

MIND CTI LTD  
Form 20-F  
June 27, 2007

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 20-F**

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

**OR**

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

For the fiscal year ended December 31, 2006

**OR**

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 000-31215

**MIND C.T.I. LTD.**

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(Exact name of Registrant as specified in its charter and translation of Registrant's name into English)

**ISRAEL**

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(Jurisdiction of incorporation or organization)

Industrial Park, Building #7, Yoqneam, 20692, Israel

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(Address of principal executive offices)

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

Title of each class	Name of each exchange on which registered
<b>Ordinary Shares, nominal value NIS 0.01 per share</b>	<b>Nasdaq Global Market</b>

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

None

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(Title of Class)

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

None

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(Title of Class)

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

As of December 31, 2006, the Registrant had outstanding **21,547,019** Ordinary Shares, nominal value NIS 0.01 per share.

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

Yes  No

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

Yes  No

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

Yes  No

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

Indicate by check mark which financial statement item the Registrant has elected to follow.

Item 17  Item 18

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

Yes  No

Unless the context requires otherwise, "MIND", "us", "we" and "our" refer to MIND C.T.I. Ltd. and its subsidiaries.

# FORWARD LOOKING STATEMENTS

## Cautionary Statement Regarding Forward-Looking Information

Statements in this annual report concerning our business outlook or future economic performance; anticipated revenues, expenses or other financial items; introductions and advancements in development of products, and plans and objectives related thereto; and statements concerning assumptions made or expectations as to any future events, conditions, performance or other matters, are "forward-looking statements" as that term is defined under the United States Federal Securities Laws. Forward-looking statements are subject to risks, uncertainties and other factors, which could cause actual results to differ materially from those stated in such statements. Factors that could cause or contribute to such differences include, but are not limited to, those set forth under "Risk Factors" in this annual report as well as those discussed elsewhere in this annual report and in our other filings with the Securities and Exchange Commission.

## PART I

### Item 1. Identity of Directors, Senior Management and Advisers

Not applicable.

### Item 2. Offer Statistics and Expected Timetable

Not applicable.

### Item 3. Key Information

#### A. Selected Financial Data

Except as otherwise indicated, all financial statements and other financial information included in this annual report are presented solely under U.S. GAAP

The following table presents selected consolidated financial data as of and for each of the five years in the period ended December 31, 2006. The selected consolidated financial data presented below are derived from our audited consolidated financial statements for these periods, and should be read in conjunction with these financial statements and the related notes thereto. Our audited consolidated financial statements as of December 31, 2005 and 2006 and for each of the three years in the period ended December 31, 2006 and the related notes thereto are included elsewhere in this annual report. You should read the selected financial data in conjunction with Item 5 "Operating and Financial Review and Prospects."

Years ended December 31,

2002	2003	2004	2005	2006
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(In US \$ thousands, except share and per share data)

**Consolidated Statement of Operations Data:**

Revenues:					
Sales of licenses	\$ 6,535	\$ 8,105	\$ 11,699	\$ 7,420	\$ 8,467
Services	3,473	4,831	6,107	8,181	11,593
Total revenues	10,008	12,936	17,806	15,601	20,060
Cost of revenues	2,479	3,208	4,394	4,015	5,675
Gross profit	7,529	9,728	13,412	11,586	14,385
Research and development expenses	3,723	3,319	3,833	5,086	6,118
Selling, general and administrative expenses:					
Selling and marketing expenses	4,154	4,065	4,517	2,148	3,628
General and administrative expenses	1,279	1,115	1,857	1,507	2,135
Operating income (loss)	(1,627)	1,229	3,205	2,845	2,504
Financial income (expenses) - net	2,078	2,573	3,834	1,260	(222)
Income before taxes on income	451	3,802	7,039	4,105	2,282
Taxes on income	117	169	162	43	1,373
Net income	\$ 334	\$ 3,633	\$ 6,877	\$ 4,062	\$ 909
Earnings per ordinary share					
Basic	\$ 0.02	\$ 0.18	\$ 0.33	\$ 0.19	\$ 0.04
Diluted	\$ 0.02	\$ 0.17	\$ 0.32	\$ 0.19	\$ 0.04
Weighted average number of ordinary shares used in computation of earnings per ordinary share - in thousands:					
Basic	20,677	20,732	21,089	21,431	21,515
Diluted	20,761	21,143	21,468	21,619	21,546

As of December 31,

2002	2003	2004	2005	2006
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(In US \$ thousands)

**Consolidated Balance Sheet Data:**

Cash and cash equivalents	\$ 11,312	\$ 4,391	\$ 18,687	\$ 10,174	\$ 27,571
Working capital	11,334	4,006	18,866	9,471	28,926
Total assets	47,967	49,979	55,716	55,652	53,791
Share capital and additional paid-in capital	61,142	58,567	59,130	59,452	59,601
Total shareholders' equity	44,482	45,540	50,244	49,485	47,859

**B. Capitalization and Indebtedness**

Not applicable.

**C. Reasons for the Offer and Use of Proceeds**

Not applicable.

#### **D. Risk Factors**

We believe that the occurrence of any one or some combination of the following factors would have a material adverse effect on our business, financial condition and results of operations.

##### **Risks Relating to Our Business**

**We seek to expand our business through acquisitions that could result in diversion of resources and extra expenses, and which may involve other risks that could disrupt our business and harm our financial condition.**

We pursue acquisitions of business, products and technologies, or the establishment of joint venture arrangements, that could expand our business. The negotiation of potential acquisitions or joint ventures as well as the integration of an acquired or jointly developed business, technology or product could cause diversion of management's attention from the day-to-day operation of our business. This could impair our relationships with our employees, customers, distributors, resellers and marketing allies. Future acquisitions could result in:

- potentially dilutive issuances of equity securities;
- the incurrence of debt and contingent liabilities;
- amortization of intangible assets;
- changes in our business model and margins;
- research and development write-offs; and
- other acquisition-related expenses.

Future acquisitions involve known and unknown risks that could adversely affect our future revenues and operating results. For example:

- we may fail to identify acquisitions that enable us to execute our business strategy;
- we compete with others to acquire companies. We believe that this competition has intensified and may result in decreased availability of, or increased prices for, suitable acquisition candidates;
- we may not be able to obtain the necessary regulatory approvals, including the approval of anti-competition regulatory bodies, in countries where we are seeking to consummate acquisitions;
- we may ultimately fail to consummate an acquisition even if we announce that we plan to acquire a company;
- we may fail to successfully integrate acquisitions in accordance with our business strategy;
- we may not be able to retain the skilled employees and experienced management that may be necessary to operate the businesses we acquire and, if we cannot retain such personnel, we may not be able to attract new skilled employees and experienced management to replace them; and
- we may purchase a company that has contingent liabilities that include, among others, known or unknown patent or product.

In addition, we have limited experience with respect to negotiating an acquisition and operating an acquired business. If future acquisitions disrupt our operations, our business may suffer.

**If we fail to attract and retain qualified personnel we will not be able to implement our business strategy or operate our business effectively.**

Our products require sophisticated research and development, sales and marketing, software programming and technical customer support. Our success depends on our ability to attract, train, motivate and retain highly skilled personnel within each of these areas of expertise. Qualified personnel in these areas are in great demand and are likely to remain a limited resource for the foreseeable future. We cannot assure you that we will be able to retain the skilled employees we require. In addition, the resources required to retain such personnel may adversely affect our operating margins. The failure to retain qualified personnel may harm our business. In particular, we maintain a large technical and support center in Jassy, Romania and have encountered many attempts from other technology companies to recruit our employees after we have trained them. If this phenomenon continues and increases, we may be forced to raise the salaries of our Romanian employees and our results of operations will be harmed.

**Because a substantial majority of our revenues are generated outside of Israel, our results of operations could suffer if we are unable to manage international operations effectively.**

In 2005 and 2006, approximately 93% and 94% of our revenues, respectively, were generated outside of Israel. Our sales outside of Israel are made in more than 40 countries. We currently have sales and support offices located in Silver Spring, Maryland. In addition, we have a technical and support team in Jassy, Romania. We plan to establish additional facilities in other parts of the world, either through acquisitions or internal expansion based on market needs. The expansion of our existing international operations and entry into additional international markets will require significant management attention and financial resources. Our ability to penetrate some international markets may be limited due to different technical standards, protocols and requirements for our products in different markets. We cannot be certain that our investments in establishing facilities in other countries will produce desired levels of revenue. In addition, conducting our business internationally subjects us to a number of risks, including:

- staffing and managing foreign operations;
- increased risk of collection;
- potentially adverse tax consequences;
- the burden of compliance with a wide variety of foreign laws and regulations;
- burdens that may be imposed by tariffs and other trade barriers; and
- political and economic instability.

**Because some of our customers require a lengthy approval process before they order our products, our sales process is often subject to delays that may decrease our revenues and seriously harm our business.**

In 2006, we derived 86% of our revenues from the sale of software and related services to telecommunications service providers. Before we can sell our software to some of these customers, they conduct a lengthy and complex approval and purchasing process. The following factors, among others, affect the length of the approval process:

- the time required for our customers to determine and announce their specifications;

- the time required for the customer to receive the internal approvals necessary in order for it to commit significant resources towards acquisition of the billing solution;
- the build-up of the customer's network infrastructure; and
- the timely release of new versions of products comprising enhanced functionality, specifically requested by the customer.

Additional delays in product approval may decrease our revenues and could seriously harm our business and results of operations.

**A slow down in expenditures by telecommunications service providers could have a material adverse effect on our results of operations.**

There is a global uncertainty with respect to the direction of the economy and the telecommunications market. Many new and small service providers have failed and existing service providers have been reducing or delaying expenditures on new equipment and applications. A continuation of such delays or a decline in capital expenditures by telecommunications service providers may reduce our sales and could result in additional pressure on the price of our products, both of which would have a material adverse effect on our operating results.

**If we are unable to compete effectively in the marketplace, we may suffer a decrease in market share, revenues and profitability.**

Competition in our industry is intense and we expect competition to increase. We compete both with established global billing companies such as Comverse (after the acquisition by Comverse of the Global Software Services division of CSG Systems International) and Convergys Corporation (after the acquisition of Geneva Technology by Convergys) as well as with local billing companies. Some of our competitors have greater financial, technical, sales, marketing and other resources, and greater name recognition than we do. Current and potential competitors have established, and may establish in the future, cooperative relationships among themselves or with third parties to increase their ability to address the needs of prospective customers. Accordingly, new competitors or alliances among competitors may emerge and rapidly acquire significant market share. As a result, our competitors may be able to adapt more quickly than us to new or emerging technologies and changes in customer requirements, and may be able to devote greater resources to the promotion and sale of their products. We cannot guarantee that we will be able to compete effectively against current or future competitors or that competitive pressure will not harm our financial results.

**Our revenues and operating results may vary significantly from quarter to quarter.**

Our revenues and operating results may vary significantly from quarter to quarter due to a number of factors, including the following:

- the timing of orders for our software may be delayed as customers typically order our billing and customer care software only after other vendors have provided the network infrastructure, a process that is subject to delay. It is therefore difficult for us to predict the timing of orders for our products by customers;
- the ability of our customers to expand their operations and increase their subscriber base, including their ability to obtain financing;
- changes in our pricing policies or competitive pricing by our competitors; and
- the timing of product introductions by competitors.

In future quarters, our operating results may be below the expectations of public market analysts and investors, and as a result, the price of our ordinary shares may fall.

**The customer base for our traditional wireline and wireless billing and customer care products is characterized by small to medium size telephony carriers. If this market segment fails to grow, the demand for our billing and customer care software would diminish substantially.**

Our traditional wireline and wireless billing and customer care products target small to medium size telephony carriers. Our growth in this field depends on continued growth of these traditional telephony carriers. We cannot be certain that small to medium size telephony carriers will be able to successfully compete with large telephony carriers in existing markets or will successfully develop in new and emerging markets. If this market segment fails to grow, the demand for our billing and customer care software would diminish substantially and our business would suffer. In addition, there may never be significant demand for new billing and customer care software by providers of traditional services.

**From time to time, our software and the systems into which it is installed contain undetected errors. This may cause us to experience a significant decrease in market acceptance and use of our software products and we may be subject to warranty and other liability.**

From time to time, our software, as well as the systems into which it is integrated, contain undetected errors. Because of this integration, it can be difficult to determine the source of the errors. Also, from time to time, hardware systems we resell contain certain defects or errors. As a result, and regardless of the source of the errors, we could experience one or more of the following adverse results:

- diversion of our resources and the attention of our personnel from our research and development efforts to address these errors;
- negative publicity and injury to our reputation that may result in loss of existing or future customers; and
- loss of or delay in revenue and loss of market share.

In addition, we may be subject to claims based on errors in our software or mistakes in performing our services. Our licenses and agreements generally contain provisions such as disclaimers of warranties and limitations on liability for special, consequential and incidental damages, designed to limit our exposure to potential claims. However, not all of our contracts contain these provisions and we cannot assure you that the provisions that exist will be enforceable. In addition, while we maintain product liability and professional indemnity insurance, we cannot assure you that this insurance will provide sufficient, or any, coverage for these claims. A product liability or professional indemnity claim, whether or not successful, could adversely affect our business by damaging our reputation, increasing our costs, and diverting the attention of our management team.

**Our business may be negatively affected by exchange rate fluctuations.**

Although most of our revenues are denominated in U.S. dollars, approximately 40% of our expenses are incurred in New Israeli Shekels, or NIS. As a result, we may be negatively affected by fluctuations in the exchange rate between the Euro or the NIS and the U.S. dollar. For example, in 2006, the value of the U.S. dollar decreased in relation to the NIS by 8.2%, while inflation decreased by only 0.1%. As a result, our salary expenses, which are primarily linked to the NIS, increased in U.S. dollar terms. We cannot predict any future trends in the rate of inflation in Israel or the rate of devaluation or appreciation of the NIS against the U.S. dollar. If the U.S. dollar cost of our operations in Israel increases, our U.S. dollar-measured results of operations will be adversely affected. In addition, devaluation in the Euro or local currencies of our customers relative to the U.S. dollar could cause customers to decrease or cancel orders or default on payment. We may choose to limit these exposures by entering into hedging transactions. However,



hedging transactions may not enable us to avoid exchange-related losses, and our business may be harmed by exchange rate fluctuations. The imposition of price or exchange controls or other restrictions on the conversion of foreign currencies could affect our ability to collect payments, which in turn, could have a material adverse effect on our results of operations and financial condition.

**If our products fail to achieve widespread market acceptance, our results of operations will be harmed.**

Our future growth depends on the continued commercial acceptance and success of our products. We first introduced our billing and customer care software for Voice over IP in 1997 and since then we have developed new versions that offer mediation, rating, billing and customer care for multiple services. Accordingly, we cannot be sure that our products will achieve widespread market acceptance. Our future performance will depend on the successful development, introduction and consumer acceptance of new and enhanced versions of our products. We are not certain that we will be able to develop new and enhanced products to meet changing market needs. If our new and enhanced products are not well received in the marketplace, our business and results of operations will be harmed. We cannot assure you that we will be successful in developing and marketing new products.

**We depend on our marketing alliances and reseller arrangements with manufacturers of telecommunications equipment to market our products. If we are unable to maintain our existing marketing alliances, or enter into new alliances, our revenues and income will decline.**

We have derived, and anticipate that we will continue to derive, a significant portion of our market opportunities and revenues from our marketing alliances and reseller arrangements with major manufacturers of telecommunications equipment, including Alcatel, Cisco, Lucent and Siemens, which market or recommend our products to their customers. Our marketing alliances and reseller arrangements with these parties are nonexclusive and do not contain minimum sales or marketing performance requirements. In some instances, there is no formal contractual arrangement. As a result, these entities may terminate these arrangements without notice, cause or penalty. There is also no guarantee that any of these parties will continue to market our products. Our arrangements with our resellers and marketing allies do not prevent them from selling products of other companies, including products that compete with ours. Moreover, our marketing allies and resellers may develop their own internal mediation, rating, billing and customer care software products that compete with ours and sell them as part of their equipment. If we are unable to maintain our current marketing alliances and reseller relationships, or if these marketing allies and resellers develop their own competing mediation, rating, billing and customer care software products, our revenues and income will decline.

**If our software does not continue to integrate and operate successfully with the telecommunications equipment of the leading manufacturers, we may be unable to maintain our existing customer base and/or generate new sales.**

The success of our software depends upon the continued successful integration and operation of our software with the telecommunications equipment of the leading manufacturers. We currently target a customer base that uses a wide variety of network infrastructure equipment and software platforms, which are constantly changing. In order to succeed, we must continually modify our software as new telecommunications equipment is introduced. If our product line fails to satisfy these demanding and rapidly changing technological challenges, our existing customers will be dissatisfied. As a result, we may be unable to generate future sales and our business will be materially adversely affected.

**We depend on a limited number of key personnel who would be difficult to replace. If we lose the services of these individuals, our business will be harmed.**

Because our market is new and evolving, the success of our business depends in large part upon the continuing contributions of our senior management. Specifically, continued growth and success largely depend on the managerial

and technical skills of Monica Eisinger, our President and Chief Executive Officer and one of our founders, and other members of senior management. Because the demand for highly qualified senior personnel exceeds the supply of this type of personnel, it will be difficult to replace members of our senior management if one or more of them were to leave us. If either Ms. Eisinger or other members of the senior management team are unable or unwilling to continue their employment with our company, our business will be harmed.

**Our success depends on our ability to continually develop and market new and more technologically advanced products and enhancements.**

The market for our products and the services they are used to support is characterized by:

- rapid technological advances like the development of new standards for communications protocols;
- frequent new service offerings and enhancements by our customers, such as value-added IP-based services and new rating plans; and
- changing customer needs.

We believe that our future success will largely depend upon our ability to continue to enhance our existing products and successfully develop and market new products on a cost-effective and timely basis. We cannot assure you that we will be successful in developing and marketing new products that respond adequately to technological change. Our failure to do so would have a material adverse effect on our ability to market our own products.

**If our billing and customer care software for IP services fails to achieve market acceptance among traditional telecommunications service providers, we may suffer a decrease in market share, revenues and profitability.**

We believe that as the demand for IP services grows, traditional telecommunications service providers will increasingly offer IP services to remain competitive and these providers will constitute a growing portion of the IP services market. These companies already have relationships with traditional billing and customer care software providers for their telephony services, and may wish to work with their current providers of billing and customer care software to enhance and modify that software for IP services. If our billing and customer care software for IP services fails to achieve market acceptance among traditional telecommunications service providers, we may suffer a decrease in market share, revenues and profitability.

**If we are unable to adequately protect our intellectual property or become subject to a claim of infringement, our business may be materially adversely affected.**

Our success and ability to compete depend substantially upon our internally developed or acquired technology. Any misappropriation of our technology could seriously harm our business. In order to protect our technology and products, we rely on a combination of trade secret, copyright and trademark law. Despite our efforts to protect our intellectual property rights, unauthorized parties may attempt to copy or otherwise obtain and use our software or technology or to develop software with the same functionality. Policing unauthorized use of our products is difficult and we cannot be certain that the steps we have taken will prevent misappropriation, particularly in foreign countries where the laws may not protect our intellectual property rights as fully as in the United States.

If anyone asserts a claim against us relating to proprietary technology or information, we might seek to license his intellectual property or to develop non-infringing technology. We might not be able to obtain a license on commercially reasonable terms or on any terms. Alternatively, our efforts to develop non-infringing technology could be unsuccessful. Our failure to obtain the necessary licenses or other right or to develop non-infringing technology could prevent us from selling our software and could therefore seriously harm our business.

**Breaches in the security of the data collected by our systems could adversely affect our reputation and hurt our business.**

Customers rely on third-party security features to protect privacy and integrity of customer data. Our products may be vulnerable to breaches in security due to failures in the security mechanisms, the operating system, the hardware platform or the networks linked to the platform. All our solutions provide web access to information, presenting additional security issues for our customers. Security vulnerabilities could jeopardize the security of information stored in and transmitted through the computer systems of our customers. A party that is able to circumvent our security mechanisms could misappropriate proprietary information or cause interruptions in the operations of our customers. Security breaches could damage our reputation and product acceptance would be significantly harmed, which would cause our business to suffer.

**We have not yet completed our evaluation of our internal control over financial reporting under Section 404 of the Sarbanes-Oxley Act.**

We are considered a "non-accelerated filer" under applicable SEC rules. As such, we are required to comply with internal control evaluation and certification requirements of Section 404 of the Sarbanes-Oxley Act of 2002 in the following manner: (1) reporting by management under Section 404(a) of the Sarbanes-Oxley Act will be required for the fiscal year ending on December 31, 2007, and (2) attestation by our independent auditors under Section 404(b) of the Sarbanes-Oxley Act will be required for the fiscal year ending December 31, 2008. Accordingly, we have begun to evaluate whether our existing internal control over financial reporting system is compliant with Section 404. As a result of this evaluation, we may be required to implement new internal control procedures over financial reporting. We may also experience higher than anticipated operating expenses and fees in this context, additional commitment of management's time and may need to hire additional qualified personnel in order to achieve compliance with Section 404. If we are unable to implement these changes effectively or efficiently, or if our internal controls are found to be ineffective in future periods, it could harm our operations, financial reporting or financial results and could result in our being unable to obtain an unqualified report in internal controls from our independent auditor.

**Risks Relating to the Market of our Ordinary Shares**

**Our share price has fluctuated and could continue to fluctuate significantly.**

The market for our ordinary shares, as well as the prices of shares of other technology companies, has been volatile. The price of our ordinary shares has fluctuated significantly since our initial public offering in August 2000. A number of factors, many of which are beyond our control, may cause the market price of our ordinary shares to fluctuate significantly, such as:

- fluctuations in our quarterly revenues and earnings and those of our publicly held competitors;
- shortfalls in our operating results from the levels forecast by securities analysts;
- public announcements concerning us or our competitors;
- changes in pricing policies by us or our competitors;
- market conditions in our industry; and
- the general state of the securities market (particularly the technology sector).

We do not control these matters and any of them may adversely affect our business internationally. In addition, trading in shares of companies listed on the Nasdaq Global Market in general and trading in shares of technology

companies in particular has been subjected to extreme price and volume fluctuations that have been unrelated or disproportionate to operating performance. These broad market and industry factors may depress our share price, regardless of our actual operating results.

### **Substantial sales of our ordinary shares could adversely affect our share price**

Sales of a substantial number of our ordinary shares could adversely affect the market price of our ordinary shares. Given the likely volatility that exists for our ordinary shares, such sales could cause the market price of our ordinary shares to decline.

As of June 1, 2007, we had 21,592,510 outstanding ordinary shares, of which approximately 17 million ordinary shares were freely tradable without restriction or further registration under the federal securities laws unless purchased by our "affiliates", as that term is defined in Rule 144 under the Securities Act. As of June 1, 2007, there were outstanding options to purchase a total of 1,114,010 ordinary shares, of which 447,010 were vested. We were also authorized to grant options to purchase 2,215,700 additional ordinary shares. We have filed a registration statement on Form S-8 covering all of the ordinary shares issuable upon the exercise of options under our stock option plans, at which time these shares will be immediately available for sale in the public market, subject to the terms of the related options.

### **Our ordinary shares are listed for trading in more than one market and this may result in price variations.**

Our ordinary shares are listed for trading on the Nasdaq Global Market, or Nasdaq, and on the Tel Aviv Stock Exchange, or TASE. Trading in our ordinary shares on these markets is made in different currencies (U.S. dollars on Nasdaq and New Israeli Shekels on TASE), and at different times (resulting from different time zones, different trading days and different public holidays in the United States and Israel). The trading prices of our ordinary shares on these two markets often differ, resulting from the factors described above, as well as differences in exchange rates. Any decrease in the trading price of our ordinary shares on one of these markets could cause a decrease in the trading price of our ordinary shares on the other market.

### **Risks Relating to Our Location in Israel**

#### **Potential political, economic and military instability in Israel may harm our operating results.**

We are organized under the laws of the State of Israel and a substantial portion of our assets and our principal operations, are located in Israel. Accordingly, our operations, financial position and operating results are directly influenced by economic, political and military conditions in and relating to Israel. Since the establishment of the State of Israel in 1948, a condition of hostility, varying in degree and intensity, has led to security and economic problems for Israel. Since October 2000, there has been a high level of violence between Israel and the Palestinians which has strained Israel's relationship with its Arab citizens, Arab countries and, to some extent, with other countries around the world. The establishment in early 2006 of a government in the Palestinian Authority by representatives of the Hamas militant group has created additional unrest and uncertainty in the region. Further, in the summer of 2006, Israel fought a war against Hezbollah, a Lebanon-based Islamist Shiite militia group, which involved thousands of missile strikes and disrupted most day-to-day civilian activity in northern Israel. Any armed conflicts or political instability in the region could negatively affect business conditions and harm our results of operations. We cannot predict the effect on the region of the increase in the degree of violence between Israel and the Palestinians. Furthermore, several countries restrict business with Israel and Israeli companies, and additional countries may restrict doing business with Israel and Israeli companies as a result of the recent increase in hostilities. These restrictive laws and policies may seriously harm our operating results, financial condition or the expansion of our business. In addition, the current situation in Israel could adversely affect our operations if our customers and/or strategic allies believe that instability in the region could affect our ability to fulfill our commitments.

**We currently participate in or receive tax benefits from government programs. These programs require us to meet certain conditions and these programs and benefits may be terminated or reduced in the future.**

We receive tax benefits under Israeli law for capital investments, the Law for Encouragement of Capital Investments, 1959, as amended, or the Investments Law, that are designated as "Approved Enterprises". To maintain our eligibility for these tax benefits, we must continue to meet several conditions including making required investments in fixed assets. If we fail to comply with these conditions in the future, the tax benefits received could be cancelled. The termination or reduction of the tax benefits under the Investments Law could seriously harm our business, financial condition and operating results. For more information about Approved Enterprises, see Item 10.E "Taxation - Law for the Encouragement of Capital Investments, 1959" and Note 9 to our financial statements contained in Item 18.

**Because we have received grants from the Office of the Chief Scientist, we are subject to on-going restrictions that limit the transferability of our funded technology and of our right to manufacture outside of Israel any products developed with such technology, and certain of our large shareholders are required to undertake to observe such restrictions.**

We have received grants in the past from the Office of the Chief Scientist of the Israeli Ministry of Industry, Trade and Labor. According to Israeli law, generally, any products developed with grants from the Office of the Chief Scientist are required to be manufactured in Israel, unless we obtain prior approval of a governmental committee. In addition, we are prohibited from transferring out of Israel the know-how developed with these grants, without the prior approval of a governmental committee. Approval is not required for the sale or export of any products resulting from the funded know-how. Any shareholder who becomes a controlling shareholder of our company or any non-Israeli who becomes a direct holder of 5% or more of our outstanding ordinary shares will be required to notify the Office of the Chief Scientist and to undertake to observe the law governing the grant programs of the Office of the Chief Scientist, the principal restrictions of which are described above in this paragraph.

**Our operating results may be negatively affected by the obligation of some of our key personnel to perform military service.**

Some of our executive officers and employees in Israel are obligated to perform military reserve duty, which could accumulate annually from several days to up to two months in special cases and circumstances. The length of such reserve duty depends, among other factors, on an individual's age and prior position in the army. In addition, if a military conflict or war occurs, these persons could be required to serve in the military for extended periods of time. Our operations could be disrupted by the absence for a significant period of one or more of our executive officers or key employees due to military service. Any disruption in our operations would harm our business.

**It may be difficult to enforce a U.S. judgment against us, our officers and directors or to assert U.S. securities laws claims in Israel.**

We are incorporated in the State of Israel. Substantially most of our executive officers and directors are nonresidents of the United States, and a substantial portion of our assets and the assets of these persons are located outside the United States. We have been informed by our legal counsel in Israel that it may be difficult to bring original actions in Israel to enforce civil liabilities under the Securities Act and the Exchange Act. Israeli courts may refuse to hear a claim based on a violation of U.S. securities laws because Israel is not the most appropriate forum to bring such a claim. In addition, even if an Israeli court agrees to hear a claim, it may determine that Israeli law and not U.S. law is applicable to the claim. If U.S. law is found to be applicable, the content of applicable U.S. law must be proved as a fact, which can be a time-consuming and costly process. Certain matters of procedure will also be governed by Israeli law. There is little binding case law in Israel addressing these matters.

Subject to specified time limitations and legal procedures, under the rules of private international law currently prevailing in Israel, Israeli courts may enforce a United States final judgment in a civil matter, including judgments

based upon the civil liability provisions of the U.S. securities laws and including a monetary or compensatory judgment in a non-civil matter, provided that:

- the judgment is enforceable in the state in which it was given;
- adequate service of process has been effected and the defendant has had a reasonable opportunity to present his arguments and evidence;
- the judgment and the enforcement thereof are not contrary to the law, public policy, security or sovereignty of the State of Israel;
- the judgment was not obtained by fraud and does not conflict with any other valid judgment in the same matter between the same parties; and
- an action between the same parties in the same matter is not pending in any Israeli court at the time the lawsuit is instituted in the United States court.

Therefore, it may be difficult for a shareholder, or any other person or entity, to collect a judgment obtained in the United States against us or any of these persons, or to effect service of process upon these persons in the United States.

**Provisions of Israeli law and our articles of association may delay, prevent or make difficult a change of control and therefore may depress the price of our stock.**

Some of the provisions of our articles of association and Israeli law could, together or separately:

- discourage potential acquisition proposals;
- delay or prevent a change in control; and
- limit the price that investors might be willing to pay in the future for our ordinary shares.

In particular, our articles of association provide that our board of directors will be divided into three classes that serve staggered three-year terms and authorize our board of directors to adopt protective measures to prevent or delay a coercive takeover, including without limitation the adoption of a "Shareholder Rights Plan". In addition, Israeli corporate law regulates mergers and acquisitions of shares through tender offers, requires approvals for transactions involving significant shareholders and regulates other matters that may be relevant to these types of transactions. See Item 10.B "Memorandum and Articles of Associations - Mergers and Acquisitions under Israeli Law." Furthermore, Israeli tax law treats stock-for-stock acquisitions between an Israeli company and a foreign company less favorably than does U.S. tax law. For example, Israeli tax law may subject a shareholder who exchanges his ordinary shares for shares in another corporation to taxation prior to the sale of the shares received in such stock-for stock swap.

**Item 4. Information on the Company**

**A. History and Development of the Company.**

**General**

Our name is MIND C.T.I. Ltd. for both legal as well as commercial purposes. We were incorporated under the laws of the State of Israel on April 6, 1995 as a company with limited liability, and we are subject to the Israeli Companies Law, 1999 and the regulations promulgated thereunder. Our principal executive offices are located at Industrial Park,

Building 7, Yoqneam 20692, Israel. Our telephone number is +972 4 993 6666. Our agent in the United States is Sentori, Inc. and its principal offices are located at 12211 Plum Orchard Drive, Suite 320, Silver Spring, MD 20904, USA.

### **Important Events in the Development of the Company**

In 1997 we started the development and marketing of a real-time mediation and billing solution, mainly to the Internet protocol, or IP, prepaid markets, known as MIND-iPhonEX.

During 2005, we completed the acquisition of the Sentori Inc., a U.S. leading provider of customer care and billing solutions to wireless carriers and mobile virtual network operators, or MVNOs, mainly in the United States and the Caribbean. We are in the process of incorporating the Sentori functionality into the MIND-iPhonEX product line, and we intend to brand the combined products under the MINDBill name. We plan to continue to support the Sentori product with new maintenance releases, as well as customization requests. In addition, we will offer our existing customers a migration path to MINDBill.

During 2005 and 2006 we invested heavily in the development of MINDBill and started the implementation of MINDBill at a large East European operator with over one million subscribers. We believe that this valued reference customer will serve us to gain more large sized deals in mobile markets.

### **Principal Capital Expenditures**

During 2004, 2005 and 2006, the aggregate cash amounts of our capital expenditures were \$1.2 million, \$0.6 million and \$0.4 million, respectively. These expenditures were principally for the purchase of property and other equipment. Although we have no material commitments for capital expenditures, we anticipate an increase in capital expenditures if we decide to construct a building for our office in Romania or if we purchase or merge with companies or purchase assets in order to obtain complementary technology and to expand our product offerings, customer base and geographical presence.

## **B. Business Overview**

### **Overview**

We develop, manufacture and market real-time and off-line billing and customer care software for various types of communication providers, including traditional wireline and wireless, voice over IP, or VoIP, and broadband IP network operators, cable operators, 3G operators and mobile virtual network operators, or MVNOs.

Our convergent billing and customer care solution supports multiple services, including voice, data and content services as well as both prepaid and post-paid payment models in a single platform. Prepaid subscribers can enjoy the full range of services offered by the provider, with their special bundles, rating plans and limits. The prepaid solution authorizes each service and controls each session in real time, taking care that the balance is not exceeded. Post-paid subscribers, including credit-limited and non-limited, either retail or business customers, represent the loyal and the higher average revenue per user, or ARPU, market. All services used by a post-paid subscriber appear in a single bill, which includes all charges, including one-time, recurring and usage-related charges. Our billing solution is unique as it includes our own integrated real-time mediation product that provides interfaces with IP and traditional telecommunication equipment.

The latest version of our billing and customer care solution includes a powerful workflow engine to support the creation and execution of business processes such as order management, trouble ticket and debt collection. It also includes an integral point of sale solution that covers all dealer, store and cashier management and sales processes. The MIND solution introduces multi-layered architecture supporting real-time distributed processing, achieving

performance, scalability and high availability. It uses an open architecture, including Service Oriented Architecture (SOA) and Document Oriented Architecture (DOA), thus enabling fast and seamless integration with other systems and third party applications. The MIND solution is built using standardized best-of-breed object-oriented technologies such as Java and XML, and it is J2EE compatible as it is powered by a commercial application server.

We also provide professional services, primarily to our billing and customer care customers, consisting of installation, turnkey project implementation services, customer support, training and maintenance services, customization and project management. Our professional services also include enhanced support options, known as managed services, that are offered to customers in the United States and Europe and are performed from our offices. These managed services include performing day to day billing operational tasks.

In addition to our billing and customer care solutions, we offer three call management systems used by organizations for call accounting, traffic analysis and fraud detection. Our traditional enterprise software, which we call PhonEX, has been installed in over 15,000 locations throughout the world. Our other enterprise software, which we call MEIPS, is a product directed towards the same market segment where IP switches are implemented. MEIPS has been installed in over 1,000 locations around the world. Our latest product, PhonEXONE, delivers one unified solution for all voice communication expenses including traditional, IP and mobile telephony. The flexible and scalable architecture of PhonEXONE meets the needs of large enterprises, supporting an unlimited number of extensions and sites, it introduces full functionality through a web browser, based on Microsoft SQL database and enhanced by the advanced ASP.NET technology.

## **Our Market Opportunity**

### *Billing and Customer Care Industry*

Billing and customer care are critical to telecommunications service providers as they enable them to track and bill for usage, manage revenues and customer relations, and launch, deploy and charge new services, marketing programs and rate plans. The need for comprehensive billing solutions is driven by the market trend that requires service providers to introduce new services more rapidly, to be innovative in creating new product offerings and to optimize business processes for maximum efficiency. We provide tier 2 and tier 3 service providers with flexible, easy to deploy, convergent and scalable billing solutions.

Recently, many telecommunications service providers have initiated searches for billing solutions to replace existing ones, mainly in the developed telecom markets, where competition, consolidation and customer loyalty are key issues. Service providers explore the option to replace existing solutions in order to offer additional services, reduce costs and improve service.

An additional market opportunity is the trend towards all-IP networks, offering multiple next generation services, particularly in the developing world. New investment is taking place in many of these regions, driven by social and economic factors, with new licenses and new initiatives, such as VoIP and downloaded content. New billing solutions are required to enable the new services, and we are well positioned to support this need. As a pioneer in VoIP billing since 1997, we have the experience and the solution portfolio that is proven to be capable of delivering these technically demanding projects for all-IP networks.

### *Mobile Market*

The Sentori acquisition, with its existing mobile customer base, provided the required presence to build upon and enhance our position in the mobile market. With our combined product - MINDBill - we will be able to offer convergent services billing to the already existing customer base and to new GSM and CDMA operators.



A niche market in the mobile market in which we see opportunities in is the MVNO market. Market saturation is pushing mobile carriers that own the network, to use MVNOs as an alternative means for subscriber growth, without incurring the associated costs of acquiring and servicing a subscriber as the additional subscribers are acquired and serviced by the MVNO. Along with cutting operational costs, it enables the operators to increase their network utilization and revenues through wholesale agreements with the MVNOs. Typically, to create competitive differentiation, MVNOs require a billing and customer care solution that can ensure short time-to-market and product bundling. MVNOs specifically target consumers in well defined niches such as ethnic communities, young people and those with poor credit. Niche markets previously considered undesirable by wireless carriers due to exotic usage profiles - are now attracting attention. We have a number of MVNO's as customers and we are focused on delivering solutions that address this particular market.

### *Voice over IP Industry*

Many service providers are moving towards networks in which IP-based equipment will carry a large proportion, if not all, of their traffic. These next generation networks, or NGNs, offer cost savings over traditional switched networks, as well as the potential to offer new services like VoIP. We have a strong reputation in areas such as mediation and VoIP billing, and our products are designed to work with NGNs.

For service providers, Voice over IP presents an opportunity to generate revenue by offering additional services over the new broadband networks deployed. Voice over IP networks enable the deployment of most of the services customer receive over traditional networks at a much lower capital cost of infrastructure and reduced management cost of the network. As Voice over IP is distance independent, it allows service providers to offer competitive pricing, as only a small portion of the traffic, if any, terminates on traditional networks.

As service providers deploy convergent IP networks that can offer voice, data, video and content services, the demand for more sophisticated billing software is expected to grow. We believe that as providers of convergent networks continue to expand their service offerings, they will increasingly need products that allow them to monitor and bill their subscribers based on the type and content of services provided. As a result, we believe that this trend will increase the demand for sophisticated billing and customer care products for what is known as convergent billing, such as the solutions we offer.

Providers of multiple IP-based services typically require billing and customer care products that can handle authentication, authorization and accounting needs in real-time in order to determine the types of services to which the subscriber is entitled, as well as any applicable limits to the availability of the services. This real-time functionality is particularly important for prepaid billing plans. Finally, billing and customer care software products need to be easily adaptable to changes in the size and configuration of an IP provider's system, to new products and services and to enable rapid growth in subscriber base. Our proven solutions cover all these needs, as described below.

### **Our Billing and Customer Care Solution**

We develop, market and support real-time and off-line, scalable billing and customer care software, including mediation and rating, for providers of voice, data and content services that are designed to meet their complex, mission-critical provisioning, authentication, authorization, accounting and reporting needs. Our billing and customer care software provides our customers with the following benefits:

- *Real-Time Solution.* Service providers require a system that enables authentication, authorization and accounting and, if needed, cut-off, all in real-time. We believe that the MIND solution is one of the few billing and customer care products that offers real-time functionality for both prepaid and postpaid billing plans, and that has a real-time rating engine able to support rating of voice, data and content services simultaneously;

- *Mediation and Service Fulfillment.* IP and traditional networks that can offer voice, data, video and content services are based on various network elements each of which generates billable information. We believe that the MIND solution is one of the few billing and customer care products that provide real-time collection and correlation of various events from multiple sources that relate to the same session and convert them into billable records. In addition, the MIND solution enables end-to-end automated flow for service creation and activation, meaning that from the order for service handled by the customer care representative until the service activation, the activities that need to be completed are automatically fulfilled by MIND;
- *Scalability.* Our billing solutions are designed to be easily adapted to changes in the size and configuration of a service provider's network. They enable the network of a service provider to grow from accommodating a small number of subscribers to a large number of subscribers, primarily through the addition of hardware. This feature allows a service provider to expand its infrastructure and its subscriber base without the need to redesign or replace its billing and customer care software. The scalability of our software is important since many service providers begin with a relatively small subscriber base and experience rapid growth. For example, we designed and provided a billing and customer care solution for China Unicom, which started offering Voice over IP services in 1999. When China Unicom first deployed our software in May 1999, it was capable of supporting one million users. Our software was upgraded to support five million users in November 1999, 20 million users in June 2000 and 30 million users in June 2001. Increases in the potential number of users have been, and future increases will be, accomplished without the need to modify or replace our installed software;
- *Interoperability.* Currently, there are many standards for the interface between telecommunications equipment and billing products, such as Radius, SIP, and Diameter. Our billing platform is fully compliant with those interfaces and is interoperable with the telecommunications equipment of most of the leading manufacturers, including Alcatel, Cisco, Ericsson, Lucent, Nokia, Nortel and Siemens. This interoperability provides us with a competitive advantage, as it enables our customers to use networks composed of equipment manufactured by multiple vendors. It also allows providers to upgrade an existing network with new and different equipment without changing their billing and customer care products; and
- *Improved Time to Market.* Our billing solutions are modular, extensible software products based on software architecture designed for easy adaptability and implementation. These features allow each of our customers to tailor our products to meet their individual needs in terms of the number of subscribers serviced and the variety of services provided. In addition our products can be customized relatively quickly, enabling our customers to improve their time to market as they initially implement their networks and, later, as they add and modify the services they provide.

## **Our Strategy**

Our objective is to be a leader in the market for convergent billing and customer care software for tier 2 and tier 3 service providers and to maintain and increase profitability.

We believe that the strategic acquisition of Sentori in August 2005 strengthened our presence in the United States and in the mobile market. We have since successfully completed the integration process.

In 2006 we went through a transition phase. We invested heavily in the enhancement of our solutions, while focusing on building our business for the long-term, with larger deals and long-term contracts. These require longer sales-cycles and longer revenue spreads. The long-term relationships with our customers enable us to build future revenue streams and significant recurrent revenue from our customer base, from upgrades of licenses and services.

As we increase our focus on end-to-end billing solutions for tier 2 and tier 3 service providers, projects are now generally more complex in nature, with revenue recognized over longer periods. These factors typically extend the

recognition period of both license and service revenue streams and have some balance sheet impacts. We consider this a normal and expected development for our business as it grows and matures. In the last three years we significantly increased our professional services team to support the growth in services offered to customers. Our long-term business model contemplates that licenses, maintenance and services will each represent 30-40% of revenues and gross margins will be approximately 70%.

The key elements of our strategy to become a leader in the market for convergent billing and customer care software for tier 2 and tier 3 service providers include:

- *Expand offering through acquisitions.* We evaluate acquisition opportunities pro-actively, based on our long-term policy of growing the scale of our business and enhancing our offering, through acquisitions, which will enhance shareholder value. Our active pursuit is for business lines that provide the majority of the following criteria: existing customer base, channels and partners, presence in complementary geographic areas or markets and proven complementary technology. We will pursue such an opportunity if we estimate that it will provide an additional step towards tier 2 market leadership and that the acquisition will be accretive to our income within two or three quarters;
- *Leverage our brand name recognition and technical expertise.* We were one of the first to provide billing and customer care software for IP telephony, introducing MIND-iPhonEX in 1997. We believe that our early position in the market and our reputation for offering high quality, reliable billing and customer care software has provided us with significant brand name recognition among Voice over IP providers. The acquired Sentori customer base, team and technology has provided us with significant brand name recognition in the mobile market. We intend to leverage our reputation, brand name and recognition in the wireline and wireless markets;
- *Enhance alliances with industry leaders.* We have established cooperative relationships with leading manufacturers of telecommunications and hardware equipment and system integrators. We team with these industry leaders in marketing activities, as well as in the research and development and implementation stages of product development and enhancement. Our alliances allow us to broaden our marketing capabilities significantly, support new features offered by equipment vendors as these features are introduced to the market, and maintain our technology leadership over our competitors. We intend to continue to leverage these alliances in order to solidify and expand our market presence.
- *Maintain and expand our technological expertise.* We believe that our reputation in the market is due in large part to our technological expertise. We make significant investments in our research and development to continually enhance our products to meet the changing needs in the telecom industry. We intend to continue our commitment to technology, both to enhance our existing products and to develop new products for growing markets; and
- *Expand professional services opportunities.* As our projects are of larger scale and as convergent service offerings become more complex, our customers increasingly require consulting services, especially for customization, as well as for project management, installation and training, technical support and maintenance. This provides us with the opportunity to increase our revenue base from existing customers. We have begun to capitalize on this opportunity and, as a result, fees from providing professional services have increased.

## **Our Products and Services**

### *Billing and Customer Care Solutions*

Our billing solutions include real-time and off-line mediation, provisioning, rating, billing and customer care products for voice, data, video and content services that meet the mission-critical needs of convergent IP, Wireline and Wireless service providers and is interoperable with the telecommunications equipment of major manufacturers

Our highly functional and adaptable product enables our customers to quickly deploy new services and to rapidly grow and add new services. Our solutions support both prepaid billing plans, in which customers pre-pay for the services, or postpaid billing plans, in which customers pay for the services after using them, on the basis of either limited or unlimited credit lines. The key functionalities of our solutions are as follows:

- *Mediation.* Our mediation platform provides real-time and batch event collection interfacing with the content, data, service delivery and routing network elements. It incorporates an intelligent processing engine to correlate, aggregate, merge and filter raw events into a single valuable usage event;
- *Provisioning.* Provisioning involves setting up the ability of a subscriber to use services. The customer database includes information regarding customers' personal data, identification parameters and the services provided. This information can be provided in real time or on demand to any external system, such as network elements and legacy billing solutions. The data provided includes service parameters such as enabled features and quantitative limits;
- *Authentication.* Our real-time mediation module authenticates subscribers who dial into the network to use the service. Authentication is based on a number of methods, including user codes, passwords and caller line identification. The identification information is passed to the system, where the subscriber is authenticated and then permitted to use the service;
- *Authorization.* Our systems authorize a particular usage, among other ways, by reviewing the type of service to determine whether the service is permitted or by reviewing the existing balance, pre-rating the service, using the rating engine described below and calculating the resulting cut-off time, if any, of the call or data session;
- *Accounting.* When each session is completed, the rating engine described below is used to determine the amount to be charged to the subscriber and update the balance of the account in real-time. In addition, the usage detail records are stored for invoicing and reporting;
- *Interconnect Billing.* The networks operated by our customers are typically interconnected with the networks of other telecommunications service providers. Interconnecting providers need to charge other providers for carrying each other's services over their networks. Our billing solutions generate reports that enable providers to bill for traffic and services that are being transported across their networks by other providers;
- *Roaming.* Our solutions support the ability to provide services to visiting subscribers, on the one hand, and to roam subscribers in other networks, on the other hand. Our billing system provides the ability to define and manage the required roaming contract terms and the applicable tariff plan (IOT) for each roaming partner;
- *Virtual Providers.* MIND offers a solution that enables a carrier to have resellers of traffic under different brand names, while it is still managed from the same billing platform, as a separated entity known as Virtual Provider. This model enables the carriers that own the networks, to lease its network equipment and its billing system to other providers.
- *Call Shops.* In order to place a long-distance/international call, a person may come to a special calling center, also known as a call shop. The call shop policy may require that the person make a deposit before calling, the remaining amount being returned after the invoice is generated. MIND's billing solution supports the special business model for call shops, including fast and reliable Web access and customized reports for profit and

loss;

- *Multiple Services and Products Support.* Our billing solutions allow service providers to take advantage of their convergent networks by providing their customers with advanced voice, data, content and video services. The MIND Product Catalog allows service providers to bundle groups of services into tailor-made packages for which they can offer special rates, discounts and promotions. There are different classes of customers with respect to the availability, bandwidth, and quality of service requirements for these services. Our billing solutions offer an easy way to define these services, combine them into products, and rate each service and product differently;
- *Rating.* Our billing solutions include a real-time and flexible rating engine that allows service providers to offer subscribers a wide variety of billing plans. This flexibility also allows service providers to set different tariff parameters. For example, our billing and customer care software can support different rates for various content and video streaming services and for different customer groups, rates based on the day of the week and time of the day and rates based on the origin and destination of the call. International service providers may define rates in different currencies using the product's multi-currency functionality;
- *Invoicing.* Our billing solutions include a high-capacity invoice server that handles all stages of invoice generation. It supports multiple billing cycles and bill production on demand. The invoice includes the customer details and information, such as usage details, monthly recurring charges, discounts and taxes, which are gathered throughout the billing period. This module creates the original bills to be printed locally or exported to bill printing service bureaus, using a customizable invoice layout.
- *Subscriber Web Interface.* Our billing solutions include a user-friendly subscriber web interface that allows subscribers to resolve billing inquiries themselves. Individual customers can obtain real time information about their account, including details of calls made that have not yet been invoiced, like the time, destination, length and cost of each call. The subscriber can also browse invoices, call details and payment history records. This feature is convenient for subscribers and efficient for service providers as it reduces service costs;
- *Customer Support Representative Web Interface.* Our billing solutions include a user-friendly customer support representative web interface that allows operators of the system to perform customer care from any location. This feature is of particular significance to service providers who have remote operations centers and are required to provide support of their system in more than one location;
- *Cashier Module.* Our Cashier module offers the ability to perform cash registration, posting of payments and refunds and direct sales of services and equipment. The module provides cash register management, credit card processing and analysis reporting capabilities;
- *Resource Management Module.* Our Resource Management module automates the management and tracking of the equipment sold to subscribers. The solution keeps track and manages the equipment by serial number, status, and location, providing solutions for the flow management from the reception of the items up to the allocation of the items to the customers;
- *Business Processes.* MIND is offering in its deployments tailored, fully automated, order management processes, trouble tickets, and debt collection processes, all unique to its market segment. The flexible and robust account creation order management process handles the orders from the customer's contact, through registration, package selection, provisioning and activation. The order management process involves different users from various departments (such as supervisor approval of the contract, technician test, etc.), integration with external legacy systems (such as inventory), interaction with third party services (such as address validation) and more. MIND's billing solution uses its robust inherent workflow capabilities to tailor an order management process that meets the operator's business model;

- *Call Management and Traffic Analysis Reports (CMS module).* The CMS module allows service providers to generate reports and graphic analyses of usage activity. These reports contain information regarding peak hours, usage loads to different destinations, the number of sessions per minute for a specific gateway or group of gateways, the duration of sessions and other parameters. These features enable service providers to analyze subscriber behavior and use the information to improve their marketing and business development strategies. In addition, the traffic analyses reports assist service providers in planning the growth and development of their networks;
- *Fraud Detection.* Our billing solutions include a fraud detection tool that enables detection of "stolen" calls and telephone misuse. It detects, locates and warns of any suspicious activity by activating alarms. It is easily customized to suit the needs of each service provider and allows a provider to build fraud inquiries based on a defined set of parameters. When these specific parameters are violated, alarms at four different alarm levels may be activated. Different actions may be implemented at each level. For instance, the operator may be alerted to possible fraud via e-mail, fax, pager, audio or visual alarms;
- *Business Processes Environment.* Customer care and billing processes are one of the most significant practices to drive business performance. These processes are fundamental for bringing innovative and competitive ways of delivering products and services to market.

MIND's automated business processes engine allows operators to excel with today's top challenges. The business processes workflow implemented by the engine provides business intelligence behind day-to-day operations. The engine also automates the interaction with network elements and third party software. This is done in accordance with a uniquely defined set of business rules determined by the customer.

### *Enterprise Software*

Our enterprise products, known as PhonEX, MEIPS and PhonEXONE, are used by corporations for call accounting, traffic analysis and fraud detection. PhonEX is a call management system that collects, records and stores all call information in a customized database. The system:

- allows customers to generate near real-time reports on the enterprise's telephone use;
- produces sophisticated reports and graphics for easy and effective analysis of call activity; and
- allows customers to allocate telephone expenses to specific departments, individual clients or projects.

These functions allow organizations to more effectively manage their telecommunications resources. PhonEX is easy to install and configure, user-friendly and compatible with any switchboard system. PhonEX also performs call management and traffic analysis as well as fraud management in the same manner as our billing solutions. In addition, PhonEX is a multi-lingual and multi-currency system, which means that reports can be generated in any currency defined in the system, or in two currencies simultaneously.

Manufacturers of IP telecommunications equipment have begun to develop and market Voice over IP systems for enterprises. Our enterprise solution for IP switches, known as MEIPS, is used to provide call accounting, traffic analysis and fraud detection for enterprises that use IP telephony. MEIPS provides substantially the same functionality as PhonEX.

Our high end product, PhonEXONE, delivers one unified solution for all voice communication expenses, including traditional, IP and mobile telephony. The flexible and scalable architecture of PhonEXONE meets the needs of large enterprises, supporting an unlimited number of extensions and sites. Some of its major advantages are:

- web-based solution, providing full functionality through a web browser;
- scalable system architecture, supporting an unlimited number of sites and extensions;
- multilingual and multicurrency: the perfect solution for multinational organizations;
- supports IP, traditional and hybrid telephony networks; and
- Supports the Microsoft SQL database and is enhanced by the advanced ASP.NET technology.

We intend to further develop and market these products as the emerging market for Voice over IP systems for enterprises grows.

### *Professional Services*

We provide professional services to our customers, consisting primarily of project management, customization, installations, customer support, training and maintenance services. As our projects become more complex, more customers require customization services to add specialized features to their systems. We typically incorporate additional or specialized features developed for a particular customer into future versions of our products. We also offer enhanced support options, called managed services, that are offered to customers in the United States and Europe and are performed from our offices. The managed services include performing day to day billing operational tasks. The managed services contracts are usually for a term of three to five years and are paid on a monthly basis.

### **Technology**

Our software products are based on an open architecture, which was developed using industry standard application server programming interfaces that enables it to readily integrate with other software applications. These application program interfaces create an object-oriented, multi-layered architecture that supports a distributed environment. Our object-oriented technology enables the design and implementation of software utilizing reusable business objects rather than complex procedural code. Our layered architecture organizes these business objects to optimize the interface between the user and the application. We implement our software in a distributed configuration. This allows various modules to be installed on different servers to support the system's scalability and security. We believe that our technology allows us to offer products with the following benefits:

- fast integration and interoperability with telecommunications equipment of major manufacturers, legacy systems and external software;
- modular architecture that allows our products to be easily scalable and enables us to customize our software relatively quickly;
- reliable products that support high availability of the service for mission-critical applications. Our automatic fail-over mechanism ensures minimal loss of service in case of a component failure; and
- security at all levels of the architecture. Each user of the system may be assigned to different security groups. Service providers are therefore able to determine and audit access to the system. In addition, firewalls can be installed to prevent unauthorized access to the system.

Our software products are based on multiple-tier architecture, consisting of the following tiers:

- **Client Application Tier:** This is the top tier graphic user interface between the user and the application. It includes client applications for customer registration, customer care and billing administration. In addition, it

includes Web services interfaces that enable external applications to interact with the business tier;

- **Business Object Tier:** This tier includes the business logic and rules of the system. This tier manages accounts, services, events and tariffs. It includes an object request broker that facilitates the transfer of information requested by the client application tier from the database tier;
- **Database Tier:** This tier includes the Oracle database server and management software where the actual billing and customer care information is stored.

## Sales and Marketing

### *Sales*

#### *Billing and Customer Care Solutions*

We conduct our sales and marketing activities primarily directly and also through our marketing alliances with leading network equipment vendors and systems integrators. These marketing allies and resellers provide us with a global extension of our direct sales force and are a significant source of leads and referrals. We also engage in joint marketing activities with our allies, including joint responses to requests for proposals, sharing booths in trade shows, distributing each others' marketing information and cross links and references to web sites. We believe that these relationships also help validate our technology and facilitate broad market acceptance of our software.

Our contracts with our marketing allies, distributors and resellers are non-exclusive, do not contain minimum sales or marketing performance requirements and may be terminated at any time with notice.

#### *Enterprise Software*

In Europe, the United States and Israel our enterprise software is sold by our appointed distributors, resellers and directly through our sales force.

### *Marketing*

Our marketing programs are focused on creating awareness, interest and preference for our products and services. We engage in a variety of marketing activities, including:

- participating in industry trade shows and special events;
- conducting ongoing public and press relations programs; and
- conducting training seminars for vendors and system integrators.

## Principal Markets

The following table shows our revenues for each of the past three years classified by activity and geographic market.

Years ended December 31,  
(in thousands of US \$)

	2004	2005	2006
The Americas (total)	1,977	5,556	9,643



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Sale of Licenses	1,020	2,870	4,854
Services	957	2,686	4,789
Asia Pacific and Africa (total)	2,859	2,702	1,619
Sale of Licenses	1,957	1,724	575
Services	902	978	1,044
Europe (total)	12,017	6,285	7,693
Sale of Licenses	8,361	2,503	2,769
Services	3,656	3,782	4,924
Israel (total)	953	1,058	1,105
Sale of Licenses	361	323	269
Services	592	735	836
Total	17,806	15,601	20,060
Sale of Licenses	11,699	7,420	8,467
Services	6,107	8,181	11,593

### **Customers**

#### *Billing and Customer Care Solutions*

We currently provide traditional telecommunications service providers, Internet telephony service providers and Internet service providers with our billing and customer care software. MIND-iPhonEX, VeraBill and the Sentori product line have been installed for a large base of customers worldwide, including:

- traditional telecommunications service providers that also offer IP services including VoIP or/and data, such as China United Telecommunications Corp. (China Unicom), Romtelecom S.A., Singapore Telecommunications Limited (SingTel), Sri Lanka Telecom, Telecom Colombia, and VTI;
- traditional wireline telephony providers, such as Teledome and Telefonía Bonairiano;
- wireless telephony providers, such as Bahamas Telecom, CelTel Tanzania and mTel Nigeria;
- 3rd generation (3G) mobile operators that provide broadband mobile IP services, such as H3G Italy; and
- MVNOs, such as Viaero.

#### *Enterprise Software*

Our enterprise software has been installed at over 15,000 locations throughout the world, for customers that include international banking firms, government agencies and other small to very large organizations.

### **Competition**

#### *Billing and Customer Care Solutions*

Competition in the market for billing and customer care software is intense and we expect competition to continue to be strong. We compete with many local companies and worldwide companies such as Comverse (after the acquisition by Comverse of the Global Software Services division of CSG Systems International) and Convergys Corporation (after the acquisition of Geneva Technology by Convergys).

We believe that our competitive advantage is based on:

- our ability to rapidly deploy a complete turn-key product based solution;

- our solutions' functionality, which includes billing, customer care, mediation, provisioning, rating for multiple services and prepaid IP functionality;
- our proven platform that is eight years operational and our 10 years of wireless and IP experience to satisfy customer requirements;
- our flexibility to meet customer requirements in a short time frame; and
- our financial strength.

However, we depend on our marketing alliances with manufacturers of telecommunications equipment and reseller arrangements to market our billing and customer care software. Some of our marketing allies and resellers also work with some of our competitors. Our marketing alliances and reseller arrangements are for the most part non-exclusive and do not contain minimum sales or marketing performance requirements. We may not be able to compete effectively with our competitors under these circumstances. Many of our competitors have greater financial, personnel and other resources, have longer and more established relationships with service providers and may be able to offer more aggressive pricing or devote greater resources to the promotion of their products. In addition, one or more of our competitors could develop superior products and these products could achieve greater market acceptance than our product.

#### *Enterprise Software*

Our main competitors in the market for enterprise software products include Avotus Corporation and Veramark Technologies, Inc. To compete effectively, companies must be able to offer adequate technical support and ongoing product development and customization services. In addition, multinational companies prefer call accounting systems that can be installed at their various offices throughout the world, and therefore require call accounting products that are multilingual and support the local telecommunication requirements. The principal factors upon which we compete are customer support, ease of use, compatibility with major switchboard systems and IP switches and the multi-lingual and multi-currency nature of our system.

#### **Israeli Office of the Chief Scientist**

Under the Israeli Law for the Encouragement of Industrial Research and Development, 1984, or the Research and Development Law, research and development programs which meet specified criteria and are approved by the Office of the Chief Scientist are eligible for grants of up to 50% of certain approved expenditures, in exchange for the payment of royalties from the sale of products (and any ancillary services) incorporating or based upon know-how developed in accordance with such programs, until the repayment in full of the dollar linked amount of the grants received. We have received grants in the past from the Office of the Chief Scientist and have repaid them.

Even after repayment in full of royalty obligations, the Research and Development Law and prohibits the transfer of the funded know-how outside of Israel without the prior approval of the Office of the Chief Scientist. Further, the Research and Development Law requires that the manufacture of products incorporating or basing upon funded know-how be performed in Israel.

The Research and Development Law contains reporting requirements with respect to certain changes in the ownership of a grant recipient. The Research and Development Law requires the grant recipient and its controlling shareholders and interested parties to notify the Office of the Chief Scientist of any change in control of the recipient or a change in the holdings of the means of control of the recipient that results in a non-Israeli becoming an interested party directly in the recipient and requires the new interested party to undertake to the Office of the Chief Scientist to comply with the provisions of the Research and Development Law. For this purpose, "control" is defined as the ability to direct the activities of a company other than any ability arising solely from serving as an officer or director of the company. A

person is presumed to have control if such person holds 50% or more of the means of control of a company. "Means of control" refers to voting rights and the right to appoint directors or the chief executive officer. An "interested party" of a company includes a holder of 5% or more of its outstanding share capital or voting rights, its chief executive officer and directors, someone who has the right to appoint its chief executive officer or at least one director, and a company with respect to which any of the foregoing interested parties owns 25% or more of the outstanding share capital or voting rights or has the right to appoint 25% or more of the directors. Accordingly, any non-Israeli who acquires directly 5% or more of our ordinary shares will be required to notify the Office of the Chief Scientist that it has become an interested party and to sign an undertaking to comply with the Research and Development Law.

### **C. Organizational Structure**

Set forth below is a list of our significant subsidiaries:

- Sentori Inc., a wholly owned subsidiary, incorporated in the State of Delaware;
- MIND C.T.I. Inc., a wholly owned subsidiary, incorporated in the State of New Jersey;
- MIND Software SRL, a wholly owned subsidiary, incorporated in Romania; and.
- DIROT COMP SRL, a wholly owned subsidiary, incorporated in Romania.

### **D. Property, Plant and Equipment**

Our headquarters are located in Yoqneam, Israel, approximately 50 miles north of Tel Aviv. We lease approximately 16,000 square feet at our Yoqneam headquarters. We also lease 10,593 square feet of office space in Silver Spring, Maryland and 21,500 square feet in Jassy, Romania. The office in Maryland is used primarily for supporting our customers in the United States, while the office in Jassy is used primarily for software development and for customer support. The office in Maryland is the group's headquarters in the Americas. We are currently considering purchasing or constructing a building for our office in Romania.

### **Item 4A. Unresolved Staff Comments**

Not applicable.

### **Item 5. Operating and Financial Review and Prospects**

The following discussion and analysis is based on and should be read in conjunction with our consolidated financial statements, including the related notes, contained in Item 18.

#### **Overview**

We were incorporated in Israel in 1995 and started providing our enterprise software products in that year. In 1997, we introduced our billing and customer care software for Voice over IP. We have enhanced our billing solutions since then to support multiple IP services, wireless and wireline carriers and multiple play (voice, data and content) service providers. In 2006, 85.6% of our revenues were derived from providing our billing and customer care software and 14.4% were derived from providing our enterprise software. In 2006, license fees represented 42.2% of our revenues and professional services represented 57.8%. In 2005 and 2006, no customer accounted for 10% or more of our total revenues. However, we expect to continue to derive sizeable revenues from a small number of changing customers.

In 2001, we acquired the VeraBill product line for billing and customer care for traditional tier 3 wireline and wireless service providers. In August 2005, we acquired Sentori Inc., a leading provider of billing and customer care solutions

to tier 3 and tier 2 wireless carriers and mobile virtual network operators, or MVNOs, mainly in the United States and the Caribbean. We evaluate acquisition opportunities pro-actively, based on our long-term policy of growing the scale of our business and enhancing our offering through acquisitions that are expected to enhance shareholder value.

In 2003 and 2004, we experienced quarterly sequential revenue growth and improved profitability and net income. Our revenue growth in 2004 was driven primarily by our winning larger projects than in the past, especially in Europe. In the first quarter of 2005, our revenue fell sharply to \$3.08 million from \$4.88 million in the previous quarter, due to loss of revenues caused by the cancellation of two large orders that we received in 2004 for reasons unrelated to us and in addition, the customer that represented 36% of our revenues in 2004, entered into a reorganization process and, as a result, the planned enhancements of our platform did not materialize. These three customers were expected to represent over 30% of our annual revenue. Consequently, our total 2005 revenue was lower than our 2004 revenue. In spite of the unexpected loss of revenue in first quarter of 2005, we succeeded in maintaining profitability and in showing sequential revenue growth for the four quarters thereafter. In 2006 we experienced significant growth in revenue driven primarily by our acquisition of Sentori in the third quarter of 2005, which strengthened our presence in the United States and in the mobile market generally.

As we increase our focus on end-to-end billing solutions for tier 2 and tier 3 service providers and our average deal size increases, our long-term business model changes as the professional services part of our business is increasing. An additional consequence is that projects are often now of a more complex nature, with revenue recognized over longer periods. These factors typically extend the recognition period of both license and service revenue streams and have some balance sheet impacts. We consider this a normal and expected development for our business as it grows and matures. In the last three years we significantly increased our professional services team to support the growth in services offered to customers.

Since March 2002, we have deposited most of our cash in structured, callable time deposits. Under the arrangements with the banks, whether or not the deposits bear interest depends upon the prevailing U.S. dollar LIBOR rate. Interest is payable in respect of days during which the rate is within a certain range and no interest is payable in respect of days during which it exceeds the range. Until May 2005, we achieved relatively high interest rates of over 7% per annum. Since May 2005, due to the increase of the six-month LIBOR rate, the deposits did not bear interest, causing our financial income to decrease substantially starting in the third quarter of 2005. In the second quarter of 2006, we withdrew two of our three structured deposits in the aggregate amount of \$20 million. The financial expenses arising from the early redemption of these two deposits were \$1.33 million. In the fourth quarter of 2006 the third and last structured deposit in the amount of \$10 million was released with no penalty. Since December 2006, all our funds are invested in risk-free bank deposits and investment grade, interest-bearing bonds or debentures. See below under Item 5.B - "Liquidity and Capital Resources" for more information.

In July 2003, we adopted a dividend policy, according to which we declare, subject to specific board approval and applicable law, a dividend distribution once per year, in the amount of our net income from the previous year. Additionally the board approved dividend distributions in 2003 and 2007 that were subject to approvals from an Israeli Court in accordance with Section 303 of the Israeli Companies Law due to the fact that we did not have sufficient retained earnings. Since 2003 the Company distributed cash dividends of approximately \$0.85 per share to its shareholders: \$0.14 per share in 2003, \$0.13 per share in 2004, \$0.24 per share in 2005, \$0.14 per share in 2006 and \$0.20 per share in 2007. The board decision to approve the annual distribution is based, among other factors, on our cash position at that time, potential acquisitions and future cash needs. The board may decide to discontinue the dividend distribution in whole or in part at any time.

*Revenues.* We are paid license fees by our customers for the right to use our products, based on (1) traffic volume, which is measured by factors such as minutes per month, number of lines used, number of data sources and number of subscribers, and (2) the functionality of the system based on application modules that are added to the software. In relation to our professional services, other than maintenance services, we mainly quote a fixed price based on the type of service offered, estimated direct labor costs and the expenses that we will incur to provide these services. Fees for

maintenance services are based on a fixed percentage of the license fee and are paid annually, quarterly or monthly.

We primarily use two business models when we sell our solutions, the license model and the managed services model. In the license model, the customer pays a one-time implementation fee, a one-time license fee for a perpetual license limited by the traffic metrics chosen by the customer, and additional fees to expand the scale of the network supported by our software. In addition, we are paid maintenance fees to renew periodically the maintenance agreement at the customer discretion. In the managed services model, the customer pays a one-time implementation fee, a monthly fee that includes a periodic license limited by the traffic metrics chosen by the customer, maintenance and services fees, and additional fees to expand the scale of the network supported by our software.

We provide a revenue breakdown for our billing and customer care software and our enterprise call management software. We believe that this information provides a better understanding of our performance and allows investors to make a more informed judgment about our business.

*Cost of Revenues.* The cost of revenues consists primarily of direct labor costs and overhead expenses related to software installation and maintenance. Cost of revenues also includes, among other things, software license fees to Oracle, hardware, amortization of intangible assets, packaging and shipping costs. Our cost of professional services revenues consists primarily of direct labor costs and travel expenses. Our revenues from the sale of our licenses have a higher gross margin than that from providing our professional services. We incur variable direct labor costs when we provide professional services. There is no comparable variable direct labor cost incurred when we license our software.

*Research and Development Expenses.* Our research and development expenses consist primarily of compensation, overhead and related costs for research and development personnel and depreciation of testing and other equipment. Research and development costs related to software products are expensed as incurred until the "technological feasibility" of the product has been established. Because of the relatively short time period between "technological feasibility" and product release, no software development costs have been capitalized. We expect to continue to make substantial investments in research and development.

*Selling and Marketing Expenses.* Our selling expenses consist primarily of compensation, overhead and related costs for sales and marketing personnel, the operation of international sales offices, sales commissions, marketing programs, public relations, promotional materials, travel expenses, trade shows and exhibition expenses.

*General and Administrative Expenses.* Our general and administrative expenses consist pri