees:			
Working capital			$ (536)
Loss on sale			281
			$ 255
(e) Non-cash activities:			
1. Issuance of shares in respect of SCI acquisition:			
Adjustment to the working capital			$ (282)
Goodwill			3,197
			$ 2,915
2. Unrealized losses on forward contracts			$ 38

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

NOTES TO THE FINANCIAL STATEMENTS
U.S. dollars in thousands (except per share data)

NOTE 1:- GENERAL

a. NICE Systems Ltd. ("NICE") and subsidiaries (collectively - "the Company") develop, design, manufacture and market products for integrated multimedia digital recording (audio, video and data), quality management software solutions and communication intelligence systems and provide related professional services.

Our Customer Experience Management solutions, or CEM, help customers improve their businesses by effectively capturing, evaluating and analyzing voice communications, internet collaboration, VoIP, call data, desktop screens, email storage and video. Our products are part of the CEM market space, which is an extension of the broader CTI (Computer Telephony Integration) and CRM (Customer Relationship Management) market. Our digital video solutions are used by security organizations to record and archive digital video and audio for debriefing and investigative applications. We also provide communication intelligence, or COMINT, systems that are used primarily by government agencies to detect, identify, locate, monitor and record transmissions from a variety of sources.

We serve the business needs of multiple markets, primarily customer contact centers (formerly called call centers), financial institutions, air traffic control sites, public safety centers, closed circuit television security installations and government agencies.

The Company's markets are located primarily in North America, Europe and the Far East.

The Company depends on a limited number of suppliers and on a single supplier for some components and subassemblies for its systems. If such suppliers fail to deliver the necessary components, the Company may be required to seek alternative sources of supply. Although the Company generally maintains an inventory of components to limit the potential for interruption of a supplier's ability to provide components to the Company, a change in suppliers could result in manufacturing delays, which could cause a possible loss of sales and, consequently, could adversely affect the Company's results of operations and financial position.

The Company relies upon a limited number of independent dealers to market, sell and service its products in certain markets. If the Company is unable to effectively manage and maintain relationships with its dealers, or to enter into similar relationships with others, its ability to market and sell its products in certain markets will be affected. In addition, a loss of a major dealer, or any event negatively affecting such dealer's financial condition, could cause a material adverse effect on the Company's results of operations and financial position.

As for major customer data, see Note 15c.

NOTES TO THE FINANCIAL STATEMENTS
U.S. dollars in thousands (except per share data)

NOTE 1:- GENERAL (Cont.)

b. Acquisition of Stevens Communications Inc.

In December 2000, the Company acquired certain assets and assumed certain liabilities of Stevens Communications Inc. ("SCI") for an aggregate consideration of $ 18,931 including the issuance of up to 426,745 American Depositary Shares ("ADSs") of NICE of which 186,818 ADSs were target shares contingent upon the achievement of certain objectives and events through 2002 and 38,914 ADSs are for the benefit of certain Stevens' employees. The acquisition was accounted for by a purchase method and accordingly, the purchase price has been allocated according to the fair value of the assets acquired and liabilities assumed of SCI.

SCI is a systems distributor, whose activities included the promotion, distribution, installation and maintenance of the Company's products in North America.

An amount of $ 24,162, out of the total acquisition cost, was attributed to goodwill and assembled work-force and is being amortized over their estimated useful lives.

In 2001, the Company entered into a final settlement agreement with SCI addressing a dispute with SCI regarding the fair value of SCI's working capital. The adjustments from the terms of the final settlement resulted a one time charge to other expense of $ 4,448 representing a lump-sum settlement of disputed items of $ 3,600 and obligations for future consulting services which are no longer of value to the Company.

In addition, the Company released from escrow the 186,818 ADS contingent target shares upon the achievement of the determined objectives and events and accordingly, recorded approximately $ 3 million to goodwill.

c. Acquisition of Centerpoint Solutions Inc.:

In April 2000, the Company acquired all of the outstanding capital stock of Centerpoint Solutions Inc. ("CPS") for a total consideration of $ 12,886 including the issuance of 150,000 ADSs of NICE. The acquisition was accounted for as by the purchase method and accordingly, the purchase price has been allocated according to the fair value of the assets acquired and liabilities assumed of CPS.

CPS is a developer of Internet-based applications for statistical monitoring, digital recording and automatic customer surveys for customer contact centers.

In connection with the CPS acquisition, the Company recorded in the second quarter of 2000, a one-time expense of $ 6,786 to write-off software acquired from CPS for which technological feasibility has not yet been established and for which no alternative future use exists. An amount of $ 5,395 out of the total acquisition cost was attributed to goodwill and other intangible assets and is being amortized over their estimated useful lives (see Note 2w).

NOTES TO THE FINANCIAL STATEMENTS
U.S. dollars in thousands (except per share data)

NOTE 1:- GENERAL (Cont.)

d. Acquisition of STS Software System (1993) Ltd.:

In December 1999, the Company acquired all the outstanding capital stock of STS Software Systems (1993) Ltd. ("STS") for an aggregate consideration of $ 6,496 including 50,000 warrants of NICE with an exercise price of $ 40 per share (see Note 14d). The acquisition was accounted for by the purchase method and accordingly, the purchase price has been allocated according to the fair value of the assets acquired and liabilities assumed of STS.

STS is a developer of complete digital multimedia logging solutions for information media, including technology for recording information from the Internet with an advanced VoIP (Voice over Internet Protocol) interface.

In connection with the STS acquisition, the Company recorded in the fourth quarter of 1999, a one-time expense of $ 5,155 to write-off software acquired from STS for which technological feasibility has not yet been established and for which no alternative future use exists. An amount of $ 2,278, out of the total acquisition cost was attributed to goodwill and assembled work-force and is being amortized over their estimated useful lives (see Note 2w).

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements were prepared in accordance with United States Generally Accepted Accounting Principles ("U.S. GAAP").

a. Use of estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that effect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

b. Financial statements in United States dollars:

The currency of the primary economic environment in which the operations of the Company are conducted is the U.S. dollar ("dollar"); thus, the dollar is the reporting and functional currency of the Company.

The Company’s transactions and balances denominated in U.S. dollars are represented at their original amounts. Non-dollar transactions and balances have been remeasured to U.S. dollars in accordance with Statement of Financial Accounting Standards No. 52 - “Foreign Currency Translation” (“SFAS No. 52”). All transaction gains and losses from remeasurement of monetary balance sheet items denominated in non-dollar currencies are reflected in the statements of operations as financial income or expenses, as appropriate.

NOTE TO THE FINANCIAL STATEMENTS
U.S. dollars in thousands (except per share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

c. Principles of consolidation:

Intercompany transactions and balances have been eliminated in consolidation.

d. Cash equivalents:

The Company considers unrestricted highly liquid investments originally purchased with maturities of three months or less to be cash equivalents.

e. Short-term bank deposits:

Bank deposits with maturities of more than three months but less than one year are included in short-term bank deposits. Such short-term bank deposits are stated at cost.

f. Marketable securities:

The Company accounts for investments in debt securities in accordance with Statement of financial Accounting Standard No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS No. 115").

Management determines the appropriate classification of its investments in debt securities at the time of purchase and reevaluates such determinations at each balance sheet date. Debt securities are classified as held-to-maturity when the Company has the positive intent and ability to hold the securities to maturity and are stated at amortized cost. The amortized cost of held-to-maturity securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization, decline in value judged to be other than temporary, and interest are included in financial income or expenses, as appropriate.

g. Inventories:

Inventories are stated at the lower of cost or market value. The cost of raw materials and work-in-progress is determined by the "average cost" method, and the cost of finished goods - on the basis of computed manufacturing costs.

Inventory provisions are provided to cover risks arising from slow-moving items, technological obsolescence, excess inventories, discontinued products, and for market prices lower than cost.

h. Investments in affiliates:

The investments in these companies are stated at cost, since the Company does not have the ability to exercise significant influence over operating and financial policies of these investees.

NOTES TO THE FINANCIAL STATEMENTS
U.S. dollars in thousands (except per share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Management periodically reviews the carrying value of the investments. If this review indicates that the cost is not recoverable, the carrying value is reduced to its estimated fair value.

As of December 31, 2001, no impairment losses have been identified.

i Property and equipment:

Property and equipment are stated at cost, net of accumulated depreciation. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets, at the following annual rates:

	%
Computers and peripheral equipment	20 - 33
Office furniture and equipment	6 - 20
Motor vehicles	15

Leasehold improvements are amortized by the straight-line method over the term of the lease or the estimated useful life of the improvements, whichever is shorter.

The Company periodically assesses the recoverability of the carrying amount of property and equipment and provides for any possible impairment loss based upon the difference between the carrying amount and fair value of such assets in accordance with Statement of Financial Accounting Standard No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" ("SFAS No. 121”). As of December 31, 2001, impairment losses have been identified in the amount of $ 1,946 (see Note 11).

j Other assets:

Other assets are stated at cost less accumulated amortization. Amortization is calculated using the straight-line method over the estimated useful lives at the following annual rates:

	%
Goodwill (see w)	10
Core technology	25 - 33
Other intangible assets (see w)	20 - 33
Capitalized computer software costs (see m)	20 - 33

The carrying values and the appropriateness of the amortization period of goodwill, core technology and other intangible assets are periodically reviewed by management, based on the expected future undiscounted operating cash flows over the remaining amortization period. If this review indicates that goodwill, core technology and other intangible assets will not be recoverable, the carrying value of the goodwill, core technology and other intangible assets is reduced to estimated fair value. Based on its

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

most recent analyses, management believes that impairment of goodwill exists as of December 31, 2001 in the amount of $ 1,116 (see Note 11).

k. Revenue recognition:

The Company generates revenues from sales of products, which include hardware and software solutions delivered together, software licensing, fixed price contracts, support services and maintenance.

The Company sells its products indirectly through resellers, integrators and distributors, all of whom are considered end-users, and through its direct sales force. Sales to distributors that are deemed consignment sales are recognized as revenue only upon sale to a final customer.

Revenues from product sales and software license agreements are recognized when all criteria outlined in Statement Of Position (SOP 97-2) "Software Revenue Recognition" (as amended) and Staff Accounting Bulletin No. 101 "Revenue Recognition in the Financial Statements" ("SAB No. 101") are met. Revenue from products and license fees is recognized when persuasive evidence of an agreement exists, delivery of the product has occurred, the fee is fixed or determinable, no further obligations exist and collectibility is probable.

Where software arrangements involve multiple elements, revenue is allocated to each element based on Vendor Specific Objective Evidence ("VSOE") of the relative fair values of each element in the arrangement, in accordance with the "residual method" prescribed by SOP 98-9 "Modification of SOP 97-2, Software Revenue Recognition With Respect to Certain Transactions". The Company's VSOE used to allocate the sales price to support services and maintenance is based on the renewal price. Under the residual method, revenue is recognized for the delivered elements when (1) there is VSOE of the fair values of all the undelivered elements, and (2) all revenue recognition criteria of SOP 97-2, as amended, are satisfied. Under the residual method any discount in the arrangement is allocated to the delivered element.

The Company maintains a provision for product returns in accordance with SFAS No. 48 "Revenue Recognition When Right of Return Exists". The provision was estimated based on the Company's past experience and was deducted from revenues.

The Company recognizes revenues from fixed price contracts that require significant customization, integration and installation based on Statement of Position No. 81-1 "Accounting for Performance of Construction - Type and Certain Production - Type Contracts" ("SOP 81-1"), using the percentage-of- completion method of accounting based on the value added and results achieved out of the completeness of the product as a whole. In order to verify the measure of the added value, the Company identifies elements or sub-components of those elements. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined. As of December 31, 2001, no such estimated losses were identified.

NOTES TO THE FINANCIAL STATEMENTS
U.S. dollars in thousands (except per share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Revenues from maintenance and support services are recognized ratably over the contractual period or as services are performed.

Deferred revenue includes amounts received from customers for which revenue has not yet been recognized.

l. Warranty costs:

Provisions for warranty are made at the time revenues are recognized for estimated warranty costs based on the Company's experience.

m. Research and development costs:

Research and development costs (net of grants and participations) incurred in the process of software production before establishment of technological feasibility, are charged to expenses as incurred. Costs of the production of a product master incurred subsequent to the establishment of technological feasibility are capitalized according to the principles set forth in Statements of Financial Accounting Standard No. 86 "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed" (“SFAS No. 86”). Based on the Company's product development process, technological feasibility is established upon completion of a detailed program, design or a working model.

Costs incurred by the Company between completion of the detailed program design or working model and the point at which the product is ready for general release have been capitalized.

Capitalized software development costs are amortized on a product-by-product basis commencing with general product release by the greater of the amount computed using the: (i) ratio that current gross revenues from sales of the software bear to the total of current and anticipated future gross revenues from sales of that software, or (ii) the straight-line method over the estimated useful life of the software product (3 to 5 years).

The Company assesses the recoverability of this intangible asset on a regular basis by determining whether the amortization of the asset over its remaining life can be recovered through undiscounted future operating cash flows from the specific software product sold. Based on its most recent analyses, management believes that no impairment of capitalized software development costs exists as of December 31, 2001.

n. Income taxes:

The Company accounts for income taxes in accordance with Statements of Financial Accounting Standard No. 109, "Accounting for Income Taxes" (“SFAS No. 109”). This statement prescribes the use of the liability method whereby deferred tax asset and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

rates and laws that will be in effect when the differences are expected to reverse. The Company provides a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

o. Government grants:

Non-royalty bearing grants from the Government of Israel for funding research and development projects are recognized at the time the Company is entitled to such grants on the basis of the related costs incurred and recorded as a reduction of research and development costs.

p. Concentrations of credit risk:

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, trade and unbilled receivables, short-term bank deposits and marketable securities.

The Company's cash and cash equivalents and short-term bank deposits are invested in deposits in U.S. dollars with major international banks. Such deposits in the United States may be in excess of insured limits and are not insured in other jurisdictions. Management believes that the financial institutions that hold the Company's investments are financially sound and, accordingly, minimal credit risk exists with respect to these investments.

The Company's trade and unbilled receivables are derived from sales to customers located primarily in North America, Europe and the Far East. The Company performs ongoing credit evaluations of its customers and obtains letter of credit and bank guarantees for certain receivables and, to date, has not experienced any material losses. An allowance for doubtful accounts is provided with respect to specific debts that the Company has determined to be doubtful of collection and a general provision on the remaining balance.

The Company's marketable securities include investment in debentures of U.S. corporations. Management believes that those corporations are financially sound, the portfolio is well diversified, and accordingly, minimal credit risk exists with respect to those marketable securities.

During 2001, the Company entered into forward contracts intended to protect against the increase in value of forecasted foreign currency cash flows resulting from salary payments. The contracts effectively hedge the Company's foreign currency exposure in respect of the hedged salary payments. The forward contracts mature at the time in which the related salary payments are paid. In addition, the Company entered into forward foreign exchange contracts to hedge certain trade payable payments denominated in foreign currency (see Note 10).

NOTES TO THE FINANCIAL STATEMENTS
U.S. dollars in thousands (except per share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

q. Severance pay:

The Company's liability for severance pay for its Israeli employees is calculated pursuant to Israeli severance pay law based on the most recent salary of the employees multiplied by the number of years of employment as of the balance sheet date. Employees are entitled to one month's salary for each year of employment, or a portion thereof. The Company's liability is fully provided by monthly deposits with insurance policies, deposits with severance pay funds and by an accrual.

The deposited funds include profits accumulated up to the balance sheet date. The deposited funds may be withdrawn only upon the fulfillment of the obligation pursuant to Israeli severance pay law or labor agreements. The value of the deposited funds is based on the cash surrendered value of these policies and includes immaterial profits.

Severance pay expense for 1999, 2000 and 2001, was $ 1,908, $ 1,255 and $ 2,428, respectively.

r. Basic and diluted net earnings (loss) per share:

Basic net earnings (loss) per share are computed based on the weighted average number of ordinary shares outstanding during each year. Diluted net earnings per share is computed based on the weighted average number of ordinary shares outstanding during each year plus dilutive potential equivalent ordinary shares considered outstanding during the year, in accordance with Statements of Financial Accounting Standard No. 128, "Earnings Per Share" ("SFAS No. 128").

s. Stock-based compensation:

The Company has elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB No. 25") and FASB Interpretation No. 44 "Accounting for Certain Transactions Involving Stock Compensation" ("FIN 44") in accounting for its employee stock option plan. Under APB No. 25, when the exercise price of the Company's options is less than the market value of the underlying shares on the date of grant, compensation expense is recognized and amortized over the vesting period. The pro forma information with respect to the fair value of the options is provided in accordance with the provisions of Statements of Financial Accounting Standard No. 123 "Accounting for Stock-based Compensation" ("SFAS No. 123") (see Note 14b).

The Company applies SFAS No. 123 and Emerging Issue Task Force No. 96-18 "Accounting for Equity Instruments that are Issued to Other than Employees for Acquiring, or in Conjunction with Selling, Goods or Services" ("EITF 96-18") with respect to options issued to non-employees. SFAS No. 123 requires the use of an option valuation model to measure the fair value of the options at the grant date.

NOTES TO THE FINANCIAL STATEMENTS
U.S. dollars in thousands (except per share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

t. Fair value of financial instruments:

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

The carrying amount reported in the balance sheet for cash and cash equivalents, short-term bank deposits, trade and unbilled receivables and trade payables approximates their fair value due to the short-term maturities of such instruments.

The fair value for marketable U.S. corporate securities is based on quoted market prices and does not differ significantly from the carrying amount.

u. Advertising expenses:

Advertising expenses are charged to expense as incurred (see Note 16d).

v. Derivatives and hedging activities:

In June 1998, the Financial Accounting Standards Board issued Statement No. 133, “Accounting for Derivative Instruments and Hedging Activities”, as amended. The Statement requires the Company to recognize all derivatives on the balance sheet at fair value. Derivatives that are not hedges must be adjusted to fair value through income. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives are either offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative’s change in fair value will be immediately recognized in earnings. Because the Statement allows certain foreign currency transactions to be accounted for as hedges for financial reporting purposes that were not previously treated as hedges, the Company has changed its policies toward the management of certain foreign currency exposures, in order to further reduce the Company’s exposure to foreign currency risks.

w. Impact of recently issued accounting standards:

In July 2001, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standard No. 141 "Business Combinations" ("SFAS No. 141") and Statement of Financial Accounting Standard No. 142 "Goodwill and Other Intangible Assets" ("SFAS No. 142"). SFAS No. 141 requires all business combinations initiated after June 30, 2001 to be accounted for using the purchase method. Under SFAS No. 142, goodwill and intangible assets with indefinite lives are no longer amortized but are reviewed annually (or more frequently if impairment indicators arise) for impairment. Separable intangible assets that are not deemed to have indefinite lives will continue to be amortized over their useful lives (but with no maximum life). The amortization provisions of SFAS No. 142 apply to goodwill and intangible assets acquired after June 30, 2001. With respect to goodwill and intangible

NOTES TO THE FINANCIAL STATEMENTS
U.S. dollars in thousands (except per share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

assets acquired prior to July 1, 2001, the Company is required to adopt SFAS No. 142 effective January 1, 2002. During 2002, the Company will perform the first of the required impairment tests of goodwill and indefinite lived intangible assets as of January 1, 2002 and has not yet determined what the effect of these tests will be on the earnings and financial position of the Company. Application of the non-amortization provisions of SFAS No. 142 is expected to result in an increase in net income of $3,286 in 2002 and an increase in the net earnings per share of $ 0.28 per year. In accordance with FASB No 142, assembled workforce will be reclassified and included in the amount recorded as goodwill from 2002 and thereafter.

FASB recently issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," ("SFAS 144") that is applicable to financial statements issued for fiscal years beginning after December 15, 2001. FASB's new rules on the asset impairment supersede FASB Statement No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of," and portions of APB Opinion No. 30, "Reporting the Results of Operations." SFAS No. 144 provides a single accounting model for long-lived assets to be disposed of and significantly changes the criteria that must be met to classify an asset as "held-for-sale." Classification as "held-for-sale" is an important distinction since such assets are not depreciated and are stated at the lower of fair value and carrying amount. SFAS No. 144 also requires expected future operating losses from discontinued operations to be displayed in the period(s) in which the losses are incurred, rather than as of the measurement date as presently required. The provisions of SFAS No. 144 are not expected to have a significant impact on the Company’s financial position or operating results.

x. Reclassification:

Certain amounts from prior years have been reclassified to conform to the current year's presentation. The reclassification had no effect on previously reported net loss, shareholder’s equity or cash flows.

NOTE 3:- MARKETABLE SECURITIES

	Amortized cost		Gross unrealized losses		Gross unrealized gains		Estimated fair value	
	December 31,		December 31,		December 31,		December 31,	
	2000	2001	2000	2001	2000	2001	2000	2001
U.S. corporate debentures	$ 55,005	$ 63,446	$ 461	$ -	$ -	$ 674	$ 54,544	$ 64,120

As of December 31, 2000 and 2001, all the Company's securities were classified as held-to-maturity. Prior to December 31, 1999 a portion of the Company's marketable securities was classified as available-for-sale.

Gross realized gains on sale of available-for-sale securities in earnings in 1999, totaled $ 15.

NOTES TO THE FINANCIAL STATEMENTS
U.S. dollars in thousands (except per share data)

NOTE 3:- MARKETABLE SECURITIES (Cont.)

The Company did not sell any securities prior to their maturity and accordingly did not realize any gains or losses on held-to-maturity securities in 2000 and 2001.

The scheduled maturities of held-to-maturity securities at December 31, 2001, are as follows:

	Amortized cost	Estimated fair value
Held-to-maturity:		
Due within one year	$ 29,270	$ 29,250
Due after one year through five years	34,176	34,870
	$ 63,446	$ 64,120

NOTE 4:- OTHER RECEIVABLES AND PREPAID EXPENSES

	December 31,	
	2000	2001
Government authorities	$ 2,434	$ 2,475
Interest receivable	1,649	637
Due from SCI	5,140	-
Prepaid expenses	1,654	1,243
Other	1,117	1,110
	$ 11,994	$ 5,465

NOTE 5:- INVENTORIES

	December 31,	
	2000	2001
Raw materials	$ 10,712	$ 6,995
Work in progress	1,170	843
Finished goods	9,277	3,219
	$ 21,159	$ 11,057

NOTE 6:- INVESTMENT IN AFFILIATES

NICE's investment in Espro Engineering (1992) Ltd. is presented using the cost method of accounting in the amount of $ 229 as of December 31, 2000 and 2001, and represents 8.4% of Espro Engineering (1992) Ltd.'s equity.

In 2000, NICE invested in Customersat.com an amount of $ 1,200, which represents 6.3% of Customersat.com's equity. The investment is presented using the cost method of accounting.

NOTES TO THE FINANCIAL STATEMENTS
U.S. dollars in thousands (except per share data)

NOTE 7:- PROPERTY AND EQUIPMENT, NET

	December 31,	
	2000	2001
Cost:		
Computers and peripheral equipment	$ 26,780	$ 32,093
Office furniture and equipment	8,884	8,614
Motor vehicles	5,694	2,981
Leasehold improvements	3,883	3,235
	45,241	46,923
Accumulated depreciation:		
Computers and peripheral equipment	13,657	20,404
Office furniture and equipment	2,548	2,282
Motor vehicles	2,139	1,242
Leasehold improvements	1,001	884
	19,345	24,812
Depreciated cost	$ 25,896	$ 22,111

Depreciation expenses totaled $ 5,107, $ 8,101 and $ 8,044 for the years ended December 31, 1999, 2000 and 2001, respectively.

As for pledges, see Note 12b.

NOTE 8:- OTHER ASSETS, NET

	December 31,	
	2000	2001
Cost:		
Capitalized computer software costs	$ 10,643	$ 16,078
Goodwill	29,679	31,625
Core Technology	3,989	3,989
Other intangible assets	2,373	1,798
	46,684	53,490
Accumulated amortization:		
Capitalized computer software costs	3,108	5,868
Goodwill	979	3,425
Core Technology	2,066	3,017
Other intangible assets	750	1,080
	6,903	13,390
Amortized cost	$ 39,781	$ 40,100

NOTES TO THE FINANCIAL STATEMENTS
U.S. dollars in thousands (except per share data)

NOTE 8:- OTHER ASSETS, NET

Amortization expenses amounted to $ 1,691, $ 3,624 and $ 7,222 for the years ended December 31, 1999, 2000 and 2001, respectively.

NOTE 9:- ACCRUED EXPENSES AND OTHER LIABILITIES

	December 31,	
	2000	2001
Employees and payroll accruals	$ 9,565	$ 8,445
Accrued expenses	6,936	9,001
Restructuring accrual	-	2,444
Deferred revenues	6,675	5,013
Other	291	411
	$ 23,467	$ 25,314

NOTE 10:- DERIVATIVE INSTRUMENTS

To protect against the changes in value of forecasted foreign currency cash flows resulting from salary payments, the Company has instituted a foreign currency cash flow hedging program. The Company hedges portions of its forecasted expenses denominated in foreign currencies with forward contracts.

During the year 2001, the Company entered into forward contracts to hedge a portion of the anticipated NIS payroll payments for periods of one to twelve months. These forward contracts are designated as cash flows hedges, as defined by SFAS No. 133, as amended, and are all highly effective as hedges of these expenses when the salary is recorded. The effective portion of the hedged instruments is included in payroll expenses in the statement of operations.

In addition, the Company entered into forward foreign exchange contracts to hedge certain trade payable payments denominated in foreign currency. The purpose of the Company's foreign currency hedging activities is to protect the Company from changes in the foreign exchange rate.

During the year ended December 31, 2001, the Company recognized a net loss of $ 363 related to the forward contracts hedging trade payables.

At December 31, 2001, the Company expects to reclassify $ 38 of net losses on derivative instruments from accumulated other comprehensive income to earnings during the next twelve months.

NOTES TO THE FINANCIAL STATEMENTS
U.S. dollars in thousands (except per share data)

NOTE 11:- RESTRUCTURING EXPENSES

As part of the Company's strategic plan to address the changing business dynamics in the markets for its products and offerings, the Company recorded a restructuring charge in the amount of $14,554 in the first quarter of 2001, in accordance with EITF 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs in a Restructuring)" and SAB 100 "Restructuring and Impairment Charges". The restructuring consisted of a series of actions to improve the Company's long-term strategic opportunity including a reduction of 30% of the workforce (approximately 340 employees), consolidation of functions, the closing of certain facilities (mainly in the U.S.), and the disposal of assets that were no longer required due to the change in strategic direction. In addition, goodwill impairment, was recognized for the effect of discontinuing a certain product line which was acquired in the 1997 Dees transaction.

At December 31, 2001, a total amount of $2,444 is included in accrued expenses and other liabilities. The major components of the fiscal 2001 restructuring cost are as follows:

	Provision	Utilized	Balance as of December 31, 2001
Employee termination benefits	$ 9,564	$ (7,997)	$ 1,567
Facility closure	1,928	(1,051)	877
Loss on disposal of property and equipment	1,946	(1,946)	-
Goodwill impairment	1,116	(1,116)	-
Total charge	$ 14,554	$ 12,110	$ 2,444

NOTE 12:- COMMITMENTS AND CONTINGENT LIABILITIES

a. Lease commitments:

The Company leases various office space, office equipment and motor vehicles under operating leases.

1. The Company's office space and office equipment are rented under several operating leases. Future minimum lease commitments under non-cancelable operating leases for the years ended December 31, are as follows:

2002	$ 5,346
2003	2,801
2004	1,196
2005	1,043
2006 and thereafter	25
	$ 10,411

NOTES TO THE FINANCIAL STATEMENTS
U.S. dollars in thousands (except per share data)

NOTE 12:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

Rent expense for the years ended December 31, 1999, 2000 and 2001, was approximately $ 3,246, $ 4,011 and $ 5,190, respectively.

2. The Company leases its motor vehicles under cancelable operating lease agreements for periods through 2003.

   The minimum payment under these operating leases, upon cancellation of these lease agreements, amounted to $ 372 as of December 31, 2001.

   Lease expenses for the years ended December 31, 1999, 2000 and 2001, were $ 0, $ 70 and $ 1,677, respectively.

b. Security interests and pledges:

The Company provided a guarantee in the amount of $ 56 to the Israeli Chamber of Commerce and Industry to secure the return of equipment shipped abroad in the amount of $ 548 in respect of liability for projects in progress and in the amount of $ 508 in the aggregate for the performance of projects for customers who made advance payments in respect of said projects. The Company provided a guarantee in the amount of $ 29 in respect of premises leased in France, $28 in respect of warranty of its products and $ 261 in respect of bids.

c. Legal proceedings

Lawsuits have been lodged against the Company in the ordinary course of business. The Company intends to defend itself vigorously against those lawsuits. Management cannot predict the outcome of the lawsuits nor can they make any estimate of the amount of damages; therefore, no provision has been made for the lawsuits.

1. On February 8, 2001, the trading price of the Company's securities dropped following the Company's announcement that it would be restating its financial statements for the first three quarters of 2000 and for the year ended December 31, 1999 and that the Company was revising downward its revenue estimate for the final quarter of 2000. Thereafter, various plaintiffs filed in the United States District Court for the District of New Jersey fourteen putative class action securities lawsuits against the Company and several of its present or former officers and directors. The first of these actions was commenced on February 13, 2001. All of the actions have been allocated to the Newark vicinage of the District of New Jersey, and all have been assigned to the Hon. Joseph A. Greenaway, Jr., U.S.D.J.

NOTES TO THE FINANCIAL STATEMENTS
U.S. dollars in thousands (except per share data)

NOTE 12:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

The complaint in each action alleges that the Company and the individual defendants violated Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder. The plaintiffs also attempt to state a "control person" claim against several of the individual defendants under Section 20(a) of the Exchange Act, 15 U.S.C. § 78t(a). While there are differences among the fourteen complaints, the plaintiffs essentially contend that the Company and the individual defendants misrepresented to investors, either affirmatively or through omissions, the Company's financial results and the value of its securities. The plaintiffs seek damages in an unspecified amount. The plaintiffs in each such action seek to represent a class of investors in the Company's securities throughout a specified period, approximately from February 2000 to February 2001.

On April 11, 2001, the Company and several of the individual defendants moved to consolidate the various actions under the caption "In re: Nice Systems Ltd. Securities Litigation, Master File No. 01-CV-00737 (JAG), and to establish a schedule for the filing by plaintiffs of an amended consolidated complaint and the Company and the individual defendants' response to such complaint. On April 16, 2001, three separate plaintiffs, or groups of plaintiffs, moved to be named lead plaintiff pursuant to the Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 78u-4(a)(3)(B), and for the consolidation of all fourteen actions and to be appointed lead plaintiffs in the consolidated proceedings. The Company expects that the parties named lead plaintiffs will thereafter serve and file a consolidated amended complaint, to which the defendants named therein will subsequently answer, move, or otherwise respond.

Class action proceedings against the Company have also been filed in Israel as a result of the revenue restatement announcement and ensuing decline in the trading price of our securities. On March 7, 2001, Mr. Volfin, a shareholder, filed a request for a class action against the Company and Benjamin Levin, a member of the Company's board of directors and its former Chairman of the Board, claiming that the Company's financial reports for fiscal year 1999 and the first three quarters of 2000 did not reflect its actual earnings and were therefore misleading. The class that the plaintiff requests to represent includes all shareholders that purchased the Company's ordinary shares that are traded on the Tel-Aviv Stock Exchange between February 16, 2000 and February 8, 2001. The District Court in Tel Aviv has approved a settlement agreement relating to the claim against NICE in Israel. Under the terms of the agreement, all claims by Israeli shareholders against the Company or its current or former officers and directors have been settled without any admission of liability or wrongdoing by any party.

NOTES TO THE FINANCIAL STATEMENTS
U.S. dollars in thousands (except per share data)

NOTE 12:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

2. In June 2000, Dictaphone Corporation, one of the Company's competitors, filed a patent infringement claim relating to certain technology embedded in some of its products. The claim is for damages, at the court's discretion and the enjoinment of any continued infringement of Dictaphone patents. In the court's discretion, the damages may be trebled and attorney fees awarded. The Company believes that this claim has no merit and it is vigorously defending it. The Company has received notification from its insurance company indicating that the claim is not covered by its insurance policy; however, the insurance company has agreed to reimburse the Company for all legal expenses that it is expending in defense of the claim while reserving its final decision on this matter until the final outcome of the litigation. The Company is currently in the process of discovery and at this preliminary stage, it cannot predict the outcome of the claim, nor can it make any estimate of the amount of damages, if any, for which it will be held responsible in the event of a negative conclusion to the claim.

3. In April 2000, the Company acquired CPS in a cash and share transaction. In March 2002, Douglas Chapiewski, sole shareholder of CPS, filed a suit against the Company alleging misrepresentation, breach of contract and securities fraud in connection with the transaction.

NOTE 13:- TAXES ON INCOME

a. Measurement of taxable income under the Income Tax (Inflationary Adjustments) Law, 1985:

Results for tax purposes are measured in terms of earnings in NIS after certain adjustments for increases in the Israeli Consumer Price Index ("CPI"). As explained in Note 2b, the financial statements are measured in U.S. dollars. The difference between the annual change in the Israeli CPI and in the NIS/dollar exchange rate causes a further difference between taxable income and the income before taxes shown in the financial statements. In accordance with paragraph 9(f) of SFAS No. 109, NICE and its Israeli subsidiaries have not provided deferred income taxes on these difference between the functional currency and the tax basis of assets and liabilities.

b. Tax benefits under the Israel Law for the Encouragement of Capital Investments, 1959 ("the Law"):

Certain production facilities of NICE have been granted the status of "Approved Enterprise" under the Law, in three separate investment programs.

According to the provisions of the Law, NICE elected the "alternative benefits" and has waived government grants in return for a tax exemption.

NOTES TO THE FINANCIAL STATEMENTS
U.S. dollars in thousands (except per share data)

NOTE 13:- TAXES ON INCOME (Cont.)

Income derived from the first program will be tax-exempt for a period of four years, commencing 1999, and will be taxed at the reduced rate of 10%-25% (based on the percentage of foreign ownership in each taxable year) for an additional period of six years.

Income derived from the second program will be tax-exempt for a period of four years, commencing 1997, and will be subject to corporate taxes at the reduced rate of 10%-25% (based on the percentage of foreign ownership in each taxable year) for an additional period of six years.

Income derived from the third program will be tax-exempt for a period of two years, commencing with the year the Company first earns taxable income, and will be taxed at the reduced rate of 10%-25% (based on the percentage of foreign ownership in each taxable year) for an additional period of eight years.

In December 2000, the Company has filed an application for a fourth "Approved Enterprise" investment program for its facilities in Israel. To date, the Company has not received a notice of approval for this fourth program.

The period of tax benefits, detailed above, is subject to limits of the earlier of 12 years from the commencement of production or 14 years from receiving the approval.

The Law also entitles NICE to claim accelerated depreciation on equipment used by the "Approved Enterprise" during five tax years.

The entitlement to the above benefits is conditional upon NICE's fulfilling the conditions stipulated by the above Law, regulations published thereunder and the instruments of approval for the specific investments in an "Approved Enterprise". In the event of failure to comply with these conditions, the benefits may be canceled and Nice may be required to refund the amount of the benefits, in whole or in part, including interest.

The tax-exempt income attributable to the "Approved Enterprise" can be distributed to shareholders without subjecting NICE to taxes only upon the complete liquidation of Nice. As of December 31, 2001, retained earnings included approximately $ 16,029 in tax exempt profits earned by NICE'S "Approved Enterprise". NICE has decided not to declare dividends out of such tax exempt income. Accordingly, no deferred income taxes have been provided on income attributable to NICE's "Approved Enterprises".

If the retained tax exempt income is distributed in a manner other than in the complete liquidation of NICE, it would be taxed at the corporate tax rate applicable to such profits as if NICE had not elected the alternative tax benefits (currently - 20%) and an income tax liability would be incurred of approximately $ 3,206 as of December 31, 2001.

NOTES TO THE FINANCIAL STATEMENTS
U.S. dollars in thousands (except per share data)

NOTE 13:- TAXES ON INCOME (Cont.)

Income from sources other than the "Approved Enterprise", during the period of benefits, will be taxable at regular tax rates - currently 36%.

c. Tax benefits under the Israeli Law for the Encouragement of Industry (Taxation), 1969:

NICE is an industrial company under the above law and as such is entitled to certain tax benefits, including accelerated depreciation, deduction of public offering expenses in three equal annual installments, and amortization of patents and other intangible property rights as a deduction for tax purposes.

d. Net operating loss carryforwards:

As of December 31, 2001, the Company had carryforward tax losses totaling approximately $ 62,004 , most of which can be carried forward and offset against taxable income indefinitely. The remaining carryforward tax losses can be carried forward and offset against taxable income with expiration dates from 2003 to 2021. Utilization of U.S. net operating losses may be subject to the substantial annual limitation due to the "change in ownership" provisions of the Internal Revenue Code of 1986 and similar state provisions. The annual limitation may result in the expiration of net operating losses before utilization.

Through December 2001, NICE had Israeli tax loss carryforwards of approximately $16,249, resulting from tax benefits related to employees share option exercises that can be carried forward and offset against taxable income indefinitely.

e. Deferred income taxes:

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets and liabilities are as follows:

	December 31,	
	2000	**2001**
Net operating loss carryforwards	$ 5,787	$ 11,954
Reserves and allowances	1,664	3,320
Net deferred tax asset before valuation allowance	7,451	15,274
Valuation allowance	(7,451)	(15,274)
Net deferred tax asset	$ -	$ -

NOTES TO THE FINANCIAL STATEMENTS
U.S. dollars in thousands (except per share data)

NOTE 13:- TAXES ON INCOME (Cont.)

The Company has provided valuation allowances in respect of deferred tax assets resulting from tax loss carryforwards, due to its history of operating losses and current uncertainty concerning its ability to realize these deferred tax assets in the future.

f. A reconciliation between the theoretical tax expense, assuming all income is taxed at the statutory tax rate applicable to income of the Company, and the actual tax expense as reported in the consolidated statements of operations, is as follows:

	Year ended December 31,		
	1999	2000	2001
Income (loss) before taxes on income, as reported in the consolidated statements of operations	$ 10,901	$ (5,046)	$ (46,597)
Statutory tax rate in Israel	36%	36%	36%
Theoretical tax expense (income tax benefit)	$ 3,924	$ (1,817)	$ (16,775)
Losses and other items for which a valuation allowance was provided	-	2,456	12,837
"Approved Enterprise" benefit (1)(2)	(2,934)	-	-
Non-deductible acquisition-related costs	2,112	2,761	338
Issuance expenses	(862)	-	-
Exempt interest income	(1,922)	(2,117)	(1,554)
Non-deductible expenses	163	244	257
Increase (decrease) from difference between Israeli currency income and U.S. dollar income	336	(1,159)	5,031
Other	(743)	(95)	64
Actual tax expense	$ 74	$ 273	$ 198
(1) Basic per shares effect of "Approved Enterprise" benefits	$ 0.25	$ -	$ -
(2) Diluted per share effect of "Approved Enterprise" benefits	$ 0.24	$ -	$ -

g. Income (loss) before income taxes is comprised as follows:

	Year ended December 31,		
	1999	2000	2001
Domestic	$ 12,887	$ 2,740	$ (31,057)
Foreign	(1,986)	(7,786)	(15,540)
	$ 10,901	$ (5,046)	$ (46,597)

NOTES TO THE FINANCIAL STATEMENTS
U.S. dollars in thousands (except per share data)

NOTE 13:- TAXES ON INCOME (Cont.)

h. The provision for income taxes is comprised as follows:

	Year ended December 31,		
	1999	2000	2001
Current taxes	$ 84	$ 273	$ 198
Previous years - deferred taxes	(10)	-	-
	$ 74	$ 273	$ 198
Domestic	$ 80	$ 90	$ 100
Foreign	(6)	183	98
	$ 74	$ 273	$ 198

NOTE 14:- SHAREHOLDERS' EQUITY

a. The ordinary shares of the Company are traded on the Tel Aviv Stock Exchange and its ADSs are traded on NASDAQ.

In April 2000, the Company issued 150,000 ADSs to the sole shareholder of CPS as part of the consideration for the acquired shares of CPS (See Note 1c).

In December 2000, the Company issued 220,523 ADSs of NICE as part of the consideration for the acquisition of certain assets and liabilities of SCI (See Note 1b).

In December 2001, the Company issued 186,818 ADSs of NICE as part of a settlement agreement with SCI (See Note 1b).

b. Share option plans:

In 1995, the Company adopted an employee share option plan (the "1995 Option Plan"). Under the 1995 option plan, employees and officers of the Company may be granted options to acquire ordinary shares. The options to acquire ordinary shares, which may be determined by the board of directors of the Company, are granted at an exercise price, subject to certain exceptions, of not less than the fair market value of the ordinary shares on the grant date. 6,994,516 of the 1995 options were granted at an exercise price of not less than the fair market value of the ordinary shares at the date of grant.

NOTES TO THE FINANCIAL STATEMENTS
U.S. dollars in thousands (except per share data)

NOTE 14:- SHAREHOLDERS' EQUITY (Cont.)

The options generally vest gradually over a four-year period from the date of grant. As of February 15, 2000, the board of directors of the Company adopted a resolution amending the exercise terms for any option to be granted subsequent to February 15, 2000 under the 1995 Option Plan whereby 25% of the stock options granted become exercisable on the first anniversary of the date of grant and 6.25% become exercisable once every quarter during the subsequent three years. The options expire no later than 6 years from the date of grant.

In 1996, the Company adopted the 1997 Executive Share Option Plan (the "1997 Option Plan"). Under the terms of the 1997 Option Plan, stock options will be exercisable during a 60-day period ending four years after grant. The plan met the definition of Time Accelerated Restricted Stock Award Options ("TARSAP"). The TARSAP includes an acceleration feature based on the followings: if the year-end earnings per share of the Company shall reach certain defined targets, 40% of such stock options shall become exercisable; if earnings per share shall reach certain higher defined targets, an additional 30% of such stock options shall become exercisable; and if earnings per share shall reach certain higher defined targets, an additional 30% of such stock options shall become exercisable, provided that with respect to all of the above-referenced periods, the operating profit of the Company shall not be less than 10% of revenues and earnings per share shall exclude any non-recurring expenses related to mergers and acquisitions. Notwithstanding the foregoing, none of the stock options shall be exercisable before the expiration of two years from the date of issuance. 950,000 of the 1997 options were granted at an exercise price of not less than the fair market value of the ordinary shares at the date of grant.

In 2001, the Company adopted the 2001 Stock Option Plan (the "2001 Option Plan"). The options to acquire ordinary shares, which may be determined by the board of directors of the Company, are granted at an exercise price, of not less than the fair market value of the ordinary shares on the grant date. 3,133,050 of the 2001 options were granted at an exercise price of not less than the fair market value of the ordinary shares at the date of grant. Under the terms of the 2001 Plan, a third of the stock options granted became exercisable ten months after the grant date and the remaining two thirds will become exercisable on the first and second anniversaries of the first date of exercise so long as the grantee is, subject to certain exceptions, employed by the Company at the date the stock option becomes exercisable. The third portion of the Options may be exercised at the end of the second year following the first date of exercise, if the Company meets a pre-tax profit target of 20%, as determined by the Board of Directors and at its discretion. Unless otherwise determined by the Company's Board of Directors as of the date of grant, stock options expire six years after the date of grant.

NOTES TO THE FINANCIAL STATEMENTS

U.S. dollars in thousands (except per share data)

NOTE 14:- SHAREHOLDERS' EQUITY (Cont.)

In 2001, the Company adopted the 2001 Stock Option Plan for Transitional Employees (the "2001 Transitional Employees Plan") for the terminated employees as part of the restructuring plan (See Note 11). The options to acquire ordinary shares, which may be determined by the board of directors of the Company, are granted at an exercise price, of not less than the fair market value of the ordinary shares on the grant date. 174,150 of the 2001 transitional employees options were granted at an exercise price of not less than the fair market value of the ordinary shares at the date of grant. Under the terms of the 2001 Transitional Employees Plan, each share option granted generally becomes exercisable upon the optionee's termination of employment in accordance with the optionee's termination agreement with the Company and will remain exercisable until the first to occur of the date which is six months following the date of such termination and the expiration of the share option's term. Unless otherwise determined by the board of directors as of the date of grant, stock options expire on December 31, 2002. A summary of the Company's stock option activity and related information for the years ended December 31, 1999, 2000 and 2001, is as follows:

	1999		2000		2001	
	Number of options	Weighted-average exercise price	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding at the beginning of the year	2,268,291	$ 22.66	3,036,591	$ 26.37	4,463,523	$ 50.58
Granted	1,702,500	$ 27.78	3,116,200	$ 69.48	4,030,700	$ 12.62
Exercised	(590,225)	$ 18.02	(615,643)	$ 21.79	(33,809)	$ 11.61
Forfeited	(343,975)	$ 23.23	(981,125)	$ 51.83	(2,051,589)	$ 43.08
Cancelled	-	$ -	(92,500)	$ 70.88	-	$ -
Outstanding at the end of the year	3,036,591	$ 26.37	4,463,523	$ 50.58	6,408,825	$ 29.31
Exercisable at the end of the year	138,583	$ 20.24	307,744	$ 27.45	1,393,959	$ 46.25

The options outstanding as of December 31, 2001, have been separated into exercise price categories as follows:

Ranges of exercise price	Options outstanding as of December 31, 2001	Weighted average remaining contractual life	Weighted average exercise price	Options exercisable as of December 31, 2001	Weighted average exercise price of options exercisable
		(Years)			
$ 10.95 - $ 15.90	3,331,360	5.34	$ 12.33	82,850	$ 13.24
$ 16.55 - $ 22.81	1,050,114	3.37	$ 20.59	504,114	$ 21.95
$ 25.25 - $ 30.13	167,500	3.25	$ 25.99	25,000	$ 28.22
$ 40.94 - $ 52.63	763,875	4.47	$ 51.97	276,625	$ 50.93
$ 76.25 - $ 78.88	1,095,976	4.26	$ 74.02	505,370	$ 74.23
	6,408,825	4.67	$ 29.31	1,393,959	$ 46.25

NOTES TO THE FINANCIAL STATEMENTS

U.S. dollars in thousands (except per share data)

NOTE 14:- SHAREHOLDERS' EQUITY (Cont.)

When the Company has recorded deferred stock compensation for options issued with an exercise price below the fair value of the ordinary shares, the deferred compensation is amortized and recorded as compensation expense ratably over the vesting period of the options.

Pro forma information regarding net income (loss) and net earnings (loss) per share is required (for grants issued after December 1994) by SFAS No. 123, and has been determined as if the Company had accounted for its employee options under the fair value method prescribed by that statement. The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions for 1999, 2000 and 2001: risk-free interest rates of 6%, 6% and 4.3%, respectively dividend yields of 0%, 0% and 0%, respectively volatility factors of the expected market price of the Company's ordinary shares of 0.738, 0.821 and 0.506, respectively, and a weighted average expected life of the option of 3, 3.5 and 4.3 years, respectively.

Weighted average fair values and weighted average exercise prices of options whose exercise price is equal or less than the market price of the shares at date of grant are as follows:

	Weighted average fair value of options granted at an exercise price			Weighted average exercise price of options granted at an exercise price		
	Year ended December 31,					
	1999	2000	2001	1999	2000	2001
Less than fair value at date of grant	$ -	$ 55.11	$ -	$ -	$ 22.707	$ -
Equal to fair value at date of grant	$ 12.44	$ 38.93	$ 5.66	$ 27.5	$ 69.042	$ 12.664

Pro forma information under SFAS No. 123:

	Year ended December 31,		
	1999	2000	2001
Net income (loss) as reported	$ 10,827	$ (5,319)	$ (46,795)
Pro forma net income (loss)	$ 1,706	$ (49,163)	$ (78,408)
Pro forma basic net earnings (loss) per share	$ 0.15	$ (3.97)	$ (6.01)
Pro forma diluted net earnings (loss) per share	$ 0.14	$ (3.97)	$ (6.01)

NOTES TO THE FINANCIAL STATEMENTS

U.S. dollars in thousands (except per share data)

NOTE 14:- SHAREHOLDERS' EQUITY (Cont.)

c. Employee Stock Purchase Plan:

In February 1999, the Company's board of directors adopted the Employee Stock Purchase Plan (the "Purchase Plan"). Eligible employees can have up to 10% of their earnings withheld, up to certain maximums, to be used to purchase ordinary shares. The price of ordinary share purchased under the Purchase Plan will be equal to 85% of the lower of the fair market value of the ordinary share on the commencement date of each offering period or on the semi-annual purchase date.

d. Warrants:

In December 1999, the Company granted 50,000 warrants to purchase ordinary shares in consideration of the acquisition of STS. The warrant is exercisable through December 2001 at a price of $ 40 per share. Fair market value was estimated using the Black-Scholes valuation model with the following weighted average assumptions: expected volatility of 0.738, risk free interest of 6%, dividend yield of 0% and weighted average expected life of 2 years. The Company accounted for this transaction in accordance with EITF 96-18 and SFAS No. 123 and recorded $ 229 as part of the total consideration for the acquisition of STS. During 2000, STS exercised 18,750 warrants in the amount of $ 750. The warrant expired in November 2001.

e. Dividends:

Dividends, if any, will be paid in NIS. Dividends paid to shareholders outside Israel may be converted to U.S. dollars on the basis of the exchange rate prevailing at the date of the conversion. The Company does not intend to pay cash dividends in the foreseeable future.

NOTE 15: - MAJOR CUSTOMER AND GEOGRAPHIC INFORMATION

a. Summary information about geographic areas:

The Company manages its business on a basis of one reportable segment. See Note 1a for a brief description of the Company's business. The following data is presented in accordance with Statement of Financial Accounting Standard No. 131 "Disclosure About Segments of an Enterprise and Related Information" ("SFAS No. 131"). Total revenues are attributed to geographic areas based on location of end customers.

NOTES TO THE FINANCIAL STATEMENTS
U.S. dollars in thousands (except per share data)

NOTE 15: - CUSTOMERS AND GEOGRAPHIC INFORMATION (Cont.)

The following presents total revenues and long-lived assets for the years ended December 31, 1999, 2000 and 2001:

	1999		2000		2001	
	Total revenues	Long-lived assets	Total revenues	Long-lived assets	Total revenues	Long-lived assets
Israel	$ 1,678	$ 22,097	$ 4,490	$ 29,796	$ 4,814	$ 29,260
North America	58,499	7,048	81,646	37,213	60,545	34,183
Europe (excluding United Kingdom)	28,376	95	27,447	59	24,602	67
United Kingdom	10,467	19	8,430	38	5,366	43
Far East	10,061	-	18,232	-	21,015	-
Other	8,330	-	12,918	-	10,766	87
	$ 117,411	$ 29,259	$ 153,163	$ 67,106	$ 127,108	$ 63,640

b. Product lines:

Total revenues from external customers divided on the basis of the Company's product lines are as follows:

	Year ended December 31,		
	1999	2000	2001
CEM	$ 103,066	$ 128,655	$ 99,785
Digital video	5,670	15,824	14,084
COMINT	8,675	8,684	13,239
	$ 117,411	$ 153,163	$ 127,108

c. Major customers data as a percentage of total revenues:

	Year ended December 31,		
	1999	2000	2001
		%	
Customer A	16.4	18.6	12.3

NOTES TO THE FINANCIAL STATEMENTS
U.S. dollars in thousands (except per share data)

NOTE 16:- SELECTED STATEMENTS OF OPERATIONS DATA

a. Research and development, net:

	Year ended December 31,		
	1999	**2000**	**2001**
Total costs	$ 15,240	$ 25,406	$ 26,017
Less: grants and participations	(317)	(1,174)	(1,392)
Less: capitalization of software development costs	(2,570)	(4,730)	(5,435)
	$ 12,353	$ 19,502	$ 19,190

b. Financial income, net:

	1999	2000	2001
Financial expenses:			
Interest	$ (40)	$ (80)	$ (38)
Foreign currency translation	(555)	(163)	-
Other	(223)	(328)	(551)
	(818)	(571)	(589)
Financial income:			
Gains, interest and amortization of premium/discount	2,307	3,326	3,371
Foreign currency translation	-	-	166
Interest	3,320	3,433	1,294
Other	-	-	12
	5,627	6,759	4,843
	$ 4,809	$ 6,188	$ 4,254

c. Amortization of acquired intangible assets, restructuring expenses and other special charges:

	1999	2000	2001
In-process research and development write-off (Note 1c,d)	$ 5,155	$ 6,786	$ -
Restructuring expenses (Note 11)	-	-	14,554
Amortization of acquired intangibles	260	860	3,413
	$ 5,415	$ 7,646	$ 17,967

	1999	2000	2001
d. Advertising expenses	$ 1,247	$ 1,485	$ 1,265

NOTES TO THE FINANCIAL STATEMENTS
U.S. dollars in thousands (except per share data)

NOTE 16:- SELECTED STATEMENTS OF OPERATIONS DATA (Cont.)

e. Net earnings (loss) per share:

The following table sets forth the computation of basic and diluted net earnings (loss) per share:

1. Numerator:

	Year ended December 31,		
	1999	**2000**	**2001**
Net income (loss)	$ 10,827	$ (5,319)	$ (46,795)
Numerator for basic and diluted net earnings (loss) per share -			
Income (loss) available to ordinary shareholders	$ 10,827	$ (5,319)	$ (46,795)

2. Denominator:

	Year ended December 31,		
	1999	**2000**	**2001**
	Number of shares in thousands		
Weighted average number of shares	11,559	12,317	13,047
Denominator for basic net earnings (loss) per share	11,559	12,317	13,047
Effect of dilutive securities:			
Employee stock options and warrants granted to non-employees	690	(* -	(* -
Dilutive potential ordinary shares	690	(* -	(* -
Denominator for diluted net earnings (loss) per share - adjusted weighted - average shares assuming exercise of options	12,249	12,317	13,047

*) Anti-dilutive - as of December 31, 1999, 2000 and 2001, options to purchase 263, 3,541 and 3,471 shares, respectively, were not included in the computation of diluted earning per share because the effect would have been anti-dilutive.

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Corporate Directory

Directors and Officers

Ron Gutler, Chairman of the Board of Directors

Joseph Atsmon, Vice-Chairman of the Board of Directors

Leora Meridor, Director

Dan Falk, Director

Rimon Ben-Shaoul, Director

Joseph Dauber, Director

David Kostman, Director

Dan Goldstein, Director

Haim Shani, President and Chief Executive Officer

Lauri Hanover, Corporate Vice President and Chief Financial Officer

Ya'a kov Huberman, Corporate Vice President, Business Development

Dr. Rivi Sherman, Corporate Vice President, Chief Technology Officer

Daphna Kedmi, Corporate Vice President, General Counsel and Corporate Secretary

Meni Gal, Vice President, General Manager Global Operations and Human Resources

Yoav Zaltzman, Corporate Vice President, Global Business Operations

Doron Eidelman, Executive Vice President, President of Security Division

Mordekhay Dor-On, Vice President, General Manager ISS Division

Eytan Bar, Vice President, Co-General Manager CEM Product Division

Lior Arussy, Corporate Vice President - Global Marketing and Co-General Manager CEM Product Division

Dr. Shlomo Shamir, President and Chief Executive Officer of NICE Systems Inc.

Eran Porat, Corporate Controller

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Form F-20

Copies of the Company's Annual Report on Form F-20, as filed with the Securities and Exchange Commission, may be obtained by shareholders without charge by written request.

American Depositary Shares (ADSs)

The Company's ADSs are traded over the counter (National Market System) with the NASDAQ symbol NICE. The Company's Ordinary Shares are traded on the Tel Aviv Stock Exchange.

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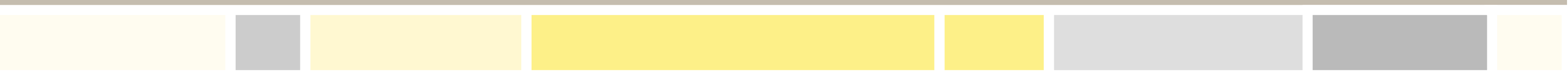

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