TD AMERITRADE HOLDING CORP
Form 4
February 17, 2017

FORM 4

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

Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

OMB APPROVAL
OMB Number: 3235-0287
Expires: January 31, 2005
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(Print or Type Responses)

1. Name and Address of Reporting Person *
BOYLE STEPHEN J

(Last) (First) (Middle)

200 S. 108TH AVE.

(Street)

OMAHA, NE 68154

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
TD AMERITRADE HOLDING CORP [AMTD]

3. Date of Earliest Transaction (Month/Day/Year)
02/15/2017

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

_____ Director _____ 10% Owner
__X__ Officer (give title below) _____ Other (specify below)
EVP and CFO

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Common Stock	02/15/2017		A		541	A	$ 0	131,475	D	

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)		8. Price of Derivative Security (Instr. 5)	9. Nu Deriv Secur Bene Own Follo Repo Trans (Instr
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares		

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
BOYLE STEPHEN J 200 S. 108TH AVE. OMAHA, NE 68154			EVP and CFO	

Signatures

/s/ Brenna M. O'Connor, as attorney-in-fact for Stephen J. Boyle	02/17/2017
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number. rris has served as a Class III director of Sterling Bancshares, Inc., a bank holding company. From 1996 to 2001, he served as Chief Medical Officer and Vice President for Space Hab, an aerospace company. Dr. Harris is a former astronaut, having completed two space shuttle missions. He completed his residency in Internal Medicine at the Mayo Clinic and trained as a flight surgeon at the Aerospace School of Medicine at Brooks Air Force Base.

Marlin W. Johnston has served on our Board since 1992. Mr. Johnston has been a management consultant with Tonn & Associates, a management consulting firm, since 1993. During 1992 and 1993, Mr. Johnston served as a management consultant to the Texas Department of Health and the Texas Department of Protective and Regulatory Services.

J. Livingston Kosberg rejoined our Board of Directors on July 6, 2004 and served as our interim Chief Executive Officer in 2004. Mr. Kosberg previously served as our Chief Executive Officer from 1992 to 1995 and as our Chairman of the Board from 1992 to 2001. Mr. Kosberg has been involved in a variety of industries, including healthcare, finance and construction, and currently serves as an advisor to several investment funds.

Jerald L. Pullins has served on our Board since 2003. He is currently engaged in the development and management of private enterprises in the healthcare field. From October 2007 to the present, Mr. Pullins has been the Managing Member of SeniorCare Homes, LLC, which develops, owns and operates supervised, residential homes for senior citizens with Alzheimers, dementia and other memory impairment conditions. From 2007 to present, he has also served as Chairman of the Board of Directors of Pet Partners, LLC, a private enterprise involved in the acquisition and management of primary care, small animal veterinary hospitals.

Regg E. Swanson joined our Board on September 6, 2007. Mr. Swanson is Managing Director of STAR Physical Therapy, LP, a subsidiary of the Company. Mr. Swanson is founder of STAR Physical Therapy, LLC, and from 1997 to 2007, was its president and managing member. He is a licensed athletic trainer and has been involved with sports medicine and physical therapy for over 25 years.

Clayton K. Trier joined our Board on February 23, 2005. Mr. Trier is a private investor. He was a founder and former Chairman and Chief Executive Officer of U.S. Delivery Systems, Inc., which developed the first national network providing same-day delivery service, from 1993 to 1997. Before it was acquired in 1996, U.S. Delivery was listed for two years on the New York Stock Exchange.

The persons named on the proxy card will vote FOR all of the nominees for director listed above unless you withhold authority to vote for one or more of the nominees. As required by Nevada law, nominees will be elected by a plurality of the votes cast at the Annual Meeting. Abstentions and broker non-votes will not be treated as a vote for or against any particular nominee and will not affect the outcome of the election of directors. Continental Stock Transfer & Trust Co. will tabulate the votes cast by proxy or in person at the Annual Meeting.

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All of our nominees have consented to serve as directors. Our Board has no reason to believe that any of the nominees will be unable to act as a director. However, if any director is unable to serve, the Board may designate a substitute. If a substitute nominee is named, the persons named on the proxy card will vote FOR the election of the substitute nominee.

THE BOARD OF DIRECTORS RECOMMENDS THAT THE STOCKHOLDERS

VOTE FOR THE ELECTION OF THE ELEVEN NOMINEES FOR DIRECTOR

NAMED IN THE PROXY STATEMENT.

CORPORATE GOVERNANCE AND BOARD MATTERS

Independent Directors

The Board currently consists of eleven directors, eight of whom the Board has affirmatively determined have no relationship with the Company or its subsidiaries that would interfere with the exercise of independent judgment in carrying out the responsibilities of a director and are independent, as defined in the applicable NASDAQ Listing Standards. Specifically, the Board determined that the eight members of the Board are independent as defined in Rule 4200 of the NASDAQ Marketplace Rules, and the directors comprising the Company s Audit Committee are independent as defined in Rule 10A-3(b)(1) under the Exchange Act.

Attendance at Board Meetings and Board Committees

The Board of Directors conducts its business through its meetings and through meetings of certain committees of the Board of Directors. All committees act for the Company. The Board of Directors is comprised of a majority of independent directors as required by the applicable NASDAQ Listing Standards.

The Board has the following standing committees: (i) Governance and Nominating, (ii) Corporate Compliance (sub-committee of the Audit Committee), (iii) Compensation, and (iv) Audit Committees. During 2008, the Board of Directors met eight times, the Governance and Nominating Committee met once, the Corporate Compliance Committee met four times, the Compensation Committee met four times and the Audit Committee met seven times. Each of our directors attended at least 75% of the aggregate meetings of the Board of Directors and the committees on which he served. These committees are constituted as follows:

Governance and Nominating Committee

The Governance and Nominating Committee currently consists of Messrs. Arnold (Chairman), Broussard and Trier, all of whom are independent , as defined in the applicable NASDAQ Listing Standards. The function of the committee is to select, screen and recommend to the full Board nominees for election as directors, including any nominees proposed by stockholders who have complied with the procedures described below. The committee also has ongoing responsibility for oversight review of Board performance and ensuring each Board member s continuing commitment to the Board and the Company s goals and objectives. Additional functions include regularly assessing the appropriate size of the Board, and whether any vacancies on the Board are expected due to retirement or otherwise. In the event that vacancies are anticipated, or otherwise arise, the committee will consider various potential candidates for director. Candidates may come to the attention of the committee through current Board members, stockholders, or other persons. The committee may also hire third parties to identify, to evaluate, or to assist in identifying or evaluating potential nominees should it be determined necessary. The committee is required to meet twice a year and operates under a written charter, a copy of which is available on our website at www.usph.com.

Nomination Criteria. In its consideration of Board candidates, the Governance and Nominating Committee considers the following criteria: the candidate s general understanding of the health care sector, marketing, finance and other disciplines relevant to the success of a publicly-traded company; strategic business contacts and regard or reputation in the community, industry and civic affairs; financial, regulatory and business experience; integrity, honesty and reputation; diversity; size of the Board of Directors; and regulatory obligations. In the case of incumbent directors whose terms of office are set to expire, the committee reviews each such director s overall

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service to the Company during said director s terms, including the number of meetings attended, level of participation, quality of performance, and whether the director continues to meet the independence standards set forth in the applicable SEC rules and regulations and the applicable NASDAQ Listing Standards. In the case of new director candidates, the questions of independence and financial expertise are important to determine which roles can be performed by the candidate, and the committee preliminarily determines whether the candidate meets the independence standards set forth in the SEC rules and regulations and the applicable NASDAQ Listing Standards, and the level of the candidate s financial expertise. Candidates are first screened by the committee, and if approved by the committee, then they are screened by other members of the Board. The full Board approves the final nomination(s) based on recommendations from the committee. The Chairman of the Board, acting on behalf of the full Board, will extend the formal invitation to become a nominee of the Board of Directors. Qualified candidates for membership on the Board will be considered without regard to race, color, religion, sex, ancestry, national origin or disability.

Stockholder Nomination Procedures. The Governance and Nominating Committee will consider director candidates recommended by the stockholders. Generally, for a stockholder of the Company to make a nomination, he or she must give written notice to our Corporate Secretary so that such notice is received at least 120 calendar days prior to the first anniversary of the date the Company s proxy statement is sent to the stockholders in connection with the previous year s annual meeting of stockholders. If no annual meeting of stockholders was held in the previous year (or if the date of the annual meeting of stockholders was changed by more than 30 calendar days from the date of the previous year s annual meeting), the notice must be received by the Company within a reasonable period prior to the time the Company begins to print and send its proxy materials for the applicable annual meeting. The stockholder s notice must set forth as to each nominee: (i) the name, age, business address and residence address of such nominee, (ii) the principal occupation or employment of such nominee, (iii) the number of shares of our common stock which are beneficially owned by such nominee, and (iv) any other information relating to such nominee that may be required under federal securities laws to be disclosed in solicitations of proxies for the election of directors (including the written consent of the person being recommended as a director candidate to being named in the proxy statement as a nominee and to serve as a director if elected). The stockholder s notice must also set forth as to the stockholder giving notice: (i) the name and address of such stockholder, and (ii) the number of shares of our common stock which are beneficially owned by such stockholder.

If the information supplied by the stockholder is deficient in any material aspect or if the foregoing procedure is not followed, the chairman of the applicable annual meeting may determine that such stockholder s nomination should not be brought before the meeting and that such nominee shall not be eligible for election as a director of the Company. The committee will not alter the manner in which it evaluates candidates, including the minimum criteria set forth above, based on whether or not the candidate was recommended by a stockholder.

Corporate Compliance Committee

The Corporate Compliance Committee is a sub-committee of the Audit Committee, and consists of three independent directors. The current members of the committee are Messrs. Johnston (Chairman) and Pullins, and Dr. Harris, all of whom are independent, as defined in the applicable NASDAQ listing standards. The committee has general oversight of our Company s compliance with the legal and regulatory requirements regarding healthcare operations. The Chairman of the committee is provided with information regarding calls received on the Company s compliance hotline and reports findings to the committee. The committee relies on the expertise and knowledge of management, especially our Compliance Officer (CO) and other compliance, management, operations and/or legal personnel. The CO is in ongoing contact with the Chairman of the committee. The committee meets at least two times a year and as necessary to carry out its responsibilities and reports periodically to the Board of Directors regarding its actions and recommendations. The committee reviews and assesses the activities and findings of clinic internal audits, reviews reports of material noncompliance and reviews and approves corrective actions proposed by management.

Compensation Committee

The current members of the Compensation Committee are Messrs. Arnold (Chairman), Broussard, Kosberg and Trier all of whom are independent , as defined in the applicable NASDAQ Listing Standards. Mr. Kosberg was

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appointed to the committee in March 2009. As more fully described in the Compensation Committee Charter, which can be found on our website at www.usph.com, the committee is responsible for, among other things:

establishing goals and objectives relevant to incentive compensation awards (annual and long-term) for the Chief Executive Officer and other senior executive officers of the Company;

evaluating the Chief Executive Officer s and other senior executive officers performance and the overall corporate performance in light of these goals and objectives and approve any incentive compensation for such executives;

determining any periodic adjustments to be made in the Chief Executive Officer s and other senior executive officers base salary level based on the committee s evaluation thereof;

for officers and key employees of the Company other than the senior executives, reviewing the proposed salary levels and annual adjustments thereto and the incentive compensation plans formulated by senior management and the annual bonus payments to be made thereunder, and providing input and advice to senior management with respect to these compensation decisions;

approving all executive perquisites and any special benefit plans to be made available to senior executive officers;

advising on compensation of members of the Board;

administering the Company s equity compensation plans and approving grants to executive officers, employees, directors, and consultants under such plans;

reviewing the Compensation Discussion and Analysis to be included in the Company s annual proxy statement as required by the rules of the Securities and Exchange Commission and recommending to the Board of Directors whether such Compensation Discussion and Analysis should be included in the annual proxy statement; and

annually reviewing the committee s performance of its responsibilities and duties and reviewing and reassessing the adequacy of the Compensation Committee Charter and recommending to the Board of Directors any necessary revisions/improvements to the Charter that the committee considers appropriate.

The committee may delegate its responsibilities to subcommittees of one or more directors. The committee meets at least two times a year to carry out its responsibilities. The chief executive officer is not permitted to be present during any deliberations or voting with respect to his or her compensation. The committee s processes and procedures for determining executive compensation are described below under Compensation Discussion and Analysis.

Audit Committee

The Audit Committee currently consists of Messrs. Johnston (Chairman), Harris, Pullins and Trier. Our Board of Directors has determined that Mr. Trier and Mr. Pullins are audit committee financial experts under the rules of the SEC. As more fully described in the Audit Committee Charter, which can be found on our website, www.usph.com, the committee is responsible for, among other things:

overseeing our financial reporting processes, including the quarterly reviews and annual audits of our financial statements by the independent auditors;

the appointment, compensation, retention and oversight of the work of the independent auditors;

pre-approving audit and permitted non-audit services, and related fees and terms of engagement, provided by the independent auditors; and

reviewing with management and independent auditors issues relating to disclosure controls and procedures and internal control over financial reporting.

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The Audit Committee Charter requires that the committee consist of at least three independent members of our Board. Each member of the Audit Committee is independent , as defined in the applicable NASDAQ Listing Standards and the rules of the SEC.

Codes of Conduct and Procedures Regarding Related Party Transactions

Codes of Conduct

Our Board has approved and we have adopted a Code of Business Conduct and Ethics for our officers and all employees, and an additional Code of Business Conduct and Ethics which is applicable to our directors. The Codes are available on our website at www.usph.com. Our Board, or a committee of its independent members, is responsible for reviewing and approving or rejecting any requested waivers to the Codes, as such waivers may apply to our directors and officers. Any waivers of these Codes for directors, officers and employees will be disclosed in a Form 8-K filed with the SEC, which will be available on the SEC s website at www.sec.gov. The Code applicable to directors requires each director to disclose to the Board any interest he or she may have in a potential transaction, arrangement or agreement to which the Company is or will be a party, and refrain from participating directly or indirectly in the transaction unless the Board approves such participation with all interested directors abstaining from the consideration and deliberation of, and any votes concerning, such matter.

Our Board has further approved and we have adopted an additional Code of Business Conduct and Ethics, applicable to our Chief Executive Officer, Chief Financial Officer and senior financial officers, relating to dealings with our auditors and the preparation of our financial statements and other disclosures made to the public under SEC rules and regulations. This Code is available on our website at www.usph.com. The Board, or a committee of its independent members, is responsible for reviewing and approving or rejecting any requested waivers from and amendments to this Code. Neither the Board, nor a committee of its independent members received any requests for waivers or amendments to the Code, and none were granted. Any waivers from and amendments to the Code will be disclosed in a Form 8-K filed with the SEC, which will be available on the SEC s website at www.sec.gov. The Code requires the officers to disclose directly to the Audit Committee any conflicts of interest, including any material transaction or relationship involving a potential conflict of interest.

Certain Relationships and Related Transactions

The charter of the Audit Committee requires that the Audit Committee review and approve all insider and affiliated party transactions. The Audit Committee did not consider any insider or affiliated party transaction in 2008. The Board is considering the adoption of a standalone Policy Statement regarding related party transactions.

Communications with the Board of Directors and Attendance at Annual Meeting.

The Board of Directors maintains an informal process for stockholders to communicate with the Board of Directors. Stockholders wishing to communicate with the Board of Directors should send any communication to Lawrance McAfee, our Assistant Secretary, at our principal executive offices, 1300 West Sam Houston Parkway South, Suite 300, Houston, Texas 77042. Any such communication must state the number of shares beneficially owned by the stockholder making the communication. The Assistant Secretary will forward such communication to the full Board of Directors or to any individual director or directors to whom the communication is directed unless the communication is unduly hostile, threatening, illegal or similarly inappropriate, in which case the Assistant Secretary has the authority to discard the communication or take appropriate legal action regarding the communication.

Although the Company does not have a formal policy requiring them to do so, all of the members of our Board of Directors are encouraged to attend our annual meeting of stockholders. At the 2008 annual meeting, all eleven directors were in attendance.

Compensation of Directors

For 2008, each of our non-employee directors received $7,500 per quarter (Retainer Fee) for serving as a member of our Board of Directors and are paid $500 for each committee meeting attended in person or

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telephonically (hereinafter referred to as Meeting Fees). Each of the Chairman of the Audit Committee and Compliance Committee is paid a $5,000 annual fee and the Chairman of the Board is paid a $20,000 annual chairman fee (hereinafter all referred to as Chairman Fees). Directors are also reimbursed for their out-of-pocket travel and related expenses incurred in attending Board and committee meetings. Directors who are also our employees or consultants are not compensated separately for serving on our Board. In addition, in May 2008, Mr. Arnold was granted 3,500 shares of restricted stock, each of the non-employee directors received 3,000 shares of restricted stock and Mr. Swanson received 3,000 shares of restricted stock.

Director Compensation Table

The following table discloses the cash, equity awards and other compensation earned, paid or awarded, as the case may be, to each of the Company s directors who are not Named Executive Officers during the fiscal year ended December 31, 2008.

Name	Fees Earned or Paid in Cash(1)	Stock Awards(2)	Option Awards	Non-Equity Incentive Plan Compensation	Change in Pension Value and Nonqualified Deferred Compensation Earnings	All Other Compensation	Total
Daniel C. Arnold	$ 52,000	$ 55,440	$	$	$	$	$ 107,440
Mark J. Brookner	$ 30,000	$ 49,121	$	$	$	$	$ 79,121
Bruce D. Broussard	$ 32,000	$ 49,121	$	$	$	$	$ 81,121
Dr. Bernard A. Harris, Jr.	$ 35,000	$ 49,121	$	$	$	$	$ 84,121
Marlin W. Johnston	$ 40,000	$ 49,121	$	$	$	$	$ 89,121
J. Livingston Kosberg	$ 30,000	$ 49,121	$	$	$	$	$ 79,121
Jerald L. Pullins	$ 34,500	$ 49,121	$	$	$	$	$ 83,621
Regg E. Swanson(3)	$	$ 37,913	$	$	$ 1,961	$ 203,846	$ 243,720
Clayton K. Trier	$ 35,500	$ 49,121	$	$	$	$	$ 84,621

(1) Includes Retainer Fees, Chairman Fees and Meeting Fees.

(2) The amount shown represents the compensation expense related to restricted stock awards included in the Company s financial statements for fiscal year 2008 per FAS 123 (R) adjusted to reflect actual rather that estimated forfeitures for awards with service- based conditions. Actual forfeitures were insignificant. Compensation expense for the grants of restricted stock awards is recognized based on the fair value per share on the date of grant. For the above directors, except for Mr. Swanson, includes 834 shares at a value of $13.44 per share. For the above directors, except for Mr. Arnold, includes 2,250 shares at a value of $16.85 per share. For Mr. Arnold, includes 2,500 shares at a value of $16.85 per shares. At December 31, 2008, each of the directors, except for Mr. Arnold, had stock awards with 750 shares of restricted stock in which the restriction lapses on March 31, 2009. At December 31, 2008, Mr. Arnold had 875 shares in which the restriction lapses on March 31, 2009. For further details on equity compensation expense, see footnote 10 of the Notes to Consolidated Financial

Statements contained in our Annual Report on Form 10-K for the year ended December 31, 2008. The non-employee directors have the following outstanding stock options at December 31, 2008. All stock options are fully vested and exerecisable.

Name	**Number of Shares**
Arnold	50,002
Brookner	25,000
Broussard	40,002
Harris	30,000
Johnston	37,500
Kosberg	30,000
Pullins	57,500
Trier	32,500

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(3) Other compensation represents salary received by Mr. Swanson in his role as Managing Director of STAR Physical Therapy, LP, a subsidiary of the Company. Mr. Swanson does not receive any additional compensation for being a director.

STOCK OWNERSHIP

Stock Owned by Directors, Nominees and Executive Officers

The following table shows the number and percentage of shares of our common stock beneficially owned by our directors, executive officers named in the Summary Compensation Table and all directors and executive officers as a group as of March 31, 2009. Each person has sole voting and investment power for the shares shown below unless otherwise indicated.

Name of Beneficial Owner	Number of Shares Owned(1)	Right to Acquire(2)	Percent of Common Stock
Directors:			
Daniel C. Arnold	130,002	50,002	1.1%
Chairman of the Board			
Christopher J. Reading	255,000(3)	220,000	2.1%
President, Chief Executive Officer and Director			
Lawrance W. McAfee	230,000(4)	195,000	1.9%
Executive Vice President, Chief Financial Officer and Director			
Mark J. Brookner	112,500(5)	25,000	*
Bruce D. Broussard	53,002	40,002	*
Dr. Bernard A. Harris, Jr.	35,500	30,000	*
Marlin W. Johnston	58,000	37,500	*
J. Livingston Kosberg	297,210(6)	30,000	2.5%
Jerald L. Pullins	68,000	57,500	*
Regg E. Swanson	146,942(7)		1.2%
Clayton K. Trier	39,500	32,500	*
Non-Director Executive Officers:			
Glenn D. McDowell	65,000(4)	40,000	*
Chief Operating Officer			
All directors and executive officers as a group (12 persons)	1,490,656	757,504	10.2%

* Less than 1%.

(1) Includes shares of our common stock subject to outstanding options that are currently exercisable or exercisable through May 30, 2009. None of the shares are pledged.

(2) Number of shares of our common stock (of the total beneficially owned) that can be acquired through stock options exercisable through May 30, 2009.

(3) Includes 27,500 restricted shares with a quarterly vesting schedule as to the lapse of restrictions thereof with 2,500 shares vesting quarterly with the next vesting date of June 30, 2009 and continuing through December 31, 2011.

(4) Includes 22,917 restricted shares with a quarterly vesting schedule as to the lapse of restrictions thereof with 2,083 shares vesting quarterly with the next vesting date of June 30, 2009 and continuing through September 30, 2011 with the final 2,087 shares vesting on December 31, 2011.

(5) Includes 30,500 shares of our common stock owned directly by Mr. Brookner and 57,000 shares of common stock held in various trusts of which Mr. Brookner is the trustee.

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(6) Includes 230,000 shares of our common stock held by the Livingston Kosberg Trust of which Mr. Kosberg is the trustee and income beneficiary. Also includes 18,700 shares of our common stock held directly by Mr. Kosberg, 15,000 shares of our common stock held in a trust of which Mr. Kosberg is the trustee and 3,510 shares of our common stock held by Mr. Kosberg s spouse for which Mr. Kosberg disclaims beneficial ownership.

(7) Includes 143,942 shares of our common stock held by the Regg E. Swanson Revocable Trust of which Mr. Swanson is the trustee and beneficiary. Also includes 3,000 shares of our common stock held directly by Mr. Swanson.

Stock Owned by Certain Beneficial Holders

The table below shows the ownership of our shares of common stock by persons known to us to beneficially own more than 5% of our common stock. Unless otherwise noted, the information is based on the most recent statements filed with the SEC on Schedule 13G, submitted to us by those persons.

Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership	Percent of Common Stock Outstanding
Royce & Associates, LLC 1414 Avenue of the Americas New York, NY 10019	1,564,475(1)	13.0%
Renaissance Technologies LLC 600 University Street, Suite 2500 Seattle, WA 98101	809,374(2)	6.7%
Bank of America Corporation 100 North Tryon Street, Floor 25 Charlotte, NC 28255	699,842(3)	5.8%

(1) Royce & Associates, LLC has sole voting and dispositive power over all of the shares as disclosed in a Schedule 13G filed on January 30, 2009. Various accounts managed by Royce & Associates, LLC have the right to receive or the power to direct the receipt of dividends from, or the proceeds from the sale of shares of the issuer. The interest of one account, Royce Pennsylvania Mutual Fund, an investment company registered under the Investment Company Act of 1940 and managed by Royce & Associates, LLC, amounted to 905,675 shares or 7.52% of the total shares outstanding.

(2) Pursant to a Schedule 13G filed on February 13, 2009, Renaissance Technologies LLC has sole voting power over 728,304 of the shares, sole dispositive power over 807,574 of the shares and shared dispositive power over 1,800 of the shares. The Schedule 13G was filed by Renaissance Technologies LLC and James H. Simon because of Mr. Simons position as a control person of Renaissance Technologies LLC.

(3) Bank of America has shared voting power over 566,238 of the shares and has shared dispositive power over all of the 699,842 shares. The 699,842 shares includes those held in separately managed account programs over which unaffiliated managers exercise investment discretion and voting power and over which, in certain instances, they

have shared investment discretion and voting power for purposes of reporting these shares on Schedule 13G dated February 13, 2009. Filing discloses multiple entities having different amounts of voting and disposition power.

EXECUTIVE OFFICERS

The current executive officers of the Company are as follows:

Name	**Position**
Christopher J. Reading	President and Chief Executive Officer
Lawrance W. McAfee	Executive Vice President and Chief Financial Officer
Glenn D. McDowell	Chief Operation Officer

For information concerning Messrs. Reading and McAfee see Election of Directors above.

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Glenn D. McDowell, 52, was promoted to Chief Operating Officer effective January 24, 2005. Mr. McDowell served as our Vice President of Operations overseeing the west region since joining us in October 2003 until January 2005. From 1996 to 2003, Mr. McDowell was employed by HealthSouth Corporation, a provider of outpatient surgery, diagnostic imaging and rehabilitative healthcare services. His most recent position with HealthSouth Corporation was Vice President of Operations West Ambulatory Division where he oversaw the operations of more than 165 outpatient rehabilitation and other facilities.

COMPENSATION DISCUSSION AND ANALYSIS

The Compensation Committee, composed entirely of independent directors, administers the Company s executive compensation program. The role of the committee includes establishing and overseeing compensation and benefit programs for our executive officers including the Chief Executive Officer (CEO) and the other executive officers listed in the Summary Compensation table (the Named Executives). The committee also evaluates the performance of the CEO and reviews the performance of our other executive officers every year. Based upon these performance evaluations, the committee establishes compensation for the CEO and other executive officers, and executive management consults with the committee with respect to compensation levels and plans for key employees. Elements of our executive compensation program include: base salary; annual cash incentive compensation; long-term equity incentive awards; post-employment benefits; and benefits and perquisites.

In establishing and overseeing the program, the committee s goal is to ensure that we can attract and retain superior management talent critical to our long-term success. To ensure that executive compensation is aligned with the performance of the Company and the interests of its stockholders, a significant portion of compensation available to executives is linked directly with financial results and other factors that influence stockholder value.

Compensation Support

Our management, our Human Resources department and our outside consultants, from time to time, support the committee in discharging its duties. In performing duties relating to the development and administration of our executive compensation program, our Human Resources department and the committee periodically review matters that relate to the competitive position, value and design of our short-term and long-term incentive compensation plans, performance goals and rewards available at various levels of performance.

Under its charter, the committee also may retain at the Company s expense, compensation consultants to provide independent advice and counsel directly to the committee. In 2008, no compensation consulting services were retained by the committee or by the Company.

Peer Group and Compensation Targets

During 2006, with the assistance of an external consulting firm, the committee selected a compensation peer group consisting of a number of publicly traded companies (the Peer Group). The committee reviewed the Peer Group compensation data to ensure competitiveness of the executive compensation program.

Compensation Philosophy and Objectives

Our compensation policies are designed to enable us to attract, motivate and retain experienced and qualified executives. We seek to provide competitive compensation. Historically, our policy has been to provide a significant component of an executive officer s compensation through the grant of stock options or restricted shares that vest over a number of years. We believe that grants of equity-based incentives to executives and key employees help to align the interests of these persons with the interests of our stockholders.

The committee s policy is to compensate and reward executive officers and other key employees based on the combination of some or all of the following factors, depending on the person s responsibilities: corporate performance, business unit performance and individual performance. The committee evaluates corporate performance and business unit performance by reviewing the extent to which the Company has accomplished strategic business objectives, such as improved profitability, cash flow and management of working capital. The committee evaluates individual performance by comparing actual accomplishments to the objectives established for the

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individual under the Company s management development program. The committee determines increases in base salary and annual cash incentive awards based on actual accomplishments during the performance period and determines long-term incentive awards based on LTIP (as defined below) criteria.

The committee believes that compensation to executive officers should be aligned closely with the Company s performance on both a short-term and long-term basis. As a result, a significant portion of compensation to each executive officer is at risk and tied directly to the attainment of financial performance goals. The executive compensation program is also designed to incentivize continuous improvements in financial performance by providing enhanced compensation as results improve. While a significant portion of compensation to the Company s executive officers is performance-based, the committee also believes it prudent to provide competitive base salaries and benefits in order to attract and retain the management talent necessary to achieve our long-term strategic objectives. The committee also takes into account the compensation practices of comparable companies to ensure that the Company is able to attract, retain and reward executive officers whose contributions are critical to our long-term success.

Base Salaries

Base salaries of executives are initially determined by evaluating the responsibilities of the position, the experience and knowledge of the individual and the competitive marketplace for executive talent. Base salaries for executive officers are reviewed annually by the committee based on, among other things, individual performance and responsibilities, inflation and competitive market conditions.

Annual Cash Incentive Compensation

Based on individual and Company performance, incentive compensation opportunities are available to a wide range of our employees. We believe that incentive compensation is effective in reinforcing both the overall values of our Company and our specific operating goals.

Incentive compensation programs are designed to focus employees attention on our key performance goals, to identify the expected levels of performance and to reward individuals who meet or exceed our expectations. The aggregate amounts available for incentive awards are determined by our overall financial performance. The actual awards paid to individual recipients, other than to executive officers, are formulated by management, generally payable on an annual basis and reviewed by the committee prior to payment. The committee formulates and determines incentive awards for Named Executives. See Summary Compensation Table below.

In May 2007, the committee approved the performance criteria that were used to determine executive officer cash bonus awards for the 2007 Fiscal Year (2007 Executive Officer Incentive Plan) for the Company s Chief Executive Officer, Chief Financial Officer and Chief Operating Officer (the Participants). Under the 2007 Executive Officer Incentive Plan, each Participant could earn up to 50% of the Participant s base salary depending on target levels of growth in net earnings from continuing operations over the 2006 Fiscal Year (Objective Portion of Bonus Calculation) and up to 50% of the Participant s base salary based on a subjective determination of the committee utilizing certain performance criteria including: stock price performance, same store growth, clinic productivity improvements, management development, operational performance relative to the external environment, accretive acquisitions, clinic development including number and quality of new partners recruited, sales and marketing, regulatory compliance, maintaining adequate internal controls, investor relations, quality of earnings, and cash flow including accounts receivable management. In 2008, the objective criteria was changed by the committee from net earnings from continuing operations to diluted earnings per share.

For the 2008 fiscal year, the Participants were eligible to earn up to 50% of their respective base salaries dependent upon the Company achieving diluted earnings per share in the range of $0.75 to $0.87. Based on actual reported

diluted earnings per share of $0.83 for 2008, which represented an improvement over 2007 of 10.7%, the Participants were entitled to 69.2% of the 50% tied to the objective criteria. The remaining portion of the Participants cash bonus award was based upon a subjective determination of the committee. The committee utilizes certain performance criteria as listed above but generally does not consider it practicable to, nor does it generally

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attempt to, quantify, rank or otherwise assign relative weights to the specific performance criteria it considers in reaching its decision. In considering these performance criteria, the individual members of the committee may have given different weights to different performance criteria. The performance criteria are not intended to be rigid or formulaic but rather serve as a framework under which the committee reviews the total compensation and performance of the Participants to determine what incentive amount is appropriate for any specific year. For 2008, Mssrs. Reading, McAfee and McDowell received $150,000, $144,000 and $86,000, respectively, for their subjective portion.

Long-term Equity Incentive Awards

Our 2003 Stock Incentive Plan and Amended and Restated 1999 Employee Stock Option Plan (1999 Plan) were approved by our Board and stockholders to align employee and outside director interests with stockholders interests, to provide incentives to our key employees by encouraging their ownership of our common stock and to aid us in attracting and retaining key employees, upon whose efforts our success and future growth depends.

Options and restricted shares are granted at the discretion of the committee, which administers the Company s equity compensation plans. The objective of such long-term equity-based awards, which generally vest over three to five years, is primarily to incentivize management and key employees for future performance rather than to reward specific past performance. Individual grant sizes are primarily determined based on the employee s duties and level of responsibility and his or her ability to exert significant influence and make meaningful contributions to the overall future success of the Company and, to a lesser degree, organizational and individual performance. At the discretion of the committee, and based on the recommendation of management, options may also be used as an incentive for candidates recruited to fill key positions and for existing employees who receive significant promotions with increased responsibilities.

During 2008, the committee granted a total of 52,500 restricted shares of common stock to 19 employees. In addition, in May 2008, 24,500 restricted shares of common stock were granted to eight non-employee directors and 3,000 to Mr. Swanson. During 2008, the committee also granted 80,000 restricted shares of common stock to the Named Executives in connection with renewal and extension of the employment agreements with such executives. See Grants of Plan-Based Awards for additional detail on the restricted stock granted to the Named Executives. There were no stock options granted in 2008.

Post-Employment Benefits

We have entered into employment and termination agreements with our Named Executives which provide for the payment of severance and other post-termination benefits depending on the nature of the termination, including, severance payments in the event of a termination following a change in control. The committee believes that the terms and conditions of these agreements are reasonable and assist us in retaining the executive talent needed to achieve our objectives. In particular, the termination agreements, in the event of a change in control, help executives focus their attention on the performance of their duties in the best interests of the stockholders without being concerned about the consequences to them of a change in control and help promote continuity of senior management. Information regarding the specific payments that are applicable to each termination event, as well as the effect on unvested equity awards, is provided under the heading Named Executive Officer Compensation Employment Agreements and Potential Benefits Upon Termination or Change-in-Control below.

Benefits and Perquisites

Defined Contribution Plan. The Company maintains a qualified retirement plan pursuant to Internal Revenue Code Section 401(k) (the 401(k) Plan) covering substantially all employees subject to certain minimum service

requirements. The 401(k) Plan allows employees to make voluntary contributions and provides for discretionary matching contributions by the Company. The assets of the 401(k) Plan are held in trust for grantees and are distributed upon the retirement, disability, death or other termination of employment of the grantee. The Board, in its discretion, determines the amount of any Company contributions. We did not make any contributions to the 401(k) Plan during 2008.

Life Insurance. The Company maintains, at its expense, for the benefit of each of its full-time employees, life insurance policies in the amount of one times the employee s annual salary, up to $200,000.

Health and Welfare Benefits. All executive officers, including the Named Executives, are eligible for welfare benefits from the Company including: medical, dental, vision, life insurance, short-term disability and long-term disability. Named Executives participate in these plans on the same basis and subject to the same costs, terms and conditions as other salaried employees at their assigned work location.

Employment and Consulting Agreements

In October 2004, each of Messrs. Reading and McAfee entered into new employment agreements effective as of November 1, 2004 that superseded their employment agreements that were effective in September 2003. These employment agreements have three-year terms with automatic one-year renewals if not terminated on at least 12 months notice, and established annual base compensation at $325,000. Additional compensation to each employee included non-qualified stock options to purchase 150,000 shares of the Company s common stock pursuant to the Company s 2003 Stock Option Plan. These options vest at the rate of 20% per year beginning on the anniversary date of the employment agreement. Both Messrs. Reading and McAfee are entitled to a special benefit payment equal to $500,000 (payable in equal amounts over the remaining term of the agreement) as defined by their respective employment agreements in the event of a change in control and Mr. Reading does not continue as the President and Chief Executive Officer of the Company after the change in control, or Mr. McAfee does not continue as the Executive Vice President and Chief Financial Officer of the Company after the change in control. In addition, if either executive is terminated without cause or resigns for good reason (as defined under their respective agreement), he is entitled to his base salary through the remaining term of the contract, an amount equal to his last year s bonus or the average over the last three years, whichever is greater, and accrued but unpaid vacation. The employment agreements also provide for certain non-competition and non-solicitation covenants that extend up to two years after termination of employment. These agreements were amended and restated in May 2007 and December 2008 to change the expiration dates to December 31, 2009 and December 31, 2011, respectively. No other material changes were made to the agreements. Effective January 4, 2009, the annual base salary under the agreements was increased to $382,500 for Mr. Reading and $367,200 for Mr. McAfee.

On May 24, 2007, Glenn D. McDowell entered into a new employment agreement (the McDowell Employment Agreement) which was subsequently amended on December 2, 2008, to change the expiration date from December 31, 2009 to December 31, 2011. Effective January 4, 2009, Mr. McDowell s annual base salary was increased to $230,000 per year.

The McDowell Employment Agreement may be terminated by the Company prior to the expiration of its term in the event Mr. McDowell s employment is terminated for cause (as defined in the McDowell Employment Agreement). If a change in control (as defined in the McDowell Employment Agreement) occurs and Mr. McDowell does not continue as our Chief Operating Officer after the change of control, Mr. McDowell will be entitled to a change of control benefit payment of $283,333 (payable in equal amounts over the remaining term of the agreement). If the employment of Mr. McDowell is terminated by the Company without cause or by Mr. McDowell for good reason, he would be entitled to receive the compensation then in effect for the remainder of the term of the agreement and the greater of: (i) the bonus paid or payable to Mr. McDowell with respect to the last fiscal year completed prior to the termination, or (ii) the average of the bonuses paid to Mr. McDowell over the last three fiscal years of employment ending with the last fiscal year prior to termination.

Messrs. Reading, McAfee and McDowell are eligible to receive annual cash bonuses and are entitled to participate in any employee benefit plans adopted by us. In December 2008 in connection with the renewal and extension of their employment agreements as discussed above, the Compensation Committee granted 30,000, 25,000, and 25,000, respectively, shares of restricted stock to Messrs. Reading, McAfee and McDowell.

Messrs. Reading, McAfee and McDowell s employment agreements may each be terminated by the Company prior to the expiration of their term in the event their respective employment is terminated for cause (as defined in each such agreement). See discussion below entitled Post Termination/Change-in- Control Benefits regarding Change in Control provisions.

We do not have any executive retention and severance arrangements or change in control agreements with our Named Executives other than those described above.

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Long-Term Incentive Plan 2007 -09

On June 20, 2007, the Compensation Committee approved and adopted the USPH Executive Long-Term Incentive Plan 2007-09 (LTIP) under which cash-based awards may be awarded to the Company s executive management including the chief executive officer, chief financial officer and chief operating officer, upon satisfaction of certain performance criteria established by the Compensation Committee. The LTIP is included as Exhibit 10.1 to the Company s current report on Form 8-K filed with the SEC on June 20, 2007. The discussions set forth below are qualified in their entirety by reference to such Exhibit 10.1.

Incentive and Reward for Stockholder Return Based upon Stock Price Appreciation Cash awards are paid to the chief executive officer (CEO), chief financial officer (CFO) and chief operating officer (COO) in accordance with the LTIP. A cash award will be paid to each of the CEO, CFO and COO in early 2010, if at all, for every 1% the weighted average trading price per share of our common stock for the second half of calendar year 2009 exceeds $15.63 (the Target Price). The Target Price represents 6% annual compound appreciation for three years over the $13.12 average trading price of the common stock for the second half of calendar year 2006. The cash awards will be equal to $18,000 for the CEO, $17,300 for the CFO and $9,600 for the COO, for each 1% increase in the trading price of the common stock over the Target Price. The per share price calculation will be adjusted for any cash or stock dividends, stock splits/combinations or recapitalizations.

In the case of Change in Control (as defined in the Company s 2003 Incentive Stock Plan) that occurs prior to January 1, 2010, the calculation of the LTIP cash award will be made as though the closing price for the next-to-last day of trading of our common stock prior to such Change in Control was the weighted average trading price per share for the second half of 2009, and the Target Price will be recalculated assuming 6% annual compound appreciation through the date of the Change in Control. The LTIP cash award would be payable at the time of the Change in Control and the LTIP will then cease to be in effect.

If any participating executive s employment with the Company is terminated for any reason (other than in connection with a Change in Control as discussed above) prior to January 1, 2010, such executive will not be eligible for any LTIP cash award based on the weighted average trading price performance criteria described above

Maximum cash awards under the LTIP depending on the weighted average trading price per share of common stock achieved for the second half of calendar year 2009 are $1,458,000 for the CEO, $1,401,300 for the CFO and $777,600 for the COO. This maximum cash award will only be achieved (absent a Change in Control) if the weighted average trading price per share of common stock for the second half of calendar year 2009 exceeds $26.24 which equals a 100% or more appreciation in the stock price as compared to the $13.12 average trading price of the common stock for the second half of calendar year 2006.

Incentive and Reward for Growth in Diluted Earnings per Share An additional objective under the LTIP is to grow the diluted earnings per share of the Company by more than 12.5% per annum during each of the years 2007, 2008 and 2009. No amounts were accrued or paid under the LTIP relating to the years ended 2007 and 2008.

The CEO, CFO and COO each have the opportunity to earn cash awards for achieving the objective during each year of the LTIP. The maximum amount of cash incentive that can be earned over the three year measurement period of the LTIP is as stated below:

CEO	$ 750,000
CFO	$ 720,000
COO	$ 375,000

Using diluted earnings per share of the Company from continuing operations of $0.70 for 2006 as a baseline, if the comparable diluted earnings per share of the Company for 2007 is greater than $0.70 by 12.5% ($.7875) or more, each of the CEO, CFO and COO will be entitled to a cash award under the LTIP (Performance Award) equal to one-sixth (16.67%) of the executive s total maximum incentive. In addition, one-sixth (16.67%) of the executive s total maximum incentive will be placed in the Deferred Performance Awards category. The diluted earnings per share of the Company for 2007 then becomes the base for the 2008 calculation, and so on. Upon achievement of the 12.5% target percentage in any given year during the three-year period, each executive will be entitled to Performance Award equal to one-sixth (16.67%) of the executive s total maximum incentive and another

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one-sixth (16.67%) of the executive s total maximum incentive will be placed in the Deferred Performance Awards category. Performance Awards will vest on January 1 following the fiscal year for which they are awarded and will be paid in cash within 30 days after the diluted earnings per share of the Company is determined for 2007, 2008 and 2009, as applicable. All Deferred Performance Awards will be vested on January 1, 2010 and will be paid in cash within 30 days after the diluted earnings per share of the Company is determined for fiscal year 2009.

In any year that growth in diluted earnings per share of the Company is less than 12.5% from the prior year base, no Performance Awards will be earned by the executives. However, to the extent that growth in diluted earnings per share of the Company during the 3-year period of the LTIP is 42% or greater, all the Performance Awards and Deferred Performance Awards available during such 3-year period shall be considered to have been earned.

In computing achievement of the performance criteria, if for any year during the testing period the diluted earnings per share is less than the prior year, the base for the following year will not be adjusted. Diluted earnings per share will be based on the Company s annual audited financial statements subject to applicable accounting being applied from year to year, and thus, the calculation may be adjusted consistent with changes in accounting rules or policies. In addition, the committee may elect to exclude extraordinary, unusual or non-recurring items of gain or loss in a particular year from reported diluted earnings per share for that year for purposes of the calculations above.

Compensation of Chief Executive Officer

Mr. Reading joined our Company in November 2003 as Chief Operating Officer and, effective November 1, 2004, was promoted to President and Chief Executive Officer. Under his employment agreement with us (see Employment and Consulting Agreements above), Mr. Reading s annual base salary was increased by the Compensation Committee to $341,250 effective February 27, 2006, to $355,000 effective January 7, 2007, to $375,000 effective January 7, 2008 and to $382,500 effective January 4, 2009. Mr. Reading received a bonus of $75,000 for 2006, which was paid in March 2007 and a bonus of $177,500 for 2007 which was paid in March 2008. For 2008, Mr. Reading earned a bonus of 279,750 which was paid in March 2009. Although Mr. Reading participated in our 401(k) Plan in 2008, we did not make any matching contributions to the plan during the year. Effective beginning in 2007, Mr. Reading participates in the LTIP under which he is eligible for cash awards based on Company performance through 2009, as previously described. In addition to cash compensation, under our 2003 Stock Incentive Plan, during 2008, Mr. Reading was granted 30,000 shares of restricted stock which restrictions lapse in equal quarterly installments of 2,500 shares beginning March 31, 2009 and continuing through December 31, 2011. No stock options were granted to Mr. Reading in 2008, 2007 and 2006.

In determining the appropriate compensation for Mr. Reading, the Compensation Committee evaluates our overall performance under Mr. Reading s leadership, as well as his individual contributions to key strategic, financial and development objectives. The committee utilized a combination of quantitative measures and qualitative factors in reviewing his performance and compensation. In 2006, the committee used the services of a third party consulting firm to review the compensation packages of the Named Executives, including Mr. Reading, and to compare their present level of compensation to comparably-sized publicly traded companies and to other comparably-sized healthcare companies. The committee has not felt the need to engage a third party consulting firm since this time.

Compensation Deductibility Policy

Under Section 162(m) of the Internal Revenue Code of 1986 (the Code) and applicable Treasury regulations, no deduction is allowed for annual compensation in excess of $1 million paid by a publicly traded corporation to its chief executive officer and the four other most highly compensated officers. Under those provisions, however, there is no limitation on the deductibility of qualified performance-based compensation.

In general, our policy is to maximize the extent of tax deductibility of executive compensation under the provisions of Section 162(m) so long as doing so is compatible with the most appropriate methods and approaches for the design and delivery of compensation to our executive officers.

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Executive Compensation

Summary Compensation

The following table sets forth the compensation paid or accrued for services rendered in all capacities on behalf of our Company during 2006, 2007 and 2008 to Messrs. Reading, McAfee and McDowell (Named Executives).

Summary Compensation Table
For the Fiscal Years Ended December 31, 2008, 2007 and 2006

Name and Principal Position	Year	Salary ($)	Bonus(1) ($)	Stock Awards(2) ($)	Option Awards(3) ($)	Non-Equity Incentive Plan Compensation(4) ($)	Change in Pension Value and Non-Qualified Deferred Compensation Earnings ($)	All Other Compensation(5) ($)	Total ($)
Christopher J. Reading	2008	374,231		6,819	333,658	279,750		810	995,268
Chief Executive	2007	354,471			344,664	177,500		540	877,175
Officer	2006	338,750	75,000		344,809			443	759,002
Lawrance W. McAfee	2008	359,423		5,681	333,658	268,560		1,242	968,564
Chief Financial	2007	344,856			344,664	172,500		1,242	863,262
Officer	2006	338,750	75,000		344,809			1,038	759,597
Glenn D. McDowell	2008	214,249		5,681	74,343	160,390		1,028	455,691
Chief Operating	2007	195,310			75,426	100,000		938	371,674
Officer	2006	190,337	35,000		75,406			426	301,169

1. The amounts shown represent annual incentive bonuses earned by the Named Executives for fiscal year 2006 which was paid in March 2007. See Compensation Discussion and Analysis Annual Incentive Compensation for further details. The Named Executive s annual bonus for 2005, which was paid in 2006, is not reported in this table as it related to the Named Executive s performance during 2005 and has been previously disclosed.

2. The amounts shown represents the compensation expense related to restricted stock awards included in the Company s financial statements for fiscal year 2008 per FAS 123 (R) adjusted to reflect actual rather than estimated forfeitures for awards with service-based conditions. There were no forfeitures. Compensation expense for the grants of restricted stock awards is recognized based on the fair value of $10.91 per share on the date of grant. See the Company s Annual Report for the year ended December 31, 2008 for a description of the FAS 123(R) valuations and a description of the equity plans. There were no grants of restricted stock to the Named Executives in 2007 and 2006. For further details on equity compensation expense, see footnote 10 of the Notes To Consolidated Financial Statements contained in our Annual Report on Form 10-K for the year ended December 31, 2008.

3. The amounts shown represent the compensation expense related to option awards included in the Company s financial statements for fiscal years 2008, 2007 and 2006 per FAS 123(R) adjusted to reflect actual rather than estimated forfeitures for awards with service-based vesting conditions. Actual forfeitures were insignificant. The awards consist of stock options granted to the Named Executives under the 2003 Stock Incentive Plan and inducement options. See the Company s Annual Report for the year ended December 31, 2008 for a description of the FAS 123(R) valuations and a description of the 2003 Stock Incentive Plan and inducement options. The compensation expense for the option awards includes the values for awards granted in prior fiscal years. There were no grants of stock options to the Named Executives in 2008, 2007 and 2006. For further details on equity compensation expense, see footnote 10 of the Notes to Consolidated Financial Statements contained in our Annual Report on Form 10-K for the year ended December 31, 2008.

4. The amounts shown represent annual incentive bonuses earned by the Named Executives for fiscal years 2008 and 2007 which were paid in March 2009 and March 2008, respectively. See Compensation Discussion and Analysis Annual Cash Incentive Compensation for further details.

5. Represents the value of life insurance premiums for life insurance coverage provided to the Named Executives.

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Grants of Plan-Based Awards

The following table sets forth the grants of plan-based awards during 2008 to Messrs. Reading, McAfee and McDowell (Named Executives).

Grant of Plan-Based Awards
For Fiscal Year Ended December 31, 2008

Name	Grant Date	Estimated Possible Payouts Under Non-Equity Incentive Plan Awards(1): Threshold ($)	Target ($)	Maximum ($)	All Other Stock Awards: Number of Shares of Stock or Units (#)	Grant Date Fair Value of Stock and Option Awards ($)
Christopher J. Reading	12/1/2008				30,000(2)	327,300
	4/28/2008	$	$ 375,000	$ 375,000		
Lawrance W. McAfee	12/1/2008				25,000(3)	272,750
	4/28/2008	$	$ 360,000	$ 360,000		
Glenn D. McDowell	12/1/2008				25,000(3)	272,750
	4/28/2008	$	$ 215,000	$ 215,000		

1. Possible payments under the Executive Officer Incentive Plan for 2008. See Summary Compensation Table for actual amounts earned for 2008 which were paid in March 2009.

2. Grant of restricted stock under the 1999 Plan, with a three year quarterly vesting schedule as to the lapse of restrictions thereof with 1/12 equal portions (2,500 shares) vesting quarterly, with the first 1/12 vested on March 31, 2009 and thereafter equal 1/12 portions on June 30, September 30 and December 31 each year until all such shares shall have vested on December 31, 2011.

3. Grant of restricted stock under the 1999 Plan with a three year quarterly vesting schedule as to the lapse of restrictions thereof with 1/12 equal portions (2,083 shares with the final portion being 2,087) vesting quarterly, with the first 1/12 vested on March 31, 2009 and thereafter equal 1/12 portions on June 30, September 30 and December 31 each year until all such shares shall have vested on December 31, 2011.

Narrative Disclosure to Summary Compensation Table and Grants of Plan-Based Awards Table

See Employment and Consulting Agreements above and Post-Termination/Change-in-Control Benefits below for the material terms of our employment agreement with our Named Executives. See Compensation Discussion and Analysis above for an explanation of the amount of salary and bonus in proportion to total compensation. See the footnotes to the Summary Compensation Table and Grants of Plan-Based Awards Table for narrative disclosure with respect to those tables.

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Outstanding Equity Awards at Fiscal Year-End

The following table shows outstanding stock option awards classified as exercisable and unexercisable and stock awards that have not vested as of December 31, 2008 for each Named Executive.

Outstanding Equity Awards at Fiscal Year-End December 31, 2008

	Option Awards					Stock Awards			
Name	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options (#)	Option Exercise Price ($)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested ($)(1)	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#)	Equity Incentive Plan Awards Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested ($)
Christopher J. Reading	50,000			$ 14.32	11/18/2013	30,000(2)	$ 399,900		$
	50,000			$ 12.51	6/2/2014				
	120,000	30,000(3)		$ 13.54	10/5/2014				
Lawrance W. McAfee	40,000			$ 14.32	11/18/2013	25,000(4)	$ 333,250		$
	35,000			$ 12.51	6/2/2014				
	120,000	30,000(3)		$ 13.54	10/5/2014				
Glenn D. McDowell	4,000			$ 14.32	11/18/2013	25,000(4)	$ 333,250		$
	36,000	9,000(3)		$ 13.97	2/23/2015				

1. Calculated based on the closing market price of our common stock on December 31, 2008 at $13.33 per share.

2. The restricted shares have a three year quarterly vesting schedule as to the lapse of restrictions thereof with 1/12 equal portions (2,500 shares) vesting quarterly, with the first 1/12 vested on March 31, 2009 and thereafter equal 1/12 portions on June 30, September 30 and December 31 each year until all such shares shall have vested on

December 31, 2011.

3. For Mssrs. Reading and McAfee the 30,000 shares vest on November 1, 2009. For Mr. Dowell, the 9,000 shares vest February 23, 2010.

4. The restricted shares have a three year quarterly vesting schedule as to the lapse of restrictions thereof with 1/12 equal portions (2,083 shares with the final portion being 2,087 shares) vesting quarterly, with the first 1/12 vested on March 31, 2009 and thereafter equal 1/12 portions on June 30, September 30 and December 31 each year until all such shares shall have vested on December 31, 2011.

Option Exercises and Stock Vested Table

No stock options were exercised by and no stock awards vested for the Named Executives during the year ended December 31, 2008.

Post Termination/Change-in-Control Benefits

Messrs. Reading, McAfee and McDowell s employment agreements may be terminated by us prior to the expiration of its term in the event their respective employment is terminated for cause (as defined in each agreement). If a change in control (as defined in each agreement) occurs and Mr. Reading does not continue as the President and Chief Executive Officer of the Company after the change of control, or Mr. McAfee does not continue as Executive Vice President and Chief Financial Officer of the Company after the change of control, each of Messrs. Reading and McAfee, as applicable, will be entitled to a change of control benefit of $500,000 (payable in equal amounts over the remaining term of the agreement). If the employment of Mr. Reading or Mr. McAfee is terminated by us without cause or by the executive for good reason, he would be entitled to receive the compensation then in effect for the remainder of the term of the agreement and the greater of: (i) the bonus paid or payable to Mr. Reading or Mr. McAfee, as applicable, with respect to the last fiscal year completed prior to the termination, or (ii) the average of the bonuses paid to Mr. Reading or Mr. McAfee, as applicable, over the last three fiscal years of employment ending with the last fiscal year prior to termination. If a change in control (as defined in the McDowell Employment Agreement) occurs and Mr. McDowell does not continue as our Chief Operating

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Officer after the change of control, Mr. McDowell will be entitled to a change of control benefit of $283,333 (payable in equal amounts over the remaining term of the agreement). If the employment of Mr. McDowell is terminated by the Company without cause or by Mr. McDowell for good reason, he would be entitled to receive the compensation then in effect for the remainder of the term of the McDowell Employment Agreement and the greater of: (i) the bonus paid or payable to Mr. McDowell with respect to the last fiscal year completed prior to the termination, or (ii) the average of the bonuses paid to Mr. McDowell over the last three fiscal years of employment ending with the last fiscal year prior to termination.

The amount of compensation payable to each Named Executive under the agreements is detailed in the tables below:

Christopher Reading Chief Executive Officer

Executive Benefits and Payments Upon Termination(1)	Voluntary Termination or For Cause	Without Cause	Executive Resigns For Good Reason	Change In Control
Compensation				
Severance(2)	$	$ 1,147,500	$ 1,147,500	$ 382,500
Annual Cash Incentive(3)		279,750	279,750	279,750
Change of Control Benefit(4)				500,000
Restricted Stock (Unvested and (Accelerated)(5)		399,900	399,900	399,900
Benefits and Perquisities				
Health and Dental Coverage(6)		28,080	28,080	9,360
Total	$	$ 1,855,230	$ 1,855,230	$ 1,571,510

Lawrance McAfee Chief Financial Officer

Executive Benefits and Payments Upon Termination(1)	Voluntary Termination or For Cause	Without Cause	Executive Resigns For Good Reason	Change In Control
Compensation				
Severance(2)	$	$ 1,101,600	$ 1,101,600	$ 367,200
Annual Cash Incentive(3)		268,560	268,560	268,560
Change of Control Benefit(4)				500,000
Restricted Stock (Unvested and (Accelerated)(5)		333,250	333,250	333,250
Benefits and Perquisities				
Health and Dental Coverage(6)		28,080	28,080	9,360
Total	$	$ 1,731,490	$ 1,731,490	$ 1,478,370

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Glenn McDowell Chief Operating Officer

Executive Benefits and Payments Upon Termination(1)	Voluntary Termination or For Cause	Without Cause	Executive Resigns For Good Reason	Change In Control
Compensation				
Severance(2)	$	$ 690,000	$ 690,000	$ 230,000
Annual Cash Incentive(3)		160,390	160,390	160,390
Change of Control Benefit(4)				283,333
Restricted Stock (Unvested and (Accelerated)(5)		333,250	333,250	333,250
Benefits and Perquisities				
Health and Dental Coverage(6)		28,080	28,080	9,360
Total	$	$ 1,211,720	$ 1,211,720	$ 1,016,333

1. For purposes of this analysis, we assumed the effective date of termination is December 31, 2008, the price per share of our common stock on the date of termination is $13.33 and that the executive s base salary is as follows: Mr. Reading $382,500; Mr. McAfee $367,200; and Mr. McDowell $230,000.

2. Under Without Cause and Executive Resigns for Good Reason , severance is calculated as base salary over the remaining term of the employment agreement which expires December 31, 2011.

3. Annual cash incentive is based on the greater of (i) the bonus paid or payable to the executive with respect to last fiscal year of the Company completed prior to termination or (ii) the average of the bonuses paid to the executive over the three fiscal years of the Company ending with the last fiscal year completed prior to the termination.

4. Based on amounts stipulated in the respective employment agreements.

5. Pursuant to the Restricted Stock Agreement for each executive, all restrictions and conditions on shares of restricted stock will be deemed satisfied and shares will be fully vested.

6. Calculated for the remaining term of the agreement which expires on December 31, 2011. In the event of a Change in Control , the remaining term of the agreements is one year from such event.

COMPENSATION COMMITTEE REPORT

The Compensation Committee was composed of three independent directors during 2008. It acts under a written charter adopted by the Board. The primary function of the Compensation Committee is to recommend to the Board the compensation to be paid to our directors, determine the compensation for our executive officers and administer incentive stock plans. The committee has reviewed and discussed with management the Compensation Discussion and Analysis set forth herein. Based on its review, the related discussions and such other matters deemed relevant and appropriate by the committee, the committee has recommended to the Board that the Compensation Discussion and Analysis be included in the Company s Proxy Statement relating to the 2009 Annual Meeting of Stockholders.

Respectfully submitted,

The Compensation Committee
Daniel C. Arnold, Chairman
Bruce D. Broussard
Clayton K. Trier

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Compensation Committee Interlocks and Insider Participation

The members of the Compensation Committee during 2008 were Messrs. Arnold (Chairman), Broussard and Trier. Mr. Kosberg was appointed to the Compensation Committee in March 2009. None of the members of the Compensation Committee has been an officer or employee of the Company or any of its subsidiaries and none of our executive officers has served on the board of directors or compensation committee of any other entity that has or has had an executive officer who served as a member of our board of directors or Compensation Committee during 2008.

Securities Authorized for Issuance Under Equity Compensation Plans

The following table provides information about our common stock that may be issued upon the exercise of options and rights under all of our existing equity compensation plans as of December 31, 2008:

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options and Rights	Weighted Average Exercise Price of Outstanding Options and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans Excluding Securities Reflected in 1st Column
Equity Compensation Plans Approved by Stockholders(1)	766,309	$ 14.17	343,224
Equity Compensation Plans Not Approved by Stockholders(2)	126,000	$ 13.95	
Total	892,309	$ 14.14	343,224

1. The 1992 Stock Option Plan, as amended (the 1992 Plan), expired in 2002, and no new option grants can be awarded subsequent to this date. The 2003 Stock Incentive Plan (the 2003 Plan) permits us to grant stock-based compensation to employees, consultants and outside directors of the Company. The Amended and Restated 1999 Employee Stock Option Plan (the Amended 1999 Plan) permits us to grant stock-based compensation to employees and non-employee directors. The Amended 1999 Plan was approved by our stockholders at our annual meeting of stockholders held on May 20, 2008.

2. Inducement options were granted to certain individuals in connection with their offers of employment or initial affiliation with us. Each inducement option was made pursuant to an option grant agreement.

For further descriptions of the 1992 Plan, Amended 1999 Plan, 2003 Plan and the inducement options, see Equity Based Plans in Note 10 of the Notes to the Consolidated Financial Statements in Item 8 of our Annual Report on Form 10-K for the year ended December 31, 2008.

Certain Relationships and Related Transactions

The charter of the Audit Committee requires that the Audit Committee review and approve all insider and affiliated party transactions. The Audit Committee did not consider any insider or affiliated party transaction in 2008. The Board is considering the adoption of a stand alone policy statement regarding related party transactions.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934 requires our directors and executive officers, and persons who own more than 10% of our equity securities to file with the SEC initial reports of ownership and reports of changes in ownership of our common stock. Officers, directors and greater than 10% stockholders are required by SEC regulation to furnish us with copies of all Section 16(a) reports they file.

To our knowledge, based solely on a review of the copies of those forms furnished to the Company and written representations from the executive officers and directors, we believe that during 2008 all Section 16(a) filing requirements applicable to our directors and officers were complied with on a timely basis.

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ITEM 2 ***RATIFICATION OF THE APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM***

Our Audit Committee has appointed and recommends the ratification of the appointment of Grant Thornton LLP as our independent registered public accounting firm to conduct the audit of our financial statements for the year ending December 31, 2009 and to render other services as required and approved by the committee. Grant Thornton LLP has acted as our independent registered public accounting firm since August 27, 2004. Representatives of Grant Thornton LLP are expected to attend our Annual Meeting, are expected to be available to respond to questions by stockholders and will have an opportunity to make a statement if they desire to do so, although it is not expected that a statement will be made.

If the stockholders fail to ratify the appointment of Grant Thornton LLP, the committee will consider whether or not to retain that firm since shareholder ratification of the appointment is not required and the committee has the responsibility for appointment of our independent registered public accounting firm. Even if the stockholders ratify the appointment, the committee, in its discretion, may direct the appointment of a different independent firm at any time during the year if it determines that such a change would be in the best interests of the Company and our stockholders.

Properly executed but unmarked proxies will be voted FOR approval of the ratification of the appointment of Grant Thornton LLP as our independent registered public accounting firm for the year ending December 31, 2009. The Board of Directors believes that ratifying the appointment of Grant Thornton LLP is in the best interest of the Company. The approval of the ratification of Grant Thornton LLP will require the affirmative vote of holders of a majority of votes cast on this matter in person or by proxy. Accordingly, abstentions applicable to shares present at the meeting will not be included in the tabulation of votes cast on this matter.

THE BOARD OF DIRECTORS RECOMMENDS THAT THE STOCKHOLDERS VOTE FOR THE RATIFICATION OF THE APPOINTMENT OF GRANT THORNTON LLP AS OUR INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FOR THE YEAR ENDING DECEMBER 31, 2009

INDEPENDENT PUBLIC ACCOUNTANTS

Grant Thornton LLP has acted as our independent registered public accounting firm since August 27, 2004.

Audit and Non-Audit Fees

The following table sets forth the fees billed for services performed by Grant Thornton LLP for fiscal year 2008 and 2007:

	2008	2007
Audit Fees	$ 440,725	$ 446,000
Audit-Related Fees		
Tax Fees		
All Other Fees		

$ 440,725	$ 446,000

Audit fees include fees for professional services rendered in connection with the audit of our financial statements and internal controls over financial reporting for the fiscal year as well as reviews of our financial statements included in our quarterly reports on Form 10-Q.

The Audit Committee is authorized to delegate to one or more of its members the authority to pre-approve any defined audit and permitted non-audit services provided by the independent auditors, and related fees and other terms of engagement on these matters, provided that each pre-approval decision is presented to the full Audit Committee at its next scheduled meeting. In 2008 and 2007, 100% of the audit-related services were pre-approved

pursuant to these pre-approval procedures. Grant Thornton LLP has not provided any tax or other non-audit services to the Company.

Report of the Audit Committee

The following Audit Committee Report is provided in accordance with the rules and regulations of the SEC. Pursuant to such rules and regulations, this report does not constitute soliciting materials and should not be deemed filed with or incorporated by reference into any other Company filings with the SEC under the Securities Act of 1933 or the Securities Exchange Act of 1934 or subject to the liabilities of Section 18 of the Exchange Act, except to the extent the Company specifically incorporates such information by reference.

The Board of Directors has appointed an Audit Committee consisting of Messrs. Johnston (Chairman), Pullins and Trier, and Dr. Harris, all of whom are financially literate and independent (as that term is defined by applicable NASDAQ Listing Standards and SEC Rule 10A-3(b)). The Board of Directors has determined Mr. Trier and Mr. Pullins to be the audit committee financial experts under the rules of the SEC.

Under the Sarbanes-Oxley Act, the Audit Committee is directly responsible for the selection, appointment, retention, compensation and oversight of the Company s independent auditors, including the pre-approval of both audit and non-audit services (including fees and other terms), and the resolution of disagreements between management and the auditors regarding financial reporting, accounting, internal controls, auditing or other matters.

In carrying out its responsibilities, the committee: (i) makes such inquiries and reviews as are necessary to monitor the Company s financial reporting, its external audits and its processes for compliance with laws and regulations, (ii) monitors the adequacy and effectiveness of the accounting and financial controls of the Company and elicits recommendations for the improvement of internal control processes and systems, (iii) reviews the planning, scope and results of the annual audit of the Company s financial statements conducted by the Company s independent auditors, (iv) reviews the scope and approves in advance any other services to be provided by the Company s independent auditors, and (v) provides to the Board of Directors the results of its reviews and any recommendations derived therefrom, including such additional information and materials as it may deem necessary to make the Board aware of significant financial matters that may require Board attention.

The audit committee has a sub-committee which provides general oversight of our Company s compliance with legal and regulatory requirements regarding healthcare operations (Compliance Committee). The Compliance Committee also monitors the Company s telephone hotline by which it can directly receive, on an anonymous and confidential basis, complaints regarding any subject, including accounting, internal accounting controls, questionable accounting, auditing or other matters that the Company s employees, and non-employees, may have. Members of the Compliance Committee are Messrs. Johnston (Chairman) and Pullins, and Dr. Harris.

The Audit Committee is authorized to engage independent counsel and other advisors it determines necessary to carry out its duties. The committee did not deem it necessary to engage independent counsel for any matters during 2008.

Management has the primary responsibility for the financial statements and the reporting process, including the systems of internal controls, and for the preparation of financial statements in accordance with accounting principles generally accepted in the United States of America. The Company s independent auditors are responsible for auditing the financial statements and expressing an opinion on the conformity of those audited financials statements with accounting principles generally accepted in the United States of America. The Audit Committee monitors and reviews these processes, and reviews the Company s periodic reports and quarterly earning releases before they are filed with the SEC, but is not responsible for the preparation of the Company s financial statements and reports.

In fulfilling its oversight responsibilities, the Audit Committee reviewed and discussed the audited financial statements included in the Company s Annual Report on Form 10-K with management, including a discussion of the quality, not just the acceptability, of the accounting principles, the reasonableness of significant judgments, and the clarity of disclosures in the financial statements. The committee also met with the Company s Chief Executive Officer and Chief Financial Officer to discuss their review of the Company s disclosure controls and procedures and internal accounting and financial controls in connection with the filing of the Annual Report on Form 10-K and

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other periodic reports with the SEC. However, members of the committee are not employees of the Company and have relied, without independent verification, on management s representation that the financial statements have been prepared with integrity and objectivity and in conformity with accounting principles generally accepted in the United States of America and on the representations of the independent auditors included in their report on the Company s financial statements.

Prior to commencement of audit work, the committee reviewed and discussed with representatives of Grant Thornton LLP, the Company s independent auditors for fiscal 2008, the overall scope and plans for their audit of the Company s financial statements for fiscal 2008. The committee also reviewed and discussed with Grant Thornton LLP, who are responsible for expressing an opinion on the conformity of those audited financial statements with accounting principles generally accepted in the United States of America, their judgments as to the quality, not just the acceptability, of the Company s financial statements, any changes in accounting policies, sensitive accounting estimates, accounting principles and such other matters as are required to be discussed with the committee under auditing standards generally accepted in the United States of America, including the matters required to be discussed by Auditing Standards No. 61, as amended, (AICPA, Professional Standards, Vol. 1. AU Section 380) as adopted by the Public Company Accounting Oversight Board in Rule 3200T. The committee met with Grant Thornton LLP, with and without Company management present, to discuss whether any significant matters regarding internal controls over financial reporting had come to the auditors attention during the conduct of the audit, and the overall quality of the Company s financial reporting.

The committee has received the written disclosures and the letter from Grant Thornton LLP required by applicable requirements of the Public Company Accounting Oversight Board regarding the independent auditors communications with the committee concerning independence and the committee has discussed with Grant Thornton LLP their independence. The committee considered, among other things, whether the services Grant Thornton LLP provided to the Company were compatible with maintaining Grant Thornton LLP s independence. The committee also considered the amount of fees Grant Thornton LLP received for audit and non-audit services.

Based on the reviews and discussions referred to above, the committee recommended to the Board of Directors that the audited financial statements be included in the Annual Report on Form 10-K for the year ended December 31, 2008 for filing with the SEC.

The committee is governed by a written charter, adopted by the Board of Directors of the Company, which is included on our website at www.usph.com.

Respectfully submitted,

The Audit Committee
Marlin W. Johnston, Chairman
Dr. Bernard A. Harris
Jerald L. Pullins
Clayton K. Trier

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DEADLINE FOR SUBMISSION OF STOCKHOLDER PROPOSALS TO BE PRESENTED AT THE 2010 ANNUAL MEETING OF STOCKHOLDERS

Any proposal intended to be presented by any stockholder for action at the 2010 annual meeting of Stockholders (2010 Annual Meeting) must be received by us on or before December 15, 2009 in order for the proposal to be considered for inclusion in the proxy statement and form of proxy relating to the 2010 Annual Meeting. If the date of next year s 2010 Annual Meeting is changed by more than 30 days from May 19, 2010, the deadline will be a reasonable time before we print and mail our proxy materials. However, we are not required to include in our proxy statement and form of proxy for the 2010 Annual Meeting any stockholder proposal that does not meet all of the requirements for inclusion established by the SEC in effect at the time the proposal is received. In order for any stockholder proposal that is not included in such proxy statement and form of proxy to be brought before the 2010 Annual Meeting, such proposal must be received by the Corporate Secretary of U.S. Physical Therapy, Inc. at its principal executive offices at 1300 West Sam Houston Parkway South, Suite 300, Houston, Texas 77042 by February 28, 2010. If a timely proposal is received, the Board may exercise any discretionary authority granted by the proxies to be solicited on behalf of the Board in connection with the 2009 Annual Meeting of stockholders.

OTHER MATTERS

As of the date of this Proxy Statement, our Board of Directors does not know of any other matters to be presented for action by stockholders at the 2009 Annual Meeting. If, however, any other matters not now known are properly brought before the meeting, the persons named in the accompanying proxy will vote the proxy as directed by a majority of the Board of Directors.

By Order of the Board of Directors,

Lawrance McAfee
Assistant Secretary

Houston, Texas
April 14, 2009

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. FOLD AND DETACH HERE AND READ THE REVERSE SIDE . FOR all nominees listed (except WITHHOLD as marked to AUTHORITY the contrary to vote for all below) nominees listed. 1. ELECTION OF DIRECTORS Election of eleven directors to serve until the next annual meeting of stockholders. Nominees: Daniel C. Arnold, Christopher J. Reading, Lawrance W. McAfee, Mark J. Brookner, Bruce D. Broussard, Bernard A. Harris, Jr., Marlin W. Johnston, J. Livingston Kosberg, Jerald L. Pullins, Regg E. Swanson and Clayton K. Trier. WITHHOLD AUTHORITY TO VOTE FOR ANY INDIVIDUAL NOMINEES (Print Name in Space Provided.) 2. Approval of the Amended and Restated 1999 Employee Stock Option Plan. Please mark your votes like this X FOR AGAINST ABSTAIN FOR AGAINST ABSTAIN 3. Ratification of the appointment of Grant Thornton LLP as our independent registered public accounting firm for 2008. 4. As determined by a majority of our Board of Directors, the proxies are authorized to vote upon other business as may properly come before the meeting or any adjournments. COMPANY ID: PROXY NUMBER: ACCOUNT NUMBER: Signature ___Signature ___Date___ Please date and sign exactly as name appears hereon and return in the enclosed envelope. Signature of Stockholder or Authorized Representative (Only one signature is required in the case of stock ownership in the name of two or more persons.)

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. FOLD AND DETACH HERE AND READ THE REVERSE SIDE . PROXY PROXY U.S. PHYSICAL THERAPY, INC. PROXY FOR ANNUAL MEETING OF STOCKHOLDERS MAY 20, 2008 THE PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS I, the undersigned stockholder of U.S. Physical Therapy, Inc. (the Company), hereby appoint Christopher J. Reading and Lawrance W. McAfee, and each of them, with full power of substitution, as my true and lawful attorneys, agents and proxies to cast all votes with respect to the Company s common stock, which I am entitled to cast at the 2008 Annual Meeting of Stockholders to be held on Tuesday, May 20, 2008, at 9:00 a.m. (CT), at the Company s offices at 1300 West Sam Houston Parkway South, Suite 300, Houston, Texas 77042, and at any adjournments or postponements of such meetings, upon the following matters. This proxy will be voted as directed by you. PROPERLY EXECUTED BUT UNMARKED PROXIES WILL BE VOTED FOR THE ELECTION OF THE NOMINEES FOR DIRECTOR LISTED, FOR THE APPROVAL OF THE AMENDED AND RESTATED 1999 EMPLOYEE STOCK OPTION PLAN AND FOR THE RATIFICATION OF THE APPOINTMENT OF GRANT THORNTON LLP AS OUR INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FOR 2008 AND AS DIRECTED BY A MAJORITY OF THE BOARD OF DIRECTORS AS TO OTHER MATTERS. The undersigned stockholder hereby acknowledges receipt of the Notice of Annual Meeting and Proxy Statement and the 2007 Annual Report on Form 10-K, and hereby revokes any proxy or proxies heretofore given with respect to such shares of the Company s common stock. This proxy may be revoked at any time before its exercise. (continued and to be signed and dated on reverse side)

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Sales in 2010 increased by 48.1% to $30,399 thousand compared to $20,526 thousand in 2009. The increase in sales is mostly attributed to the fact that many existing customers increased their ongoing orders, the fact that some of our larger customers began integrating additional Silicom products into their product lines, and the fact that we continue expanding our customer base. The increase in sales is also affected, among other factors, by an increasing market demand in light of signs of economic recovery in 2010 following the global economic downturn in 2009.

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Sales in 2009 decreased by 19.7% to $20,526 thousand compared to $25,554 thousand in 2008. The decrease in sales is mostly attributed to the generally lower demand caused by the global economic downturn. As a result of this economic downturn, during 2009 we have experienced a significant reduction in ongoing purchase orders, particularly from some of our major customers.

Gross profit in 2010 was $12,909 thousand compared to $8,065 thousand in 2009. Gross profit as a percentage of sales in 2010 was 42.5%, compared to 39.3% in 2009. Our gross profit is largely dependent on the mix of products we sell during a specific year. The higher gross profit percentage in 2010 was primarily a result of changes to the mix of sold products. Gross profit is also affected, among other factors, by write-downs of inventory made with respect to any obsolete or slow moving inventory we can no longer use. The inventory write-downs as a percentage of sales in 2010 has decreased to 2.6%, compared to 4.2% in 2009.

Gross profit in 2009 was $8,065 thousand compared to $10,149 thousand in 2008. Gross profit as a percentage of sales in 2009 was 39.3%, compared to 39.7% in 2008. Our gross profit is largely dependent on the mix of products we sell during a specific year. The slightly lower gross profit percentage in 2009 was primarily a result of changes to the mix of sold products. Gross profit is also affected, among other factors, by write-downs of inventory made with respect to any obsolete or slow moving inventory we can no longer use. The inventory write-downs as a percentage of sales in 2009 has slightly increased to 4.2%, compared to 3.6% in 2008.

Research and development costs in 2010 increased by 20.8% to $3,280 thousand compared to $2,716 thousand in 2009. This increase was mainly attributed to our continued investment in new product development, enhancements to existing products and the development of new networking and connectivity technologies, which contributed approximately $360 thousand to such increase, and to a relative weakening of the US Dollar against the New Israeli Shekel (since a significant portion of our research and development expenses are incurred in New Israeli Shekels), which contributed approximately $200 thousand to such increase.

Research and development costs in 2009 decreased by 10.9% to $2,716 thousand compared to $3,048 thousand in 2008. This decrease was mainly attributed to a relative strengthening of the US dollar against the New Israeli Shekel (since a significant portion of our research and development expenses are incurred in New Israeli Shekels).

Selling and marketing expenses in 2010 increased by 21.2% to $2,207 thousand compared to $1,821 thousand in 2009. This increase was mainly attributed to our continued investment in the promotion of our server networking products, which contributed approximately $300 thousand to such increase, and to a relative weakening of the US Dollar against the New Israeli Shekel (since a significant portion of our research and development expenses are incurred in New Israeli Shekels), which contributed approximately $90 thousand to such increase.

Selling and marketing expenses in 2009 decreased by 13.0% to $1,821 thousand compared to $2,093 thousand in 2008. This decrease was mainly attributed to a relative strengthening of the US dollar against the New Israeli Shekel (since a significant portion of our selling and marketing expenses are incurred in New Israeli Shekels).

General and administrative expenses in 2010 increased by 16.0% to $1,523 thousand compared to $1,313 thousand in 2009. This increase was mainly attributed to a relative weakening of the US Dollar against the New Israeli Shekel (since a significant portion of our general and administrative expenses are incurred in New Israeli Shekels).

General and administrative expenses in 2009 decreased by 8.0% to $1,313 thousand compared to $1,427 thousand in 2008. This decrease was mainly attributed to a relative strengthening of the US dollar against the New Israeli Shekel (since a significant portion of our general and administrative expenses are incurred in New Israeli Shekels).

Financial income, net in 2010 decreased by 32.1% to $617 thousand compared to $909 thousand in 2009. The decrease was primarily caused by the relative weakening of the US dollar against the New Israeli Shekel (a significant portion of our balance sheet assets and obligations are denominated in New Israeli Shekels), which created a net financial expense in US dollars from exchange rate differences, and the decrease in yields from investments in marketable securities. Thus, despite the increase in funds available for investment, there was a decrease in financial income in 2010.

Financial income, net in 2009 decreased by 23.5% to $909 thousand compared to $1,188 thousand in 2008. The decrease was primarily caused by the decrease in yields from investments in marketable securities. Thus, despite the effect of a relative strengthening of the US dollar against the New Israeli Shekel (a significant portion of our balance sheet assets and obligations are denominated in New Israeli Shekels), which creates a net financial income in US dollars from exchange rate differences, and an increase in funds available for investment, there was a decrease in financial income in 2009.

In 2010 we recorded current income tax expenses of $657 thousand and deferred income tax expenses of $156 thousand compared to current income tax expenses of $358 thousand and deferred income tax expenses of $19 thousand in 2009. In addition, in 2010 we recorded income tax benefit relating to former years (tax returns) of $12 thousand.

In 2009 we recorded current income tax expenses of $358 thousand and deferred income tax expenses of $19 thousand compared to current income tax expenses of $438 thousand and deferred income tax benefit of $314 thousand in 2008. In addition, in 2009 we recorded income tax benefit relating to former years (tax returns) of $72 thousand.

The net change in valuation allowance for the years ended December 31, 2008, 2009 and 2010 was an increase of $31 thousand, a decrease of $423 thousand, and a decrease of $17 thousand, respectively. In assessing the realizability of the deferred tax assets, our management has to consider whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences and/or loss carry-forward become deductible. In making this assessment, our management has to consider the projected future taxable income as well as tax planning strategies.

For the year ended December 31, 2008, we recorded valuation allowance in the amount of its non-current deferred tax assets due to the uncertainty of their realization. In assessing the need for a valuation allowance, our management considered our historical levels of income, the fact that we had a single product line, short lead time of customer's orders and flexible forecasting and expectation of future taxable income and ongoing tax planning strategies.

For the year ended December 31, 2009, our management re-evaluated the need for a valuation allowance, due to our cumulative profits in recent years and in particular completing profitable quarters in 2009 despite the major worldwide economic downturn which started at the end of 2008. In light of the projections for future taxable income over the periods in which the deferred tax are deductible, our management believed that it is more likely than not that we would realize the benefits of these deductible differences. In making these projections we have considered our currently stable work environment related to our existing line of products, which enables us to present current positive operating income and net income. Additionally, we have considered our planned new line of products.

Accordingly, the Company reversed a major part of the valuation allowance and recorded an income tax benefit of $423 thousands in 2009. In 2010 the Company's view remained unchanged. As of December 31, 2010 all of the valuation allowance refers to loss carry-forward related to Silicom Connectivity Solutions, Inc., which is our U.S. subsidiary that files tax returns in the United States.

Based upon projections for future taxable income over the periods in which the deferred tax assets are deductible, the Company believes it is more likely than not that it will realize the benefits of these deductible differences, net of existing valuation allowance. The amount of the deferred tax asset considered realizable, however, could be reduced in the future if the estimations of future taxable income during the carryforward period are reduced.

In 2010 we recorded net income of $5,715 thousand compared to net income of $2,819 thousand in 2009, a 102.7% increase. This increase was mainly due to our higher sales in 2010.

In 2009 we recorded net income of $2,819 thousand compared to net income of $4,645 thousand in 2008, a 39.3% decrease. This decrease was mainly due to the respective decrease in sales, and occurred despite a decrease in our operational expenses as described above.

Impact of Inflation and Currency Fluctuations on Results of Operations, Liabilities and Assets

Since the majority of our revenues are denominated and paid in U.S. dollars, we believe that inflation and fluctuations in the U.S. dollar exchange rate have no material effect on our revenue. Inflation in Israel and the Israeli currency as well as U.S. dollar exchange rate fluctuations, may however, have an effect on our expenses and, as a result, on our net income/loss. The cost of our Israeli operations, as expressed in U.S. dollars, is influenced by the extent to which any change in the rate of inflation in Israel is not offset (or is offset on a lagging basis) by a change in valuation of the NIS in relation to the U.S. dollar.

We do not presently engage in any hedging or other transactions intended to manage the risks relating to foreign currency exchange rate or interest rate fluctuations. However, we may in the future undertake such transactions, if management determines that it is necessary to offset such risks.

Liquidity and Capital Resources

As of December 31, 2010, we had working capital of $33,708 thousand and our current ratio (current assets to current liabilities) was 6.78. Cash and cash equivalents as of December 31, 2010 decreased by $596 thousand to $6,657 thousand, compared to $7,253 thousand as of December 31, 2009. Short-term bank deposits increased by $1,956 thousand to $9,209 thousand, compared to $7,253 thousand as of December 31, 2009. Short-term marketable securities decreased by $2,263 thousand to $8,162 thousand and long-term marketable securities increased by $3,465 thousand to $21,773. The net increase of $2,562 thousand in these four balance sheet items in 2010 was mainly due to net cash provided by operating activities.

Trade receivables increased to $6,762 thousand as of December 31, 2010, compared to $5,172 thousand as of December 31, 2009, mainly due to the increase in sales in the fourth quarter of 2010, as compared to sales in the fourth quarter of 2009. Other receivables increased to $555 thousand as of December 31, 2010, compared to $371 thousand as of December 31, 2009.

Trade payables increased to $3,753 thousand as of December 31, 2010, compared to $2,261 thousand as of December 31, 2009, mainly due to the increase in inventory in the forth quarter of 2010.

Other payables and accrued liabilities decreased to $2,074 thousand as of December 31, 2010, compared to $2,138 thousand as of December 31, 2009.

Cash provided by operating activities in 2010 amounted to $3,236 thousand compared to $3,835 thousand in 2009. The cash provided by operating activities in 2010 was the result of our positive operating income.

Inventories increased to $8,140 thousand as of December 31, 2010, compared to $4,677 thousand as of December 31, 2009, mainly due to the fact that as our sales grow and customers demand receipt of products within a number of weeks following the issuance of purchase orders, we are required to be ready to deliver our products in accordance with our customers' expectations.

Capital expenditures on property and equipment as of December 31, 2010 were $466 thousand, compared to $258 thousand as of December 31, 2009.

In January 2006, we completed an offering and sale of 10,000 units in Israel, composed of 800,000 of our ordinary shares and 400,000 warrants, pursuant to a prospectus filed with the Israeli Securities Authority and TASE. The sale of units resulted in net proceeds of approximately $5.6 million. As of January 31, 2008 (i.e. the expiration date of the warrants), 399,934 warrants were exercised, resulting in additional proceeds of approximately $3.5 million in the aggregate. See "Item 4. Information on the Company – History and Development of the Company."

In May 2007, we conducted a private placement, pursuant to which we issued to certain "accredited investors" and "qualified institutional purchasers" 875,000 ordinary shares at a purchase price of $20.50 per share and warrants to purchase up to 218,750 ordinary shares at an exercise price of $28.25 per share. We issued to the placement agents warrants to purchase up to an aggregate of 10,937 ordinary shares on the same terms as the warrants issued to the investors. Net proceeds from the private placement were approximately $16.8 million, net of $1.2 million of issuance costs. The warrants issued to the investors and to the placement agents expired in July 2010. Prior to their expiration in July 2010, no such warrants were exercised into shares.

We have cash and cash equivalents that we believe are sufficient for our present requirements. Furthermore, our cash resources are sufficient to fund our operating needs for the next twelve months.

Research and development, patents and licenses, etc.

Because the market for our products is characterized by rapidly changing technology and evolving industry standards, our success depends upon our ability to select, develop, manufacture and market new and enhanced products in a timely manner to meet changing market needs. As such, we invest significant resources in research and new product development, enhancements to existing products, and the development of new networking and connectivity technologies, and we expect to continue to do so.

On April 8, 2010, we filed a patent application in the United States the "Server-Based Network Appliance", to protect our proprietary intellectual property with respect to SETAC products.

On November 15, 2010, we filed a provisional patent application in the United States, the "NIC with Ethernet-Managed Bypass", to protect our proprietary information with respect to Ethernet-managed network interface cards.

We cannot assure you that a patent will actually be issued or that the scope of any issued patent will adequately protect our intellectual property rights.

The Government of Israel encourages research and development projects oriented towards products for export or projects which will otherwise benefit the Israeli economy. In each of the three fiscal years from 1999 to 2001, we received grants from the OCS for the development of systems and products. We have received from the OCS approximately 30% of certain research and development expenditures for particular projects. Under the terms of Israeli Government participation, a royalty of 2% or up to 5% of the net sales of products developed from a project funded by the OCS must be paid, beginning with the commencement of sales of products developed with grant funds and ending when 100% or 150% of the grant is repaid. For projects approved after January 1, 1999, the amount of royalties payable is up to a dollar-linked amount equal to 100% of such grants plus interest at LIBOR. The terms of Israeli Government participation also place restrictions on the location of the manufacturing of products developed with government grants, which, in general, must be performed in Israel, and on the transfer to third parties of technologies developed through projects in which the government participates. See "Item 10. Additional Information - Taxation." We received approximately 20% of certain research and development expenditures for a particular project in 2003 and approximately 30% of a particular project in 2004. We did not have any new grant programs with the OCS from 2005 to 2010. In August 2005, we received approval for a $54 thousand dollar grant from the Korea-Israel Industrial Research and Development Foundation, or Koril-RDF, in connection with the joint development of a certain product with a Korean company. Under the terms of this grant we are required to repay the amounts received at a rate of 2.5% per year of our gross sales of the product developed with the grant in each such year, until 100% of the grant (and any other sums received from Koril-RDF) are repaid. The annual payment for every year following the first sale of the product will not exceed certain percentages of the amounts received from Koril-RDF. As of January 2006 and to date, our research and development activities have been sponsored and funded by us, and we did not participate in any new encouragement programs or received any additional grants from the OCS or Koril- RDF.

We expect that we will continue to commit resources to research and development in the future. As of February 28, 2011, we employed 30 persons in research and development. In 2008, 2009 and 2010, our research and development expenses were $3,048, $2,716 and $3,280, respectively, constituting approximately 11.9%, 13.2% and 10.8%, respectively, of our sales. For additional information concerning commitments to pay royalties on sales of products developed from projects funded by the OCS, see Note 10A to our financial statements included elsewhere in this annual report and see "Item 10. Additional Information - Taxation."

Trend Information

In late 2002, we leveraged our expertise and know-how in networking and operating systems to develop a line of high-end server networking cards (Server Adapters). In today's network-based environment, there is a growing demand for server-based systems. The markets for such systems are almost continuously growing. Furthermore, the security market is growing due to an increase in demand for security appliances, most of which are server based, and the WAN optimization market is growing due to an increase in demand for better WAN connection between branch offices and headquarters. These two markets are now the main markets in which our Server Adapters provide added value. We began investing in marketing and sales of this line to potential markets and customers during 2003 and received initial purchase orders from a number of sources. We continued to invest in the marketing of these products during 2004-2010. During 2004-2007, the number of purchase orders for these products significantly increased. In 2008 there was a slight decrease in purchase orders as compared with 2007, and in 2009 there was a further decrease in purchase orders as compared with 2008, which was mostly attributed to the generally lower demand for the products due to the global economic downturn. The sales cycles in the markets for our products are long, but once we establish a customer base, each such customer will represent an opportunity for sustained, long-term revenues. During the years 2002-2009, our business was based in its entirety on this product line, which generated all of our revenues, and, during this period, we expected that this product line would continue to be our principal line of business in the coming years, specifically with respect to the 10Gbps cards, higher port density cards, bypass cards and intelligent and programmable cards.

In 2009, despite the impact of the major worldwide economic downturn as discussed above, we have continued to be profitable and completed four profitable quarters despite the year's significant challenges. Furthermore, in the last two quarters of 2009, we have been able to restore a process of growth in our business, a trend which continued in 2010. In 2010, the number of purchase orders for our products significantly increased, and we reached our highest revenues to date. Many of our customers have renewed their purchases to their level of purchases prior to the economic crisis, and we made sales associated with new products and customers. In 2009 and 2010 we launched new products, such as our new product family, the patent-pending SETAC (Server To Appliance Converter), which received a positive reaction in the market, penetrated our existing customer base and facilitated cooperation with new customers including a significant cooperation at the end of 2010 with a pioneering developer and manufacturer of high-performance server platforms, and with a major vendor in the security industry, who will be incorporating SETAC products in their next-generation lines of security appliances to be launched in 2011, and a significant cooperation at the beginning of 2011 with a leading server manufacturer which will begin offering appliances integrating Silicom's SETAC products with of a popular model of its standard servers. We believe that as products such as SETAC will further prove themselves in commercial deployments, the demand for such products is expected to increase and, consequentially, may turn this product family into one of our growth drivers in future years.

However, although we expect our business and products to further develop in the coming years, there is no assurance that we will continue to generate significant sales in the areas in which we operate.

Off-Balance Sheet Arrangements

On July 22, 2002, our Audit Committee and the Board of Directors approved an Indemnification Agreement with our directors and officers. Our shareholders approved the terms of this agreement in a General and Extraordinary Meeting held on January 7, 2004. In the March 2005 amendment to the Israeli Companies Law-1999, the instances in which a company may indemnify its officers and directors were broadened. In December 2007 each of our Audit Committee and Board of Directors approved a new form of Indemnification Agreement with our directors and officers so as to reflect this amendment. Our shareholders approved the terms of this new Indemnification Agreement in January 2008. The Agreement provides that the directors and officers will be exempt from liability in certain circumstances. The Agreement also provides for the indemnification by the Company for certain obligations and expenses imposed on the officer in connection with an act performed in his or her capacity as an officer of the Company. This right to indemnification is limited, and does not cover, among other things, a breach of an officer's duty of loyalty, a willful breach of an officer's duty of care, or a reckless disregard for the circumstances or consequences of a breach of duty of care. The right to indemnification also does not cover acts that are taken intentionally to unlawfully realize personal gain. The maximum amount of our liability under these Indemnification Agreements is currently $3,000,000.

Tabular disclosure of contractual obligations

The following table shows our outstanding contractual obligations by category and by payments due as of December 31, 2010:

		Payments due by period			
Contractual Obligations	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Operating Leases	$ 784,000	$ 561,000	$ 223,000		
Purchase Obligations	$ 5,782,000	$ 5,782,000			
Total	$ 6,566,000	$ 6,343,000	$ 223,000		

The Company's total outstanding contingencies in respect of royalty-bearing participations received or accrued, net of royalties paid or accrued before interest, amounted to approximately $2,960 thousand as of December 31, 2010 ($2,960 thousand as of December 31, 2009), of which $2,782 thousand are attributable to sales of our legacy products and $178 thousand are attributable to sales of our new line of products.

Item 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

Directors and Senior Management

The following table and notes thereto set forth information regarding our officers, directors and senior management as of February 28, 2011.

Name	Age	Position with Company
Avi Eizenman	53	Active Chairman of the Board
Shaike Orbach	59	President, Chief Executive Officer, Director
Zohar Zisapel	62	Director
Einat Domb-Har	43	External Director
Ilan Erez	43	External Director
David Hendel	49	Vice-President Research and Development
Eran Gilad	43	Chief Financial Officer

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Avi Eizenman co-founded the Company in 1987 and has served as its President and as a Director, since its inception. Mr. Eizenman also served as Chief Executive Officer from the Company's inception until April 1, 2001, and on such date, he resigned from his position as Chief Executive Officer and was appointed Active Chairman of the Board of Directors. Mr. Eizenman served as head of the ASIC department at Scitex Ltd. in 1986. From 1979 until 1985, Mr. Eizenman held various positions, including project manager, ASIC specialist and engineer, with the Electronic Research & Development Department of the Israeli Ministry of Defense. Mr. Eizenman holds a B.Sc. degree, with honors, in Electrical Engineering from the Technion, and an M.B.A. from Tel Aviv University.

Shaike Orbach has been President and Chief Executive Officer of the Company since April 2001. In December 2001, Mr. Orbach was named a Director, replacing Zohar Zisapel, who resigned from the Board of Directors. Prior to that, for a period of four and a half years, Mr. Orbach was President and CEO of Opgal Ltd., a high-tech subsidiary of Israel's Rafael and El-Op corporations. Previously, he was General Manager of Edusoft, an Israeli company the shares of which were traded on the NASDAQ National Market (now, the NASDAQ Global Market), and Managing Director of Tecsys Ltd. He holds a B.Sc degree in Mechanical Engineering from the Technion.

Zohar Zisapel is a co-founder of the Company. He served as a Director from the Company's inception and until 2001. Mr. Zisapel is also a founder and a director of RAD Data Communications Ltd., of which he served as CEO from January 1982 until January 1998 and has served as chairman since 1998. Mr. Zisapel serves as chairman of three other public companies – Ceragon Networks Ltd. (Ticker Symbol CRNT), RADVision Ltd. (Ticker Symbol RVSN) and RADCOM Ltd. (Ticker Symbol RDCM) – and as chairman or director of several private companies belonging to the RAD Group. The Company has certain dealings with members of the Rad Group (see "Item 7. Major Shareholders and Related Party Transactions" below). Since July 2008, Mr. Zisapel has been a director of Amdocs Limited (Ticker Symbol DOX). Mr. Zisapel received a B.Sc. and a M.Sc. in electrical engineering from the Technion, Israel Institute of Technology, and an M.B.A. from Tel Aviv University.

Einat Domb-Har has served as Chief Financial Officer of Olista Ltd., a company providing unique solutions for the cellular industry, since June 2006. From April 2004 to April 2006 Ms. Domb-Har served as the Chief Financial Officer of Stage One Venture Capital, which focuses on seed investment in the telecom industry. From 2000 to 2004 Ms. Domb-Har served as a controller of Pitango Venture Capital, Israel's largest pool of four venture capital funds. From 1994 to 1999 Ms. Domb-Har served as a senior manager at Kost, Forer and Gabbay, CPA, a member of Ernst & Young International. Ms. Domb-Har is an Israeli Certified Public Accountant and holds a BA in Economics and Accounting from Tel Aviv University. She also holds an M.B.A. from the Israeli extension of Bradford University.

Ilan Erez has served as Chief Financial Officer of Cimatron Ltd. (Ticker Symbol CIMT) engaged in the design and sale of CAD/CAM software for the tool-making and discrete manufacturing industries, since July 2005. From 1998 to 2005 Mr. Erez served as the Chief Financial Officer of the Company. He also served as VP Operations of the Company from May 2001 to 2005. From 1996 to 1998 Mr. Erez served as Controller and assistant to the Chief Executive Officer at Bio-Dar Ltd. From 1994 to 1996 Mr. Erez served as an auditor at Kesselman & Kesselman, a member of Price Waterhouse Coopers. Mr. Erez is a Certified Public Accountant in Israel and holds a B.A in Accounting and Economics from the Hebrew University and an LL.M. in Business Law from Bar-Ilan University.

David Hendel has been Vice-President, Research and Development of the Company since 1995. From 1991 to 1995, he served as a Senior Hardware Engineer of the Company. Mr. Hendel previously served as an engineer in the Intelligence Corps of the Israeli Defense Forces. He holds a B.Sc. degree in Electrical Engineering from Ben-Gurion University.

Eran Gilad has been the Chief Financial Officer of the Company since May 2005. From 2002 to 2004 Mr. Gilad served as VP of Finance & Operation at Frontline PCB Solutions Ltd. From 2000 until 2002 Mr. Gilad held senior financial and operational positions at Lynx Photonic Networks Inc. From 1996 until 2000 Mr. Gilad held senior financial positions at Technomatix Technologies Ltd. He is a Certified Public Accountant in Israel and holds an M.A in Economics from Tel-Aviv University and a B.A in Accounting and Economics from Tel-Aviv University.

Compensation

The aggregate direct remuneration paid to all persons as a group who served in the capacity of director or executive officer during the year ended December 31, 2010 was $1,118 thousand. The aggregate amount accrued to provide for severance payments to all persons as a group who served in the capacity of director or executive officer as of the year ended December 31, 2010 was $946 thousand. The severance terms of the Company's Chief Executive Officer and Chairman of the Board, as approved by the audit committee, board of directors and shareholders of the Company, may entitle them, in certain circumstances, to additional payments. We did not pay cash compensation to Yehuda Zisapel and do not pay cash compensation to Zohar Zisapel for serving on our board of directors. We do pay cash compensation to Avi Eizenman who is an active Chairman of the Board, to Shaike Orbach, who is the President and Chief Executive Officer, and to Ms. Einat Domb-Har and Mr. Ilan Erez who are external directors and receive compensation in accordance with the regulations promulgated under the Israeli Companies Law-1999. All our officers work full time for us. Certain of the compensation previously paid to our directors was paid in the form of options under the Silicom Directors Share Incentive Option Plan (1994) and certain of such compensation is paid in the form of options under the Share Option Plan (2004) described below. The Directors Share Incentive Option Plan (1994) was adopted by the board of directors in August 1994, in order to grant options to members of the board of directors who served on the board of directors for at least three fiscal quarters. The Director Share Incentive Option Plan was administered by the board of directors, which designated the optionees, dates of grant and the exercise price of options. Under the Director Share Incentive Option Plan, 500,000 of our ordinary shares were reserved for issuance. The options granted under the Director Share Incentive Option Plan expire at the end of ten years from their date of grant and are non-assignable except by the laws of descent. The grantee is responsible for all personal tax consequences of the grant and the exercise thereof. We believe that we will bear no tax consequences in connection with such grant or exercise. The Director Share Incentive Option Plan was cancelled in July 2004 with respect to any share capital previously reserved and not yet allocated as well as any share capital that becomes unallocated from time to time as outstanding options expire or are forfeited. As of February 28, 2011, there are no outstanding options under the Director Share Incentive Plan (1994).

On October 24, 2000, the board of directors adopted the Silicom Ltd. US Share Option Plan (2000). This Plan is intended to constitute a means of providing additional incentive to officers, consultants and certain other present and future employees and directors of the Company and its subsidiaries. Pursuant to the Plan, the Company may grant both Incentive Stock Options (as such term is defined in Section 422 of the Internal Revenue Code of 1986, as amended; "ISOs") and Nonqualified Stock Options (“NSOs”), provided, however, that only our employees or employees of our subsidiaries can receive ISOs. The Plan is administered by the board of directors, which has full authority to grant options under the Plan. Under the terms of the Plan, up to a maximum of 200,000 of our ordinary shares are reserved for issuance, subject to certain adjustments. The exercise price of the options granted under the Plan shall be not less than 100 percent (or, in the case of a grant of ISO's to a holder of more than 10% of the Company's outstanding shares, 110 percent) of the fair market value (as defined in the Plan) of the ordinary shares subject to the option on the date the option is granted. The vesting period of the options is subject to the discretion of the Board. The term of ISOs shall not exceed 10 years from the date on which they are granted (or 5 years, in the case of optionees who hold more than 10% of our outstanding shares). In total, as of February 28, 2011, we have granted 22,600 options pursuant to the US Share Option Plan (2000) to employees of our US subsidiary – Silicom Connectivity Solutions, Inc., of which 11,300 were returned to the Company due to certain employees who left their positions not exercising their options and 2,500 expired without exercise due to the expiration of their term.

On December 30, 2004, our shareholders adopted our Share Option Plan (2004). Under the original terms of the Share Option Plan (2004) up to a maximum of 282,750 of our ordinary shares are reserved for issuance, subject to certain adjustments, upon the exercise of options granted to employees, directors, officers, consultants and service providers. In December 2007, the Board of Directors increased the number of our ordinary shares available for issuance under the Share Option Plan (2004) by 300,000. The Share Option Plan (2004) is administered by the board of directors, which designates the optionees, dates of grant, vesting periods and the exercise price of options. The options are non-assignable except by the laws of descent. Certain tax advantages apply to certain of our directors, officers and employees with respect to options granted to them under the Share Option Plan (2004). As of February 28, 2011, we have granted a total of 791,000 options under the Share Option Plan (2004), of which (i) 160,000 options were granted to Mr. Avi Eizenman, such that (a) 30,000 at an exercise price of $2.53 and at a termination date of December 30, 2014; (b) 40,000 expired in July 2008, (c) 40,000 at an exercise price of $3.82 and at a termination date of the earlier to occur of October 15, 2016 or the closing price of our shares falling below $1.91 and (d) 50,000 at an exercise price of $18.82 and at a termination date of the earlier to occur of December 21, 2018 or the closing price of our shares falling below $9.41, (ii) 30,000 options were granted to Mr. Yehuda Zisapel, at an exercise price of $2.53 and at a termination date of December 30, 2014, (iii) 160,000 options were granted to Mr. Shaike Orbach, such that (a)30,000 at an exercise price of $2.53 and at a termination date of December 30, 2014, (b) 40,000 expired in July 2008,(c) 40,000 at an exercise price of $3.82 and at a termination date of the earlier to occur of October 15, 2016 or the closing price of our shares falling below $1.91, and (d) 50,000 at an exercise price of $18.82 and at a termination date of the earlier to occur of December 21, 2018 or the closing price of our shares falling below $9.41 (iv) 30,000 options were granted to Ms. Einat Domb-Har at an exercise price of $2.53 and at a termination date of December 30, 2014 ; and (v) 30,000 options were granted to Mr. Ilan Kalmanovich, our former external director, at an exercise price of $2.53 and at a termination date of December 30, 2014. 20,500 of the options granted under the Share Option Plan (2004) were returned to the company due to certain employees who left their positions not exercising their options and 197,500 of the options granted under the Share Option Plan (2004) expired without exercise due to the expiration of their term.

In addition to the Plans described above, the oldest of the Company's share option plans was adopted in December 1993, and amended in 1997. Pursuant to this plan, 300,000 ordinary shares were reserved for issuance upon the exercise of options granted to employees and consultants of the Company. This reserve was increased by the board of directors to 500,000. The Share Option Plan was administered by the board of directors, which designated the optionees, dates of grant, vesting periods and the exercise price of options. The options granted under this plan expire after 10 years from their date of grant and are non-assignable except by the laws of descent. The grantee is responsible for all personal tax consequences of the grant and the exercise thereof. The 1993 share option plan was cancelled in July 2004 with respect to any share capital previously reserved and not yet allocated as well as any share capital that becomes unallocated from time to time as outstanding options expire or are forfeited.

Board Practices

Each of Yehuda Zisapel, Avi Eizenman and Shaike Orbach was elected to the board of directors most recently on April 14, 2010 to serve until the next Annual Shareholders' Meeting. Messrs. Yehuda Zisapel and Avi Eizenman are both Founders of the Company, and have served as Directors since our inception in 1987. On July 15, 2010, Yehuda Zisapel resigned from serving as director on the board of directors of the Company, and, on September 2, 2010, Zohar Zisapel was elected to the board of directors to serve until the next Annual Shareholders' Meeting. Mr. Zohar Zisapel is also a founder of the Company. On June 30, 2004 Ms. Einat Domb-Har and Mr. Ilan Kalmanovich were elected to the board of directors of the Company to hold office as external directors for a period of three years in accordance with Section 245(a) of the Companies Law – 1999. On September 23, 2007, the appointments of each of Ms. Einat Domb-Har and Mr. Ilan Kalmanovich as external directors were extended for additional three-year terms. On July 1, 2010, the terms of service of Mr. Ilan Kalmanovich and Ms. Einat Domb-Har as external directors in the Company expired. On September 2, 2010, the appointment of Ms. Einat Domb-Har as external director was extended for an additional three-year term, and Mr. Ilan Erez was elected to hold office as external director for a period of three years.

None of the members of the board of directors is entitled to receive any severance or similar benefits upon termination of his or her service with the board of directors, except for Avi Eizenman, who also functions as the active Chairman of the board and Shaike Orbach, who also functions as President and Chief Executive Officer (See “Item 6. Directors and Senior Management – Compensation” above).

In December 2007 our Audit Committee and Board of Directors approved severance arrangements for each of Mr. Avi Eizenman and Mr. Shaike Orbach, which provide for extended notice provisions and severance payments in the event of termination. The arrangements were approved by our shareholders in January 2008, and include the following main terms and conditions (identical with respect to each of Mr. Avi Eizenman and Mr. Shaike Orbach):

Notice of Termination

The termination of the executive’s employment, by him or the company, for any reason other than cause (which is generally defined as willful conduct or omission materially injurious to the company), death or disability, shall require 12 months advance written notice. If, however, following a change in control transaction, either: (i) he shall give notice of termination of his employment for good reason (which is generally defined as an adverse change to the status, responsibilities, salary or other material terms of his employment); or (ii) we shall give notice of termination of his employment for any reason other than cause or disability, 18 months advance written notice shall be required. A change in control transaction includes transactions such as sale of all or substantially all of the company’s shares or assets, or a merger, acquisition, or other reorganization in which control of our company changes following such transaction.

Severance Payments

If the executive's employment shall be terminated for any reason other than cause, he shall be entitled to receive his last full monthly salary multiplied by the number of years (or portions thereof) that he was employed by us (i.e. the severance amount he would be entitled to receive under the Israeli law, had we terminated his employment for any reason other than cause) (the "Severance Law Amount"). If, however, his employment shall be terminated: (i) by the company for any reason other than cause or disability; or (ii) by him for a good reason following a change in control, he shall be entitled to receive one and half times the Severance Law Amount. If the executive's employment under the arrangement is terminated by reason of death or disability, then, in addition to the above, he shall be entitled to receive a lump sum severance payment equal to his last full monthly salary multiplied by twelve 12 months.

Board of Directors

Our Articles of Association provide for a board of directors of not less than two nor more than eight members. Each director (except external directors) is elected to serve until the next annual general meeting of shareholders and until his or her successor has been elected. Officers serve at the discretion of the board of directors. The Articles of Association of the Company provide that any director may, subject to the provisions of the Israeli Companies Law-1999 and the approval by the Board of Directors, appoint another person to serve as a substitute director and may cancel such appointment. Under the Israeli Companies Law-1999, a person who is already serving as a director will not be permitted to act as a substitute director. Additionally, the Israeli Companies Law-1999 prohibits a person from serving as a substitute director for more than one director. Appointment of a substitute director for a member of a board committee is only permitted if the substitute is a member of the board of directors and does not already serve as a member of such committee. If the committee member being substituted is an external director, the substitute may only be another external director who possesses the same expertise as the external director being substituted. The term of appointment of a substitute director may be for one meeting of the board of directors or for a specified period or until notice is given of the cancellation of the appointment. To our knowledge, no director currently intends to appoint any other person as a substitute director, except if the director is unable to attend a meeting of the board of directors.

On December 5, 2010, our board of directors has established a compensation committee, composed of at least two directors who shall initially be Mr. Zohar Zisapel, as chairman, and Mr. Avi Eizenman. The Committee does not have the authority to approve resolutions and take action in lieu of the board of directors, and its sole function is to recommend to the board of directors with respect to the following matters and any other matters as the board of directors shall decide from time to time:

- goals and objectives relating to the compensation of the Chief Executive Officer and Active Chairman of the Board of Directors, evaluation of their performance in light of such goals and objectives and determination and approval of their compensation based on such evaluation;
- compensation of other directors;
- indemnification and insurance of directors and executive officers;
- employee stock option plans; and
- this committee's performance.

External Directors; Audit Committee

Under the Israeli Companies Law-1999, companies registered under the laws of Israel the shares of which have been offered to the public in or outside of Israel are required to appoint no less than two external directors. No person may be appointed as an external director if such person or the person’s relative, partner, employer or any entity under the person’s control, has or had, on or within the two years preceding the date of the person’s appointment to serve as external director, any affiliation with the company or any entity controlling, controlled by or under common control with the company. The term “affiliation” includes:

- an employment relationship;
- a business or professional relationship maintained on a regular basis;
- control; and
- service as an office holder.

A person shall be qualified to serve as an external director only if he or she possesses “expertise in finance and accounting” or “professional qualifications”. At least one external director must posses expertise in finance and accounting.

A director can satisfy the requirements of having “expertise in finance and accounting” if due to his or her education, experience and qualifications he or she has acquired expertise and understanding in business and accounting matters and financial statements, in a manner that allows him or her to understand, in depth, the company’s financial statements and to spur a discussion regarding the manner in which the financial data is presented.

A public company's board of directors must evaluate the proposed external director's expertise in finance and accounting, by considering, among other things, such candidate’s education, experience and knowledge in the following: (i) accounting and auditing issues typical to the field in which the company operates and to companies of a size and complexity similar to such company; (ii) the company's independent public accountant’s duties and obligations; (iii) preparation of the company’s consolidated financial statements and their approval in accordance with the Companies Law and the Israeli Securities Law - 1961.

A director is deemed to be “professionally qualified” if he or she meets any of the following criteria: (i) has an academic degree in any of the following professions: economics, business administration, accounting, law or public administration; (ii) has a different academic degree or has completed higher education in a field that is the company’s main field of operations, or a field relevant to his or her position; or (iii) has at least five years experience in any two of the following: (A) a senior position in the business management of a corporation with a significant extent of business, (B) a senior public position or a senior position in public service, or (C) a senior position in the company's main field of operations. As with a candidate’s expertise in finance and accounting, the board of directors here too must evaluate the proposed external director's "professional qualification" in accordance with the criteria set forth above.

The declaration required by law to be signed by a candidate to serve as an external director must include a statement by such candidate concerning his or her education and experience, if relevant, in order that the board of directors may properly evaluate whether such candidate meets the requirements of having "expertise in finance and accounting" or being "professionally qualified" as set forth in the regulations. Additionally, the candidate should submit documents and certificates that support the statements set forth in the declaration.

No person may serve as an external director if the person’s position or other business activities create, or may create, a conflict of interest with the person’s responsibilities as an external director or may otherwise interfere with the person’s ability to serve as an external director. If, at the time external directors are to be appointed, all current members of the board of directors are of the same gender, then at least one external director must be of the other gender.

External directors are to be elected by a majority vote at a shareholders’ meeting, provided that either:

- the majority of shares voted at the meeting, including at least one-third of the shares held by non-controlling shareholders voted at the meeting, vote in favor of election of the director; or
- the total number of shares held by non-controlling shareholders voted against the election of the director does not exceed one percent of the aggregate voting rights in the company.

The initial term of an external director is three years and may be extended for additional terms of three years. External directors may be removed only by the same percentage of shareholders as is required for their election, or by a court, and then only if the external directors cease to meet the statutory qualifications for their appointment, violate their duty of loyalty to the company or are found by a court to be unable to perform their duties on a full time basis. External directors may also be removed by an Israeli court if they are found guilty of bribery, fraud, administrative offenses in a company or use of inside information. Each committee of a company’s board of directors must include at least one external director. See “Item 10. Additional Information- Companies Law Amendment” below for a discussion of a recent amendment to the Israeli Companies Law-1999 which, once it enters into effect, may impact our company’s corporate governance practices as discussed herein.

An external director is entitled to compensation as provided in regulations adopted under the Israeli Companies Law-1999 and is otherwise prohibited from receiving any other compensation, directly or indirectly, in connection with service provided as an external director. Ms. Einat Domb-Har and Mr. Ilan Kalmanovich were elected to the board of directors as external directors on June 30, 2004 and were subsequently re-elected on September 23, 2007. On September 2, 2010, Ms. Einat Domb-Har was re-elected and Mr. Ilan Erez was elected to the board of directors as external directors for a term of three years.

Audit Committee

The Israeli Companies Law-1999 requires public companies to appoint an audit committee. The responsibilities of the audit committee include identifying irregularities in the management of our business and approving related party transactions as required by law. An audit committee must consist of at least three directors, including all the external directors of the company. The chairman of the board of directors, any director employed by or otherwise providing services to the company, and a controlling shareholder or any relative of a controlling shareholder, may not be a member of the audit committee. Currently, Ms. Einat Domb-Har, Mr. Ilan Erez and Mr. Zohar Zisapel serve as members of our audit committee. See “Item 10. Additional Information- Companies Law Amendment” below for a discussion of a recent amendment to the Israeli Companies Law-1999 which, once it enters into effect, may impact our company’s corporate governance practices as discussed herein.

As of December 31, 2010, pursuant to Companies Regulations (Instructions and Conditions to the Approval Procedures of Financial Statements) - 2010 ("Regulations for Approval of Financials"), our audit committee also serves as a special committee for the review of financial statements (the "Financial Statements Committee"). The function of the Financial Statements Committee is to review our financial statements and make recommendations on certain topics to the board of directors, as set forth in the Regulations for Approval of Financials. The board of directors, in turn, considers the recommendations of the Financial Statements Committee while it approves our financial statements.

Internal Auditor

Under the Israeli Companies Law-1999, the board of directors must appoint an internal auditor, nominated by the audit committee. The role of the internal auditor is to examine, among other matters, whether our actions comply with the law and orderly business procedure. Under the Israeli Companies Law-1999, the internal auditor may be an employee of the company but not an office holder (as defined in Item 10 below), or an affiliate, or a relative of an office holder or affiliate, and he or she may not be our independent accountant or its representative. Our board of directors appointed Fahn Kaneh Control Management Ltd. to be our internal auditor on April 26, 2005, according to the recommendation of the audit committee.

Employees

The number of employees over the last three financial years is set forth in the table below.

As of December 31	2008	2009	2010
Total Employees	74	76	85
Marketing, Sales, Customer Services	11	10	10
Research & Development	23	25	30
Manufacturing	32	33	37
Corporate Operations and Administration	8	8	8

As of February 28, 2011, we had 85 employees, including 11 in marketing, sales and customer services, 30 in research and development, 36 in manufacturing, and 8 in corporate operations and administration. All such employees, except for 2 employees in the United States, are based in Israel. We consider our relations with our employees excellent and have never experienced a labor dispute, strike or work stoppage. None of our employees is represented by a labor union. We do not employ a significant number of temporary employees, but we do use temporary employees from time to time, as necessary.

Certain provisions of the collective bargaining agreements between the Histadrut (General Federation of Labor in Israel) and the Coordination Bureau of Economic Organizations including the Industrialists' Associations are applicable to our Israeli employees by order of the Israeli Ministry of Labor. The laws principally concern the length of the work day, contributions to a pension fund, recuperation pay, travel expenses payment and other conditions of employment. We generally provide our employees with benefits and working conditions beyond the required minimums.

Israeli law generally requires severance pay, which may be funded by managers' insurance and/or a pension fund described below, upon the retirement or death of an employee or termination of employment without cause (as defined in the law). The payments to the managers' insurance and/or pension fund in respect of severance pay amount to approximately 8.33% of an employee's wages, in the aggregate. Furthermore, Israeli employees and employers are required to pay predetermined sums to the National Insurance Institute, which is similar to the United States Social Security Administration. Such amounts also include payments for national health insurance. The payments to the National Insurance Institute are equal to approximately 16% of an employee's wages, of which the employee contributes approximately 62.5% and the employer contributes approximately 37.5%.

A general practice followed by the Company, is the contribution of funds on behalf of most of its employees either to a fund known as managers' insurance or to a pension fund, or to a combination of both. Such practice was further reinforced by the Company in July 1, 2008, when the Company entered into agreements with a majority of its employees in order to implement Section 14 to the Severance Pay Law, according to which the payment of monthly deposits by the Company into managers' insurance and/or pension fund are in respect of severance obligation to such employees. See Note 9 of our consolidated financial statements. These funds provide a combination of savings plan, insurance and severance pay benefits to the employee, giving the employee a lump sum payment upon retirement and securing the severance pay or part of it, if legally entitled, upon termination of employment. To the funds, each employee contributes an aggregate amount equal to between 5% and 5.5% of his base salary, and we contribute, in the aggregate, including the 8.33% abovementioned which are contributed as severance pay, between 13.3% and 15.8% of the employee's base salary.

Share Ownership

The following table sets forth, as of February 28, 2011, the number of Shares owned by officers, directors and senior management of the Company:

Name and Address	Number of Shares and Options Owned1	Percent of Outstanding Shares	
Zohar Zisapel2	1,511,722	21.94	%
Avi Eizenmann	237,022	3.42	%
Shaike Orbach	*	*	
Einat Domb Har	*	*	
Ilan Kalmanovich	*	*	
David Hendel	*	*	
Eran Gilad	*	*	
All directors and officers as a group	1,748,744	25.20	%

* Denotes ownership of less than 1% of the outstanding shares.

1 The table above includes the number of shares and options that are exercisable within 60 days of February 28, 2011. Ordinary shares subject to these options are deemed beneficially owned for the purpose of computing the ownership percentage of the person or group holding these options, but are not deemed outstanding for purposes of computing the ownership percentage of any other person. To our knowledge, the persons and entities named in the table have sole voting and dispositive power with respect to all shares shown as beneficially owned by them.

2 Based on Schedule 13D/A filed on March 5, 2009.

See also "Item 6. Directors and Senior Management – Compensation."

Item 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

Major Shareholders

The shareholders of the Company who beneficially own over 5% or more of each class of shares, as well as the number of shares owned and the percentage of outstanding shares owned by each, and additional information, is set forth below. The voting rights of our major shareholders do not differ from the voting rights of other holders of our ordinary shares.

Name of Shareholder	Number of Shares and Options Owned3	Percentage of Outstanding Shares		Any Significant Change in Past 3 Years
Zohar Zisapel4	1,511,722	21.94	%	+837,999

3 The table above includes the number of shares and options that are exercisable within 60 days of February 28, 2011. Ordinary shares subject to these options are deemed beneficially owned for the purpose of computing the ownership percentage of the person or group holding these options, but are not deemed outstanding for purposes of computing the ownership percentage of any other person. To our knowledge, the persons and entities named in the table have sole voting and dispositive power with respect to all shares shown as beneficially owned by them.

4 Based on Schedule 13D/A filed on March 5, 2009.

As of February 28, 2011, there were approximately 13 record holders of ordinary shares, including approximately 10 record holders in the United States. Collectively, these 13 record holders held approximately 16% of the outstanding ordinary shares.

Related Party Transactions

Messrs. Yehuda and Zohar Zisapel are brothers and are our founders. On July 15, 2010 Mr. Yehuda Zisapel resigned from serving as director on our board of directors, and on September 2, 2010, Mr. Zohar Zisapel was elected to serve as a director on our board. Messrs. Yehuda and Zohar Zisapel are also founders, directors and principal shareholders of several other corporations within the “Rad Group”, as described in “Item 6. Directors, Senior Management and Employees”.

There are other members of the Rad Group that are actively engaged in designing, manufacturing, marketing and supporting data communications products, none of which are currently the same as our products. Certain products of members of the Rad Group are complementary to, and may be used in connection with, our products. We and other members of the Rad Group also market certain of our products through the same distribution channels. Such products may, to a limited extent, compete with one another for the distributors’ time and efforts.

The Rad Group provides us with certain services, and is reimbursed by us for the costs of providing such services. During 2010, we purchased from the Rad Group internet services for an amount of up to $35,000, testing services for our products for an amount of up to $36,000 and car leasing services for an amount of up to $6,000. We also sub-lease office space in Paramus, New Jersey, for an amount of up to $10,000 (monthly rent payments of approximately $800) from Radcom Equipmet, Inc., an affiliated company of the Rad Group. We began to sub-lease this space in February 2004; the sub-lease was in effect until January 31, 2006 and was renewed for additional one-year periods through January 31, 2011. On January 31, 2011, we extended the sub-lease for an additional one-year period until January 31, 2,012.

During 2010, we sold external bypass switches and Server Adapters to members of the Rad Group for an amount of up to $290,000.

The material terms of the arrangements with the Rad Group, described in the preceding paragraphs, occur within the Company's ordinary course of business, and on market terms. We believe that such arrangements are neither material to the Company nor unusual in their nature or conditions. We further believe that the terms of the transactions in which we have engaged and are currently engaged with other members of the Rad Group are generally no less favorable to us than terms which might be available to us from unaffiliated third parties.

In January 2006 our board of directors approved a resolution under which sales to or purchases from any members of the Rad Group must meet certain criteria or be specifically approved by the audit committee, board of directors and shareholders, as applicable in accordance with Israeli law. These criteria included a stipulation that transactions between us and members of the Rad Group relate to standard equipment, services and products purchased or sold by us and the Rad Group, as applicable, and that such transactions occur within our ordinary course of business. The January 2006 resolution determined that transactions with members of the Rad Group must be entered into at least on market terms and at a value lower than 0.5% of our annual turnover per transaction and not more than 1% of our annual turnover in the aggregate for all such transactions in a financial year. Further, all future related party transactions and arrangements (or modifications of existing ones) with members of the Rad Group, transactions in which office holders of the Company have a personal interest, or transactions which raise issues of such office holders’ fiduciary duties, could require audit committee, board of directors and shareholder approval under the Israeli Companies Law-1999.

In January 2011, recognizing that sales to or purchases from the Rad Group may in the aggregate exceed 1% of our annual turnover in such year (without constituting extraordinary transactions as defined in the Israeli Companies Law), our board of directors revised its January 2006 resolution in respect of related party transactions.

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In its new resolution, on January 23, 2011, the board of directors approved sales to or purchases from the Rad Group, from time to time, of standard equipment, services and products, which are (i) within our ordinary course of business and (ii) at least at market terms and at a value lower than 0.5% of our annual turnover per transaction and 2.5% of our annual turnover for all such transactions in a financial year, aggregated together. Our management is required to examine on a quarterly basis whether transactions with the Rad Group comply with such criteria. Transactions which do not meet the criteria will require specific approvals in the applicable manner prescribed by Israeli law

Our board of directors further determined that our transactions with the Rad Group during 2010, which constituted 1.2% of our annual turnover, were (i) within our ordinary course of business; (ii) at least at market terms and at a value lower than 0.5% of our annual turnover per transaction and (iii) did not have any material effect on our profitability, assets or obligations.

In addition to being a founder, director and principal shareholder of each member of the Rad Group, Yehuda Zisapel is the founder and principal shareholder of Bynet and its subsidiaries. Bynet acts as a distributor in Israel for us and for other members of the Rad Group and also acts as a distributor in Israel for numerous unaffiliated manufacturers of data communications and other equipment. We believe that the terms of our relationship with Bynet are generally no less favorable to us than terms which might be available to us from unaffiliated third parties.

Except as indicated above, we do not directly currently compete with other members of the Rad Group and do not currently contemplate engaging in competition with any other member of the Rad Group in the future. However, opportunities to develop, manufacture or sell new products (or otherwise enter new fields) may arise in the future, which opportunities might be pursued by us or by one or more other members of the Rad Group to the exclusion of (or in competition with) other members of the Rad Group (including us). In the event that any such opportunity arises, the directors then in office will determine whether or not we should seek to pursue it. Any such determination will be based upon such factors as the directors then deem relevant. However, in making any such determination, the directors will be bound by their fiduciary duties to the Company (and to any other corporation or other person to whom they then owe a fiduciary duty).

On July 22, 2002, our audit committee and the Board of Directors approved an Indemnification Agreement with our directors and officers. Our shareholders approved the terms of this agreement in a General and Extraordinary Meeting held on January 7, 2004. In the March 2005 amendment to the Israeli Companies Law-1999, the instances in which a company may indemnify its officers and directors were broadened. In December 2007 each of our Audit Committee and Board of Directors approved a new form of Indemnification Agreement with our directors and officers so as to reflect this amendment. Our shareholders approved the terms of this new Indemnification Agreement in January 2008. The Agreement provides that our directors and officers will be exempt from liability in certain circumstances. The Agreement also provides for the indemnification by the Company for certain obligations and expenses imposed on the officer in connection with act performed in his or her capacity as an officer of the Company. This right to indemnification is limited, and does not cover, among other things, a breach of an officer’s duty of loyalty, a willful breach of an officer’s duty of care, or a reckless disregard for the circumstances or consequences of a breach of a duty of care. The right to indemnification also does not cover acts that are taken intentionally to unlawfully realize personal gain. The maximum amount of our liability under these Indemnification Agreements is currently $3,000,000.

We have maintained liability insurance for our directors and officers. On September 23, 2007 our shareholders approved the procurement of a policy, which provides for coverage of up to $4,000,000. All of our directors are parties to our Indemnification Agreements and are covered by our directors and officers insurance policy.

See “Item 10. Additional Information- Companies Law Amendment” below for a discussion of a recent amendment to the Israeli Companies Law-1999 which, once it enters into effect, may impact our company’s corporate governance practices as discussed herein.

See also “Item 6. Directors and Senior Management – Compensation.”

Item 8. FINANCIAL INFORMATION

Our consolidated financial statements and other financial information are included herein on pages F-1 through F-37.

Legal Proceedings

We are not a party to any material litigation and we are not aware of any pending or threatened litigation that would have a material adverse effect on us or our business.

Item 9. THE OFFER AND LISTING

Markets and Share Price History

The primary trading market for our ordinary shares is the NASDAQ Global Market (previously NASDAQ National Market), where our shares have been listed and traded under the symbol SILC (previously SILCF) since February 11, 2008. Prior thereto, our shares were listed and traded on the NASDAQ Capital Market (previously known as the NASDAQ Small-Cap).

The table below sets forth the high and low reported sales prices in dollars of our ordinary shares, as reported by NASDAQ during the indicated periods:

PERIOD	HIGH	LOW
LAST 6 CALENDAR MONTHS		
February 2011	21.85	16.79
January 2011	21.00	17.18
December 2010	19.54	15.75
November 2010	17.78	14.53
October 2010	16.50	13.61
September 2010	14.60	12.09
FINANCIAL QUARTERS DURING THE PAST TWO YEARS		
Fourth Quarter 2010	19.54	13.61
Third Quarter 2010	14.60	8.02
Second Quarter 2010	10.79	8.07
First Quarter 2010	11.49	8.50
Fourth Quarter 2009	10.20	7.47
Third Quarter 2009	9.55	6.22
Second Quarter 2009	8.00	6.07
First Quarter 2009	6.90	4.11
FIVE MOST RECENT FULL FINANCIAL YEARS		
2010	19.54	8.02
2009	10.20	4.11
2008	16.75	2.87
2007	28.24	8.40
2006	12.46	3.75

On December 27, 2005, our shares commenced trading on the Tel Aviv Stock Exchange in Israel under the symbol “SILC” (in Hebrew letters). The following table sets forth, for the periods indicated, the high and low reported sales prices, in NIS, of the ordinary shares on the Tel Aviv Stock Exchange:

PERIOD	HIGH	LOW
LAST SIX CALENDAR MONTHS		
February 2011	80.64	63.50
January 2011	75.50	63.02
December 2010	71.20	59.20
November 2010	63.85	52.52
October 2010	61.40	50.01
September 2010	54.97	44.76
FINANCIAL QUARTERS DURING THE PAST TWO YEARS		
Fourth Quarter 2010	71.20	50.01

Third Quarter 2010	54.97	30.31
Second Quarter 2010	40.14	31.81
First Quarter 2010	43.63	30.40
Fourth Quarter 2009	44.44	25.51
Third Quarter 2009	36.00	24.52
Second Quarter 2009	34.55	25.25
First Quarter 2009	30.00	16.20
FIVE MOST RECENT FULL FINANCIAL YEARS		
2010	71.20	30.31
2009	44.44	16.20
2008	59.80	13.05
2007	111.70	36.31
2006	56.59	20.16

Item 10. ADDITIONAL INFORMATION

Memorandum and Articles of Association

Articles of Association

Our shareholders approved our Amended and Restated Articles of Association ("Articles") on January 24, 2008. The objective stated in the Articles is to carry on any business and perform any act which is not prohibited by law.

We have currently outstanding only one class of shares, our Ordinary Shares, having a nominal value of NIS 0.01 per share. Holders of Ordinary Shares have one vote per share, and are entitled to participate equally in the payment of dividends and share distributions and, in the event of a liquidation of the Company, in the distribution of assets after satisfaction of liabilities to creditors. No preferred shares are currently authorized.

Our Articles require that we hold our annual general meeting of shareholders each year no later than 15 months from the last annual meeting, at a time and place, either within or without the State of Israel, determined by the board of directors, upon 21 days' prior notice to our shareholders or 35 days' prior notice to the extent required under the regulations to the Israeli Companies Law-1999 the "Companies Law"). In general, no business may be commenced at a general meeting until a quorum of two or more shareholders holding at least 33 1/3% of the voting rights is present in person or by proxy. Shareholders may vote in person or by proxy.

A simple majority is required to amend the articles of association of a company.

Pursuant to the Israeli Companies Law, resolutions regarding the following matters must be passed at a general meeting of shareholders:

- appointment or termination of our auditors;
- appointment and dismissal of directors;
- approval of interested party acts and transactions requiring general meeting approval as provided in sections 255 and 268 to 275 of the Israeli Companies Law;
- a merger as provided in section 320(a) of the Israeli Companies Law;
- the exercise of the powers of the board of directors, if the board of directors is unable to exercise its powers and the exercise of any of its powers is vital for our proper management, as provided in section 52(a) of the Israeli Companies Law.

An extraordinary general meeting may be convened by demand of two directors or by written request of one or more shareholders holding at least 5% of our issued share capital and 1% of the voting rights or one or more shareholders holding at least 5% of the voting rights. Shareholders requesting a special meeting must include in their request all relevant information, including the reason that such subject is proposed to be brought before the special meeting.

The Israeli Companies Law-1999

We are subject to the provisions of the Israeli Companies Law, which became effective on February 1, 2000. The Israeli Companies Law codifies the fiduciary duties that “office holders,” including directors and executive officers, owe to a company. An office holder, as defined in the Israeli Companies Law, is a director, general manager, chief business manager, deputy general manager, vice general manager, executive Vice-President, Vice-President, another manager directly subordinate to the managing director or any other person assuming the responsibilities of any of the foregoing positions without regard to such person's title. Each person listed in the table in “Item 6. Directors, Senior Management and Employees” above is an office holder. See “Item 10. Additional Information- Companies Law Amendment” below for a discussion of a recent amendment to the Israeli Companies Law which, once it enters into effect, may impact our company’s corporate governance practices as discussed herein.

The Israeli Companies Law requires that an office holder of a company promptly disclose, no later than the first board meeting in which such transaction is discussed, any personal interest that he or she may have and all related material information known to him or her, in connection with any existing or proposed transaction by the company. In addition, if the transaction is an extraordinary transaction, the office holder must also disclose any personal interest held by the office holder’s relative, or by any corporation in which the office holder is a 5% or greater shareholder, holder of 5% or more of the voting power, director or general manager or in which he or she has the right to appoint at least one director or the general manager. An extraordinary transaction is defined as a transaction not in the ordinary course of business, not on market terms, or that is likely to have a material impact on the company’s profitability, assets or liabilities.

In the case of a transaction that is not an extraordinary transaction, after the office holder complies with the above disclosure requirement, only board approval is required unless the articles of association of the company provide otherwise. The transaction must not be adverse to the company's interests. If the transaction is an extraordinary transaction, then, in addition to any approval required by the articles of association, it must also be approved by the audit committee and by the board of directors, and, under specified circumstances, by a meeting of the shareholders, as well.

Subject to certain exceptions provided for in the regulations to the Israeli Companies Law, agreements regarding directors' terms of compensation require the approval of the audit committee, board of directors and the shareholders of the company. In all matters in which a director has a personal interest, including matters of his or her terms of compensation, he or she shall not be permitted to vote on the matter or be present in the meeting in which the matter is considered. However, if a majority of the audit committee or of the board of directors has a personal interest in the matter then:

- all of the directors are permitted to vote on the matter and attend the meeting in which the matter is considered; and
- the matter requires approval of the shareholders at a general meeting.

According to the Israeli Companies Law, the disclosure requirements discussed above also apply to a controlling shareholder of a public company. Such requirements also apply to certain shareholders of a public company, with respect to private placements that will increase their relative holdings in the company. The term "controlling shareholder" is defined as a shareholder who has the ability to direct the activities of a company, other than if this power derives solely from the shareholder's position on the board of directors or any other position with the company, and the definition for these purposes also includes shareholders that hold 25% or more of the voting rights if no other shareholder owns more than 50% of the voting rights in the company. In general, extraordinary transactions with a controlling shareholder or in which a controlling shareholder has a personal interest, and agreements relating to employment and compensation terms of a controlling shareholder, require the approval of the audit committee, the board of directors and the shareholders of the company. The shareholder approval must either include at least one-third of the shares held by disinterested shareholders who actively participate in the voting process (without taking abstaining votes into account), or, alternatively, the total shareholdings of the disinterested shareholders who vote against the transaction must not represent more than one percent of the voting rights in the company.

Private placements in a public company require approval by a company's board of directors and shareholders in the following cases:

- A private placement that meets all of the following conditions:

µ The private placement will increase the relative holdings of a shareholder that holds five percent or more of the company's outstanding share capital, assuming the exercise of all of the securities convertible into shares held by that person, or that will cause any person to become, as a result of the issuance, a holder of more than five percent of the company's outstanding share capital.

µ 20 percent or more of the voting rights in the company prior to such issuance are being offered.

µ All or part of the consideration for the offering is not cash or registered securities, or the private placement is not being offered at market terms.

- A private placement which results in anyone becoming a controlling shareholder of the public company.

In addition, under the Companies Law, certain transactions or a series of transactions are considered to be one private placement.

Any placement of securities that does not fit the above description may be issued at the discretion of the board of directors.

Under the Israeli Companies Law, a shareholder has a duty to act in good faith towards the company and other shareholders when exercising his or her rights and refrain from abusing his power in the company, including, among other things, voting in the general meeting of shareholders on the following matters:

- any amendment to the articles of association;
- an increase of the company's authorized share capital;
- a merger; or
- approval of interested party acts and transactions that require general meeting approval as provided in sections 255 and 268 to 275 of the Israeli Companies Law.

In addition, any controlling shareholder, any shareholder who knows that it possesses power to determine the outcome of a shareholder vote and any shareholder who has the power to appoint or prevent the appointment of an office holder in the company is under a duty to act with fairness towards the company. The breach of such duty is governed by Israeli contract laws. The Israeli Companies Law does not describe the substance of this duty. The Israeli Companies Law requires that specified types of transactions, actions and arrangements be approved as provided for in a company's articles of association and in some circumstances by the audit committee, by the board of directors and by the general meeting of the shareholders. In general, the vote required by the audit committee and the board of directors for approval of these matters, in each case, is a majority of the disinterested directors participating in a duly convened meeting. See "Item 10. Additional Information- Companies Law Amendment" below for a discussion of a recent amendment to the Israeli Companies Law which, once it enters into effect, may impact our company's corporate governance practices as discussed herein.

Companies Law Amendment

Recently, the Israeli legislature, the Knesset, approved a new amendment to the Israeli Companies Law (the "Companies Law Amendment") that will come into effect within the next few months. The main purpose of the Companies Law Amendment is to revise and enhance existing provisions governing corporate governance practices of Israeli companies.

The main revisions contemplated under the Companies Law Amendment are, among others, as follows:

- Audit Committee. A majority of the Audit Committee must be comprised of "independent directors" (which is defined as directors with the qualifications of External Directors that did not serve as directors in the company for over 9 years); any person regularly engaged by or rendering services to a controlling shareholder may not serve on the Audit Committee; the Audit Committee is authorized to classify a transaction as extraordinary or significant.
- External Directors.The initial three-year term of service of External Directors can be extended, at the election of the company subject to certain conditions, by two additional three-year terms; External Directors will be elected by a majority vote at a shareholders' meeting, provided that either the majority of shares voted at the meeting, including at least one- half (instead of one-third, as under the current law) of the shares held by non-controlling shareholders voted at the meeting, vote in favor; or the total number of shares held by non-controlling shareholders voted against does not exceed two percent (instead of one percent, as under current law) of the aggregate voting rights in the company.
- Extraordinary Transactions. Extraordinary transactions with a controlling shareholder or in which a controlling shareholder has a personal interest, and agreements relating to employment and compensation of a controlling shareholder, require shareholders' approval that shall either include at least one- half (instead of one-third, as under current law) of the shares held by disinterested shareholders participating in the vote, or, alternatively, the total shareholdings of disinterested shareholders voting against the transaction must not represent more than two percent (instead of one percent, as under current law) of the voting rights; agreements relating to engagement or provision of services for a period exceeding three years, must generally be approved once every three years.
- Code of Corporate Conduct. A code of recommended corporate governance practices has been attached to the Companies Law Amendment; we are currently determining the applicability of such code to our company.
- Fines.The Israeli Securities Authority shall be authorized to impose fines on any person or company performing an action specifically designated as a breach under the Companies Law Amendment.

Although we expect to be in compliance with the Companies Law, there is no assurance that we will not be required to adjust our current corporate governance practices, as discussed in this annual report, pursuant to the provisions of this amendment.

The Israeli Securities Law- 1968 and the Securities Law Amendment

On February 27, 2011, an amendment to the Israeli Securities Law- 1968 (the “Israeli Securities Law”) came into effect (the “Securities Law Amendment”), which applies to Israeli public companies, including companies the securities of which are also listed on NASDAQ Global Market. The main purpose of the Securities Law Amendment is creating an administrative enforcement procedure to be used by the Israeli Securities Authority ("ISA") to enhance the efficacy of enforcement in the securities market in Israel. The new administrative enforcement procedure may be applied to any company or person (including director, officer or shareholder of a company) performing any of the actions specifically designated as breaches of law under the Securities Law Amendment.

Furthermore, the Securities Law Amendment requires that the chief executive officer of a company supervise and take all reasonable measures to prevent the company or any of its employees from breaching the Israeli Securities Law. The chief executive officers is presumed to have fulfilled such supervisory duty if the company adopts internal enforcement procedures designed to prevent such breaches, appoints a representative to supervise the implementation of such procedures and takes measures to correct the breach and prevent its reoccurrence.

Under the Securities Law Amendment, a company cannot obtain insurance against or indemnify a third party (including its officers and/or employees) for any administrative procedure and/or monetary fine (other than for payment of damages to an injured party). The Securities Law Amendment permits insurance and/or indemnification for expenses related to an administrative procedure, such as reasonable legal fees, provided that it is permitted under the company's articles of association.

We are currently examining the implications of the Securities Law Amendment; however, its effect and consequences, as well as our scope of exposure, are yet to be determined in practice. There is no assurance that we will not be required to take certain actions in order to enhance our compliance with the provisions of the Amendment, such as adopting and implementing an internal enforcement plan to reduce our exposure to potential breaches of the Israeli Securities Law, or amending our articles of association to permit insurance and/or indemnification as contemplated by this amendment.

NASD Marketplace Rules and Home Country Practices

In accordance with Israeli law and practice and subject to the exemption set forth in Rule 4350(a)(1) of the NASD Marketplace Rules, we follow the provisions of the Israeli Companies Law – 1999, rather than the requirements of Rule 4350 of the Market Place Rules with respect to the following requirements:

- Distribution of annual and quarterly reports to shareholders – Under Israeli law we are not required to distribute annual and quarterly reports directly to shareholders and the generally accepted business practice in Israel is not to distribute such reports to shareholders. We do however make our audited financial statements available to our shareholders prior to our annual general meeting and file our quarterly and annual financial results with the Securities Exchange Commission on Form 6-K.

- Independence, Nomination and Compensation of Directors – A majority of our board of directors is not comprised of independent directors as defined in Rule 4200 of the NASD Marketplace Rules. Our board of directors contains two external directors in accordance with the provisions contained in Sections 239-249 of the Israeli Companies Law – 1999. Israeli law does not require, nor do our external directors conduct, regularly scheduled meetings at which only they are present. In addition, with the exception of our external directors, our directors are elected for terms of one year or until the following annual meeting, by a general meeting of our shareholders. The nominations for director which are presented to our shareholders are generally made by our directors. Israeli law does not require the adoption of and our board has not adopted a formal written charter or board resolution addressing the nomination process and related matters. Compensation of our directors and other officers is determined in accordance with Israeli law.

- Audit Committee– Our audit committee does not meet with all the requirements of Rules 4350(d)(2)(A)(i), 4350(d)(2)(A)(iii) and 4350(d)(2)(A)(iv) of the NASD Marketplace Rules. We are of the opinion that the members of our audit committee comply with the requirements of Rule 10A-3(b) of the general rules and regulations promulgated under the Securities Act of 1933 and all requirements under Israeli law. Our audit committee has not adopted a formal written audit committee charter specifying the items enumerated in Rule 4350(d)(1) of the NASD Marketplace Rules.

- Quorum – Under Israeli law a company is entitled to determine in its articles of association the number of shareholders and percentage of holdings required for a quorum at a shareholders meeting. Our Articles of Association provide that a quorum of two or more shareholders, present in person or by proxy, holding shares conferring in the aggregate more than thirty three and a third (33 1/3 %) percent of the voting power of the Company is required for commencement of business at a general meeting.

- Approval of Related Party Transactions – All related party transactions are approved in accordance with the requirements and procedures for approval of interested party acts and transactions, set forth in sections 268 to 275 of the Israeli Companies Law-1999.

- Shareholder Approval – We seek shareholder approval for all corporate action requiring such approval, in accordance with the requirements of the Israeli Companies Law – 1999.

See “Item 10. Additional Information- Companies Law Amendment” above for a discussion of a recent amendment to the Israeli Companies Law which, once it enters into effect, may impact our company’s corporate governance practices as discussed herein.

Material Contracts

All of our contracts over the past two years have been entered into in the ordinary course of business, except for our real property leases. Information regarding our real property leases is provided in “Item 4. Information on the Company – Property, Plant and Equipment” and "Item 19. Exhibits".

Exchange Controls

Under current Israeli regulations, any dividends or other distributions paid in respect of our ordinary shares purchased by nonresidents of Israel with certain non-Israeli currencies (including dollars) and any amounts payable upon the dissolution, liquidation or winding up of our affairs, as well as the proceeds of any sale in Israel of our securities to an Israeli resident, will be freely repatriable in such non-Israeli currencies at the rate of exchange prevailing at the time of conversion pursuant to the general permit issued under the Israeli Currency Law, 1978, provided that Israeli income tax has been paid on (or withheld from) such payments. Because exchange rates between the NIS and the U.S. dollar fluctuate continuously, U.S. shareholders will be subject to any such currency fluctuation during the period from when such dividend is declared through the date payment is made in U.S. dollars.

Investments outside Israel by the Company no longer require specific approval from the Controller of Foreign Currency at the Bank of Israel.

Taxation

The following is a summary of some of the current tax law applicable to companies in Israel, with special reference to its effect on us. The following also contains a discussion of specified Israeli tax consequences to our shareholders and government programs from which we benefit. To the extent that the discussion is based on tax legislation (including the legislation passed as part of the recent tax reform in Israel) that has not been subject to judicial or administrative interpretation, there can be no assurance that the views expressed in the discussion will be accepted by the tax authorities in question.

The discussion is not intended, and should not be construed, as legal or professional tax advice and is not exhaustive of all possible tax considerations.

Holders of our ordinary shares should consult their own tax advisors as to the United States, Israeli or other tax consequences of the purchase, ownership and disposition of ordinary shares, including, in particular, the effect of any foreign, state or local taxes.

General Corporate Tax

Israeli companies are subject to corporate tax at the rate of 25% in the 2010 tax year and 24% in the 2011 tax year. The corporate tax rate has been scheduled to further decline in the amendment to the Income Tax Ordinance (Amendment No. 171 dated July 23, 2009) to 23% in 2012, 22% in 2013, 21% in 2014, 20% in 2015 and 18% in 2016 and thereafter. However, the effective tax rate payable by a company which derives income from an Approved Enterprise (as further discussed below) may be considerably less.

Law for the Encouragement of Capital Investments, 1959

Certain of our facilities have been granted “Approved Enterprise” status under the Law for the Encouragement of Capital Investments, 1959, as amended (the “Investment Law”). The Investment Law provides that a capital investment in eligible facilities may, upon application to the Israel Investment Center of the Ministry of Industry and Trade of the State of Israel (referred to as the Investment Center), be designated as an Approved Enterprise. Each certificate of approval for an Approved Enterprise relates to a specific investment program delineated both by its financial scope, including its capital sources and its physical characteristics, for example, the equipment to be purchased and utilized pursuant to the program. The tax benefits derived from any such certificate of approval relate only to taxable income attributable to the specific Approved Enterprise.

An amendment to the Investment Law which came into effect as of April 1, 2005 (the "First Amendment”) has significantly changed the provisions of the Investment Law. The First Amendment determined criteria for the approval of a facility as an Approved Enterprise, such as provisions generally requiring that at least 25% of the income of an Approved Enterprise will be derived from exports. Additionally, as explained below, the First Amendment sets forth major changes in the manner in which tax benefits were awarded under the Investment Law whereby companies were no longer require Investment Center approval (and Approved Enterprise status) in order to qualify for tax benefits. However, the Investment Law provides that terms and benefits included in any certificate of approval already granted will remain subject to the provisions of the Investment Law as in effect on the date of such approval. Therefore the tax benefits granted to our Approved Enterprises under the Investment Law will generally not be subject to the provisions of the First Amendment. Many of the requirements under the Investment Law following the First Amendment were amended again in a second amendment to the Investment Law (the “Second Amendment”), as will be described below.

Tax Benefits Prior to the First Amendment

In general, taxable income of a company derived from an Approved Enterprise was subject to tax exemption and/or reduced corporate tax than the rates stated above (this will also apply to Approved Enterprises approved after the First Amendment, as explained below). The reduced corporate tax rate applies for a period of time termed the "benefit period". The benefit period was a period of seven years commencing with the year in which the Approved Enterprise first generates taxable income. In any event, the benefit period was limited to 12 years from the commencement of production or operation, or 14 years from the year in which the approval was received, whichever is earlier. Under certain circumstances (as further detailed below), the benefit period may have been extended to a maximum of ten years from the commencement of the benefit period. In the event that a company was operating under more than one approval or that only part of its capital investments were approved (a "Mixed Enterprise"), its effective corporate tax rate was the result of a weighted combination of the various applicable rates.

A company which qualifies as a "Foreign Investors' Company" was entitled to an extended benefit period and to further reductions in the tax rate normally applicable to Approved Enterprises. Subject to certain conditions, a "Foreign Investors' Company" was defined as a company which has more than 25% of its combined shareholders' investment in share capital (in terms of rights to profits, voting and the appointment of directors) and in long term shareholders' loans, as defined in the Investment Law, made by persons who are not residents of Israel. The percentage owned by nonresidents of Israel for any tax year will be determined by the lowest percentage in any of the above rights held by nonresidents during that year. Foreign Investors' Company paid Company Tax at reduced rates for an extended ten-year (rather than the otherwise applicable seven-year) period as detailed below:

Level of Foreign Investment	Company Tax Rate		Benefit period (years)
Over 0% but less than 25%	25	%	7
Over 25% but less than 49%	25	%	10
49% or more but less than 74%	20	%	10
74% or more but less than 90%	15	%	10
90% or more	10	%	10

There can be no assurance that the above-mentioned shareholding proportion will be reached for each subsequent year.

Prior to the First Amendment, a company owning an Approved Enterprise approved after April 1, 1986 (or prior thereto provided no government grants or loans had previously been granted regarding such enterprise) was entitled to elect (as we have) to forego certain Government grants extended to Approved Enterprises in return for an "alternative route" of tax benefits (the "Alternative Route"). Under the Alternative Route, a company's undistributed income derived from an Approved Enterprise was exempt from corporate tax for a period of between two and ten years from the first year of taxable income, depending on the geographic location of the Approved Enterprise within Israel, and such company was eligible for the reduced tax rates under the Investment Law for the remainder of the benefit period as mentioned above.

Our production facilities have been granted "Approved Enterprise" status under the Alternative Route according to the Investment Law. The initial Approved Enterprise status was granted in 1988 ("Initial Approved Enterprise"). An extension program was granted Approved Enterprise status in 1995 (the "Extended Approved Enterprise"). Income derived from our Approved Enterprises is tax exempt during six years of the seven year tax benefit period and is subject to a reduced tax rate of 25% in the seventh year. The seven year period of benefits commences in the year the Approved Enterprise first earns taxable income but is limited to twelve years from commencement of production or fourteen years from date of approval, whichever is earlier. The period of tax benefits, relating to our Initial Approved Enterprise, commenced in 1991 and expired in 1997. The period of tax benefits relating to our Extended Approved Enterprise commenced in 1997 and expired in 2006, as explained below.

In June 1995, we reached an agreement with the tax authorities regarding our entitlement to benefits under the Investment Law. The agreement, effective from tax year 1994 and thereafter, relates to the method of determination of taxable income from our research and development activities. Pursuant to the agreement, for the purpose of determining our tax liability, our income will be allocated to our manufacturing plant and to our research and development center, according to a formula based on the net costs plus royalties of the research and development center and our profitability. Income allocated to the expansion of the manufacturing plant will benefit from a ten-year tax exemption, while income allocated to the research and development center will benefit from a two-year exemption, and for a five-year period immediately following will be taxed at a 25% rate.

Our income to be attributed to our Extended Approved Enterprise in any year will be computed as a ratio of the increase in our sales turnover, if any, in that year to our turnover in the year before the Extended Approved Enterprise commenced its tax benefits entitlement. The tax authorities have reserved their right to reconsider our claim to such tax benefits in future years.

The entitlement to the above benefits is conditional upon our fulfillment of the conditions stipulated by the law, regulations published thereunder and the instruments of approval for the specific investments in the Approved Enterprise. In the event of failure to comply with these conditions, the benefits may be canceled and we may be required to refund the amount of the benefits, in whole or in part, with the addition of linkage differences, interest and penalties. Should we derive income from sources other than the Approved Enterprise during the relevant periods of benefits, such income will be taxable at regular corporate tax rates stated above.

A company that elected the Alternative Route prior to the First Amendment and that subsequently paid a dividend out of income derived from the Approved Enterprise(s) during the tax exemption period will be subject to Company Tax in the year the dividend is distributed in respect of the amount distributed (including the corporate tax thereon), at the rate that would have been applicable had the company not elected the Alternative Route (10%-25%, depending on the level of foreign investment in the company, as explained above). In addition, the dividend recipient is taxed at the reduced rate applicable to dividends from Approved Enterprises (15%), if the dividend is distributed during the tax exemption period or within a specified period thereafter (in the event, however, that the company qualified as a Foreign Investors' Company, there was no such time limitation).

Subject to certain provisions concerning income subject to the Alternative Route, all dividends are considered to be attributable to the entire enterprise and the effective tax rate is the result of a weighted combination of the various applicable tax rates. Under the Investment Law, a company that has elected the alternative package of benefits was not required to distribute exempt retained profits, and may generally decide from which year’s profits to declare dividends.

The Investment Law also provided that an Approved Enterprise was entitled to accelerated depreciation on its property and equipment that were included in an approved investment program. We have not utilized this benefit.

Grants and certain other incentives received by a company in accordance with the Investment Law remained subject to final ratification by the Israel Investment Center and final determination by the Israel Tax Authority. Such ratification and determination were conditional upon fulfillment of all of the terms of the approved program.

Tax Benefits under the First Amendment

As a result of the First Amendment, a company was no longer required to acquire Approved Enterprise status in order to receive the tax benefits previously available under the Alternative Route and therefore such companies did not need to apply to the Investment Center for this purpose. However, the Investment Center continued granting Approved Enterprise status to companies seeking Governmental grants. A company could have claimed the tax benefits offered by the Investment Law directly in its tax returns, provided that its facilities meet the criteria for tax benefits set forth in the First Amendment (a “Benefited Enterprise”). Companies were also entitled to approach the Israeli Tax Authority for a pre-ruling regarding their eligibility for benefits under the First Amendment. The First Amendment included provisions intended to ensure that a company will not enjoy both government grants and tax benefits for the same investment program.

Tax benefits were available under the First Amendment to production facilities and other eligible facilities, which were generally required to derive more than 25% of their business income from exports. In order to receive the tax benefits, the First Amendment stated that the company must make an investment in the Benefited Enterprise exceeding a minimum amount specified in the Investment Law. Such investment could have been made over a period of no more than three years, such period concluding at the end of the year in which the company requested to have the tax benefits apply to its Benefited Enterprise (the “Year of Election”). Where the company requested to have the tax benefits apply to an expansion of existing facilities, only the expansion was considered a Benefited Enterprise and the company’s effective tax rate was the result of a weighted combination of the applicable rates. In the case of an expansion of existing facilities, the minimum investment required in order to qualify as a Benefited Enterprise was determined as a certain percentage of the company’s production assets before the expansion and in any case was not less than NIS 300,000.

The tax benefits which were available under the First Amendment to qualifying income of a Benefited Enterprise were determined by the geographic location of the Benefited Enterprise in Israel. The Investment Law divides the country into three zones – A, B and C, so that a Benefited Enterprise operating in Zone A (which generally includes areas remote from the center of Israel) received the greatest benefits and Benefited Enterprises in Zone C received the least benefits.

The First Amendment provided that a company producing income from a Benefited Enterprise in Zone A could have elected either that (i) the undistributed income derived from the Benefited Enterprise will be fully tax exempt for the entire benefit period described below ("tax exemption"), in which case the ordinary provisions described below concerning the taxation of the company and shareholder for distribution of dividends will apply; or (ii) that the income from its Benefited Enterprise will be subject to corporate tax at a rate of a 11.5%, in which case dividends paid out of such income to a foreign resident will be taxed at a rate of 4% and to an Israeli resident will be taxed at a rate of 15%, and the company will not be subject to additional tax upon dividend distribution. Further benefits were available in the event of certain large investments by multinational companies. Benefited Enterprises located in Zones B and C was exempt from tax for six and two years, respectively, and subject to tax at a rate of 10%-25% for the remainder of the benefit period, depending on the extent of foreign investment in the Company, as described above.

Dividends paid out of income derived by a Benefited Enterprise, or out of dividends received from a company whose income was derived from a Benefited Enterprise, were generally subject to withholding tax at the rate of 15% or less under certain anti double-taxation treaties, such tax being deductible at source. The reduced withholding tax rate of 15% was limited to dividends and distributions out of income derived during the benefit period and actually paid at any time up to 12 years thereafter. A company qualified for tax benefits under the First Amendment which paid a dividend out of income derived by its Benefited Enterprise during the tax exemption period will be subject to corporate tax in respect of the gross amount of the dividend. The rate of the tax was the rate which would have been applicable had the company not been tax exempt. Such tax rate was lower in the case of a qualified "Foreign Investors' Company".

The period for which tax benefits were available under the First Amendment was also determined by the geographical location of the Benefited Enterprise in Israel. The benefit period for Benefited Enterprises in Zone A ended on the earlier of (i) a period of ten years from the tax year in which the company first derived taxable income from the Benefited Enterprise (the "Commencement Year"); or (ii) twelve years (or in certain cases fourteen years) from the first day of the Year of Election. The benefit period for Benefited Enterprises in Zones B and C was extended until the earlier of (i) seven years from the Commencement Year or (ii) 12 years from the first day of the Year of Election. This period could have been extended for Benefited Enterprises owned by a "Foreign Investors' Company" during all or part of the benefit period.

Additionally, the First Amendment sets forth a minimal amount of foreign investment required for a company to be regarded a Foreign Investors' Company.

We have selected the 2004 tax year, the 2006 tax year and the 2009 tax year to be our Year of Election, from which the period of benefits under the Investment Law commenced.

There can be no assurance that we will attain approval for additional tax benefits under the Amendment, or receive approval for Approved Enterprises in the future.

The Second Amendment to the Investment Law

Recently the Israeli legislature, the Knesset, approved significant changes to the Investment Law, which revamped the tax incentive regime in Israel and are effective as of January 1, 2011. The main changes enacted under the Second Amendment are, inter alia, as follows:

- Replacement of all future tax incentives under the existing law as amended by the First Amendment; as a result, commencing 2011, industrial companies that meet the conditions set out by the Second Amendment will no longer be entitled to the existing tax incentives provided under the First Amendment, such as the exemption from tax on undistributed profits and a reduced tax rate thereafter but rather to the tax incentives under the Second Amendment.
- Under the transition provisions, any tax benefits obtained prior to 2011 shall continue to apply until expired, unless the company elects to apply the provisions of the Second Amendment to its income.
- The Second Amendment provides that industrial companies meeting the criteria set out by the Investment Law will be eligible for flat tax rates of 10% or 15% for the years 2011 through 2012, 7% or 12.5% for years 2013 through 2014 and 6% or 12% for years 2015 onwards, with the actual tax rates determined by the location of the enterprise. Under the Second Amendment, the tax incentives offered by the Investment Law are no longer dependant neither on minimum qualified investments nor on foreign ownership.
- The Second Amendment allows a company to enjoy both government grants and tax benefits concurrently. Governmental grants will not necessarily be dependent on the extent of enterprise's investment in assets and/or equipment. Commencing 2011, the approval of "Preferred Enterprise" status by either the Israeli Tax Authorities or the Investment Center will be accepted by the other. Therefore a Preferred Enterprise will be eligible to receive both tax incentives and government grants, under certain conditions.

Chapter B1 of the Investment Law determines that the “Preferred Income” of a “Preferred Enterprise” will be subject to corporate income tax rate of 10% if located in a preferred zone or 15% if not located in a preferred zone in years 2011-2012, a rate of 7% or 12.5%, for years 2013-2014 and a rate of 6% or 12% from 2015 and onwards.

“Preferred Income” is defined by the Second Amendment as income from the sale of products of the Preferred Enterprise (including components that were produced by other enterprises); income from the sale of semiconductors by other non related enterprises which use the Preferred Enterprise’s self-developed know-how; income for providing a right to use the Preferred Enterprise’s know how or software; royalties from the use of the know-how or software which was confirmed by the Head of Investment Center to be related to the production activity of the Preferred Enterprise and services with respect to the aforementioned sales. In addition, the definition of “Preferred Income” also includes income from the provision of industrial R&D services to foreign residents to the extent that the services were approved by the Head of Research for the Industrial Development and Administration.

A “Preferred Enterprise” is defined under the Second Amendment as an Industrial Enterprise (including, inter alia, an enterprise which develops software, an enterprise which provides approved R&D services to foreign residents and an enterprise which the Chief Scientist confirmed is carrying out R&D in the field of alternative energy), which generally more than 25% of its business income is from export. As mentioned above, the new tax incentives no longer depend on minimum qualified investments nor on foreign ownership.

Chapter B2 of the Investment Law determines the conditions and limitations applying to the tax benefits offered to a “Special Preferred Enterprise”. Chapter B2 determines that a “Special Preferred Enterprise” will be able to enjoy corporate income tax rate in a rate of 5% if located in a preferred zone and 8% if not located in a preferred zone.

A “Special Preferred Enterprise” is defined following the Second Amendment as a Preferred Enterprise which meets one of the following conditions: (a) its Preferred Income is equal to or exceeds NIS 1.5 billion; (b) the total income of the company which owns the Preferred Enterprise or which operates in the same field of the Preferred Enterprise and which consolidates in its financial reports the company that owns the Preferred Enterprise equals or exceeds NIS 20 billions; or (c) its business plan was approved by the authorities as significantly benefitting the Israeli economy, either by an investment of at least NIS 400 - 800 million in assets; 100 -150 million NIS in R&D or the employment of at least 250 to 500 new employees, for preferred zones and regular zones, respectively.

With respect to the distribution of dividends, the Investment Law provides that distribution of dividends out of earnings that are subject to the new tax incentives is subject to a 15% withholding tax. Nevertheless, under the transition rules, dividend distributed by companies that elected to convert to the new law until 30 June 2015 (in respect to their existing programs) will not be subject to tax provided that: (a) the distribution is of nonexempt earnings derived by the company under the previous law; and (b) the distribution is made to an Israeli company.

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The Company is currently examining the implications of the Second Amendment to the Investment Law. There can be no assurance that we will comply with the conditions of the Investment Law in the future or that we will be entitled to any additional benefits under the amended Investment Law under the First Amendment and/or the Second Amendment and whether the influence of the expected changes will be beneficial to the Company or not.

Law for the Encouragement of Industrial Research and Development, 1984

Under the Law for the Encouragement of Industrial Research and Development (the "Research Law"), research and development programs approved by the Research Committee (the "Research Committee") of the Office of the Chief Scientist ("OCS") are eligible for grants or loans if they meet certain criteria, in return for the payment of royalties from the sale of the product developed in accordance with the program and subject to other restrictions. Once a project is approved, the OCS will award grants of up to 50% of the project's expenditures in return for royalties, usually at the rate of 3% to 6% of sales of products developed with such grants. For projects approved after January 1, 1999, the amount of royalties payable is up to a dollar-linked amount equal to 100% of such grants plus interest at LIBOR. There is no further liability for payment.

The terms of these grants prohibit the manufacture outside of Israel of the product developed in accordance with the program without the prior consent of the Research Committee of the OCS. Such approval, if granted, is generally subject to an increase in the total amount to be repaid to the OCS to between 120% and 300% of the amount granted, depending on the extent of the manufacturing to be conducted outside of Israel.

The Research Law also provides that know-how from the research and development, which is used to produce the product, may not be transferred to Israeli third parties without the approval of the Research Committee. Until 2005, the Research Law stated that such know-how may not be transferred to non-Israeli third parties at all. An amendment to the Research Law has set forth certain exceptions to this rule; however, the practical implications of such exceptions are quite limited. The Research Law has stressed, that it is not just transfer of know-how that is prohibited, but also transfer of any rights in such know-how. Such restriction does not apply to exports from Israel of final products developed with such technologies. Approval of the transfer may be granted only if the transferee undertakes to abide by all of the provisions of the Research Law and regulations promulgated thereunder, including the restrictions on the transfer of know-how and the obligation to pay royalties. There can be no assurance that such consent, if requested, will be granted or, if granted, that such consent will be on reasonable commercial terms.

Tax Benefits for Research and Development

Israeli tax law allows, under certain conditions, a tax deduction in the year incurred for expenditures (including capital expenditures) in scientific research and development projects, if the expenditures are approved by the relevant Israeli Government Ministry (determined by the field of research) and the research and development is for the promotion of the enterprise and is carried out by or on behalf of the company seeking such deduction. Such expenditures not so approved are required to be deducted over a three-year period. Though we received such approvals for the years 2006, 2007 and 2008 and could deduct the tax in the year the expenditures were incurred, we chose to deduct the tax over a three-year period.

Law for the Encouragement of Industry (Taxes), 1969

Under the Law for the Encouragement of Industry (Taxes), 1969 (the “Industry Encouragement Law”), Industrial Companies (as defined below) are entitled to the following tax benefits:

(a) Amortization of purchases of know-how and patents over eight years for tax purposes.

(b) Amortization of expenses incurred in connection with certain public securities issuances over a three-year period.

(c) Accelerated depreciation rates on equipment and buildings.

Eligibility for benefits under the Industry Encouragement Law is not subject to receipt of prior approval from any governmental authority. Under the Industry Encouragement Law, an “Industrial Company” is defined as a company resident in Israel, at least 90% of the income of which, in any tax year, determined in Israeli currency, exclusive of income from government loans, capital gains, dividends, interest and linkage differences, is derived from an “Industrial Enterprise” owned by it. An “Industrial Enterprise” is defined as an enterprise whose major activity in a given tax year is industrial production activity.

We believe that we currently qualify as an Industrial Company within the definition of the Industry Encouragement Law. No assurance can be given that we will continue to qualify as an Industrial Company or that the benefits described above will be available in the future.

Calculation of Results for Tax Purposes

The Israeli Income Tax Regulations (Rules for Maintaining Accounting Records of Foreign Investors’ Companies and Certain Partnerships and Determining Their Taxable Income) - 1986 provide that as a Foreign Investors’ Company (as defined in the Investment Law described above) is eligible to calculate its taxable income in accordance with these regulations, and therefore, if we elect to follow such regulations, our taxable income or loss is to be calculated in dollars. We have elected to apply these regulations and accordingly our taxable income or loss is calculated in dollars in the manner set forth in such regulations.

Capital Gains Tax on Sales of Our Ordinary Shares

Until the end of the year 2002 and provided we maintained our status as an industrial corporation, capital gains from the sale of our securities were generally exempt from Israeli Capital Gains Tax. This exemption did not apply to a shareholder whose taxable income is determined pursuant to the Israeli Income Tax Law (Inflationary Adjustments) 1985, or to a person whose gains from selling or otherwise disposing of our securities were deemed to be business income.

On January 1, 2006 an amendment to the Israeli tax regime, or the 2006 Tax Reform, became effective. The 2006 Tax Reform significantly changed the tax rates applicable to income derived from shares.

According to the 2006 Tax Reform, an individual is subject to a 20% tax rate on real capital gains derived from the sale of shares, as long as the individual is not a "substantial shareholder" (generally a shareholder with 10% or more of the right to profits, right to nominate a director and voting rights) in the company issuing the shares.

A substantial shareholder will be subject to tax at a rate of 25% in respect of real capital gains derived from the sale of shares issued by a company in which he or she is a substantial shareholder. The determination of whether the individual is a substantial shareholder will be made on the date on which the securities are sold. In addition, the individual will be deemed to be a substantial shareholder if at any time during the 12 months preceding the date of sale, he or she was a substantial shareholder.

Non-Israeli residents are exempt from Israeli capital gains tax on any gains derived from the sale of shares in an Israeli corporation publicly traded on TASE and/or on a foreign stock exchange, provided such gains do not derive from a permanent establishment of such shareholders in Israel and that such shareholders did not acquire their shares prior to the issuer’s initial public offering. However, non-Israeli corporations will not be entitled to such exemption if an Israeli resident has a controlling interest of 25% or more in such non-Israeli corporation, or is the beneficiary of, or is entitled to, 25% or more of the revenues or profits of such non-Israeli corporation, whether directly or indirectly.

In some instances where our shareholders may be liable for Israeli tax on the sale of their ordinary shares, the payment of the consideration may be subject to the withholding of Israeli tax at the source.

Pursuant to the treaty between the governments of the United States and Israel with respect to taxes on income, or the U.S.-Israel tax treaty, the sale, exchange or disposition of our ordinary shares by a person who qualifies as a resident of the United States under the treaty and who is entitled to claim the benefits afforded by the treaty, will generally not be subject to Israeli capital gains tax. This exemption does not apply to a person who held, directly or indirectly, shares representing 10% or more of the voting power in our company during any part of the 12 month period preceding the sale, exchange or disposition, subject to certain conditions. A sale, exchange or disposition of our shares by a U.S. resident qualified under the treaty, who held, directly or indirectly, shares representing 10% or more of the voting power in our company at any time during the 12 month period preceding such sale, exchange or disposition, would be subject to Israeli tax, to the extent applicable; however, under the treaty, this U.S. resident would be permitted to claim a credit for these taxes against the U.S. income tax with respect to the sale, exchange or disposition, subject to the limitations in U.S. laws applicable to foreign tax credits.

Taxation of Dividends

Non-residents of Israel are subject to income tax on income accrued or derived from sources in Israel. These sources of income include passive income such as dividends, royalties and interest, as well as non-passive income from services rendered in Israel. On distributions of dividends (other than bonus shares or stock dividends) to Israeli individuals and foreign resident individuals and corporations we would be required to withhold income tax at the rate of 20%. If the income out of which the dividend is being paid is attributable to an Approved Enterprise or Benefited Enterprise under the Investment Law, the rate is 15%. A different rate may be provided for in a treaty between Israel and the shareholder's country of residence. Under the U.S.-Israel tax treaty, if the income out of which the dividend is being paid is not attributable to an Approved Enterprise or Benefited Enterprise, then we are required to withhold income tax at a rate of 12.5% with respect to shareholders that are U.S. corporations and held at least 10% of our voting power in the 12 month period preceding the distribution of such dividends.

Residents of the United States will generally have taxes in Israel withheld at source. Such persons generally would be entitled to a credit or deduction for United States Federal income tax purposes for the amount of such taxes withheld, subject to limitations applicable to foreign tax credits.

Passive Foreign Investment Company Status under U.S. Federal Income Tax Law

In general, a non-U.S. corporation will be classified for U.S. tax purposes as a passive foreign investment company (hereafter also referred to as a "PFIC") in any taxable year in which either (i) 75% or more of its gross income (including the pro-rata gross income of any company (U.S. or foreign) in which it is considered to own 25% or more of the ordinary shares by value) for the taxable year is passive income, or (ii) at least 50% of the average value of all of its gross assets (including the pro-rata fair market value of the assets of any company in which it is considered to own 25% or more of the ordinary shares by value) during the taxable year, calculated quarterly by value, produce, or are held for the production of, passive income. Passive income for these purposes includes items such as dividends, interest, royalties, rents and gains from commodities and securities transactions.

If we are classified as a passive foreign investment company, highly complex rules will apply to our U.S. shareholders. Accordingly, U.S. shareholders are urged to consult their tax advisors regarding the application of such rules.

If a corporation is a passive foreign investment company, a U.S. shareholder will be subject to one of three alternative taxing regimes:

The simplest is the "QEF" regime. If the shareholder elects to treat the PFIC as a "qualified electing fund" ("QEF"), then each year the shareholder includes in its gross income a proportionate share of the PFIC's ordinary income and net capital gain. We do not currently intend to prepare or provide the information that would enable you to make a Qualified Election Fund election. A second regime may be elected if the PFIC stock is "marketable." The U.S. shareholder may elect to "mark the stock to market" each year. At the end of each taxable year, the shareholder recognizes gain equal to the excess of the fair market value of the PFIC stock over the shareholder's tax basis in the stock. (Losses may also be recognized to the extent of previously recognized gains.)

A U.S. shareholder making neither of these elections is subject to the "excess distribution" regime. The tax is triggered when the shareholder receives an "excess distribution" from the PFIC. An excess distribution is either (1) a distribution with respect to stock that is greater than 125% of the average of such distributions over the preceding three years, or (2) 100% of the gain from the disposition of shares in the PFIC.

An excess distribution is subject to special tax rules. In most cases, only a portion of it is included in the gross income of the U.S. shareholder and taxed at normal rates. The remainder is never so included, but is used as the basis for calculating a "deferred tax amount", which is simply added to the shareholder's tax liability.

The deferred tax amount is computed as follows. The excess distribution is first ratably allocated, share by share, to each day of the shareholder's holding period. Portions allocated to the current year, and to any pre-PFIC years (that is, years before 1987, when there were no PFICs, or years before the first year in which the company was a PFIC with respect to that shareholder), are included in ordinary income for the current year. Portions allocated to prior PFIC years are hypothetically taxed at the highest marginal rate in effect for those years (without regard to the shareholder's actual rate or to any deductions or credits for those years). To this hypothetical tax is added the interest that the shareholder would have paid if it were simply paying that tax late for that year. The sum of the tax and the interest charge is the deferred tax amount, which cannot be offset or otherwise affected by current net operating losses or other deductions.

A U.S. person who inherits shares in a foreign corporation that was a PFIC in the hands of the decedent (who did not make either of the elections described above), is denied the otherwise available step-up in the tax basis of such shares to fair market value at the date of death. The U.S. person steps into the shoes of the decedent and will be subject to the rules described above.

Although a determination as to a corporation's PFIC status is made annually, an initial determination that a corporation is a PFIC for any taxable year generally will cause the above-described consequences to apply for all future years as to U.S. shareholders who held shares in the corporation at any time during the PFIC taxable year and who made neither a valid QEF election with respect to such shares nor a valid election to mark such shares to market. This will be true even if the corporation loses its PFIC status in later years. However, with respect to a PFIC that does not make any distributions or deemed distributions, the above tax treatment would apply only to gains realized on the disposition of such shares by a U.S. shareholder.

If we are classified as a PFIC, complicated rules will apply to our U.S. shareholders. Our status in future years will depend on our assets and activities in those years, although shareholders will be treated as continuing to own an interest in a passive foreign investment company if we are a passive foreign investment company in any year in which a shareholder owns our shares, unless certain elections are made.

This discussion does not address all aspects of U.S. federal income taxation that may be relevant to a U.S. shareholder in light of his or her particular circumstances or to a U.S. shareholder subject to special treatment under U.S. federal income tax law. We do not currently intend to prepare or provide the information that would enable you to make a Qualified Election Fund election. U.S. shareholders are urged to consult their tax advisors about the U.S. federal income taxation rules to which they will be subject, as well as the PFIC rules, including the advisability, procedure and timing of making a mark-to-market election, in connection with their holding of our shares, including warrants or rights to acquire our shares.

Tax Assessment

The Company and its subsidiary file income tax returns in Israel and in the US. The Israeli tax returns of the Company are open to examination by the Israeli tax authorities for the tax years beginning in 2007. The US tax returns of the US subsidiary are open to examination by the US tax authorities for tax years beginning in 2006.

Documents on Display

We are required to file reports and other information with the Securities and Exchange Commission (the "SEC") under the Securities Exchange Act of 1934 (the "Exchange Act") and the regulations thereunder applicable to foreign private issuers. Although as a foreign private issuer we are not required to file periodic information as frequently or as promptly as United States companies, we generally do publicly announce our quarterly and year-end results promptly and file periodic information with the SEC under cover of Form 6-K. We are also exempt from the rules under the Exchange Act prescribing the furnishing and content of proxy statements and our officers, directors and principal shareholders are exempt from the reporting and other provisions in Section 16 of the Exchange Act.

You may review a copy of our filings with the SEC, including any exhibits and schedules, at the SEC's public reference room at 100 F Street N.E., Washington, D.C. 20549. You may call the SEC at 1-800-SEC-0330 for further information on the public reference room. As a foreign private issuer, all documents which were filed after November 4, 2002 on the SEC's EDGAR system will be available for retrieval on the SEC's website at www.sec.gov. These SEC filings are also available to the public on the Israel Securities Authority's Magna website at www.magna.isa.gov.il and from commercial document retrieval services. The documents referred to in this document may be inspected at the Company's offices, located at 8 Hanagar Street, Kfar Sava, Israel 44000.

Any statement in this annual report about any of our contracts or other documents is not necessarily complete. If the contract or document is filed as an exhibit to the annual report the contract or document is deemed to modify the description contained in this annual report. We urge you to review the exhibits themselves for a complete description of the contract or document.

Item 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the risk of loss related to changes in market prices, including interest rates and foreign exchange rates, of financial instruments that may adversely impact our consolidated financial position, results of operations or cash flows. Our primary market risk exposures relate to our investment portfolio and fluctuation of the exchange rate of the US Dollar, which is the primary currency in which we conduct our operations, against the NIS.

Interest Rate Risk

As of December 31, 2010, our investment portfolio consisted of approximately $29.9 million invested in corporate debt securities and securities of US government agencies. These securities are classified as "held to maturity". The majority of the Company's investments (approximately 92%) are in fixed-rate instruments, while a small portion of its investments (approximately 8%) are in variable-rate instruments. Therefore, the Company's exposure to interest rate risk from variable-rate instruments is very limited and not material to the Company. In addition, since the securities are "held to maturity", any changes in fair value of the Company's instruments due to fluctuations in the interest rates, that are not classified as OTTI, do not affect the Company's profit or loss.

For quantitative information on the Company's marketable securities, please see Note 4 to our consolidated financial statements included elsewhere in this annual report.

As of December 31, 2010 we did not have any short or long term interest bearing loans or debts, hence with respect to the Company's business operations, we do not have any exposure to interest rate risk.

Foreign Currency Exchange Risk

Most of our revenues are generated in U.S. dollars. In addition, most of our costs are denominated and determined in U.S. dollars and NIS. According to the salient economic factors indicated in ASC 830 “Foreign Currency Matters” (formerly SFAS No. 52), “Foreign Currency Translation,” our cash flow, sale price, sales market, expense, financing and inter-company transactions, and arrangement indicators, are predominantly denominated in U.S. dollars. In addition, the U.S. dollar is the primary currency of the economic environment in which we operate, and thus, the U.S. dollar is our functional and reporting currency. In our balance sheet, we re-measure into U.S. dollars all monetary accounts (principally cash and cash equivalents and liabilities) that are maintained in other currencies. For this re-measurement, we use the relevant foreign exchange rate at the balance sheet date. Any gain or loss that results from this re-measurement is reflected in the statement of operations as appropriate. We measure and record non-monetary accounts in our balance sheet in U.S. dollars. For this measurement, we use the U.S. dollar value in effect at the date that the asset or liability was initially recorded in our balance sheet (the date of the transaction).

As of December 31, 2010 we had accounts receivable in New Israeli Shekels (NIS) or in funds linked thereto in the amount of $1,063,993. Market risk was estimated as the potential decrease in balance resulting from a hypothetical 10% increase in the year-end Dollar exchange rate. Assuming such increase in the Dollar exchange rate, the balance of our accounts receivable would decrease by $96,727. As of December 31, 2010 we had accounts payable in New Israeli Shekels (NIS) or linked thereto in the amount of $4,925,608. Market risk was estimated as the potential increase in balance resulting from a hypothetical 10% decrease in the year-end Dollar exchange rate. Assuming such decrease in the Dollar exchange rate, the balance of our accounts payable would increase by $547,290.

In 2010 there was a decrease of 5.99% in the Dollar exchange rate which resulted in an aggregate increase in the fair value of our assets of $227,980 and an aggregate increase in the fair value of our liabilities of $381,587.

Since the majority of our revenues are denominated and paid in U.S. dollars, we believe that fluctuations in the U.S. dollar exchange rate do not have a significant effect on our accounts receivable. Inflation in Israel and the Israeli currency as well as U.S. dollar exchange rate fluctuations may have only a limited effect on our accounts payable, as described above.

The Company’s operating expenses may be affected by fluctuations in the value of the U.S dollar as it relates to the NIS. By way of example, a hypothetical 10% weakening in the value of the dollar relative to the currencies in which the Company’s operating expenses are denominated in 2010 would have resulted in an increase in operating expenses of approximately $750 thousand for the year ended December 31, 2010.

As of December 31, 2010 our investment portfolio consisted only of investments in US dollars and is therefore not subject to any exposure to foreign currency exchange risk.

As of December 31, 2010, we were not engaged in any hedging or other transactions intended to manage the risks relating to foreign currency exchange rate or interest rate fluctuations.

Credit Risk

Our investment portfolio includes held to maturity marketable securities. These securities include investments issued by highly rated corporations or investments issued by agencies of governments. As of December 31, 2010, the rating of the securities in our portfolio was at least A. Nonetheless, these investments are subject to general credit and counterparty risks (such as that the counterparty to a financial instrument fails to meet its contractual obligations), which were exacerbated by the recent turmoil that has affected the financial markets and the global economy and caused credit issues for a number of reputable financial institutions. Any changes in fair value of the Company's investment securities due to credit risk do not affect the Company's profit or loss unless there is other-than-temporary impairment (OTTI) (referred to in ASC 320-10 (formally known as FSP FAS 115-2) and ASC 958-320 (formally known as FAS 124-2).

As of December 31, 2010, we were not required to adjust the carrying value of our investment securities since there were no other-than-temporary impairments.

Item 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

Not Applicable.

PART II.

Item 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

None.

Item 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS

None.

Item 15. CONTROLS AND PROCEDURES.

Not Applicable.

Item 15T. CONTROLS AND PROCEDURES

Our Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of December 31, 2010, have concluded that, as of such date, our disclosure controls and procedures were effective to ensure that the information required in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms, and such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in its Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms, and that such information is accumulated and communicated to our Chief Executive Officer and Chief Financial Officer to allow timely decisions regarding required disclosure. Our management, including our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of our disclosure controls and procedures, as defined under Exchange Act Rule 13a-15(e), as of the end of the period covered by this Annual Report on Form 20-F. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of such date, our disclosure controls and procedures were effective.

Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

Management assessed our internal control over financial reporting as of December 31, 2010, the end of our fiscal year. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in "Internal Control — Integrated Framework."

Based on our assessment, management has concluded that our internal control over financial reporting was effective as of December 31, 2010 to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles. We reviewed the results of management’s assessment with the Audit Committee of our Board of Directors.

This annual report does not include an attestation report of the Company's registered public accounting firm regarding the effectiveness of the Company’s internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm. The Dodd–Frank Wall Street Reform and Consumer Protection Act that was signed into law on July 21, 2010, provides, among other things, an exemption to issuers that are neither ‘accelerated filers’, nor ‘large accelerated filer’ (as defined in Rule 12b–2 of the Securities Exchange Act), from the requirement to include auditor attestation on the effectives of its internal controls over financial reporting, thus permitting us to provide only management's report in this annual report.

Inherent Limitations on Effectiveness of Controls

Internal control over financial reporting has inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of such limitation, there is a risk that material misstatements will not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

Changes in Internal Control over Financial Reporting

There was no change in our internal controls over financial reporting that occurred during the period covered by this annual report that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

Item 16. Reserved

Item 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Our board of directors has determined that Ms. Einat Domb-Har is our audit committee financial expert, and that Ms. Domb-Har is independent as such term is defined under the Nasdaq Capital Market listing requirements.

Item 16B. CODE OF ETHICS

Our company has adopted a code of ethics, which applies to all of our employees, officers and directors, including our Chief Executive Officer, our Chief Financial Officer and our principal accountant. A copy of the code of ethics is attached as an exhibit to this annual report.

Item 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The following table presents fees for professional services for the audit of the Company’s consolidated annual financial statements for the years ended December 31, 2010 and 2009, audit-related services and tax services rendered by Somekh Chaikin, a member firm of KPMG International.

	2009	2010
Audit Fees(1)	$95,000	$95,000
Audit-Related Fees(2)	-	$5,000
Tax Fees(3)	$5,000	$5,000
Other Tax-Related Fees(4)	$11,000	$11,000

(1) Audit fees consist of fees for professional services rendered for the audit of the Company's annual consolidated financial statements and services normally provided by the independent auditor in connection with statutory and regulatory filings or engagements.

(2) Audit-Related Fees consist of accounting consultation and consultation on financial accounting standards, not arising as part of the audit.

(3) Tax services fees consist of compliance fees for the preparation of original and amended tax returns and claims for refunds.

(4) Other Tax-Related Fees consist of fees billed for tax-related products and services other than as described above.

Audit committee's pre-approval policies and procedures

We are required to obtain the approval of our audit committee (and subsequently the consent of the board of directors and shareholders) before engaging our independent auditors, Somekh Chaikin, a member firm of KPMG International, to audit our consolidated financial statements, as well as to provide other audit or permitted non-audit services to us. This policy, which is designed to assure that such engagements do not impair the independence of our auditors, requires pre-approval from the audit committee on an annual basis for the various audit and non-audit services that may be performed by our auditors. Our audit committee is not permitted to approve the engagement of our auditors for any services that would be inconsistent with maintaining the auditor's independence or that are not permitted by applicable law.

Item 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES

Not Applicable.

Item 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

Not Applicable.

Item 16F. CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANT

Not Applicable.

Item 16G. CORPORATE GOVERNANCE

Our corporate governance practices differ from those followed by domestic companies as required under the listing standards of the NASDAQ Global Market, due to an exemption that we obtained from NASDAQ as foreign private issuer which enables us to comply with our home country laws of the State of Israel in lieu of NASDAQ Marketplace Rules. We follow the provisions of the Israeli Companies Law – 1999, rather than the requirements of the Market Place Rules with respect to the following:

- We are not required to distribute annual and quarterly reports directly to shareholders, but we do make our audited financial statements available to our shareholders prior to our annual general meeting and file our quarterly and annual financial results with the Securities Exchange Commission on Form 6-K.

- A majority of our board of directors is not comprised of independent directors as defined in the NASD Marketplace Rules, but our board of directors contains two external directors in accordance with the Israeli Companies Law – 1999. Israeli law does not require, nor do our external directors conduct, regularly scheduled meetings at which only they are present. In addition, with the exception of our external directors, our directors are elected for terms of one year or until the following annual meeting, by a general meeting of our shareholders. The nominations for director which are presented to our shareholders are also generally made by our directors. Israeli law does not require the adoption of and our board has not adopted a formal written charter or board resolution addressing the nomination process and related matters. Compensation of our directors and other officers is determined in accordance with Israeli law.

- Our audit committee has not adopted a formal written audit committee charter specifying the items enumerated in Rule 4350(d)(1) of the NASD Marketplace Rules. We believe that the members of our audit committee comply with the requirements of the Israeli law, as well as Rule 10A-3(b) of the general rules and regulations promulgated under the Securities Act of 1933. For a detailed discussion please refer to "Item 6. Directors, Senior Management and Employees- Audit Committee".

- As opposed to Rule 4350(f) of the NASD Marketplace Rules, which sets forth a required quorum for a shareholders meeting, under Israeli law a company is entitled to determine in its articles of association the number of shareholders and percentage of holdings required for a quorum at a shareholders meeting. Our current articles of association provide that a quorum of two or more shareholders, present in person or by proxy, holding shares conferring in the aggregate more than thirty three and a third (33 1/3 %) percent of the voting power of the Company is required.

- All related party transactions are approved in accordance with the requirements and procedures for approval of interested party acts and transactions set forth in the Israeli Companies Law-1999, and are not subject to the review process set forth in Rule 4350(h) of the NASD Marketplace Rules. For a detailed discussion please refer to "Item 10. Additional Information- the Israeli Companies Law-1999".

- We seek shareholder approval for all corporate action requiring such approval in accordance with the requirements of the Israeli Companies Law – 1999 rather than under the requirements of the NASDAQ Marketplace Rules, including (but not limited to) the appointment or termination of auditors, appointment and dismissal of directors, approval of interested party acts and transactions requiring general meeting approval as discussed above and a merger.

See “Item 10. Additional Information- Companies Law Amendment” above for a discussion of a recent amendment to the Israeli Companies Law-1999 which, once it enters into effect, may impact our company’s corporate governance practices as discussed herein.

PART III.

Item 17. FINANCIAL STATEMENTS

Not Applicable

Item 18. FINANCIAL STATEMENTS

See pages F-1 to F-37.

Item 19. EXHIBITS

1.1 Amended and Restated Articles of Association, adopted on January 24, 2008, filed by us as an Exhibit to our registration statement on Form S-8, as filed with the Securities and Exchange Commission on February 11, 2008, and incorporated herein by reference.

4.1. Lease between the Company and Yaakov Metzkin and Dov Segev, for premises in Kfar Sava, Israel, dated November 1, 1994, and amendment dated March 17, 2002, filed by us as an Exhibit to our annual report on Form 20-F for the fiscal year ended December 31, 2001, as filed with the Securities and Exchange Commission on June 27, 2002, and incorporated herein by reference. As this lease and the amendment are written in Hebrew, a summary of each was included in the Exhibit.

4.2 Lease between the Company and Naji Yechezkel Yokenam Industrial Center Ltd. for manufacturing facility in Yokneam, Israel, dated November 20, 2008 filed by us as an Exhibit to our annual report on Form 20-F for the fiscal year ended December 31, 2008, as filed with the Securities and Exchange Commission on March 23, 2009, and incorporated herein by reference. As this lease is written in Hebrew, a summary was included in the Exhibit.

4.3 Lease between Silicom Connectivity Solutions, Inc. and RAD Data Communications Inc., for space in Mahwah, New Jersey, dated as of September 1, 1997, filed by us as an Exhibit to our annual report on Form 20-F for the fiscal year ended December 31, 2000, as filed with the Securities and Exchange Commission on June 30, 2001, and incorporated herein by reference.

4.4 Sublease Agreement between Silicom Connectivity Solutions, Inc. and Radcom Equipmet, Inc., for space in Paramus, New Jersey, dated as of February 1, 2004, filed by us as an Exhibit to our annual report on Form 20-F for the fiscal year ended December 31, 2003, as filed with the Securities and Exchange Commission on June 30, 2004, and incorporated herein by reference.

8. List of subsidiaries, filed by us as an Exhibit to our annual report on Form 20-F for the fiscal year ended December 31, 2000, as filed with the Securities and Exchange Commission on June 30, 2001, and incorporated herein by reference.

11.1 Code of Ethics, filed by us as an Exhibit to our annual report on Form 20-F for the fiscal year ended December 31, 2007, as filed with the Securities and Exchange Commission on March 26, 2008, and incorporated herein by reference.

12.1 Certification by Chief Executive Officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002.

12.2 Certification by Chief Financial Officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002.

13.1 Certification by Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

13.2 Certification by Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

14.1 Opinion of McGladrey & Pullen, LLP, dated January 6, 2003, on the financial statements of Silicom Connectivity Solutions, Inc., for the two years ended December 31, 2001 and 2002, filed by us as an Exhibit to our annual report on Form 20-F for the fiscal year ended December 31, 2003, as filed with the Securities and Exchange Commission on June 30, 2004, and incorporated herein by reference.

14.2 Opinion of McGladrey & Pullen, LLP, dated January 6, 2003, on the financial statements of Silicom Connectivity Solutions, Inc., for the year ended December 31, 2002 filed by us as an Exhibit to our annual report on Form 20-F for the fiscal year ended December 31, 2004, as filed with the Securities and Exchange Commission on May 31, 2005, and incorporated herein by reference.

15.1 Consent of KPMG Somekh Chaikin, Independent Registered Public Accounting Firm.

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SIGNATURES

The Registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

SILICOM LIMITED

By: /s/ Shaike Orbach
Shaike Orbach
Chief Executive Officer

March 16, 2011

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Silicom Ltd.

and its Subsidiary

Consolidated
Financial Statements

As of and for the year ended
December 31, 2010

Silicom Ltd. and its Subsidiary

Consolidated Financial Statements as of December 31, 2010

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders of Silicom Ltd.:

We have audited the accompanying consolidated balance sheets of Silicom Ltd and its subsidiary (the "Company") as of December 31, 2010 and 2009 and the related consolidated statements of Operations, changes in shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2010. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company and its subsidiary as of December 31, 2010 and 2009, and the consolidated results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2010, in conformity with U.S. generally accepted accounting principles.

Somekh Chaikin
Certified Public Accountants (Isr.)
Member Firm of KPMG International

Tel Aviv, Israel
March 16, 2011

Silicom Ltd. and its Subsidiary

Consolidated Balance Sheets as of December 31

	Note	2009 US$ thousands	2010 US$ thousands
Assets			
Current assets			
Cash and cash equivalents	3	7,253	6,657
Short-term bank deposits	2E	7,253	9,209
Marketable securities	4	10,425	8,162
Accounts receivable:			
Trade, net	2G	5,172	6,762
Other	5	371	555
Inventories	6	4,677	8,140
Deferred tax assets	14H	233	50
Total current assets		35,384	39,535
Marketable securities	4	18,308	21,773
Assets held for employees' severance benefits	9	1,105	1,302
Deferred tax assets	14H	192	219
Property, plant and equipment, net	7	602	650
Total assets		55,591	63,479

Avi Eizenman	Shaike Orbach	Eran Gilad
Chairman of the Board of Directors	Chief Executive Officer	Chief Financial Officer

Kfar-Saba, Israel
March 16, 2011

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

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Silicom Ltd. and its Subsidiary

Consolidated Balance Sheets as of December 31 (Continued)

	Note	2009 US$ thousands	2010 US$ thousands
Liabilities and shareholders’ equity			
Current liabilities			
Trade accounts payable		2,261	3,753
Other accounts payable and accrued expenses	8	2,138	2,074
Total current liabilities		4,399	5,827
Long-term liability			
Liability for employees’ severance benefits	9	1,967	2,222
Total liabilities		6,366	8,049
Commitments and contingencies	10		
Shareholders’ equity	11		
Ordinary shares, NIS 0.01 par value; 10,000,000 shares authorized; 6,824,284 and 6,894,659 issued as at December 31, 2009 and 2010, respectively; 6,809,313 and 6,879,688 outstanding as at December 31, 2009 and 2010, respectively		20	20
Additional paid-in capital		34,154	34,644
Treasury shares (at cost) - 14,971 ordinary shares as at December 31, 2009 and 2010		(38)	(38)
Retained earnings		15,089	20,804
Total shareholders' equity		49,225	55,430
Total liabilities and shareholders’ equity		55,591	63,479

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

Silicom Ltd. and its Subsidiary

Consolidated Statements of Operations for the Year Ended December 31

	Note	2008	2009	2010
		US$ thousands Except for share and per share data		
Sales	12	25,554	20,526	30,399
Cost of sales		15,405	12,461	17,490
Gross profit		10,149	8,065	12,909
Operating expenses				
Research and development		3,048	2,716	3,280
Sales and marketing		2,093	1,821	2,207
General and administrative		1,427	1,313	1,523
Total operating expenses		6,568	5,850	7,010
Operating income		3,581	2,215	5,899
Financial income, net	13	1,188	909	617
Income before income taxes		4,769	3,124	6,516
Income taxes	14	124	305	801
Net income		4,645	2,819	5,715
Income per share:				
Basic income per ordinary share (US$)	2S	0.695	0.420	0.838
Diluted income per ordinary share (US$)		0.685	0.412	0.824
Weighted average number of ordinary shares used to compute basic income per share (in thousands)		6,685	6,720	6,821
Weighted average number of ordinary shares used to compute diluted income per share (in thousands)		6,780	6,843	6,938

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

Silicom Ltd. and its Subsidiary

Consolidated Statements of Changes in Shareholders' Equity

	Ordinary shares		Additional paid-in capital	Treasury shares	Retained earnings	Total shareholders' Equity
	Number of shares(1)		US$ thousands			
Balance at January 1, 2008	6,570,876	20	31,727	(38)	7,625	39,334
Exercise of options	14,700	*-	38	-	-	38
Exercise of warrants	108,487	*-	983	-	-	983
Share-based compensation	-	-	334	-	-	334
Net income	-	-	-	-	4,645	4,645
Balance at December 31, 2008	6,694,063	20	33,082	(38)	12,270	45,334
Exercise of options	115,250	*-	633	-	-	633
Share-based compensation	-	-	439	-	-	439
Net income	-	-	-	-	2,819	2,819
Balance at December 31, 2009	6,809,313	20	34,154	(38)	15,089	49,225
Exercise of options	70,375	*-	259	-	-	259
Share-based compensation	-	-	231	-	-	231
Net income	-	-	-	-	5,715	5,715
Balance at December 31, 2010	6,879,688	20	34,644	(38)	20,804	55,430

(1) Net of 14,971 shares held by the subsidiary

* Less than 1 thousand.

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

Silicom Ltd. and its Subsidiary

Consolidated Statements of Cash Flows for the Year Ended December 31

	2008	2009	2010
		US$ thousands	
Cash flows from operating activities			
Net income	4,645	2,819	5,715
Adjustments required to reconcile net income to net cash provided by operating activities:			
Depreciation	450	437	416
Write-off of other assets	39	-	-
Write-down of obsolete inventory	915	860	780
Liability for employees' severance benefits, net	195	23	58
Expense (income) from marketable securities	(96)	169	467
Share-based compensation expense	334	439	231
Deferred taxes	(314)	19	156
Capital loss (gain)	(10)	14	2
Changes in assets and liabilities:			
Accounts receivable – trade	1,696	(323)	(1,590)
Accounts receivable - other	(15)	(18)	(184)
Inventories	(2,106)	(268)	(4,243)
Trade accounts payable	(316)	(420)	1,492
Other accounts payable and accrued expenses	339	84	(64)
Net cash provided by operating activities	5,756	3,835	3,236
Cash flows from investing activities			
Short term bank deposits	-	(7,253)	(1,956)
Purchases of property, plant and equipment	(574)	(258)	(466)
Proceeds from sale of property, plant and equipment	14	-	-
Proceeds from maturity of marketable securities	6,500	10,300	11,303
Purchases of marketable securities	(12,308)	(14,572)	(12,972)
Net cash used in investing activities	(6,368)	(11,783)	(4,091)
Cash flows from financing activities			
Exercise of options and warrants	964	633	259
Net cash provided by financing activities	964	633	259
Increase (decrease) in cash and cash equivalents	352	(7,315)	(596)
Cash and cash equivalents at beginning of year	14,216	14,568	7,253
Cash and cash equivalents at end of year	14,568	7,253	6,657
Supplementary cash flow information			
Cash paid during the year for:			

Income taxes	76	606	1,148

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

Note 1 - General

Silicom Ltd. is an Israeli corporation engaged in designing, manufacturing, marketing and supporting server networking solutions for a broad range of servers and server based systems.

The Company's shares have been traded in the United States on the National Association of Securities Dealers Automated Quotation System ("NASDAQ"), since February 1994 and in Israel on the Tel Aviv Stock Exchange ("TASE"), since December 2005. Since February 11, 2008, the Company's shares have been traded on the NASDAQ Global Market (prior thereto they were traded on the NASDAQ Capital Market).

Silicom markets its products directly, through (i) Original Equipment Manufacturers ("OEMs") which sell the Company's connectivity products under their own private labels or incorporate the Company's products into their products, (ii) a worldwide network of independent distributors and (iii) its US-based subsidiary.

In these financial statements the terms "Company" or Silicom refer to Silicom Ltd. and its wholly owned subsidiary, Silicom Connectivity Solutions, Inc., whereas the term "subsidiary" refers to Silicom Connectivity Solutions, Inc., a wholly owned subsidiary of Silicom Ltd.

Note 2 – Summary of significant Accounting Policies

The significant accounting policies, which are applied consistently throughout the periods presented, are as follows:

A. Financial statements in US dollars

Substantially all sales of the Company are made outside of Israel (see Note 12A regarding geographical destination), in US dollars ("dollars"). Most purchases of materials and components, and most marketing costs are made or incurred, primarily in dollars. Therefore, the functional currency of the Company is the dollar.

Transactions and balances in other currencies are translated into the functional currency using current exchange rate.

All exchange gains and losses from remeasurement of monetary balance sheet items denominated in non-dollar currencies are reflected in earnings when they arise.

B. Basis of presentation

The accompanying consolidated financial statements have been prepared with accounting principles generally accepted in the United States of America and include the accounts of the Company and its wholly-owned subsidiary in the United States. All intercompany balances and transactions have been eliminated in consolidation.

Note 2 - Summary of significant Accounting Policies (cont'd)

C. Estimates and assumptions

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant items subject to such estimates and assumptions include the useful lives of fixed assets; allowances for doubtful accounts; deferred tax assets, fixed assets, inventory, allowance for product warranty, investments, and share-based compensation; income tax uncertainties and other contingencies.

D. Cash and cash equivalents

The Company considers highly liquid investments with original maturities of three months or less from the date of deposit to be cash equivalents.

E. Short-term bank deposits

Short term bank deposits consist of bank deposits with maturities of more than three months and up to twelve months.

As of December 31, 2010 the company's short-term bank deposits consist of bank deposits primarily in US$ and NIS, that bear fixed annual interest of 0.96%-2.1%. These short-term bank deposits are held with a major Israeli Bank, and with its US located branch, and their use and withdrawal are not subject to any restrictions.

F. Marketable securities

Investment securities at December 31, 2010 consist of corporate debt and Government debt and investment securities at December 31, 2009 consist of corporate debt.

The Company classifies its marketable securities as held-to-maturity as they are debt securities in which the Company has the intent and ability to hold to maturity. Held-to-maturity debt securities are recorded at amortized cost adjusted for the amortization or accretion of premiums or discounts.

Premiums and discounts on debt securities are amortized or accreted over the life of the related held-to-maturity security as an adjustment to yield using the effective interest method. Such amortization and accretion is included in the "Financial income, Net" line item in the consolidated statements of operations.

In April 2009, the FASB issued ASC 320-10 (formally known as FSP FAS 115-2) and ASC 958-320 (formally known as FAS 124-2), Recognition and Presentation of Other-Than-Temporary Impairments, which amends the recognition guidance for other-than-temporary impairments (OTTI) of debt securities and expands the financial statements disclosures for OTTI on debt and equity securities. When other-than-temporary impairment has occurred, the amount of the other-than-temporary impairment recognized in earnings depends on whether the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any

current-period credit loss.

Note 2 - Summary of significant Accounting Policies (cont'd)

F. Marketable securities (cont'd)

If the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary impairment is recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. If the Company does not intend to sell the security and it is not more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary impairment is separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings. Standards ASC-320-10 and ASC958-320 did not have a material effect on the Company's financial statements.

G. Provision for doubtful accounts receivable

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. Amounts collected on trade accounts receivable are included in net cash provided by operating activities in the Consolidated Statements of Cash Flows. The Company maintains an allowance for doubtful accounts for estimated losses inherent in its accounts receivable portfolio. In establishing the required allowance, management considers historical losses adjusted to take into account current market conditions and its customers' financial condition, the amount of receivables in dispute, and the current receivables aging and current payment patterns.

As of December 31, 2009 and 2010, the provision for doubtful accounts receivable amounted to US$ 20 thousand.

H. Inventories

Inventories are stated at the lower of cost or market. Cost is determined using the "average-cost" method.

The Company writes down obsolete or slow moving inventory to its market value, on a quarterly basis.

I. Assets held for employees' severance benefits

Assets held for employees' severance benefits represent contributions to severance pay funds and cash surrender value of life insurance policies. The assets are recorded at their current cash redemption value.

Note 2 - Summary of significant Accounting Policies (cont'd)

J. Property, plant and equipment

Property, plant and equipment are stated at cost. Depreciation is calculated on the straight-line method over the estimated useful life of the assets at the following annual rates:

	%
Machinery and equipment	20 - 33
Office furniture and equipment	6 - 20
Leasehold improvements	*

* Leasehold improvements are amortized straight-line over the lease term or estimated useful life of the assets.

K. Long lived assets

In accordance with Impairment or Disposal of Long-Lived Assets Subsections of FASB ASC Subtopic 360-10, Property, Plant, and Equipment - Overall (formally known as FASB Statement No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets") long-lived assets, such as property, plant, and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If circumstances require a long-lived asset or an asset group to be tested for possible impairment, the Company first compares undiscounted cash flows expected to be generated by that asset or asset group to its carrying value. If the carrying value of the long-lived asset or asset group is not recoverable on an undiscounted cash flow basis, an impairment is recognized to the extent that the carrying value exceeds its fair value.

L. Revenue recognition

Revenues from sales of products are recognized upon delivery provided that the collection of the resulting receivable is reasonably assured, there is persuasive evidence of an arrangement, no significant obligations in respect of installation remain and the price is fixed or determinable.

Sales taxes collected from customers and remitted to governmental authorities are accounted for on a net basis and, therefore, are excluded from revenues in the consolidated statements of income.

M. Research and development costs

Research and development costs are expensed as incurred.

Note 2 - Summary of significant Accounting Policies (cont'd)

N. Royalty bearing participations

Royalty bearing participations from the Government of Israel for funding research and development activities are recognized at the time the Company is entitled to such grants based on the related cost incurred. See also Note 10A.

Royalty expenses are recognized pursuant to the sale of related products and are classified as cost of sales.

O. Allowance for product warranty

The Company grants service warranties related to certain products to end-users. The Company estimates its obligation for such warranties to be immaterial on the basis of historical experience. Accordingly, these financial statements do not include an accrual for warranty obligations.

P. Treasury shares

Treasury shares are recorded at cost and presented as a reduction of shareholders' equity.

Q. Income taxes

Deferred taxes are accounted for under the asset and liability method based on the estimated future tax effects of temporary differences between the financial statements carrying amounts of existing assets and liabilities and their respective tax bases, and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the consolidated statement of operations in the period that includes the enactment date. The Company provides a valuation allowance to reduce deferred tax assets to the extent it believes it is more likely than not that such benefits will not be realized. Deferred taxed and liabilities are classified as current or non-current based on the classification of the related asset or liability for financial reporting, or according to the expected reversal dates of the specific temporary differences where appropriate.

Beginning with the adoption of ASC 740-10, “Accounting for Uncertainty in Income Taxes” ("ASC 740-10") as of January 1, 2007 the Company recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs.

The Company records interest related to unrecognized tax benefits in interest expense and penalties in general and administrative expenses.

Note 2 - Summary of significant Accounting Policies (cont'd)

R. Share-based compensation

The Company recognizes compensation expense based on estimated grant date fair value in accordance with ASC Topic 718, Compensation -Stock Compensation as follows:

For share-based awards granted after January 1, 2008, include features that are not supported by the Black and Scholes valuation model, such as expiration date to occur if the closing price of the Shares falls below 50% of grant date Share price, therefore, for share-based awards granted in 2008, the Company recognized compensation expense based on estimated grant date fair value using the Monte Carlo option-pricing model; with the weighted average assumptions detailed in Notes 11(B)(5) and 11B(6). For share-based awards granted on December 21, 2010 the Company recognized compensation expense based on estimated grant date fair value using the Binomial option-pricing model; with the weighted average assumptions detailed in Note 11(B)(7).

S. Income per ordinary share

Basic income per ordinary share is calculated by dividing the net income attributable to ordinary shares, by the weighted average number of ordinary shares outstanding. Diluted income per ordinary share calculation is similar to basic income per ordinary share except that the weighted average of common shares outstanding is increased to include outstanding potential common shares during the period if dilutive. Potential common shares arise from stock options and the dilutive effect is reflected by the application of the treasury stock method.

The following table summarizes information related to the computation of basic and diluted income per ordinary share for the years indicated.

	Year ended December 31		
	2008	2009	2010
Net income attributable to ordinary shares (US$ thousands)	4,645	2,819	5,715
Weighted average number of ordinary shares outstanding used in basic income per ordinary share calculation	6,684,905	6,719,508	6,820,721
Add assumed exercise of outstanding dilutive potential ordinary shares	95,075	123,600	117,735
Weighted average number of ordinary shares outstanding	6,779,980	6,843,108	6,938,456

used in diluted income per ordinary share calculation			
Basic income per ordinary shares (US$)	0.695	0.420	0.838
Diluted income per ordinary shares (US$)	0.685	0.412	0.824
Number of options and warrants excluded from the diluted earnings per share calculation because of anti-dilutive effect	229,687	229,687	137,500

Note 2 - Summary of significant Accounting Policies (cont’d)

T. Comprehensive Income

For the year ended December 31, 2008, 2009 and 2010, Comprehensive Income equals net income.

U. Fair Value Measurements

The Company's financial instruments include mainly cash and cash equivalents, accounts receivable, short term bank deposits, assets held for severance benefits, marketable securities and accounts payable. The carrying amounts of these financial instruments approximate their fair value, for marketable securities fair value see note 4.

The Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible. The Company determines fair value based on assumptions that market participants would use in pricing an asset or liability in the principal or most advantageous market. When considering market participant assumptions in fair value measurements, the following fair value hierarchy distinguishes between observable and unobservable inputs, which are categorized in one of the following levels:

Level 1 Inputs: Unadjusted quoted prices in active markets for identical assets or liabilities accessible to the reporting entity at the measurement date.

Level 2 Inputs: Other than quoted prices included in Level 1 inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability.

Level 3 Inputs: Unobservable inputs for the asset or liability used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at measurement date.

V. Recently Issued Accounting Standards

In October 2009, the FASB issued Accounting Standards Update (ASU) 2009-13, Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements (EITF Issue No. 08-1, “Revenue Arrangements with Multiple Deliverables”). ASU 2009-13 amends FASB ASC Subtopic 605-25, Revenue Recognition—Multiple-Element Arrangements, to eliminate the requirement that all undelivered elements have vendor specific objective evidence of selling price (VSOE) or third party evidence of selling price (TPE) before an entity can recognize the portion of an overall arrangement fee that is attributable to items that already have been delivered. In the absence of VSOE and TPE for one or more delivered or undelivered elements in a multiple-element arrangement, entities will be required to estimate the selling prices of those elements. The overall arrangement fee will be allocated to each element (both delivered and undelivered items) based on their relative selling prices, regardless of whether those selling prices are evidenced by VSOE or TPE or are based on the entity’s estimated selling price. Application of the “residual method” of allocating an overall arrangement fee between delivered and undelivered elements will no longer be permitted upon adoption of ASU 2009-13. Additionally, the new guidance will require entities to disclose more information about their multiple-element revenue arrangements. ASU 2009-13 is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted.

The Company expects that the adoption of ASU 2009-13 in 2011 will not have a material impact on its consolidated financial statements.

Note 2 - Summary of significant Accounting Policies (cont’d)

W. Concentrations of risks

(1) Credit risk

Financial instruments, which potentially subject the Company to significant concentrations of credit risk, consist principally of cash and cash equivalents, short-term bank deposits, marketable securities and trade receivables. Cash and cash equivalents balances of the Company, which are subject to credit risk, consist of cash accounts held with major financial institutions. Short-term bank deposits balances of the Company, which are subject to credit risk, consist of short-term bank deposits held with a major Israeli Bank and with its US located branch. Marketable securities include held to maturity marketable securities issued by highly rated corporations or governmental securities. As of December 31, 2009 and 2010, the rating of the securities in the company's portfolio was at least A. Nonetheless, these investments are subject to general credit and counterparty risks (such as that the counterparty to a financial instrument fails to meet its contractual obligations). Any changes in fair value of the Company's investment securities due to credit risk do not affect the Company's profit or loss unless there is other-than-temporary impairment (OTTI).

Concentrations of credit risk with respect to trade receivables are limited due to the Company’s diverse customer base and their wide geographical dispersion. The Company closely monitors extensions of credit and has never experienced significant credit losses.

(2) Concentrations of Trade accounts payable

Certain key components used in the Company’s products are currently available from only one source and others are available from a limited number of sources. The Company believes it maintains inventory of these components to protect against delays in deliveries.

(3) Dominant Single product line

The Company depends on one line of products for most of its revenues. The majority of the company's current business is based on its Multi-Port Gigabit-Ethernet Server Adapter product line and the majority of its revenue is generated from that product line.

X. Subsequent events

Effective April 1, 2009, the Company adopted ASC 855-10, subsequent events which with minimal impact establishes general standards for accounting for and disclosure of events that occur after the balance sheet date but before financial statements are available to be issued (subsequent events). The adoption of ASC 855-10 has no material effect on the Company’s consolidated results of operations and financial position.

Y. Liabilities for loss contingencies

Liabilities for loss contingencies arising from claims, assessments, litigation, fines, and penalties and other sources are recorded when it is probable that a liability has been incurred and the amount can be reasonably estimated. Legal costs incurred in connection with loss contingencies are expensed as incurred.

Note 3 - Cash and Cash Equivalents

	December 31 2009	2010
	US$ thousands	
Cash	3,394	2,566
Cash equivalents *	3,859	4,091
	7,253	6,657

* Comprised mainly of deposits in banks as at December 31, 2009 and 2010 carrying a weighted average interest of 0.69% and 1.22%, respectively.

Note 4 - Marketable Securities

The Company's investment in marketable securities as of December 31, 2009 and 2010 are classified as "held-to-maturity" and consist of the following:

	Aggregate cost basis	Gross unrealized holding gains	Gross unrealized holding (losses)	Aggregate fair value*
At December 31, 2010				
Held to maturity:				
Corporate debt securities and government debt securities				
Current	8,162	18	(85)	8,095
Non-Current	21,773	74	(155)	21,692
	29,935	92	(240)	29,787
At December 31, 2009				
Held to maturity:				
Corporate debt securities				
Current	10,425	68	(98)	10,395
Non-Current	18,308	113	(108)	18,313
	28,733	181	(206)	28,708

* Fair value is being determined using quoted market prices in active markets.

Note 4 - Marketable Securities (Cont'd)

The amortized cost, gross unrealized losses and fair value of the debt securities by major interest type were as follows:

	December 31, 2010		
	Amortized cost	Net unrealized holding gains/(losses)	Fair value
	US$ thousands		
Up to 4%	28,401	(123)	28,278
4.063% - 4.241%	1,534	(25)	1,509
	29,935	(148)	29,787

	December 31, 2009		
	Amortized cost	Net unrealized holding gains/(losses)	Fair value
	US$ thousands		
Up to 5%	24,368	53	24,421
5.01% - 5.34%	4,365	(78)	4,287
	28,733	(25)	28,708

Maturities of the debt securities were as follows as at December 31, 2010:

	Amortized cost	Fair value
	US$ thousands	
Current maturities	8,162	8,095
Due after one year through 2.8 years	21,773	21,692
	29,935	29,787

The following table summarizes the gross unrealized losses on investment securities for which other-than-temporary impairments have not been recognized and the fair value of those securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2010:

	Less than 12 months		12 months or more		Total	
Held to maturity	Unrealized Losses	Fair value	Unrealized Losses	Fair value	Unrealized Losses	Fair value

Corporate debt securities	(207)	13,799	(33)	6,126	(240)	19,925

The unrealized losses on the investments were caused by interest rate increases. The Company has the ability and intent to hold these investments until maturity and it is more likely than not that the Company will not be required to sell any of the securities before recovery; therefore these investments are not considered other than temporary impaired.

Note 5 - Accounts Receivable - Other

	December 31	
	2009	2010
	US$ thousands	
VAT	181	216
Advanced to suppliers	19	17
Income Tax Payable	-	159
Other	171	163
	371	555

Note 6 - Inventories

	December 31	
	2009	2010
	US$ thousands	
Raw materials and components	2,016	3,266
Products in process	2,199	3,980
Finished products	462	894
	4,677	8,140

Note 7 - Property, Plant and Equipment, Net

	December 31	
	2009	2010
	US$ thousands	
Machinery and equipment	2,295	2,580
Office furniture and equipment	240	275
Leasehold improvements	251	276
Property, plant and equipment	2,786	3,131
Accumulated depreciation	(2,184)	(2,481)
	602	650

Depreciation expenses for the years ended December 31, 2008, 2009 and 2010 were US$ 450 thousand, US$ 437 thousand and US$ 416 thousand, respectively.

Note 8 - Other Accounts Payable and Accrued Expenses

	December 31	
	2009	2010
	US$ thousands	
Employees and related liabilities	365	578
Provision for vacation pay	463	587
Employee benefits	474	552
Royalty payable	19	-
Income tax payable	331	-
Accrued expenses	268	199
Other	218	158
	2,138	2,074

Note 9 - Assets Held and Liability for Employees' Severance Benefits

A. Under Israeli law and labor agreements, Silicom is required to make severance payments to retired or dismissed employees and to employees leaving employment in certain other circumstances.

In respect of the liability to the employees, individual insurance policies are purchased and deposits are made with recognized severance pay funds.

The liability for severance pay is calculated on the basis of the latest salary paid to each employee multiplied by the number of years of employment. The liability is covered by the amounts deposited including accumulated income thereon as well as by the unfunded provision.

B. According to Section 14 to the Severance Pay Law ("Section 14") the payment of monthly deposits by a company into recognized severance and pension funds or insurance policies releases it from any additional severance obligation to the employees that have entered into agreements with the company pursuant to such Section 14. Commencing July 1, 2008, the Company has entered into agreements with a majority of its employees in order to implement Section 14. Therefore, as of that date, the payment of monthly deposits by the Company into recognized severance and pension funds or insurance policies releases it from any additional severance obligation to those employees that have entered into such agreements and therefore the Company incurs no additional liability since that date with respect to such employees. Amounts accumulated in the pension funds or insurance policies pursuant to Section 14 are not supervised or administrated by the Company and therefore neither such amounts nor the corresponding accrual are reflected in the balance sheet.

Note 9 - Asset Held and Liability for Employees' Severance Benefits (cont'd)

C. Consequently, the assets held for employees' severance benefits reported on the balance sheet, in respect of deposits for those employees who have signed agreements pursuant to Section 14, represent the redemption value of deposits made through June 30, 2008. The liability for employee severance benefits, with respect to those employees, represents the liability of the Company for employees' severance benefits as of June 30, 2008.

As a result of the implementation of Section 14, as described above, the liability with respect to those employees is calculated on the basis of number of years of employment as of June 30, 2008, multiplied by the latest salary paid. The liability is covered by the amounts deposited, including accumulated income thereon, as well as by the unfunded provision. Such liability will be removed, either by termination of employment or retirement.

D. Expenses recorded in respect to employees' severance payments for the years ended December 31, 2008, 2009 and 2010 were US$ 416 thousand, US$ 252 thousand and US$ 372 thousand, respectively.

Note 10 - Commitments and Contingencies

A. Royalty commitments

The Company is obligated to pay royalties to the Government of Israel and the Korea Israel Industrial Research and Development Foundation on revenues from product sales related to research and development, which was undertaken with Government grants and other grants. Since January 1, 1997, royalty rates are 2% to 5%. The royalty rates applicable for the Company's research and development projects are 2% - 3.5%, except for one project that took place in the period July 1, 1997 - January 31, 2000, where the royalty rate is 4%.

Royalties are payable from the commencement of sales of each of these products until the cumulative amount of the royalties paid equals 100% of the dollar linked amounts of the grants received, without interest for projects approved prior to December 31, 2000 and with LIBOR interest for amounts received after that date.

The Company's total outstanding obligation in respect of royalty-bearing participations received or accrued, net of royalties paid or accrued before interest, amounted to approximately US$ 2,960 thousand as at December 31, 2010 (US$ 2,960 thousand as at December 31, 2009).

B. Lease commitments

The premises and facilities occupied by the Company are leased under various operating lease agreements. Furthermore, the Company has entered into several operating lease agreements for motor vehicles in Israel.

The agreements are in New Israeli Shekel (NIS) or in NIS, linked to the Israeli Consumer Price Index.

Note 10 - Commitments and Contingencies (Cont’d)

B. Lease commitments (cont’d)

The minimum future rental payments under the above leases at exchange rates in effect on December 31, 2010, are as follows:

	US$ thousands
Year ended December 31	
2011	561
2012	164
2013	59

Rental expenses under the lease agreements for the years ended December 31, 2008, 2009 and 2010 were US$ 528 thousand, US$ 514 thousand and US$ 542 thousand, respectively.

C. Credit line

The Company has one line of credit provided to it by a bank (approximately US$ 169 thousand). The bank is allowed to cancel or change the line of credit with no early notice.
As at December 31, 2010, this credit line has not been used.

Note 11 - Shareholders' Equity

A. Share capital and warrants

In May 2007, the Company conducted a private placement, pursuant to which the Company issued to certain “accredited investors” and “qualified institutional purchasers” 875,000 ordinary shares at a purchase price of US$20.50 per share and warrants to purchase up to 218,750 ordinary shares at an exercise price of US$28.25 per share. The warrants issued to the investors expired in July 2010. Net proceeds from the private placement were approximately US$16.8 million, net of US$1.2 million of issuance costs. In addition, the Company issued to the placement agents warrants to purchase up to an aggregate of 10,937 ordinary shares on the same terms as the warrants issued to the investors.

As at December 31, 2010, no warrants were exercised into shares related to this issuance.

B. Stock options to employees and directors

1. In October 2000, the Board of Directors of Silicom adopted the Silicom Ltd. US Share Option Plan (2000) (the “US Plan”). The US Plan provides that options may be granted to any officer, consultants and certain other present and future employees and directors of Silicom and its subsidiary. Under the terms of the US Plan, up to a maximum of 200,000 ordinary shares of Silicom are reserved for issuance, subject to certain adjustments. The exercise price of the options granted under the US Plan shall be not less than 100 percent (or, in the case of a grant to a holder of

more than 10% of Silicom's outstanding shares, 110 percent) of the fair market value of the ordinary shares subject to the option on the date the option is granted. The vesting period of the options is subject to the discretion of the Board. The term of the option shall not exceed 10 years from the date that the option was granted (or five years, in the case of optionees who hold more than 10% of Silicom's outstanding shares).

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Note 11 - Shareholders' Equity (cont'd)

B. Stock options to employees and directors (cont'd)

2. On July 21, 2004, the Board resolved, subject to shareholders' approval that was given on December 30, 2004, to adopt the Share Option Plan (2004) (the "2004 Plan") and to cancel any authorized share capital of the Company that had been previously reserved and unexercised under the 1993 and 1994 plans, which was not then allocated under such plans or which would become unallocated from time to time as outstanding options expire or are forfeited collectively (the "Cancelled Reserve"). The Cancelled Reserve consisted of 282,750 authorized Ordinary Shares of the Company.

The 2004 Plan, covers up to 582,750 options at a conversion rate of 1:1 to be granted to Israeli employees and directors. Option grants to employees under the 2004 Plan, including terms of vesting and the exercise price are subject to the Board of Directors' approval. Option grants to directors are subject to the approvals of the Audit Committee, Board of Directors and Shareholders. The term of the options shall not exceed 10 years from the date that the option was granted.

3. No options have been granted by the Company other than to employees and directors, as mentioned above.

4. Options granted to Israeli residents may be granted under Section 102 of the Israeli Income Tax Ordinance pursuant to which the awards of options, or the ordinary shares issued upon their exercise, must be deposited with a trustee for at least two years following the date of grant. Under Section 102, any tax payable by an employee from the grant or exercise of the awards is deferred until the transfer of the awards or ordinary shares by the trustee to the employee or upon the sale of the awards or ordinary shares.

Gains on awards granted under the plan are subjected to capital tax of 25% to be paid by the employee, and the Company is not entitled to a tax deduction.

Note 11 - Shareholders' Equity (cont'd)

B. Stock options to employees and directors (cont'd)

5. On January 24, 2008, the Company granted, in the aggregate, 200,000 options to certain of its directors and employees under its Share Option Plan (2004) and US Share Option Plan (2000). In relation to this grant:

a. The exercise price for the options (per ordinary share) was US $ 11.20 and the Option expiration date was the earlier to occur of: (a) January 24, 2016; and (b) the closing price of the Shares falling below US $ 5.60 at any time after the date of grant. 50% of the options vest and become exercisable on the second anniversary of the date of grant and additional 50% of the options vest and become exercisable on the third anniversary of the date of the grant.

b. The Company recognizes compensation expenses on these options based on estimated grant date fair value using the Monte Carlo option-pricing model with the following assumptions:

Average Risk-free interest rate (1)	3.36	%
Expected dividend yield	0.0	%
Average expected volatility (2)	116.24	%
Termination rate	11	%
Suboptimal rate (3)	3.4	

(1) Risk-free interest rate represents risk free US$ zero-coupon US Government Bonds at time of grant.
(2) Expected average volatility represents a weighted average standard deviation rate for the price of the Company's ordinary shares on the NASDAQ National Market.
(3) Suboptimal rate represents the multiple of the increase in the market share price on the day of grant of the option which, should it come to pass, will lead to exercise of the option by the employee. It is the average suboptimal rate of the Company and similar companies.

c. Expenses incurred during the year ended December 31, 2010 in relation to this grant were approximately US$ 123 thousand. As at December 31, 2010, there was approximately US$ 7 thousand of unrecognized compensation costs related to this grant to be recognized over a weighted average period of 0.03 years.

d. All of these options expired by their terms on July 30, 2008 without exercise.

Note 11 - Shareholders' Equity (cont'd)

B. Stock options to employees and directors (cont'd)

6. On October 15, 2008, the Company granted, in the aggregate, 200,000 options to certain of its directors and employees under its Share Option Plan (2004) and US Share Option Plan (2000). In relation to this grant:

a. The exercise price for the options (per ordinary share) was US$ 3.82 and the Option expiration date was the earlier to occur of: (a) October 15, 2016; and (b) the closing price of the Shares falling below US$ 1.91 at any time after the date of grant. 50% of the options vest and become exercisable on the second anniversary of the date of grant and the additional 50% of the options vest and become exercisable on the third anniversary of the date of the grant.

b. The Company recognizes compensation expenses on these options based on estimated grant date fair value using the Monte Carlo option-pricing model with the following assumptions:

Average Risk-free interest rate (1)	3.73	%
Expected dividend yield	0.0	%
Average expected volatility (2)	112.42	%
Termination rate	11	%
Suboptimal rate (3)	3.45	

(1) Risk-free interest rate represents risk free US$ zero-coupon US Government Bonds at time of grant.
(2) Expected average volatility represents a weighted average standard deviation rate for the price of the Company's ordinary shares on the NASDAQ National Market.
(3) Suboptimal rate represents the multiple of the increase in the market share price on the day of grant of the option which, should it come to pass, will lead to exercise of the option by the employee. It is the average suboptimal rate of the Company and similar companies.

c. Expenses incurred during the year ended December 31, 2010 in relation to this grant were approximately US$ 99 thousand. As at December 31, 2010, there was approximately US$ 33 thousand of unrecognized compensation costs related to this grant to be recognized over a weighted average period of 0.29 years.

Note 11 - Shareholders' Equity (cont'd)

B. Stock options to employees and directors (cont'd)

7. On December 21, 2010, the Company granted, in the aggregate, 137,500 options to certain of its directors and employees under its Share Option Plan (2004). In relation to this grant:

a. The exercise price for the options (per ordinary share) was US$ 18.82 and the Option expiration date was the earlier to occur of: (a) December 21, 2018; and (b) the closing price of the Shares falling below US$ 9.41 at any time after the date of grant. 50% of the options vest and become exercisable on the second anniversary of the date of grant and the additional 50% of the options vest and become exercisable on the third anniversary of the date of the grant.

b. The Company recognizes compensation expenses on these options based on estimated grant date fair value using the Binomial option-pricing model with the following assumptions:

Average Risk-free interest rate (1)	3.00	%
Expected dividend yield	0.0	%
Average expected volatility (2)	82.64	%
Termination rate	9	%
Suboptimal rate (3)	3.45	

(1) Risk-free interest rate represents risk free US$ zero-coupon US Government Bonds at time of grant.
(2) Expected average volatility represents a weighted average standard deviation rate for the price of the Company's ordinary shares on the NASDAQ National Market.
(3) Suboptimal rate represents the multiple of the increase in the market share price on the day of grant of the option which, should it come to pass, will lead to exercise of the option by the employee. It is the average suboptimal rate of the Company and similar companies.

c. Expenses incurred during the year ended December 31, 2010 in relation to this grant were approximately US$ 9 thousand. As at December 31, 2010, there was approximately US$ 935 thousand of unrecognized compensation costs related to this grant to be recognized over a weighted average period of 2.44 years.

Note 11 - Shareholders' Equity (cont'd)

B. Stock options to employees and directors (cont'd)

8. The following table summarizes information regarding stock options as at December 31, 2010:

	Options outstanding		Options exercisable	
Exercise price US$	Number of options	Weighted average remaining contractual life (in years)	Number of options	Weighted average remaining contractual life (in years)
0.90	1,750	1.07	1,750	1.07
2.53	33,100	3.99	33,100	3.99
3.82	133,475	5.79	35,475	5.79
18.82	137,500	7.97	-	-
	305,825		70,325	

The aggregate intrinsic value of options outstanding as of December 31, 2009 and 2010 is US$ 1,131 thousand and US$ 2,541 thousand, respectively.

The aggregate intrinsic value of options exercisable as of December 31, 2009 and 2010 is US$ 246 thousand and US$ 1,089 thousand, respectively.

The total intrinsic value of options exercised during the year ended December 31, 2009 and 2010, is US$ 319 thousand and US$ 813 thousand, respectively.

The intrinsic value of the options at the date of grant is zero.

Note 11 - Shareholders' Equity (cont'd)

B. Stock options to employees and directors (cont'd)

9. The stock option activity under the abovementioned plans is as follows:

	Number of options	Weighted average exercise price US$	Weighted average grant date fair value US$
Balance at January 1, 2009	357,450		
Exercised	(115,250)	5.45	5.50
Forfeited	(1,500)	3.82	1.81
Balance at December 31, 2009	240,700		
Granted	137,500	18.82	8.69
Exercised	(70,375)	3.68	1.81
Forfeited	(2,000)	3.82	1.81
Balance at December 31, 2010	305,825		
Exercisable at December 31, 2010	70,325		

10. During 2008, 2009 and 2010, the Company recorded share-based compensation expenses. The following summarizes the allocation of the stock-based compensation expenses:

	Year ended December 31		
	2008 US$ thousands	2009 US$ thousands	2010 US$ thousands
Cost of sales	49	65	33
Research and development costs	103	138	71
Selling and marketing expenses	96	127	65
General and administrative expenses	86	109	62
	334	439	231

Note 12 - Sales

A. Information on sales by geographic distribution:

The Company has one operating segment.

Sales are attributed to geographic distribution based on the location of the customer.

	Year ended December 31		
	2008	2009	2010
	US$ thousands		
North America	16,808	14,464	22,071
Europe	2,114	3,507	4,174
Rest of the world	6,632	2,555	4,154
	25,554	20,526	30,399

All property, plant and equipment are located in Israel.

B. Sales to single customers exceeding 10% of sales (US$ thousands):

	Year ended December 31		
	2008	2009	2010
	US$ thousands		
Customer “A”	5,108	2,593	4,160
Customer “B”	*	*	3,440
Customer “C”	2,702	2,920	3,214
Customer “D”	3,521	*	*

* Less than 10% of sales.

Note 13 - Financial Income (Expenses), Net

	Year ended December 31		
	2008	2009	2010
	US$ thousands		
Interest income	1,361	1,001	861
Exchange rate differences, net	(75)	72	(130)
Bank charges	(98)	(164)	(114)
	1,188	909	617

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Note 14 - Taxes on Income

A. Measurement of results for tax purposes under the Israeli Income Tax Regulations (Rules for Maintaining Accounting Records of Foreign Invested Companies and Certain Partnerships and Determining Their Taxable Income) - 1986

As a "foreign invested company" (as defined in the Israeli Law for the Encouragement of Capital Investments-1959), the Company's management has elected to apply Income Tax Regulations (Rules for Maintaining Accounting Records of Foreign Invested Companies and Certain Partnerships and Determining Their Taxable Income) - 1986 from January 1, 2002. Accordingly, its taxable income or loss is calculated in US Dollars.

B. Israel tax reform

On July 25, 2005, the Israeli Parliament (the "Knesset") passed the Law for the Amendment of the Income Tax Ordinance (No. 147 and Temporary Order) – 2005, which provides, inter alia, for gradual reduction in the Company tax rate to 25% until 2010 tax year.

On July 14, 2009, the Knesset Passed the law for Economic Efficiency (amendment for legislation for implementation of the economic program for 2009-2010), which provides for gradual reduction in the company tax rate to 18% as from 2016. According to the amendments the company tax rate will be reduced in the following manner: in 2009 – 26%, in 2010 – 25%, in 2011 – 24%, in 2012 – 23%, in 2013 – 22%, in 2014 – 21%, in 2015 – 20%, and from 2016 onward the tax rate will be 18%.

C. Tax benefits under the Israeli Law for the Encouragement of Capital Investments, 1959 (hereinafter - the “Law”)

1. Rates

a. The Company has elected to be taxed under the alternative benefits method, whereby the Company waives grants in return for tax exemptions. For the manufacturing plant in Yokneam the Company is entitled to an exemption from tax on its taxable income for a period of ten years beginning from the year of election; For the research and development center the Company is entitled to an exemption from tax on its taxable income for two years beginning from the year of election, and not more than 25%, on its taxable income in the next eight years.

b. In the event of distribution by the Company of cash dividends out of its retained earnings that were tax exempt due to the “Approved Enterprise” status, the Company would be subject to a 25% corporate tax on the amount distributed, and a further 15% withholding tax would be deducted from the amounts distributed to the shareholders.

c. Should the Company derive income from sources other than the “Approved Enterprise” during the relevant period of benefits, such income will be taxable at the regular corporate tax rates for the applicable year.

Note 14 - Taxes on Income (cont’d)

C. Tax benefits under the Israeli Law for the Encouragement of Capital Investments, 1959 (hereinafter - the “Law”) (cont'd)

2. Accelerated depreciation

The Company is entitled to claim accelerated depreciation for a period of five years in respect of property, plant and equipment of an “Approved Enterprise”. The Company has not utilized this benefit to date.

3. Conditions for entitlement to the tax benefits

Entitlement to the tax benefits of the Company’s “Approved Enterprise” is dependent upon the Company fulfilling the conditions stipulated by the Law and the regulations published thereunder, as well as the criteria set forth in the approval for the specific investment in the Company’s “Approved Enterprise”.

In the event of failure to comply with these conditions, the tax benefits may be canceled, and the Company may be required to refund the amount of the cancelled benefits, with the addition of linkage differences and interest. As of the date of these financial statements, the Company believes it is in compliance with these conditions.

4. Amendments to the Law

On March 30, 2005, the Israeli Parliament approved a reform of the above Law. The primary changes are as follows:

(a) Companies that meet the criteria of the Beneficial Enterprise (Formerly known as Alternative Path of Approved Enterprise) benefits will receive those benefits without prior approval. In addition, there will be no requirement to file reports with the Investment Center. Companies will be required to notify the Israeli Tax Authorities regarding the implementation of the Beneficial Enterprise. Audits will take place via the Israeli Income Tax Authorities as part of the tax audits. Request for pre-ruling is possible.

(b) Tax benefits of the Beneficial Enterprise comparing to regular corporate tax regulations, include lower tax rates or no tax depending on the area and the path chosen, lower tax rates on dividend income and accelerated tax depreciation. The tax benefits do not differ from those prior the amendment.

Note 14 - Taxes on Income (cont’d)

C. Tax benefits under the Israeli Law for the Encouragement of Capital Investments, 1959 (hereinafter - the “Law”) (cont'd)

4. Amendments to the Law (cont'd)

(c) In order to receive the tax benefits in the Grant Path or the Beneficial Enterprise, the “Industrial Company” must contribute to the economic independence of Israel’s economy in one of the following ways:

1. Its primary activity is in the Biotechnology or Nanotechnology fields and pre-approval is received from the head of research and development at the Office of the Chief Scientist;

2. Its revenue from a specific country is not greater than 75% of its total revenues that year;

3. 25% or more of its revenues are derived from a specific foreign market of at least 12 million residents.

(d) Upon the establishment of a “Beneficial Enterprise”, an investment of at least NIS 300 thousand in production machinery and equipment within three years is required.

(e) For an expansion, a company is required to invest within three years the higher of NIS 300 thousand in production machinery and equipment or a certain percentage of its existing production machinery and equipment.

The amendments to the Law do not retroactively apply for investment programs having an “Approved Enterprise” approval certificate from the Investment Center issued up to December 31, 2004. Therefore, the amendments do not impact an existing “Approved Enterprise” that received prior written approval. The new tax regime shall apply for a new “Approved Enterprise” and for an “Approved Enterprise” expansion for which the elected year is 2004 onwards.

In respect to the abovementioned amendments to the Law, the Company selected the tax years 2004, 2006 and 2009 as the years of election and received the Israeli Tax Authorities’ pre-ruling acknowledging 2004, 2006 and 2009 as the years of election. Additionally, the Israeli Tax Authorities’ pre-ruling granted a formula to determine allocation of the Company's taxable income that will be subject to different tax rates as allowed under the amendments to the Law.

On December 29, 2010 the Knesset approved the Economic Policy Law for 2011-2012, which includes an amendment to the Law for the Encouragement of Capital Investments – 1959 (hereinafter – “the Amendment to the Law”). The Amendment to the Law was published in the Official Gazette on January 6, 2011. The Amendment to the Law is effective from January 1, 2011 and its provisions will apply to preferred income derived or accrued in 2011 and thereafter by a preferred company, per the definition of these terms in the Amendment to the Law.

Note 14 - Taxes on Income (cont'd)

C. Tax benefits under the Israeli Law for the Encouragement of Capital Investments, 1959 (hereinafter - the "Law") (cont'd)

4. Amendments to the Law (cont'd)

Companies can choose to not be included in the scope of the Amendment to the Law and to stay in the scope of the law before its amendment until the end of the benefits period. The 2012 tax year is the last year companies can choose as the year of election, providing that the minimum qualifying investment began in 2010.

The Amendment provides that only companies in Development Area A will be entitled to the grants track and that they will be entitled to receive benefits under this track and under the tax benefits track at the same time. In addition, the existing tax benefit tracks were eliminated (the tax exempt track, the "Ireland track" and the "Strategic" track) and two new tax tracks were introduced in their place, a preferred enterprise and a special preferred enterprise, which mainly provide a uniform and reduced tax rate for all the company's income entitled to benefits, such as: for a preferred enterprise – in the 2011-2012 tax years – a tax rate of 10% for Development Area A and of 15% for the rest of the country, in the 2013-2014 tax years – a tax rate of 7% for Development Area A and of 12.5% for the rest of the country, and as from the 2015 tax year – 6% for Development Area A and 12% for the rest of the country. Furthermore, an enterprise that meets the definition of a special preferred enterprise is entitled to benefits for a period of 10 consecutive years and a reduced tax rate of 5% if it is located in Development Area A or of 8% if it is located in a different area.

The Amendment to the Law also provides that no tax will apply to a dividend distributed out of preferred income to a shareholder that is a company, for both the distributing company and the shareholder. A tax rate of 15% shall continue to apply to a dividend distributed out of preferred income to an individual shareholder or foreign resident, subject to double taxation prevention treaties, which means that there is no change from the existing law. Furthermore, the Amendment to the Law provides relief (hereinafter – "the relief") with respect to tax paid on a dividend received by an Israeli company from profits of an approved/alternative/beneficiary enterprise that accrued in the benefits period according to the version of the law before its amendment, if the company distributing the dividend notifies the tax authorities by June 30, 2015 that it is applying the provisions of the Amendment to the Law and the dividend is distributed after the date of the notice.

The Company meets the conditions provided in the amendment to the Law for the Encouragement of Capital Investments for inclusion in the scope of the tax benefits track. The amendment to the Law will not have a material impact on the Company's consolidated financial statements as of December 31, 2010.

Note 14 - Taxes on Income (cont'd)

D. Tax benefits under the Israeli Law for Encouragement of Industry (Taxes), 1969

The Company considers that it currently qualifies as an "Industrial Company" under the above Law. As such, it is entitled to certain tax benefits, mainly the right to deduct share issuance costs over three years for tax purposes in the event of a public offering.

E. Tax assessments

For the Israeli and US Federal jurisdictions, the Company has final tax assessments for all years up to and including the tax year ended December 31, 2006. For the New-Jersey state jurisdiction, the Company has final tax assessments for all years up to and including the tax year ended December 31, 2005.

F. Taxation of the subsidiary

At December 31, 2010, the Company's subsidiary had approximately US$ 582 thousand net operating loss carryforwards for US federal income tax reporting purposes, which will expire through 2029. In addition, at December 31, 2010, the subsidiary had approximately US$ 23 thousand net operating loss carryforwards for state income tax reporting purposes, which will expire through 2015.

G. Income before income taxes and income taxes expense (benefit) included in the consolidated statements of operations

	Year ended December 31		
	2008	2009	2010
	US$ thousands		
Income before income taxes:			
Israel	4,746	3,115	6,507
Foreign jurisdiction	23	9	9
	4,769	3,124	6,516
Current taxes:			
Israel	438	358	657
Tax benefits relating to prior years:			
Israel	-	(72)	(12)
Deferred taxes:			
Israel	(307)	60	148
Foreign jurisdiction	(7)	(41)	8
	(314)	19	156

Income tax expense	124	305	801

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Note 14 - Taxes on Income (cont'd)

H. Deferred income taxes

1. A portion of Silicom's income is tax exempt due to the "Approved Enterprise" status granted to its production facilities. Silicom has decided to indefinitely reinvest the amount of the said tax-exempt income, and not to distribute such income as dividends.

2. The tax effects of significant items comprising the Company's deferred tax assets are as follows:

	December 31 2009 US$ thousands	December 31 2010 US$ thousands
Deferred tax assets:		
Accrued employee benefits	230	209
Research and development costs	151	12
Tax loss carryforwards	113	89
Fixed Assets	-	9
Other	(1)	1
Total gross deferred tax assets	493	320
Less: valuation allowance	(68)	(51)
Net deferred tax assets	425	269
In Israel	381	232
Foreign jurisdictions	44	37
Net deferred tax assets	425	269
Current	233	50
Deferred	192	219
Total	425	269

The net change in valuation allowance for the years ended December 31, 2009 and 2010 was a decrease of US$ 423 thousand and a decrease of US$ 17 thousand, respectively.

In assessing the realizability of deferred tax assets, the company considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences and/or loss carry-forward become deductible. In making this assessment, the company has to consider the projected future taxable income as well as tax planning strategies.

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Note 14 - Taxes on Income (cont'd)

H. Deferred income taxes (cont'd)

For the year ended December 31, 2008, the Company recorded valuation allowance in the amount of its non-current deferred tax assets due to the uncertainty of their realization. In assessing the need for a valuation allowance, the Company considered its historical levels of income, the fact that the Company had a single product line, short lead time of customer's orders and flexible forecasting and expectation of future taxable income and ongoing tax planning strategies.

For the year ended December 31, 2009, the Company re-evaluated the need for a valuation allowance, due to its cumulative profits in recent years and in particular completing profitable quarters in 2009 despite the major worldwide economic downturn which started at the end of 2008. In light of the projections for future taxable income over the periods in which the deferred tax are deductible, the Company believed that it is more likely than not that it would realize a major part of the benefits of these deductible differences. In making these projections the Company has considered its currently stable work environment related to its existing line of products, which enables the Company to present current positive operating income and net income. Additionally, the Company considered its planned new line of products.

Accordingly, the Company reversed a major part of the valuation allowance and recorded an income tax benefit of $423 thousands in 2009. In 2010 the Company's view remained unchanged. As of December 31, 2010 all of the valuation allowance refers to loss carry-forward related to Silicom Connectivity Solutions, Inc.

Based upon projections for future taxable income over the periods in which the deferred tax assets are deductible, the Company believes it is more likely than not that it will realize the benefits of these deductible differences, net of existing valuation allowance. The amount of the deferred tax asset considered realizable, however, could be reduced in the future if estimates of future taxable income during the carryforward period are reduced.

Note 14 - Taxes on Income (cont'd)

I. Reconciliation of the statutory tax expense to actual tax expense

	Year ended December 31		
	2008	2009	2010
	US$ thousands		
Income before income taxes	4,769	3,124	6,516
Statutory tax rate in Israel	27 %	26 %	25 %
Computed expected tax	1,288	812	1,629
Increase (decrease) in taxes resulting from:			
Non-deductible (deductible) operating expenses	105	126	25
Prior year adjustments	-	(72)	(12)
Change in valuation allowance	88	(423)	(17)
Tax effect due to "Approved Enterprise" status	(1,324)	(66)	(832)
Other	(33)	(72)	8
Income tax expense	124	305	801

J. Accounting for uncertainty in income taxes

ASC 740-10 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements. This standard prescribes a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. ASC 740-10 requires significant judgment in determining what constitute an individual tax position as well as assessing the outcome of each tax position.

As of January 1, 2008, 2009 and 2010 and during 2008, 2009 and 2010 the Company and its subsidiary did not have any unrecognized tax benefits and thus, no related interest and penalties were accrued.

In addition, the Company and its subsidiary do not expect that the amount of unrecognized tax benefits will change significantly within the next twelve months.

The Company and its subsidiary file income tax returns in Israel and in the US. The Israeli tax returns of the Company are open to examination by the Israeli tax authorities for the tax years beginning in 2007. The Federal tax returns of the US subsidiary are open to examination by the Federal tax authorities for tax years beginning in 2007, and the NJ State tax returns of the US subsidiary are open to examination by the NJ state tax authorities for tax years beginning in 2006.

Note 15 - Fair Value of Financial Instruments

The Company's financial instruments consist of cash and cash equivalents, short-term deposits, marketable securities, trade and other receivables and trade accounts payable. The carrying amounts of these financial instruments, except for marketable securities, approximate fair value because of the short maturity of these investments. Assets held for severance benefits are recorded at their current cash redemption value.

The fair value of marketable securities is presented in Note 4 to these consolidated financial statements.

Note 16 - Subsequent Events

The Company has evaluated subsequent events for the balance sheet date through March 16, 2011, the date at which the financial statements were available to be issued, and determined there are no other items to disclose.