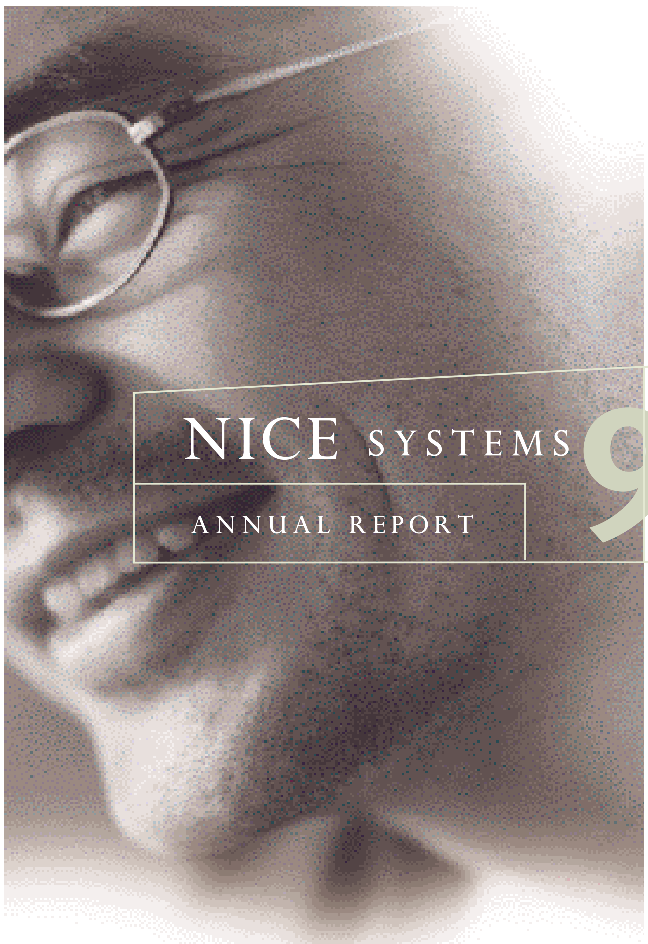
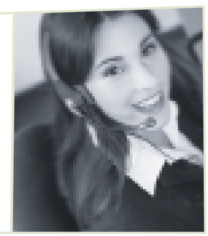


# NICE SYSTEMS 99

ANNUAL REPORT

BUILDING QUALITY CUSTOMER RELATIONSHIPS



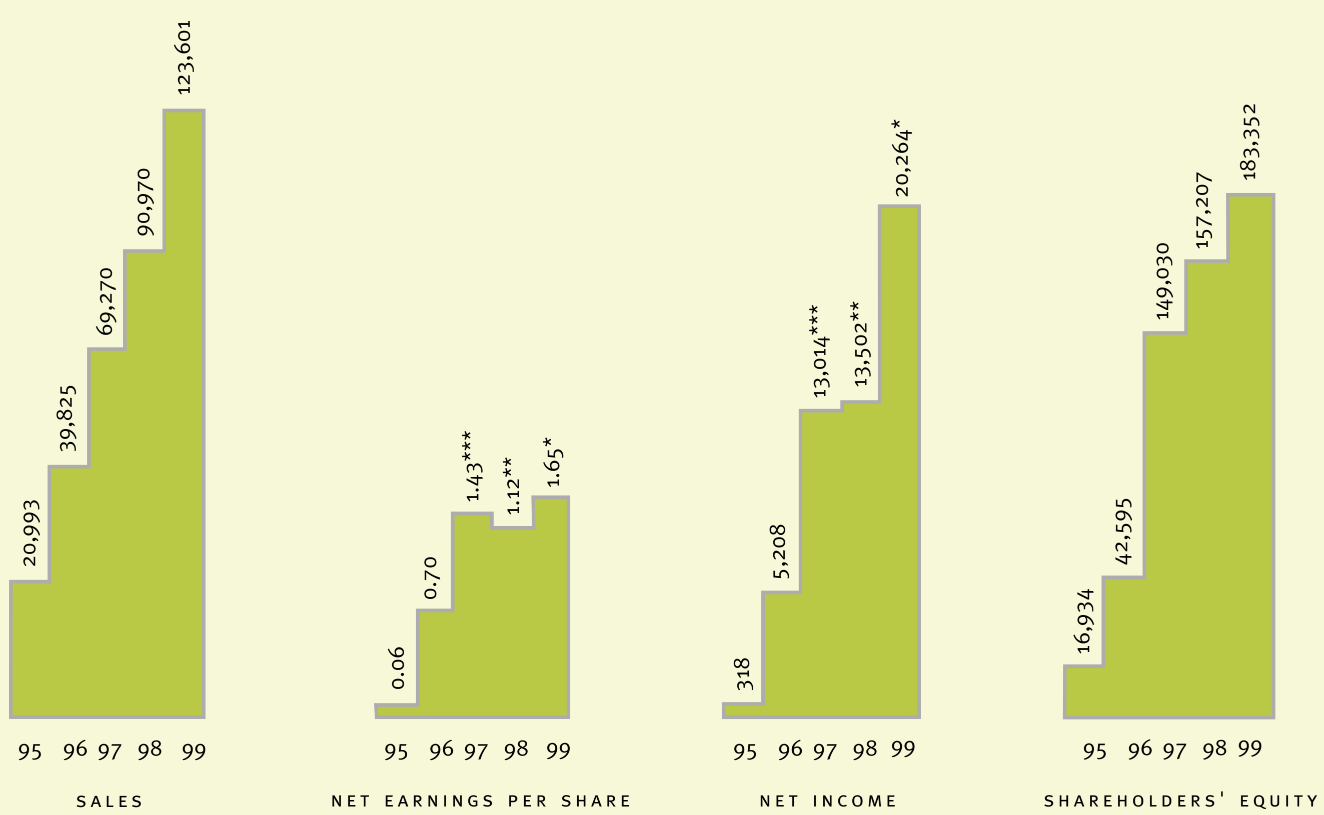
# Contents

# FINANCIAL HIGHLIGHTS

**Year ended December 31**

| US dollars in thousands (shares in thousands) | 1999 | 1998 | 1997 | 1996 | 1995 |
|---|---|---|---|---|---|
| Product sales & services | 123,601 | 90,970 | 69,270 | 39,825 | 20,993 |
| Net income | 20,264* | 13,502** | 13,014*** | 5,208 | 318 |
| Net earnings per share | 1.65* | 1.12** | 1.43*** | 0.70 | 0.06 |
| Weighted average number of shares outstanding | 12,249 | 12,010 | 9,130 | 7,462 | 5,277 |
| Working capital | 137,680 | 126,266 | 132,496 | 35,908 | 13,089 |
| Total assets | 210,304 | 179,155 | 166,653 | 52,341 | 23,559 |
| Short-term debt | 3 | — | 883 | 3 | 29 |
| Shareholders' equity | 183,352 | 157,207 | 149,030 | 42,595 | 16,934 |

*Before one-time expenses (STS acquisition)-1999
**Before one-time expenses (IBS acquisition + relocation expenses)-1998
***Before one-time expenses (Dees acquisition)-1997



# LETTER to the Shareholders

Dear Shareholders,

We are pleased to report an excellent year. Steady increases in revenues, gross and operating margins, net income and earnings per share (EPS) were generated by high profile sales to the US contact center market, reinforced by continued success in established markets. Revenues for 1999 were $123.6 million, as compared with $91 million in 1998. Net income, excluding the one-time charge related to our acquisition of STS Software Systems, totaled $20.3 million, as compared with $13.5 million in 1998 (net of the one-time charge in 1998 related to the acquisition of IBS and the Company's relocation to new premises). Earnings per share were $1.65 (diluted) as compared with $1.12 (diluted) in 1998 (both net of one-time charges).

## Capturing the US Contact Center Market

In 1999, we delivered the right products at the right time. Our major offerings for contact centers responded to market demands for a comprehensive, state-of-the-art solution. The enhanced version of the NiceUniverse quality management system, version 4.1, introduced at the beginning of 1999, together with NiceLog 7.5 and our newly released NiceLog 8.1 voice recording system, were a winning combination.

The clear superiority of our offerings not only attracted new customers, but also generated repeat orders from existing customers. The result was market leadership in the high-end contact center segment.

Focused positioning succeeded in changing the market perception of NICE as primarily a voice logging company. We gained a powerful foothold as a critical vendor for the support of effective Computer Telephony Integrated (CTI) quality management and recording solutions, offering multiple applications on a single platform. With sales of NiceUniverse catching up with those of our voice recording systems, our market position as a leader in quality management solutions was confirmed.

Next year, we plan to leverage our success in the high-end contact center market to increase our market share in the middle and low-end sectors. We believe, based on past experience, that our impressive reference accounts will give us a head start. Our new NiceUniverse LIVE software application, a standalone quality management solution, enables customers to immediately deploy—at a very attractive cost—automated quality management alongside their existing agent observation programs.

## Serving Our Customers

The Professional Services infrastructure that we established in 1998 was another cornerstone of our success in 1999. High-end customers require a complete solution, including consultation, customization, training and continuous long-term support.

We are reaching out with support to customers on other levels as well. Our Global Accounts Program targets multi-national customers with needs in many regions. These major customers want a single point of contact for all their requirements, and the new Program has also been warmly received.

NICE's strategy has always been that it is not enough to gain customers. The goal is to achieve a level of customer satisfaction that develops into a long-term relationship. That means that our investments in technology must be complemented by continuous improvement of our customer service. We are proud that a significant portion of our orders are repeats, and that our customers increasingly view NICE as integral to the realization of their business strategies.

### Responding to the Evolving Contact Center Market

In last year's Annual Report we spoke of call centers. This year we are reporting about contact centers. The two terms are far from synonymous. The familiar call center is being transformed by the web into a multimedia contact center. Customers no longer interact with agents only via voice, but also by using e-mail, web chat, Voice over Internet Protocol (VoIP) and other web-enabled formats. Moreover, whereas at the moment different agents typically deal with each type of communication, this is rapidly changing. The "universal agents" will soon be in touch with customers in the mode they, the customers, prefer, moving seamlessly from one technology to another in a day's work. Both recording and quality management solutions have to be ready for these changes, which can be expected to rapidly transform the market.

We are anticipating the new requirements. Our acquisition of STS Software in 1999 is a linchpin of our strategy for the multimedia contact center. STS has developed proprietary technology for recording data from IP networks. Using this technology, the STS logging solution can seamlessly record VoIP traffic. We intend to implement this technology in our solution for recording VoIP.

The evolution of the multimedia contact center market is driving a growing demand for enhanced Customer Relationship Management (CRM) solutions. Contact center managers want to be able to monitor the full customer experience "from cradle to grave", rather than just record interactions with specific agents. We are investing significantly in solutions that will gain us a leading position in this evolving market.

### Strengthening Market Presence

We have maintained our leadership position in the financial trading sector. In 1999, ABN AMRO Bank, operating in 76 countries and territories, developed a new virtual trading room, using the new NiceLog 8.1 digital voice recording system. The deal is designed to link ABN AMRO's dealing rooms in London and Amsterdam in one "virtual" system, with more sites to be added shortly.

Particularly satisfying was the progress of our NiceVision system for monitoring CCTV (closed circuit television) systems, which recorded first commercial sales in 1999. Our goal is to become a significant player in this market, which is in the midst of migrating from analog to digital technologies.

Our Air Traffic Control (ATC) sales continued to testify to our market dominance of this sector and our COMINT (communications intelligence) sales continued to contribute to earnings based on field-proven technologies.

### New Appointments

As we prepare for consistent technological and business growth, we have made several new appointments. Moshe Ronen, former President and CEO of Golden Channels, Israel's largest cable TV company, will become our President and CEO. Micky Golan, NICE's President and a co-founder of the company, has become Chief Technology Officer. Koby Huberman, former Vice President of Marketing for the Enterprise Internetworking Systems Group (EIS) of Lucent Technologies, is NICE's new Senior VP of Global Marketing. We are confident these new appointments will enrich NICE, and contribute to our broad vision and reservoir of experience.

In its September 1999 Recording Industry Quarterly, DATAMONITOR, a leading industry research company, wrote that "NICE is the IBM of the global recording market and the Windows of the Air Traffic Control segment." We are, of course, proud of this objective third party recognition of NICE's market presence. In 1999, we established a major presence in quality management for the high-end contact center market, while maintaining our dominant position in our traditional markets. These achievements were made possible by a dedicated global team that is firmly committed to translating the challenges of innovation into long-term customer satisfaction. We thank our employees, distributors, partners and shareholders for sharing our vision.

B. Levin

Benny Levin
Chairman and CEO

M. Golan

Micky Golan
Chief Technology Officer (former President)

From left to right: **David Ben-Ze'ev,** Director and Senior Vice President, Strategic Planning; **Micky Golan,** Director and Chief Technology Officer (former President); **Sigal Eyal Caspi,** Vice President, Human Resources; **Benny Levin,** Chairman of the Board and Chief Executive Officer; **Morgan Sturdy,** Executive Vice President and Chief Operating Officer, NICE North America; **Hagai Katz,** Senior Vice President and Chief Operating Officer; **Yuval Yanai,** Senior Vice President and Chief Financial Officer; **Rami Lazar,** Director and Senior Vice President, Business Development.


**Barbara Adcock** *Senior Manager,* Voice Operations, Arch Communications

The Arch Communications Group stepped up to NiceUniverse in 1999. One of the largest providers of paging and wireless communications products and services in the U.S., Arch Communications has implemented NiceUniverse 4.1 for its national call center operations. NICE is proud that Arch is one of its many repeat customers. “Arch has a history of working with NICE Systems,” notes Barbara Adcock. "Today we operate in a complex multi-queued environment....NICE was able to step up its integration while offering new functionality, such as screen capture on 1,000 desktops....With regard to screen capture, one of the biggest concerns of our IT department is activity on the LAN. With NiceUniverse, this was not an issue at all. NiceUniverse screen capture runs easily on our network, and is entirely undetectable to the agent.”

The Arch solution runs on a Nortel Meridian platform. NICE’s integration with Nortel is representative of NICE’s strategy to integrate its systems with the offerings of industry leaders. In 1999, NICE strengthened its relationship with Lucent and other top telecommunications vendors, enhancing customer confidence. Furthermore, NICE entered into cooperation agreements with eShare Technologies (formerly called Melita International), a provider of interactive customer contact management solutions, and with GeoTel Communications Corporation (acquired by Cisco Systems, Inc. during 1999), a vendor of customer-interaction software solutions. These new alliances will fortify NICE’s offerings for the contact center market.

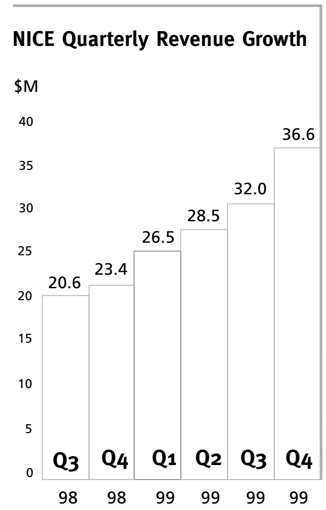
NICE solutions have become integral tools for improving customer service in contact centers. Addison Lee plc, one of the UK’s leading courier companies, has optimized the quality of its customer service operations by installing NiceLog at its call center in Euston, London, to record 5,000 calls handled daily by the company’s 40 agents. Addison Lee reports increased customer loyalty since implementing NiceLog. “NiceLog helps us to conform to the ISO 9002 quality standard as it adds to the superiority of our training program,” says Peter Ingram, IT Manager at Addison Lee. “This is crucial for us as we are deeply committed to staff training and building lasting customer relationships in an industry that is notorious for client turnover. The NiceLog system has helped us to increase customer loyalty dramatically and has also improved job satisfaction among our call center agents.”

Committed to continuously enhancing its solutions, NICE is helping its worldwide customers to improve service and is supporting them in their drive to strengthen customer satisfaction and loyalty.

In 1999, NICE established a major presence in the high-end contact center market by delivering measurable benefits.

Partnerships with leading vendors ensure seamless integration for NICE customers.

NICE has reached a global agreement with TeleTech Holdings for implementation of the NiceUniverse solution in 25 global TeleTech electronic customer interaction centers. Installation of NiceUniverse has already been completed in TeleTech's Thornton, Colorado based, customer interaction center, the first of the centers to receive the system along with eight other centers in the U.S. and Canada. Rollout of NICE's quality system for the remaining centers in the Americas, Europe and the Pacific Rim will continue over the next two years.




Boston Communications Group, Inc. (BCGI) is another market leader to have boarded the NICE bandwagon in 1999. The leading provider of prepaid services to wireless carriers in North and South America, Boston Communications, has implemented and standardized on NiceUniverse across all its contact centers, where agents provide outsourced customer care and billing services.

Andrew Beaudoin, Quality Assurance Manager for Boston Communications Group, stresses the importance of quality assurance for BCGI. "We work with the leaders in the cellular industry as it relates to service and quality....Our level of service must match up toe-to-toe with the expectations of their customer service base. We compared NiceUniverse's capabilities with other product offerings in the marketplace in terms of meeting our needs for digital recording, flexibility, servicing, CTI technologies and our quality process. NICE was our clear choice, and we can confidently say we are in-synch with the elite of the call center industry."

NiceUniverse, featuring NICE's advanced digital voice recording and screen capture capabilities, is designed to enable contact centers to improve contact center performance and optimize every customer interaction. New scoring capabilities allow the contact center to pinpoint the core skill strengths required in agents and to direct this data to training initiatives to build successful customer relationship call models. Comprehensive reporting tools pinpoint the training requirements for each agent, and can create performance profiles for an agent, group of agents and entire contact centers. It is this level of industry responsiveness, which takes into account quality management needs within specific work environments, that makes NiceUniverse a market leader.

NiceUniverse creates a competitive advantage by supporting continuous improvements in customer service.

NICE's global, multi-site solutions are supported by a Professional Services team that tailors solutions as part of a long-term commitment.

“NICE SHARES OUR COMMITMENT TO PROVIDE

# SUPERIOR

## CUSTOMER SERVICE

THROUGH A BLENDED MULTI-MEDIA OF ELECTRONIC COMMUNICATIONS. NICEUNIVERSE ALLOWS TELETECH TO OFFER A UNIQUE ADVANTAGE TO ITS CLIENTS.”

**Sean Erickson** *Senior Vice President***,** Customer Interaction Management, TeleTech Holdings, Inc.

"ABN AMRO WORKS WITH PARTNERS, NOT VENDORS, AND NICE SYSTEMS HAS BEEN PREPARED TO INVEST THE TIME IN DEVELOPING A

# LONG-TERM WORKING RELATIONSHIP

WITH US AND THE OTHER PARTNERS."

**Martin Roberscheuten** *Communication Manager*, Dealing Rooms Worldwide, ABN AMRO Bank

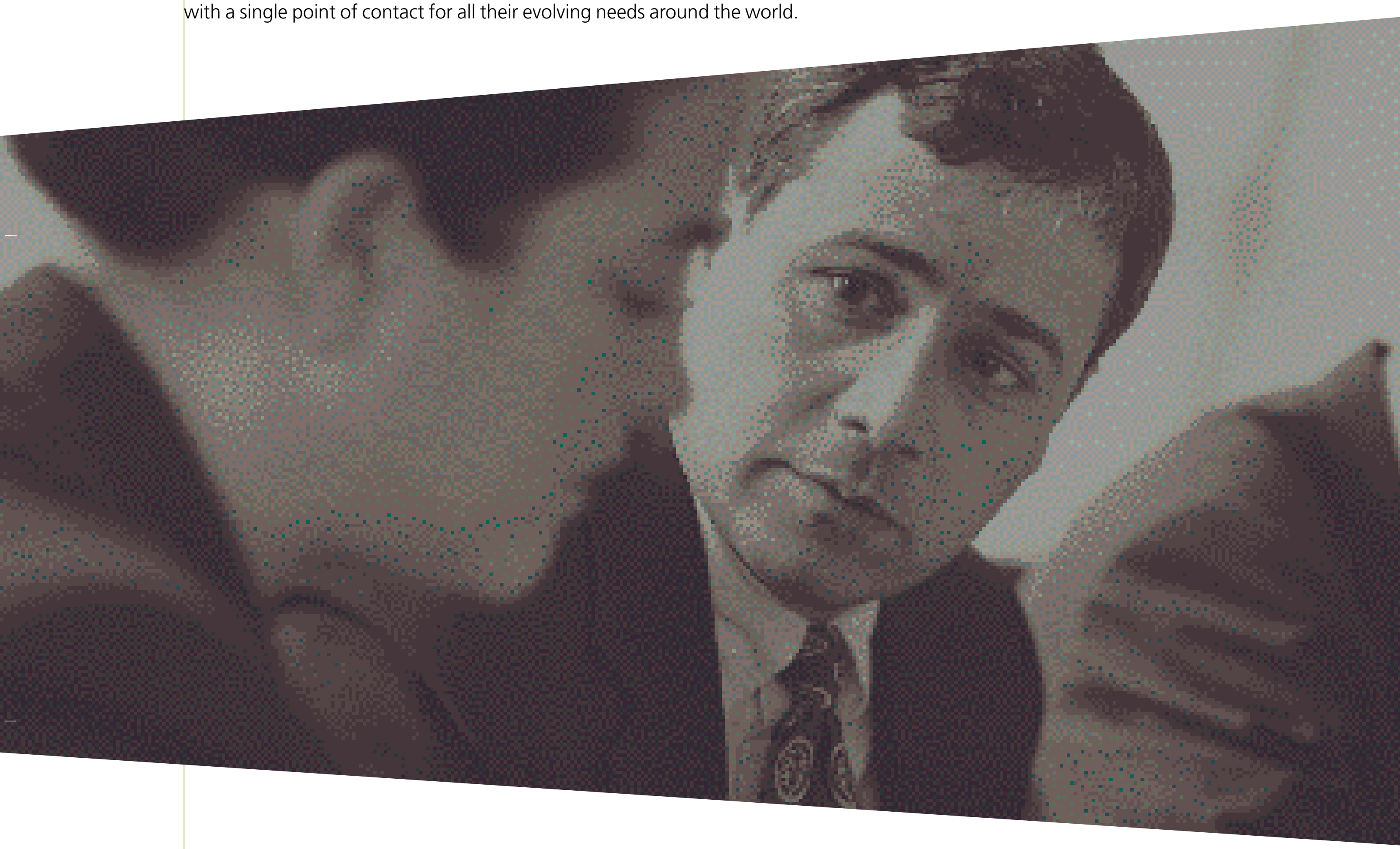
Operating in seventy-six countries and territories worldwide, ABN AMRO Bank, one of the world's leading universal banks, has developed a new virtual dealing room underpinned by the NiceLog 8.1 digital voice recording system. The project will link the global bank's dealing rooms in London and Amsterdam, with more sites to be added in the near future.

Known as the "AMLO Project", the virtual dealing room will be supported by the dynamic recording and storage of all telephone calls, regardless of where the traders are located. Supporting some 5,000 channels, NiceLog is viewed by ABN AMRO as the "spider which makes the web," integrating the different operations in the free-seating dealing room.

The AMLO project was developed through ABN AMRO's Investment Banking Division. Its services are delivered to corporate clients, governments, institutional and private investors, and are backed by a global network of expert traders and dealers in all of the world's major and emerging financial markets. ABN AMRO decided two years ago to establish a worldwide virtual dealing room network that would link 'sister markets' such as Amsterdam and London, Singapore and Sydney, New York and Chicago. The voice integration part of the project was Mr. Roberscheuten's idea. He believed that by drawing on the contact center model, ABN AMRO would be able to connect customers to a trader in whichever dealing room had the capacity to take the call, doing away with the need to transfer staff. "We can also track patterns of share dealing and trading across different markets for our clients," says Mr. Roberscheuten. Using NICE's NiceLog and NiceCLS, ABN AMRO can manage all aspects of the voice recording centrally.

The addition of a NiceCMS (Call Management Solution) to the ABN AMRO solution enables the cost of calls made by particular traders or departments to be sourced and measured.

ABN AMRO's demand for a partner rather than a vendor has made it an ideal client for NICE's Global Accounts Program. The NICE team collaborated closely with ABN AMRO in developing the system, and will continue to provide the Bank with a single point of contact for all their evolving needs around the world.

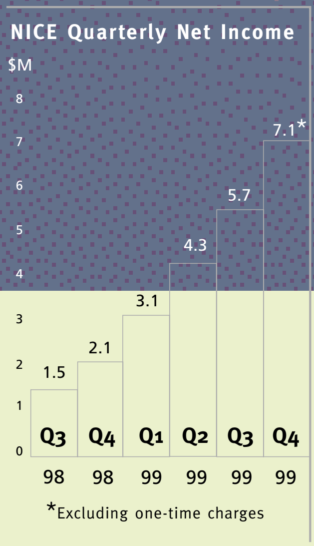


One of the world's leading universal banks, ABN AMRO, has chosen NICE as a partner in an ambitious project to create global virtual trading floors.

NICE's Global Accounts Program is ideal for multi-national companies who expect the highest standards of personalized services at every location.

# "We chose NiceFix because of its advanced technology and FIELD PROVEN RELIABILITY.

# Both our operational and technical people are happy with the NICE solution which contributes to safety - a critical factor in aviation."




**Terje Stenkjer** *Project Manager,* Norway Civil Aviation Administration


In 1999, NICE continued to add new ATC customers to its roster, while benefiting from repeat orders from satisfied clients.

The Japanese Ministry of Transport has installed the NiceLog digital voice recording system in 14 airports in Japan. The Ministry selected NiceLog because of its high audio quality, maximum reliability, and full integration with the existing telephone and radio network.

The Polish Airports State Enterprise (PPL) and The Maldives Airports Authority became NICE customers, choosing NiceLog for their ATC installations. PPL in Poland installed the NiceLog system, featuring several hundred channels, at its new Warsaw ATC center. In the Maldives, the system was installed at the Male International Airport.

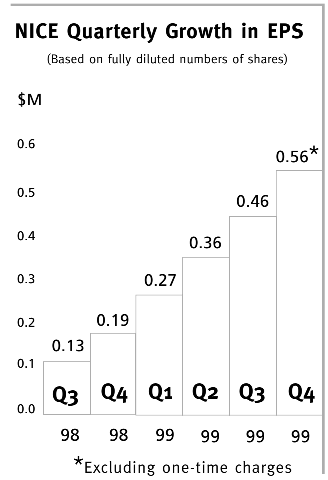
NiceLog is preferred for ATC because of its full functionality, open architecture and Commercial Off The Shelf (COTS) hardware and software modules. Customers can easily integrate NICE into their existing infrastructure while benefiting from the state-of-the-art in voice recording.

NICE's other solution for airports, NiceFix, was selected in 1999 by the Norway Civil Aviation Administration. The NiceFix Direction Finding (DF) system was also installed in Stavenger Airport. NiceFix is used primarily as a navigational aid for airports. A spin-off of NICE's offering for the government sector, NiceFix is noted for its modern interferometer-based technology, which makes extensive use of advanced Digital Signal Processing (DSP), and covers both VHF and UHF frequency ranges.

In the past five years, NICE solutions have also been selected by air traffic authorities in Austria, China, Croatia, Cyprus, Finland, Germany, Holland, Hong Kong, Hungary, Iceland, Israel, Kazakhstan, Romania, Switzerland, Turkey and the United States (FAA).

*NiceLog, featuring full functionality and COTS hardware and software, continues to score success after success in the ATC market.*

*For customers seeking a cutting edge navigation aid, NiceFix is the answer.*




Just one year after the launch of NiceVision, the digital video and audio recording system for CCTV security systems, NICE has already completed dozens of prestigious installations across the United States, comprising thousands of cameras. Customers include federal government organizations, prisons, a national airline, a major city hospital, Fortune 500 corporations and building management organizations. As in the contact center market, NICE is in place with the right product at the right time. With a growing number of CCTV network operators realizing the benefits of digital technology, NICE is ready with a solution that draws on a proven track record. This is a major selling point in a market that recognizes the need for a new technology, and is now undergoing a steady migration from analog to digital.

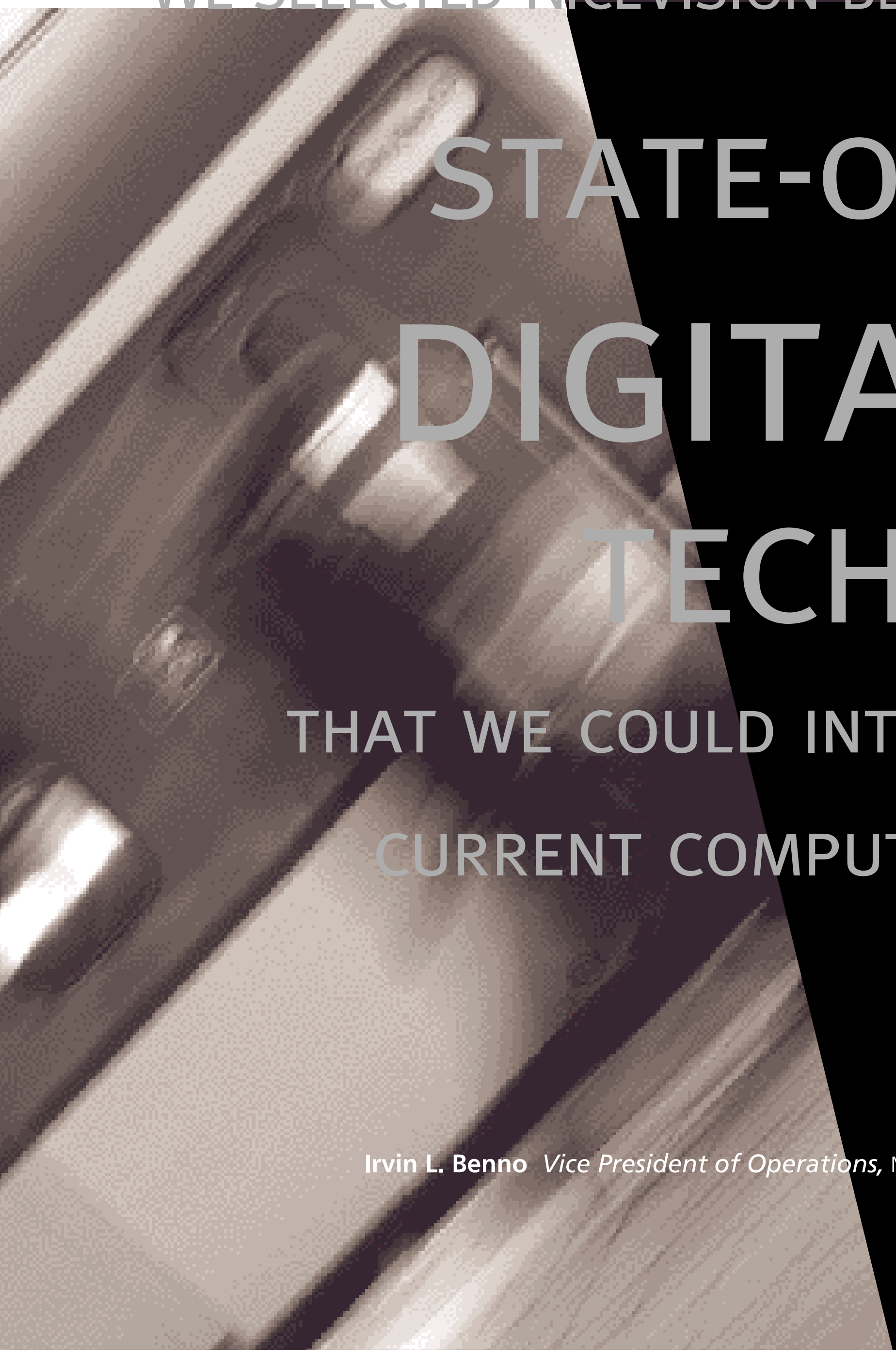
NiceVision delivers exactly what the evolving market demands: high motion digital video and audio recording along with simultaneous playback, covering multiple CCTV cameras in one or more locations. NiceVision is an ideal migration solution, as it integrates into the organization's current security environment without duplication. Moreover, with NiceVision, customers reduce the risk of obsolescence of current equipment while moving up to digital technology, thus leveraging their original investment.

In addition to the Metropolitan Nashville Airport Authority installation, NICE also recorded sales in another transportation industry sector, with the sale of NiceVision to the Helsinki Railway Station in Finland. NiceVision will provide better security protection for rail travelers and more effective incident investigation for rail management.

NiceVision is an excellent example of NICE's ability to apply its core technologies to new vertical markets. In the future, NICE will continue to enhance its offerings for its current markets while exploring new opportunities. NICE's expansion will be promoted by substantial investments in R&D, strategic acquisitions and cooperation with vendors with complementary products.

NICE is rapidly establishing a substantial presence in the digital CCTV video recording market.

NICE's future growth will be propelled by innovation, acquisitions offering complementary technologies, and cooperation with key market players.



# "We selected NiceVision because it represented STATE-OF-THE-ART DIGITAL TECHNOLOGY that we could integrate with our current computer network."

**Irvin L. Benno** *Vice President of Operations,* Metropolitan Nashville Airport Authority (MNAA)

# Financial Statements

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## Results of Operations

The following table shows, for the periods indicated, certain line items from the Company's statement of operations as a percentage of the Company's sales:

| Year ended December 31 | 1997 | 1998 | 1999 |
|---|---|---|---|
| Revenues | 100.0% | 100.0% | 100.0% |
| Cost of revenues | 43.9 | 42.6 | 42.1 |
| Gross profit | 56.1 | 57.4 | 57.9 |
| Research and development expenses, net | 10.7 | 11.8 | 11.2 |
| Selling expenses, net | 24.3 | 29.4 | 27.7 |
| General and administrative expenses | 7.2 | 7.4 | 6.4 |
| Merger and reorganization expenses | 22.6 | 9.9 | 4.2 |
| Operating income (loss) | (8.7) | (1.1) | 8.4 |
| Net income (loss) from continuing operations | (4.7) | 4.9 | 12.2 |

Revenues were $123.6 million in 1999 compared to $91 million in 1998, an increase of 36%. Revenues from sales of CTI

G5oss p3ed82.6  $91 million in 1998, an increase7of Tw[goss p3oss p3

General and administrative expenses were $7.9 million, or 6.4% of revenues, in 1999 compared to $6.7 million, or 7.4% of revenues, in 1998. The decrease in general and administrative expenses as a percentage of revenues, is due to the Company's maintaining a relatively stable level of general and administrative expenses while increasing the level of sales.

The Company recorded in the fourth quarter of 1999 a one-time expense of approximately $5.2 million to write off certain items concerning the acquisition of STS Software Systems Ltd. (STS). The STS write-off included in-process research and development of software acquired with STS, for which technological feasibility has not yet been established and for which no alternative future use exists, capitalization of R&D and reorganization expenses.

In the second quarter of 1998, the Company recorded a one-time expense of approximately $9.0 million to write-off certain items concerning the assets and liabilities acquisition of IBS, the Company's relocations to its new premises in Ra'anana, Israel, and reorganization expenses resulting from the IBS transaction. The IBS write-off included in-process research and development of software acquired from IBS, for which technological feasibility has not yet been established and for which no alternative future use exists, capitalization of R&D and reorganization expenses. The write-off related to the Company's relocations included primarily write-off of leasehold improvements in the Company's old facilities.

The Company recorded, in the third quarter of 1997, a one-time expense of approximately $16.2 million to write off certain items concerning the Dees acquisition, including in-process research and development of software acquired from Dees, for which technological feasibility has not yet been established and for which no alternative future use exists, inventory, capitalization of R&D and reorganization expenses.

As a result of the foregoing factors, operating income in 1999 was $10.4 million compared to an operating loss of $0.97 million in 1998. Excluding one-time expenses incurred due to the STS acquisition, the Company would have had operating income in 1999 of $15.5 million.

Net financial income for 1999 was $4.8 million, or 3.9% of revenues, compared to $5.8 million, or 6.4% of revenues, in 1998. This income is mainly attributable to securities and deposits which the Company holds in Israel and the U.S. The sum of approximately $98 million that was raised by the Company during its second public offering in the U.S. generated financial income starting from July 1997.

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

## Quarterly Results

The following table presents unaudited quarterly financial information for each of the four quarters for the year ended December 31, 1999. This information has been prepared on the same basis as NICE's Consolidated Financial Statements.

| Quarter ended 1999 | March 31 | June 30 | Sept. 30 | Dec. 31 |
|---|---|---|---|---|
| Total revenues | $ 26,502 | $ 28,533 | $ 31,963 | $ 36,603 |
| Gross profit | 15,238 | 16,454 | 18,519 | 21,298 |
| Research and development, net | 3,091 | 3,280 | 3,669 | 3,785 |
| Merger and reorganization | - | - | - | 5,155 |
| Operating income | 2,159 | 3,044 | 4,343 | 832 |
| Net income from continuing operations | 3,118 | 4,309 | 5,726 | 1,956 |

The Company's operating results may be subject to significant fluctuations in future periods. The Company's operating results, for any particular quarter, are not necessarily indicative of any future results. The Company's 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.

## Liquidity and Capital Resources

In the last three years, the Company's financing requirements were met primarily through funds generated from the Company's operations as well as through net proceeds in the amount of approximately $20.2 million from the Company's initial public offering in the U.S. during January 1996, and net proceeds in the amount of approximately $98 million from the Company's second public offering in the U.S. during July 1997.

The Company had cash, cash equivalents and bank deposits of $66.5 million as of December 31, 1999, compared to $74.5 million in 1998. Marketable securities and other long term cash investments totaled $48.2 million, as of December 31, 1999, compared to $29.4 million in 1998. Such increase in the aggregate of cash, cash equivalents, bank deposits and marketable securities resulted primarily from investment of the net proceeds from the Company's second offering in 1997, and from the accumulated profits since then.

As the Company's sales increase, its accounts receivables are likely to increase proportionately. Historically, the Company has not incurred any material losses as a result of unpaid debts.

As of December 31, 1999, the Company had working capital of $137.7 million, compared to $126.3 million at December 31, 1998. The Company has not utilized borrowings to any material extent to finance its operations.

## Effective Corporate Tax Rate

Certain production facilities of NICE and its subsidiaries have been granted "Approved Enterprise" status under the Law for Encouragement of Capital Investments, 5719-1959, and consequently are eligible for certain tax benefits for the first several years in which they generate taxable income. NICE has elected to participate in the Alternative Benefits Program with respect to its current "Approved Enterprises." The income derived from the Company's facilities which were granted "Approved Enterprise" status is exempt from income tax in Israel for four years commencing in the year in which the specific "Approved Enterprises" first generates taxable income. Following such a four-year period, the "Approved Enterprises" are subject to corporate tax at a reduced rate of 25% for the following three years. Since NICE has incurred tax losses through December 31, 1997, such a four-year period has not yet commenced. In 1998 the tax exemption period with respect to revenue derived from its "Approved Enterprises" commenced as the company utilized all its tax loss carried forward. Pursuant to a recent amendment to applicable regulations in Israel, the tax exemption period for any future "Approved Enterprise" program will be two years.

In the event a company is operating under more than one approval or its capital investments are only partly approved, its effective tax rate is a weighted combination of the various applicable tax rates.

# 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 its subsidiaries as of December 31, 1999 and 1998, 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, 1999. 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 generally accepted auditing standards in the U.S.. 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 its subsidiaries as of December 31, 1999 and 1998, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 1999, in conformity with generally accepted accounting principles in the U.S.

Kost Forer & Gabbay

KOST FORER & GABBAY
Certified Public Accountants (Israel)
A member of Ernst & Young International

Tel Aviv, Israel
February 15, 2000

## Consolidated Balance Sheets

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

| December 31 | 1998 | 1999 |
|---|---|---|
| **ASSETS** | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $ 29,005 | $ 23,833 |
| Short-term deposits | 45,478 | 42,623 |
| Marketable securities (Note 3) | 18,461 | 30,459 |
| Trade receivables (net of allowance for doubtful accounts of - $304 in 1998 and $1,092 in 1999) | 34,348 | 44,931 |
| Unbilled receivables | 4,703 | 2,172 |
| Other receivables and prepaid expenses (Note 4) | 3,731 | 6,510 |
| Inventories (Note 5) | 8,514 | 8,866 |
| Total current assets | 144,240 | 159,394 |
| LONG-TERM ASSETS: | | |
| Long-term investments (Note 3) | 10,965 | 17,724 |
| Severance pay fund | 3,142 | 4,018 |
| Prepaid expenses | - | 138 |
| Total long-term assets | 14,107 | 21,880 |
| FIXED ASSETS, NET (Note 6) | 15,102 | 19,992 |
| OTHER ASSETS, NET (Note 7) | 5,706 | 9,038 |
| Total assets | $ 179,155 | $ 210,304 |

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

## Consolidated Balance Sheets

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

| December 31 | 1998 | 1999 |
|---|---|---|
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| CURRENT LIABILITIES: | | |
| Short-term bank credit | $ - | $ 3 |
| Trade payables | 8,417 | 11,201 |
| Accrued expenses and other liabilities (Note 8) | 9,557 | 10,510 |
| Total current liabilities | 17,974 | 21,714 |
| LONG-TERM LIABILITIES: | | |
| Deferred lease payments | 549 | 418 |
| Accrued severance pay | 3,425 | 4,700 |
| Other long-term liability | - | 120 |
| Total long-term liabilities | 3,974 | 5,238 |
| CONTINGENT LIABILITIES AND COMMITMENTS (Note 9) | | |
| SHAREHOLDERS' EQUITY: | | |
| Share capital (Note 11) | | |
| Authorized: 50,000,000 Common shares of NIS 1.00 par value, issued and outstanding: 11,290,912 and 11,881,137 shares as of December 31, 1998 and 1999, respectively | 3,919 | 4,062 |
| Additional paid-in capital | 142,474 | 153,160 |
| Deferred compensation | (310) | (103) |
| Retained earnings | 11,124 | 26,233 |
| Total shareholders' equity | 157,207 | 183,352 |
| Total liabilities and shareholders' equity | $ 179,155 | $ 210,304 |

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

# NICE Systems Ltd. & Subsidiaries

## Consolidated Statements of Operations

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

| Year ended December 31 | 1997 | 1998 | 1999 |
|---|---|---|---|
| Revenues (Notes 12, 13a) | $ 69,270 | $ 90,970 | $ 123,601 |
| Cost of revenues | 30,404 | 38,735 | 52,092 |
| Gross profit | 38,866 | 52,235 | 71,509 |
| Operating expenses: | | | |
| Research and development, net (Note 13b) | 7,389 | 10,751 | 13,825 |
| Selling and marketing | 16,861 | 26,700 | 34,296 |
| General and administrative | 4,967 | 6,727 | 7,855 |
| Other special charges (Note 13d) | 15,688 | 9,023 | 5,155 |
| Total operating expenses | 44,905 | 53,201 | 61,131 |
| Operating income (loss) | (6,039) | (966) | 10,378 |
| Financial income, net (Note 13c) | 2,895 | 5,792 | 4,809 |
| Other income (loss), net | 25 | - | (4) |
| Income (loss) before taxes on income | (3,119) | 4,826 | 15,183 |
| Taxes on income (Note 10d) | 115 | 347 | 74 |
| Net income (loss) | $ (3,234) | $ 4,479 | $ 15,109 |
| Basic earnings (loss) per share (Note 13e) | $ (0.35) | $ 0.40 | $ 1.31 |
| Diluted earnings (loss) per share (Note 13e) | $ (0.35) | $ 0.37 | $ 1.23 |

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

## Statements of Changes in Shareholders' Equity

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

| | Share capital | Additional paid-in capital | Deferred compensation | Accumulated other comprehensive income | Retained earnings | Total comprehensive income (loss) | Total shareholders' equity |
|---|---|---|---|---|---|---|---|
| Balance as of January 1, 1997 | $ 2,866 | $ 30,797 | $ (919) | $ (28) | $ 9,879 | $ - | $ 42,595 |
| Issuance of shares, net | 863 | 97,069 | - | - | - | | 97,932 |
| Issuance of shares related to the acquisition of Dees | 123 | 11,186 | - | - | - | | 11,309 |
| Amortization of unearned compensation from stock options issued to employees | - | - | 316 | - | - | | 316 |
| Stock options exercised | 8 | 76 | - | - | - | | 84 |
| Other comprehensive income (loss) | | | | | | | |
| Foreign currency translation adjustments | - | - | - | 28 | - | $ 28 | 28 |
| Total other comprehensive income | | | | | | 28 | |
| Net loss | - | - | - | - | (3,234) | (3,234) | (3,234) |
| Total comprehensive loss | | | | | | $ (3,206) | |
| Balance as of December 31, 1997 | 3,860 | 139,128 | (603) | - | 6,645 | | 149,030 |
| Issuance of shares related to the acquisition of IBS | 10 | 1,390 | - | - | - | | 1,400 |
| Amortization of unearned compensation from stock options issued to employees | - | - | 293 | - | - | | 293 |
| Stock options exercised | 49 | 1,956 | - | - | - | | 2,005 |
| Net income | - | - | - | - | 4,479 | | 4,479 |
| Balance as of December 31, 1998 | 3,919 | 142,474 | (310) | - | 11,124 | | 157,207 |
| Issuance of options related to the acquisition of STS | - | 229 | - | - | - | | 229 |
| Amortization of unearned compensation from stock options issued to employees | - | - | 207 | - | - | | 207 |
| Stock options exercised | 143 | 10,457 | - | - | - | | 10,600 |
| Net income | - | - | - | - | 15,109 | | 15,109 |
| Balance as of December 31, 1999 | $ 4,062 | $153,160 | $ (103) | $ - | $ 26,233 | | $183,352 |

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

## Consolidated Statements of Cash Flows

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

| Year ended December 31 | 1997 | 1998 | 1999 |
|---|---|---|---|
| Cash flows from operating activities: | | | |
| Net income (loss) | $ (3,234) | $ 4,479 | $ 15,109 |
| Adjustments required to reconcile net income (loss) to net cash provided by operating activities: | | | |
| Depreciation and amortization | 2,785 | 4,544 | 6,798 |
| Write-off of fixed assets in connection with the relocation | - | 1,698 | - |
| Write-off of in-process technology in connection with Dees acquisition | 15,388 | - | - |
| Write-off of in-process technology in connection with IBS acquisition | - | 6,263 | - |
| Write-off of in-process technology in connection with STS acquisition | - | - | 5,155 |
| Increase in accrued severance pay, net | 108 | 94 | 367 |
| Loss (gain) from marketable securities and accrued interest on short-term deposits | (7) | (14) | 62 |
| Amortization of unearned compensation from stock options issued to employees | 316 | 293 | 207 |
| Increase in trade and unbilled receivables | (11,386) | (10,750) | (7,755) |
| Decrease (increase) in other receivables and prepaid expenses | (2,525) | 647 | (2,414) |
| Increase in inventories | (1,266) | (2,948) | (335) |
| Increase in long-term prepaid expenses | - | - | (138) |
| Increase in trade payables | 2,711 | 1,449 | 2,730 |
| Increase (decrease) in accrued expenses and other liabilities | 2,172 | 2,628 | (33) |
| Other | (36) | (54) | (127) |
| Net cash provided by operating activities | 5,026 | 8,329 | 19,626 |

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

## Consolidated Statements of Cash Flows

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

| Year ended December 31 | 1997 | 1998 | 1999 |
|---|---|---|---|
| Cash flows from investing activities: | | | |
| Purchase of fixed assets | (8,267) | (9,257) | (10,062) |
| Purchase of other assets | - | - | (175) |
| Purchase of held to maturity securities | (7,419) | (22,595) | (22,389) |
| Proceeds from maturity of held to maturity securities | 15,621 | 11,052 | 17,064 |
| Purchase of available for sale securities | (481) | (383) | - |
| Proceeds from sale of available for sale securities | 421 | 384 | 269 |
| Proceeds from sale of short-term deposits | 5,728 | 60,735 | 69,469 |
| Investment in long-term investment | (372) | (10,670) | (13,984) |
| Payment for acquisition of Dees (a) | (8,966) | - | - |
| Payment for acquisition of IBS (b) | - | (4,446) | - |
| Payment for acquisition of STS (c) | - | - | (6,267) |
| Investment in short-term deposits | (58,944) | (48,953) | (66,601) |
| Proceeds from sale of fixed assets | 176 | 409 | 151 |
| Capitalization of computer software costs | (1,481) | (1,930) | (2,570) |
| Proceeds from sale of investment in an affiliate | 179 | - | - |
| Other | - | (40) | - |
| Net cash used in investing activities | (63,805) | (25,694) | (35,095) |
| Cash flows from financing activities: | | | |
| Proceeds from issuance of shares and exercise of options, net | 98,016 | 2,005 | 10,600 |
| Proceeds from long-term bank loan | 15 | - | - |
| Short-term bank credit, net | 705 | (883) | (303) |
| Net cash provided by financing activities | 98,736 | 1,122 | 10,297 |
| Increase (decrease) in cash and cash equivalents | 39,957 | (16,243) | (5,172) |
| Cash and cash equivalents at the beginning of the year | 5,291 | 45,248 | 29,005 |
| Cash and cash equivalents at the end of the year | $ 45,248 | $ 29,005 | $ 23,833 |

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

## Consolidated Statements of Cash Flows

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

| Year ended December 31 | 1997 | 1998 | 1999 |
|---|---|---|---|
| Supplemental disclosure of cash flows activities: | | | |
| Cash paid during the year for: | | | |
| Income taxes | $ 440 | $ 207 | $ 58 |
| (a) Payment for acquisition of Dees: | | | |
| Estimated fair value of assets acquired and liabilities assumed: | | | |
| Working capital (excluding cash and cash equivalents) | $ 1,598 | | |
| Fixed assets | 390 | | |
| Investment in an affiliate | 136 | | |
| Other assets | 16,900 | | |
| Goodwill | 1,251 | | |
| | 20,275 | | |
| Less - amount acquired by issuance of shares | (11,309) | | |
| | $ 8,966 | | |
| (b) Purchase of IBS: | | | |
| Estimated fair value of assets acquired and liabilities assumed: | | | |
| Working capital deficiency | | $ (466) | |
| Fixed assets | | 49 | |
| Other assets | | 6,263 | |
| | | 5,846 | |
| Less amount acquired by issuance of shares | | (1,400) | |
| | | $ 4,446 | |
| (c) Payment for acquisition of STS: | | | |
| Estimated fair value of assets and liabilities acquired: | | | |
| Working capital deficiency (excluding cash and cash equivalents) | | | $ (875) |
| Fixed assets | | | 90 |
| Technology | | | 5,155 |
| Work-force | | | 287 |
| Other long-term liability | | | (152) |
| Goodwill | | | 1,991 |
| | | | 6,496 |
| Less - amount acquired by issuance of shares | | | (229) |
| | | | $ 6,267 |

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

## Note 1 General

a. NICE Systems Ltd. and its subsidiaries ("the Company" or "NICE") develop, design, manufacture, market and service a range of digital recording and quality management solutions, including the Company's flagship product, NiceLog, a technologically advanced, scaleable digital voice recording and archiving system; NiceCLS, a call logging system that incorporates all call information into one centralized location; NiceCall, a cost-effective voice recorder for applications requiring fewer channels; NiceUniverse, an effective quality management solution for automatic monitoring and objective evaluation of Call Center agent performance; NiceVision, a state-of-the-art digital video and audio recording system.

The Company's CTI (Computer Telephony Integrated) recording products are targeted at a growing range of diverse applications. The Company provides recording solutions for the Financial Trading Floor and Air Traffic Control ("ATC") markets, and has a growing presence in the Call Center (or "Contact Center") market, to which it markets both its voice recording and quality management products.

The Company also develops, designs, manufactures, and markets Communications Intelligence ("COMINT") systems. The principal products in this line are NiceFix and CDF 1500, for high-performance spectrum surveillance, signal tracing and direction finding from a fixed site, mobile platform or as a remote controlled sensor. COMINT line products are primarily used by government agencies.

The Company sells its products worldwide. For the years ended December 31, 1997, 1998 and 1999, approximately 97%, 98% and 99%, respectively, of the Company's total revenues were derived from sales to customers outside of Israel, and approximately 45%, 42% and 52%, respectively, of the Company's total revenues were made to customers in North America.

b. Acquisition of Dees Communications Ltd.:

In June 1997, the Company acquired all the outstanding capital stock of Dees Communication Ltd. ("Dees") for $8,000 in cash and securities of a wholly-owned subsidiary of NICE exchangeable for 435,000 ADSs of NICE Systems Ltd. Those securities have no other rights except the right to exchange for NICE Systems shares. The total cost of the acquisition amounted to $20 million. Dees provided, among other products, automated Call Center monitoring solutions for quality measurement training and agent productivity enhancement.

The acquisition was treated on the basis of the purchase method of accounting and accordingly, the purchase price has been allocated according to the fair value of the assets and liabilities of Dees.

Dees' financial statements are consolidated with those of the Company commencing with the third quarter of 1997.

In connection with the Dees acquisition, the Company recorded in the third quarter of 1997, a one-time expense of approximately $14,200 to write off software acquired from Dees, for which technological feasibility has not yet been established and for which no alternative future use exists.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS U.S. dollars in thousands (except per share amounts)

Other intangible assets acquired had an estimated fair value of $3,951 as shown in the following table:

| | |
|---|---|
| Technology | $ 1,800 |
| Goodwill | 1,251 |
| Other intangible assets | 900 |
| Total | $ 3,951 |

The Company recorded an additional expense in the amount of $1,488 to write-off software capitalization costs and reorganization costs resulted from the acquisition of Dees.

c. Acquisition of International Blue Software Corp.:

In April 1998, the Company purchased the business and assets and assumed the liabilities of International Blue Software Corp. ("IBS") for $4.4 million in cash and 35,110 ADSs of NICE Systems Ltd. The total cost of the acquisition amounted to $6 million.

The acquisition was treated on the basis of the purchase method of accounting and accordingly, the purchase price has been allocated according to the fair value of the assets and liabilities of IBS.

IBS provided remote control, monitoring and training solutions for Call Centers.

In connection with the above mentioned acquisition, the Company recorded in the second quarter of 1998 a one-time expense of approximately $6 million to write off software acquired from IBS, for which technological feasibility has not yet been established and for which no alternative future use exists.

The Company recorded an additional expense in the amount of $500 for reorganization costs, due to employee termination costs resulting from the acquisition of IBS.

Proforma information in accordance with APB16 has not been provided as the revenues of IBS for 1997, 1998 were not material in relation to total consolidated revenues.

d. Acquisition of STS Software Systems 1993 Ltd.:

In December 1999, the Company acquired all the outstanding capital stock of STS Software Systems (1993) Ltd. ("STS") for $6.2 million in cash and 50,000 warrants of NICE shares at an exercise price of $40 per share. The total cost of the acquisition amounted to $6,496.

STS is a developer of complete digital multimedia logging solutions for information media, and developed a simple way to record information from the Internet with an advanced VoIP (Voice over Internet Protocol) interface.

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

The acquisition was treated on the basis of the purchase method of accounting and accordingly, the purchase price has been allocated according to the fair value of the assets and liabilities of STS.

The operations of STS are included in the consolidated statements from the fourth quarter of 1999.

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.

Other intangible assets acquired had an estimated fair value of $2,278 as shown in the following table:

| | |
|---|---|
| Work force | $ 287 |
| Goodwill | 1,991 |
| | $ 2,278 |

The following represents the unaudited pro-forma results of operations assuming that the acquisition occurred on January 1, 1998:

| Year ended December 31 | 1998 | 1999 |
|---|---|---|
| Revenues | $ 92,403 | $ 124,214 |
| Net income | $ 4,472 | $ 14,095 |
| Basic earning per share | $ 0.40 | $ 1.22 |
| Diluted earning per share | $ 0.37 | $ 1.15 |

e. Other special charges:

In September 1998, the Company relocated its facilities to another location. The Company recorded an expense of $2.3 million, to reflect the relocation costs.

## Note 2 Significant Accounting Policies

The financial statements were prepared in accordance with 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 majority of the Company's and each of its subsidiaries sales, are made outside Israel in U.S. dollars ("dollars"). In addition, a substantial portion of the Company's costs are incurred in dollars. Accordingly, the Company has determined the U.S. dollar as the currency of its primary economic environment and thus its functional and reporting currency.

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 No. 52 of the Financial Accounting Standard Board ("FASB").

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.

In 1997, the functional currency for an affiliate has been determined to be the local currency, and therefore, the translation adjustment are recorded as a separate component of shareholders' equity.

c. Principles of consolidation:

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries.

Intercompany transactions and balances have been eliminated in the 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 deposits:

The Company classified deposits with maturities of more than three months but less than one year as short-term deposits.

f. Marketable securities:

The Company accounts for investments in debt and equity securities (other than those accounted for under the equity method of accounting) in accordance with FASB Statement No. 115, "Accounting for Certain Investments in Debt and Equity Securities".

Management determines the appropriate classification of its investments in debt and equity 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. Debt securities for which the Company does not have the intent or ability to hold to maturity are classified as available-for-sale. Available-for-sale securities are carried at fair value, with the unrealized gains and losses, net of income taxes, reported as a separate component of shareholders' equity. In 1997, 1998 and 1999 the unrealized gains and losses were immaterial.

The amortized cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization and interest are included in financial expense (income), net.

g. Inventories:

Inventories are stated at the lower of cost or market value. Cost is determined as follows:

Raw materials - by the "average cost" method.
Work in progress and finished goods - on the basis of computed manufacturing costs.

The Company evaluates periodically the quantities on hand relative to current selling prices and historical and forecasted sales volume. Based on these evaluations, provisions are made in each period to write inventory down to its net realizable value.

h. Investment in an affiliate:

NICE's investment in Espro Engineering (1992) Ltd. was presented by the equity method of accounting through 1996. From 1997 the investment is presented using the cost method of accounting due to decrease in the Company's holding to 15%.

In 1998 the Company invested in Espro Engineering (1992) Ltd. an additional amount of $101.

i. Fixed assets:

Fixed assets are stated at cost, net of accumulated depreciation.

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

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 | over to the term of the lease |

j. Other assets:

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

| | % |
|---|---|
| Goodwill | 10 |
| Technology | 25 |
| Other intangible assets | 20 - 33 |

k. Revenue recognition:

Revenues from product sales are recognized according to SOP97-2 (as amended) when delivery has occurred, persuasive evidence of an arrangement exists, the vendor's fee is fixed or determinable and collectibility is probable.

In December 1998, the AICPA issued Statement of Position 98-9 ("SOP 98-9"), "Modification of SOP 97-2, Software Revenue Recognition, with Respect to Certain Transactions". SOP 98-9 amends SOP 98-4 to extend the deferral to the application of certain passages of SOP 97-2 provided by SOP 98-4 through fiscal years beginning on or before March 15, 1999. All other provisions of SOP 98-9 are effective for transactions entered into in fiscal years beginning after March 15, 1999. The Company does not expect the impact of this new statement on the Company's consolidated balance sheet or results of operations, to be material.

Revenues from maintenance and services are recognized over the term of the maintenance period, which is typically 12 months.

The Company recognizes revenues from fixed price contracts on the percentage of completion method of accounting based on the contracted value of the work performed to the balance sheet date, based on the ratio of actual costs incurred to total estimated contract costs. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined.

l. 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 Statement No. 86 of the Financial Accounting Standard Board ("FASB").

Capitalized software 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 product, or (ii) the straight-line method over the estimated useful life of the product (three to five years).

At each balance sheet date, the Company compares the unamortized capitalized software costs to the net realizable value on a product by product basis. Should unamortized capitalized costs of a computer software product exceed the net realizable value, these assets will be written down by the excess amount.

m. Income taxes:

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards (SFAS) 109, "Accounting for Income Taxes". 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 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.

n. Royalty-bearing grants:

Royalty-bearing grants from the Government of Israel for funding research and development are recognized at the time the Company is entitled to such grants as approved expenses are incurred (see Note 9b).

o. Concentrations of credit risk:

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

The Company's cash and cash equivalents, short-term deposits and part of the long-term investments are invested in deposits with major Israeli and U.S. banks. 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 receivables are derived from sales to customers located primarily in the U.S. and Europe. The Company performs ongoing credit evaluations of its customers and, to date, has not experienced any material losses. The allowance for doubtful accounts is determined with respect to specific debts that are doubtful of collection. An allowance for doubtful accounts is provided with respect to those amounts that the Company has determined to be doubtful of collection.

The Company's marketable securities and long term investments 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.

p. Severance pay:

The Company's liability for severance pay 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 fund and by an accrual.

Severance pay expense for 1997, 1998 and 1999 was $963 , $1,242 and $1,908.

q. Basic and diluted earnings (loss) per share:

Basic earnings (loss) per share are computed based on the weighted average number of Common shares outstanding during each year. Diluted earnings (loss) per share is computed based on the weighted average number of Common shares outstanding during each year, plus the dilutive potential of equivalent Common shares considered outstanding during the year, in accordance with FASB Statement No. 128, "Earnings Per Share".

r. Stock based compensation:

The Company has elected to continue accounting for stock-based compensation in accordance with the provisions of Accounting Principles Board Opinion No. 25 ("APB-25"), "Accounting for Stock Issued to Employees". Under APB-25, when the exercise price of the Company's shares options equals or is higher than the market price of the underlying shares on the date of grant, no compensation expense is recognized, when the exercise price of the Company's shares options is less than the market price of the underlying shares on the date of grant, compensation expense is recognized. The pro-forma information with respect to the fair value of the options is provided in accordance with the provisions of Statement No. 123 (see Note 11).

s. Fair value of financial instruments:

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

Cash and cash equivalents and short-term deposits - The carrying amount reported in the balance sheet for cash and cash equivalents and short-term deposits approximates its fair value due to the short-term maturities of such instruments.

Marketable and long-term securities - The fair value for marketable U.S. corporate securities are based on quoted market prices.

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

2. The carrying amounts and values of the Company's financial instruments are as follows:

| | Carrying amount | | Fair value | |
|---|---|---|---|---|
| December 31 | 1998 | 1999 | 1998 | 1999 |
| Cash and cash equivalents | $ 29,005 | $ 23,833 | $ 29,005 | $ 23,833 |
| Short term deposits | $ 45,478 | $ 42,623 | $ 45,478 | $ 42,623 |
| Marketable securities | $ 18,461 | $ 30,459 | $ 18,040 | $ 30,348 |
| Long-term securities | $ 10,736 | $ 17,495 | $ 10,685 | $ 17,355 |
| Short-term bank credit | $ - | $ 3 | $ - | $ 3 |

### t. Advertising expenses:

Advertising expenses are charged to the statement of operations as incurred. Advertising expenses amounted to $1,550, $2,074 and $1,247 for the years ended December 31, 1997, 1998 and 1999, respectively.

### u. Future adoption of new accounting standards:

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133 ("SFAS 133"), "Accounting for Derivative Instruments and Hedging Activities". The Statement establishes accounting and reporting standards requiring that every derivative instrument (including certain derivative instruments embedded in other contracts) be recorded in the balance sheet as either an asset or liability measured at its fair value. The Statement requires that changes in the derivative's fair value be recognized currently in earnings, unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows a derivative's gains and losses to offset related results on the hedged item in the income statement, and requires that a company must formally document, designate and assess the effectiveness of transactions that receive hedge accounting. SFAS 133 is effective for fiscal years beginning after June 15, 2000, and must be applied to instruments issued, acquired, or substantively modified after December 31, 1998. The Company does not expect the adoption of the accounting pronouncement to have a material effect on its financial position or results of operations.

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

## Note 3 Marketable Securities

| | Amortized cost | | Gross unrealized losses | | Estimated fair value | |
|---|---|---|---|---|---|---|
| | 1998 | 1999 | 1998 | 1999 | 1998 | 1999 |
| U.S. debentures | $ 28,943 | $ 47,954 | $ 472 | $ 251 | $ 28,471 | $ 47,703 |
| Israeli Government debentures | $ 247 | $ - | $ - | $ - | $ 247 | $ - |
| Convertible debentures | $ 7 | $ - | $ - | $ - | $ 7 | $ - |

The Company's Israeli Government debentures and convertible debentures are classified as available-for-sale securities and are carried at fair value.

Gross realized gains on sale of these securities included in earnings in 1997, 1998 and 1999 totaled $7, $14 and $15, respectively.

Gross realized losses on sale of these securities included in earnings in 1997, 1998 and 1999 totaled $1, $2 and $0, respectively.

The proceeds from sales of available-for-sale securities in 1997, 1998 and 1999 totaled $421, $384 and $269, respectively.

The Company's U.S. debentures are classified as held-to maturity.

The scheduled maturities of held-to-maturity securities of December 31, 1999 are as follows:

| | Amortized cost | Estimated fair value |
|---|---|---|
| Held to maturity: | | |
| Due within one year | $ 30,459 | $ 30,348 |
| Due after one year through five years | 17,495 | 17,355 |
| | $ 47,954 | $ 47,703 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS U.S. dollars in thousands (except per share amounts)

## Note 4 Other Receivables and Prepaid Expenses

| December 31 | 1998 | 1999 |
|---|---|---|
| Government authorities | $ 1,430 | $ 1,852 |
| Interest receivable | 1,069 | 2,298 |
| Other | 1,232 | 2,360 |
| | $ 3,731 | $ 6,510 |

## Note 5 Inventories

| | 1998 | 1999 |
|---|---|---|
| Raw materials | $ 5,519 | $ 6,228 |
| Work in progress | 782 | 904 |
| Finished products | 2,213 | 1,734 |
| | $ 8,514 | $ 8,866 |

## Note 6 Fixed Assets

| | 1998 | 1999 |
|---|---|---|
| Cost: | | |
| Computers and peripheral equipment | $ 10,014 | $ 15,778 |
| Office furniture and equipment | 4,721 | 6,275 |
| Motor vehicles | 4,419 | 6,172 |
| Leasehold improvements | 2,211 | 3,031 |
| | 21,365 | 31,256 |
| Accumulated depreciation: | | |
| Computers and peripheral equipment | 4,012 | 7,451 |
| Office furniture and equipment | 933 | 1,642 |
| Motor vehicles | 1,009 | 1,568 |
| Leasehold improvements | 309 | 603 |
| | 6,263 | 11,264 |
| Depreciated cost | $ 15,102 | $ 19,992 |

Depreciation expense amounted to $2,200, $3,382 and $5,107 for the years ended December 31, 1997, 1998 and 1999, respectively.

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

## Note 7 Other Assets

| December 31 | 1998 | 1999 |
|---|---|---|
| Cost: | | |
| Capitalized computer software costs | $ 3,343 | $ 5,913 |
| Goodwill | 1,251 | 3,242 |
| Technology | 1,800 | 1,800 |
| Other intangible assets | 900 | 1,362 |
| | 7,294 | 12,317 |
| Accumulated amortization: | | |
| Capitalized computer software costs | 523 | 1,487 |
| Goodwill | 186 | 309 |
| Technology | 675 | 1,128 |
| Other intangible assets | 204 | 355 |
| | 1,588 | 3,279 |
| Amortized cost | $ 5,706 | $ 9,038 |

Amortization expense amounted to $585, $1,162 and $1,691 for the years ended December 31, 1997, 1998 and 1999, respectively.

## Note 8 Accrued Expenses and Other Liabilities

| | 1998 | 1999 |
|---|---|---|
| Employees and payroll accruals | $ 3,750 | $ 4,749 |
| Accrued expenses | 4,551 | 3,789 |
| Other | 1,256 | 1,972 |
| | $ 9,557 | $ 10,510 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS U.S. dollars in thousands (except per share amounts)

## Note 9 Contingent Liabilities and Commitments

a. Lease commitments:

Facilities of NICE and certain of its subsidiaries are rented under several operating leases for periods ending in 2004.

Future minimum lease commitments under non-cancelable operating leases for the years ended December 31, are as follows:

| | |
|---|---|
| 2000 | $ 3,372 |
| 2001 | 3,428 |
| 2002 | 1,952 |
| 2003 | 1,820 |
| 2004 | 44 |
| | $ 10,616 |

Rent expense for the years ended December 31, 1997, 1998 and 1999 was approximately, $1,557, $2,869 and $3,246, respectively.

b. Royalty commitments:

The Company is committed to pay royalties of 3%-5% to the Government of Israel on proceeds from sales of products arising from the research and development projects in which the Government participated up to the amount received by the Company linked to the dollar.

As of December 31, 1999, the Company had an outstanding contingent obligation to pay royalties in the amount of $173.

c. Guarantees:

The Company provided a guarantee in the amount of $32 to the chamber of commerce to secure the return of an equipment which was shipped abroad. The Company provided a guarantee in the amount of $635 in respect of liability for projects in progress. The Company provided guarantees in the aggregate to $3,344 for the performance of projects to customers who made advance payments in respect of said projects. In addition, the Company provided a guarantee in the amount of $33 in respect of leasing premises in France.

d. Legal proceedings

On March 22, 1999, a class action was filed with the U.S. District Court in Newark, NJ, against the Company and three of its senior executives (the defendants) by shareholders who held the Company's shares in the period between February 4, 1998 to September 24, 1998 (the time in which the earnings notice was delivered concerning the results of the third quarter of 1998). The plaintiffs claim that the defendants inflated the price of the Company ADS in NASDAQ in the relevant period, allegedly, by refraining from reporting to the shareholders on defects and flaws appearing in the product NiceUniverse (the Product) and communicated misleading and false reports on the product. In addition, the complaint alleges that the defendants refrained from reporting the discontent of the Company's customers regarding the product. Furthermore, the plaintiffs claim that the product was not approved by the Company's distributors as compatible to their systems, and as a result, the product was not sold effectively. The lawsuit does not specify the amount of the alleged damage.

The Company is of the opinion, based on the opinion of its legal counsel, that the lawsuit is baseless and in any event, the directors and officers liability insurance is supposed to provide liability coverage for the Company and the officers in whole or in part, except for a deductible in the amount of $250. The said insurance policy insure the Company and its officers, inter alia, against any damages caused to them as a result of a lawsuit filed by the holders of the Company's securities (including class action) which its cause of action is a violation of any law by the Company and/or its officers.

## Note 10 Taxes on Income

a. Tax benefits under the 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, the Company elected the "alternative benefits" and has waived government grants in return for a tax exemption.

Income derived from the first program will be tax-exempt for a period of four years, commencing with the year the Company first earns taxable income and will be taxed at the reduced rate of 20% for an additional period of six years.

Income derived from the second program will be tax-exempt for a period of four years, commencing 1998, and will be subject to corporate taxes at the reduced rate of 20%, 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 20%, for an additional period of eight years.

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.

As the Company currently has no taxable income from the first and third programs, these benefits have not yet commenced.

The tax-exempt income attributable to the "Approved Enterprise" can be distributed to shareholders without subjecting the Company to taxes only upon the complete liquidation of the Company. As of December 31, 1999, retained earnings included approximately $30,430 in tax exempt profits earned by the Company's "Approved Enterprise". The Company has decided not to declare dividend out of such tax exempt income. Accordingly, no deferred income taxes have been provided on income attributable to the Company's "Approved Enterprise".

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

If the retained tax-exempt income is distributed in a manner other than in the complete liquidation of the Company, it would be taxed at the corporate tax rate applicable to such profits as if the Company had not elected the alternative tax benefits (currently - 20%) and an income tax liability would be incurred of approximately $6,086 as of December 31, 1999.

Income from sources other than the “Approved Enterprise”, during the period of benefits, will be taxable at regular tax rates (36% in 1996 and thereafter).

The law also entitles the Company to claim accelerated depreciation on equipment used by the “Approved Enterprise” during five tax years.

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

The Company is an industrial company under the above law and as such is entitled to certain tax benefits, including accelerated depreciation and 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.

c. 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 liabilities and assets are as follows:

| December 31 | 1998 | 1999 |
|---|---|---|
| Net operating loss carryforwards | $ 5,574 | $ 7,657 |
| Reserves and allowances | 801 | 2,416 |
| Net deferred tax asset before valuation allowance | 6,375 | 10,073 |
| Valuation allowance | (6,375) | (10,073) |
| Net deferred tax asset | $ - | $ - |

The subsidiaries in the U.S. have provided valuation allowances in respect of deferred tax assets resulting from tax loss carryforwards, due to its history of operating losses. Management currently believes that it is more likely than not that the deferred tax regarding the loss carryforwards and other temporary differences will not be utilized.

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

d. 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 statements of operations, is as follows:

| Year ended December 31 | 1997 | 1998 | 1999 |
|---|---|---|---|
| Income (loss) before income taxes, as reported in the consolidated statements of operations | $ (3,119) | $ 4,826 | $ 15,183 |
| Statutory tax rate in Israel | 36% | 36% | 36% |
| Theoretical tax expense (income tax benefit) | $ (1,123) | $ 1,737 | $ 5,466 |
| Losses and other items for which valuation allowance was provided | 2,041 | 3,248 | (418) |
| "Approved Enterprise" benefit (1) (2) | (3,418) | (4,536) | (2,394) |
| Net operating losses utilized from prior years for which valuation allowance has been provided | (810) | - | - |
| Write-off of in process technology and amortization of other assets | 5,112 | 1,888 | 1,818 |
| Issuance expenses and tax benefits in respect of options to employees were allowed as an expense and in respect of which deferred taxes were not provided | (747) | (1,371) | (2,856) |
| Interest income subject to lower tax rate | (1,227) | (1,401) | (1,898) |
| Non-deductible expenses and other | 287 | 782 | 356 |
| Taxes on income in the statements of operations | $ 115 | $ 347 | $ 74 |
| (1) Basic earnings per share of the benefit resulting from the approved enterprise | $ 0.37 | $ 0.41 | $ 0.21 |
| (2) Diluted earnings per share of the benefit resulting from the approved enterprise | $ 0.37 | $ 0.38 | $ 0.20 |

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

| | 1997 | 1998 | 1999 |
|---|---|---|---|
| Domestic | $ 1,425 | $ 12,536 | $ 15,534 |
| Foreign | (4,544) | (7,710) | (351) |
| | $ (3,119) | $ 4,826 | $ 15,183 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS U.S. dollars in thousands (except per share amounts)

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

| Year ended December 31 | 1997 | 1998 | 1999 |
|---|---|---|---|
| Current taxes | $ 115 | $ 347 | $ 84 |
| Previous years – deferred taxes | - | - | (10) |
| | $ 115 | $ 347 | $ 74 |
| Domestic | $ 112 | $ 330 | $ 80 |
| Foreign | 3 | 17 | (6) |
| | $ 115 | $ 347 | $ 74 |

## Note 11 Share Capital

a. The Common shares of the Company are traded on the Tel Aviv Stock Exchange and, effective January 24, 1996, American Depositary Shares (“ADSs”) of the Company are quoted on NASDAQ.

In July 1997, the Company issued 3,047,500 American Depositary Shares (each “ADS” represents one Common share) in consideration of approximately $98 million, net of expenses.

In June 1997, the Company allocated securities of a wholly-owned subsidiary of NICE exchangeable for 435,000 ADSs to the shareholders of Dees Communications Ltd. as part of the consideration for the acquired shares of Dees. Those securities have no other rights except for the right to exchange to NICE Systems shares (see Note 1b).

In April 1998, the Company allocated 35,110 ADSs of NICE Systems Ltd. as part of the consideration for the acquired assets and liabilities of IBS (see Note 1c).

b. Employee stock option plan:

In December 1995, the Company adopted an employee stock option plan (the “1995 option plan”). Under the 1995 option plan, full-time employees, officers and directors of the Company may be granted options to acquire Common shares. The options to acquire Common shares will be granted at an exercise price, subject to certain exceptions, of not less than the fair market value of the Common shares on the grant date, or if the options are broadly distributed at a price of not less than 85% of the fair market value of the Common shares on the grant date. 4,174,366 of the 1995 options were granted at an exercise price of not less than the fair market value of the Common shares at the date of grant.

In November 1996, the Company adopted an employee stock option plan (the "1997 option plan"). Under the 1997 option plan, full-time employees, officers and directors of the Company may be granted options to acquire Common shares. 355,000 of the 1997 options were granted at an exercise price not less than the fair market value of the Common shares at date of grant. 96,000 of the 1997 options were granted at an exercise price 15% lower than the fair market value of the shares on the grant date.

In November 1997, under the above mentioned 1997 stock option plan, the Company approved the grant of 401,000 options to full-time employees, officers and directors of the Company to acquire Common shares. The options to acquire Common shares were granted at an exercise price of not less than the fair market value of the Common shares on the grant date.

On December 9, 1998, the Board of Directors decided to reduce the exercise price of all employee stock options, excluding the options of the members of the Board of Directors, that were not exercised, or forfeited and have an original exercise price above $22.5. The amount of options that were repriced was 1,122,066, and their new exercise price was determined at $22.5, the fair market value of the Common share on this date. The original exercise price of these options ranged between $33-$42.

In May 1999, the Company adopted an employees stock option plan (the "1999 option plan"). Under the 1999 option plan, full time employees, officers and directors of the Company may be granted options to acquire 588,500 Common shares. The options to acquire Common shares were granted at an exercise price of not less than the fair market value of the Common shares on the grant date.

Up to 6,000,000 Common shares were reserved for issuance under the option plans subject to certain proportionate adjustments.

The options generally vest over a four-year period from the date of grant, and expire no later than 7 years from the date of grant.

c. Employee Stock Purchase Plan:

In February 1999, the Company's Board of Directors adopted the Employee Stock Purchase Plan (the "Purchase Plan"), which provides for the issuance of a maximum of 375,000 Common shares. Eligible employees can have up to 10% of their earnings withheld, up to certain maximums, to be used to purchase Common shares. The Purchase Plan will be implemented by offering every six months with purchases occurring on December 31, 1999, and June 30, 2000. The price of the Common share purchased under the Purchase Plan will be equal to 85% of the lower of the fair market value of the Common share on the commencement date of each offering period or on the semi-annual purchase date.

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

A summary of the Company's stock option activity, and related information for the years ended December 31 1997, 1998 and 1999 is as follows:

| | 1997 | | 1998 | | 1999 | |
|---|---|---|---|---|---|---|
| | Number of options | Weighted average exercise price | Number of options | Weighted average exercise price | Number of options | Weighted average exercise price |
| Outstanding at beginning of year | 622,750 | $ 13.34 | 2,140,516 | $ 22.23 | 2,268,291 | $ 22.66 |
| Granted | 1,625,316 | 24.91 | 596,000 | 22.5 | 1,702,500 | 27.78 |
| Exercised | (28,925) | 2.91 | (179,350) | 11.34 | (590,225) | 18.02 |
| Forfeited | (78,625) | 15.63 | (288,875) | 26.21 | (343,975) | 23.23 |
| Outstanding at end of year | 2,140,516 | $22.23 | 2,268,291 | $ 22.66 | 3,036,591 | $ 26.37 |
| Exercisable at year end | 75,105 | $ 7.9 | 216,825 | $ 17.8 | 138,583 | $ 20.24 |

The options outstanding as of December 31, 1999, have been separated into exercise price categories, as follows:

| Exercise price | Options outstanding as of Dec. 31, '99 | Weighted average remaining contractual life | Weighted average exercise price |
|---|---|---|---|
| $10 - $19.67 | 376,200 | 2.82 | $ 18.05 |
| $20 - $ 22.81 | 1,595,891 | 4.54 | $ 22.64 |
| $25.25 - $30.25 | 539,000 | 5.52 | $ 27.01 |
| $39.96 - $48.13 | 525,500 | 4.99 | $ 42.98 |
| | 3,036,591 | | |

Proforma information regarding net income (loss) and earnings (loss) per share is required (for grants issued after December 1995) by Statement 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 1997, 1998 and 1999, respectively: risk-free interest rates of 6%, 5.5% and 6% dividend yields of 0%, 0% and 0% and volatility factors of the expected market price of the Company's Common shares of 0.567, 0.752 and 0.738, respectively and a weighted average expected life of the option of 3 years for each year.

Weighted average grant date fair value for options granted at an exercise price equal to the fair market value at the grant date was $13.87, $18.17 and $12.44 for the years 1997, 1998 and 1999, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS U.S. dollars in thousands (except per share amounts)

Weighted average grant date fair value for options granted at an exercise price lower than the fair market value at the grant date was $8.53 in 1997. Weighted average exercise price for these options was $17.94.

The Company recorded an expense in the amount of $316, $293 and $207 for the years ended December 31, 1997, 1998 and 1999, respectively, relating to options issued below the fair market value of the share on the grant date.

The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

Pro forma information under FAS 123:

| Year ended December 31 | 1997 | 1998 | 1999 |
|---|---|---|---|
| Net income (loss) as reported | $ (3,234) | $ 4,479 | $ 15,109 |
| Pro forma net income (loss) | $ (6,708) | $ (3,453) | $ 5,988 |
| Pro forma basic earnings (loss) per share | $ (0.73) | $ (0.31) | $ 0.52 |
| Pro forma diluted earnings (loss) per share | $ (0.73) | $ (0.31) | $ 0.49 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS U.S. dollars in thousands (except per share amounts)

## Note 12 Geographic Operating 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 Company's business is divided into five main geographic areas: Israel, North America, Europe (except United Kingdom), United Kingdom and other areas. Total revenues are attributed to geographic areas based on location of customers.

The following presents total revenues and long-lived assets for the years ended December 31, 1997, 1998, and 1999.

| | 1997 | | 1998 | | 1999 | |
|---|---|---|---|---|---|---|
| | Total revenues | Long-lived assets | Total revenues | Long-lived assets | Total revenues | Long-lived assets |
| Israel | $ 2,112 | $ 13,087 | $ 2,023 | $ 16,255 | $ 1,678 | $ 24,042 |
| North America | 30,943 | 2,954 | 38,360 | 4,372 | 64,689 | 4,874 |
| Europe (except United Kingdom) | 18,956 | 182 | 22,922 | 154 | 28,376 | 95 |
| United Kingdom | 9,381 | - | 11,352 | 27 | 10,467 | 19 |
| Other | 7,878 | - | 16,313 | - | 18,391 | - |
| | $ 69,270 | $ 16,223 | $ 90,970 | $ 20,808 | $123,601 | $ 29,030 |

b. Classes of products:

| Year ended December 31 | 1997 | 1998 | 1999 |
|---|---|---|---|
| Revenues: | | | |
| CTI | $ 58,511 | $ 85,778 | $ 114,926 |
| COMINT | 10,759 | 5,192 | 8,675 |
| | $ 69,270 | $ 90,970 | $ 123,601 |

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

## Note 13 Selected Statements of Operations Data

| Year ended December 31 | 1997 | 1998 | 1999 |
|---|---|---|---|
| | | % | |
| **a.** Major customers data as percentage of revenues: | | | |
| Customer A | 1 | 7.0 | 15.5 |
| Customer B | 7 | 9.8 | 11.5 |
| Customer C | 11.7 | 10 | 5.7 |
| | 19.7 | 26.8 | 32.7 |
| **b.** Research and development costs, net: | | | |
| Total costs | $ 9,009 | $ 12,681 | $ 16,712 |
| Less grants and participations | (139) | - | (317) |
| Capitalization of computer software costs | (1,481) | (1,930) | (2,570) |
| | $ 7,389 | $ 10,751 | $ 13,825 |
| **c.** Financial income, net: | | | |
| Financial expenses: | | | |
| Interest | $ 93 | $ 49 | $ 40 |
| Other expenses | 236 | 79 | 223 |
| Foreign currency translation differences | 29 | - | 555 |
| | 358 | 128 | 818 |
| Financial income: | | | |
| Gain on marketable securities | 661 | 1,003 | 2,307 |
| Foreign currency translation differences | - | 673 | - |
| Interest | 2,592 | 4,244 | 3,320 |
| | 3,253 | 5,920 | 5,627 |
| | $ 2,895 | $ 5,792 | $ 4,809 |

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

| Year ended December 31 | 1997 | 1998 | 1999 |
|---|---|---|---|
| d. Other special charges: | | | |
| In-process technology write-off (Note 1b,c,d) | $ 14,200 | $ 6,263 | $ 5,155 |
| Reorganization expenses (Note 1b,c) | 300 | 500 | - |
| Relocation expenses (Note 1e) | - | 2,260 | - |
| Software capitalization write off (Note 1b) | 1,188 | - | - |
| | $ 15,688 | $ 9,023 | $ 5,155 |
| e. Earnings (loss) per share: | | | |
| The following table sets forth the computation of basic and diluted earnings (loss) per share: | | | |
| 1. Numerator: | | | |
| Net income (loss) | $ (3,234) | $ 4,479 | $ 15,109 |
| Numerator for basic and diluted earnings (loss) per share - income (loss) available to Common shareholders | $ (3,234) | $ 4,479 | $ 15,109 |

| Year ended December 31 | 1997 | 1998 | 1999 |
|---|---|---|---|
| | Number of shares in thousands | | |
| 2. Denominator: | | | |
| Weighted average number of shares | 9,130 | 11,192 | 11,559 |
| Denominator for basic earnings (loss) per share | 9,130 | 11,192 | 11,559 |
| Effect of dilutive securities: | | | |
| Employee stock options | (* - | 818 | 690 |
| Dilutive potential Common shares | - | 818 | 690 |
| Denominator for diluted earnings (loss) per share - adjusted weighted - average shares assuming exercise of options | 9,130 | 12,010 | 12,249 |

*) Option to purchase 584 thousand shares were not included in the computation of diluted EPS because the effect would have been antidilutive.

# Corporate Directory

## Management

Benny Levin, Chairman of the Board
Micky Golan, Director and Chief Technology Officer (former President)
Rami Lazar, Director and Senior Vice President of Business Development
David Ben-Ze'ev, Director and Senior Vice President of Strategic Planning
Yossi Ben-Shalom, Director
Tamar Ben-David, Director
Avshalom Horan, Director
Moshe Ronen, President and Chief Executive Officer
Yuval Yanai, Senior Vice President and Chief Financial Officer
Hagai Katz, Senior Vice President and Chief Operating Officer
Morgan Sturdy, Executive Vice President and Chief Operating Officer, NICE North America
Koby Huberman, Senior Vice President of Global Marketing
Bracha Baram, Chief Accounting Officer

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## General Counsel

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NICE Systems is a leading global provider of integrated digital recording and quality management solutions. Transforming innovative technologies into solutions for vertical markets, NICE promotes better business management and customer service. A worldwide network of distributors and strategic partners enables NICE to steadily strengthen its global reach while supporting the highest level of customer satisfaction.

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

# BUILDING QUALITY CUSTOMER RELATIONSHIPS

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