

AUDIOCODES LTD
Form 20-F
June 24, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 20 F

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

OR

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

For the fiscal year ended December 31, 2007

OR

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

OR

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

Date of event requiring this shell company report _____

For the transition period from _____ to _____

Commission file number 0-30070

AUDIOCODES LTD.

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

ISRAEL

(Jurisdiction of incorporation or organization)

1 Hayarden Street, Airport City Lod 70151, Israel

(Address of principal executive offices)

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

Title of each class

Ordinary Shares, nominal value NIS 0.01 per share

Name of each exchange on which registered

NASDAQ Global Select Market

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

None

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(Title of Class)

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

None

(Title of Class)

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

As of December 31, 2007, the Registrant had outstanding 43,089,552 Ordinary Shares, nominal value NIS 0.01 per share.

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

Yes No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934: Yes No

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

Yes No

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

Large Accelerated filer Accelerated filer Non-accelerated filer

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

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

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

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

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If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): Yes No

PART I

Unless the context otherwise requires, AudioCodes, us, we and our refer to AudioCodes Ltd. and its subsidiaries.

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. *SELECTED FINANCIAL DATA*

We derived the consolidated statements of operations data for the years ended December 31, 2005, 2006 and 2007 and consolidated balance sheets data as of December 31, 2006 and 2007 from the audited consolidated financial statements set forth elsewhere in this Annual Report. We derived the consolidated statements of operations data for the years ended December 31, 2003 and 2004 and the consolidated balance sheets data as of December 31, 2003, 2004 and 2005 from audited consolidated financial statements that are not included in this Annual Report.

	Year Ended December 31,				
	2003	2004	2005	2006(*)	2007(*)
	(In thousands, except per share data)				
<u>Statement of Operations Data:</u>					
Revenues	\$ 44,228	\$ 82,756	\$ 115,827	\$ 147,353	\$ 158,235
Cost of revenues	20,037	34,375	46,993	61,242	69,185
Gross profit	24,191	48,381	68,834	86,111	89,050
Operating expense:					
Research and development, net	15,476	20,009	24,415	35,416	40,706
Selling and marketing	14,537	19,891	25,944	37,664	42,900
General and administrative	4,066	4,851	6,004	8,766	9,637
Total operating expenses	34,079	44,751	56,363	81,846	93,243
Operating income (loss)	(9,888)	3,630	12,471	4,265	(4,193)
Financial income, net	1,883	2,165	2,457	3,817	2,670
Income (loss) before taxes on income (tax benefit)	(8,005)	5,795	14,928	8,082	(1,523)
Taxes on income, net		273	799	289	1,265
Equity in losses of affiliated companies	429	516	693	916	1,097
Net income (loss)	\$ (8,434)	\$ 5,006	\$ 13,436	\$ 6,877	\$ (3,885)
Basic net earnings (loss) per share	\$ (0.22)	\$ 0.13	\$ 0.33	\$ 0.16	\$ (0.09)
Diluted net earnings (loss) per share	\$ (0.22)	\$ 0.12	\$ 0.31	\$ 0.16	\$ (0.09)
Weighted average number of ordinary shares used in computing basic net earnings (loss) per share	37,509	38,614	40,296	41,717	42,699
Weighted average number of ordinary shares used in computing diluted net earnings per share	37,509	42,607	43,086	43,689	42,699

(*) Including stock-based compensation expenses related to options granted to employees and others as a result of the adoption of SFAS 123R as of January 1, 2006.

	December 31,				
	2003	2004	2005	2006	2007
<u>Balance Sheet Data:</u>					
Cash and cash equivalents	\$ 48,898	\$ 166,832	\$ 70,957	\$ 25,171	\$ 75,063
Short-term bank deposits, structured notes, marketable securities and accrued interest			71,792	58,080	35,309
Working capital	46,232	171,447	152,047	97,454	124,676
Long-term bank deposits, structured notes and marketable securities	50,270	50,195	77,572	50,377	32,670
Total assets	128,530	272,145	292,223	337,056	344,487
Senior convertible notes		120,660	120,836	121,015	121,198
Total shareholders' equity	106,518	121,985	139,106	164,685	174,492
Capital stock	116,639	126,826	130,744	149,336	162,103

B. CAPITALIZATION AND INDEBTEDNESS

Not applicable.

C. REASONS FOR THE OFFER AND USE OF PROCEEDS

Not applicable.

D. RISK FACTORS

We are subject to various risks and uncertainties relating to or arising out of the nature of our business and general business, economic, financing, legal and other factors or conditions that may affect us. We believe that the occurrence of any one or some combination of the following factors could have a material adverse effect on our business, financial condition, cash flows and results of operations.

Risks Related to Our Business and Industry

We reported a loss for 2007. We may experience additional losses in the future.

After reporting net income for 2004, 2005 and 2006, we reported a net loss of \$3.9 million in 2007. We may continue to report losses in 2008. Our results in 2007 were impacted by weaker than expected performance by our recent acquisitions and lower than expected sales of our boards business line. The majority of our expenses are directly and indirectly related to the number of people we employ. We may increase our expenses based on projections of revenue growth. If at any given time we do not meet our expectations for growth in revenues our expenses incurred in anticipation of projected revenues may cause us to incur a loss. We may not be able to anticipate a loss in advance and adjust our expenses accordingly. We will need to increase revenues and reduce expenses in order to return to profitability.

We are dependent on the development of the VoIP market to increase our sales.

We are dependent on the development of the Voice over Internet Protocol, or VoIP, market to increase our sales. Most existing networks are still not based on Voice over Packet technology which we use in our products designed for the VoIP market. We cannot be sure that the delivery of telephone and other communications services over packet networks will expand at significant rates, or that there will be a need to interconnect to other networks utilizing the type of technology contained in our products. For example, the need for our Media Gateway products depends on the need to inter connect VoIP networks with traditional non-packet based networks. Our session border control products depend on growth in the need to inter connect Voice over Packet networks with each other. The adaptation process of connecting packet networks and telephone networks can be time consuming and costly. Sales of our VoIP products will depend on the development of packet networks and the commercialization of VoIP services. If this market develops more slowly than we expect, we may not be able to sell our products in a significant enough volume to be profitable.

We intend to expand our business through acquisitions that could result in diversion of resources and extra expenses. This could disrupt our business and adversely affect our financial condition.

Part of our strategy is to pursue acquisitions of, or investments in, businesses and technologies or to establish joint ventures to expand our business. For example, in April 2003, we purchased a product group from Nortel Networks and in May 2004 we purchased Ai-Logix Inc., now known as AudioCodes Inc. In 2005, we invested in two Israeli-based companies, MailVision Ltd. and CTI Squared Ltd., and continued investing in Natural Speech Communication Ltd. We have recognized losses from our equity investment in Natural Speech Communication in our results of operations in each of the past three years.

In July 2006, we acquired Nuera Communications, Inc. (now called AudioCodes Inc.), in August 2006, we acquired Netrake Corporation (now called AudioCodes Inc.), and in April 2007, we completed our acquisition of CTI Squared Ltd.

The negotiation of acquisitions, investments or joint ventures, as well as the integration of acquired or jointly developed businesses or technologies, could divert our management's time and resources. Nuera is significantly larger than any other acquisition we have made. As a result, we have experienced a diversion of our management's time and resources in connection with the integration and operation of Nuera's business.

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Acquired businesses, technologies or joint ventures may not be successfully integrated with our products and operations. The markets for the products produced by the companies we acquire may take longer than we anticipated to develop and to result in increased sales and profits for us. We may not realize the intended benefits of any acquisition, investment or joint venture and we may incur losses from any acquisition, investment or joint venture.

In addition, acquisitions could result in:

- substantial cash expenditures;
- potentially dilutive issuances of equity securities;
- the incurrence of debt and contingent liabilities;
- a decrease in our profit margins;
- amortization of intangibles and potential impairment of goodwill;
- write-offs of in-process research and development;
- reduction of management attention to other parts of the business;
- failure to invest in different areas or alternative investments;
- failure to generate expected financial results or reach business goals; and
- increased expenditures on human resources and related costs.

If acquisitions disrupt our sales or marketing efforts or operations, our business may suffer.

We may not be able to raise additional financing for our capital needs on favorable terms, or at all, which could limit our ability to grow and to continue our longer term expansion plans.

We may need to raise additional capital to continue our longer term expansion plans. To the extent that we cannot fund our activities and acquisition program through our existing cash resources and any cash we generate from operations, we may need to raise equity or debt funds through additional public or private financings. In addition, we may be required to repay all or a portion of our outstanding senior convertible notes in November 2009. We cannot be certain that we will be able to obtain additional financing on commercially reasonable terms, or at all. This could inhibit our growth, increase our financing costs or, if we are unable to repay our senior convertible notes, cause us severe financial difficulties.

A downturn in general economic conditions could adversely affect our revenues, operating results and financial condition.

Periods of economic slowdown or recession in the United States or other relevant regions or countries in which we market our products or the public perception that these periods of economic slowdown or recession may occur, may reduce corporate and consumer spending and decrease the demand for our products. The current weakness in the global economy, caused in part by the increase in energy prices, could reduce corporate and consumer spending. Furthermore, periods of economic slowdown or recession could adversely affect the financial stability of our subcontractors, partners, distributors and resellers. If general economic conditions fail to improve, or if they deteriorate, our revenues, operating results and financial condition could be adversely affected.

If new products we recently introduced or expect to introduce in the future fail to generate the level of demand we anticipated, we will realize a lower than expected return from our investment in research and development with respect to those products, and our results of operations may suffer.

Our success is dependent, in part, on the willingness of our customers to transition or migrate to new products, such as our expanded offering of Mediant and IPmedia products, the session border controller products that we now offer as a result of our acquisition of Netrake, the software application products that we now offer as a result of our acquisition of CTI Squared, or expected future products. We are involved in a continuous process of evaluating changing market demands and customer requirements in order to develop and introduce new products, features and applications to meet changing demands and requirements. We need to be able to interpret market trends and the advancement of technology in order to successfully develop and introduce new products, features and applications. If potential customers defer transition or migration to new products, our return on our investment in research and development with respect to products recently introduced or expected to be introduced in the near future will be lower than we originally anticipated and our results of our operations may suffer.

Because of the rapid technological development in the communications equipment market and the intense competition we face, our products can become outmoded or obsolete in a relatively short period of time, which requires us to provide frequent updates and/or replacements to existing products. If we do not successfully manage the transition process to the next generation of our products, our operating results may be harmed.

The communications equipment market is characterized by rapid technological innovation and intense competition. Accordingly, our success depends in part on our ability to develop next generation products in a timely and cost-effective manner. The development of new products is expensive, complex and time consuming. If we do not rapidly develop our next generation products ahead of our competitors, we may lose both existing and potential customers to our competitors. Further, if a competitor develops a new, less expensive product using a different technological approach to delivering informational services over existing networks, our products would no longer be competitive. Conversely, even if we are successful in rapidly developing new products ahead of our competitors and we do not cost-effectively manage our inventory levels of existing products when making the transition to the new products, our financial results could be negatively affected by high levels of obsolete inventory. If any of the foregoing were to occur, then our operating results would be harmed.

Our industry is rapidly evolving and we may not be able to keep pace with technological changes, which could adversely affect our business.

The transmission of multimedia over data networks is rapidly evolving. Short product life cycles place a premium on our ability to manage the transition from current products to new products. Our future success in generating revenues will depend on our ability to enhance our existing products and to develop and introduce new products and product features. These products and features must keep pace with technological developments and address the increasingly sophisticated needs of our customers. The development of new technologies and products is increasingly complex and uncertain. This increases the difficulty in coordinating the planning and production process and can result in delay in the introduction of new technologies and products.

The increase in the number of IP networks may adversely affect the demand for media gateway products.

Media gateway products are primarily intended to transcode voice from traditional telephony networks to IP networks and vice versa. Along with the growth in the number of IP networks, there has been an increase in the amount of information that is sent directly from one IP network to another IP network. This direct network communication potentially obviates the need to use a media gateway or transcoding. A reduction in the demand for media gateways may adversely affect the demand for our media gateway products and, in turn, adversely affect our results of operations.

New industry standards, the modification of our products to meet additional existing standards or the addition of features to our products may delay the introduction of our products or increase our costs.

The industry standards that apply to our products are continually evolving. In addition, since our products are integrated into networks consisting of elements manufactured by various companies, they must comply with a number of industry standards and practices established by various international bodies and industry forums. Should new standards gain broad acceptance, we will be required to adopt those standards in our products. We may also decide to modify our products to meet additional existing standards or add features to our products. Standards may be adopted by various industry interest groups or may be proprietary and nonetheless accepted broadly in the industry. It may take us a significant amount of time to develop and design products incorporating these new standards. We may also have to pay additional fees to the developers of the technologies which constitute the newly adopted standards.

Our OEM customers or potential customers may develop or prefer to develop their own technical solutions, and as a result, would not buy our products.

Our products are sold also as components or building blocks to large original equipment manufacturers, or OEM s, or network equipment providers, or NEP s. These customers incorporate our products into their product offerings, usually in conjunction with value-added services of their own or of third parties. OEM or NEP customers or potential customers may prefer to develop their own technology or purchase third party technology. They could also manufacture their own components or building blocks that are similar to the ones we offer. Large customers have already committed significant resources in developing integrated product offerings. Customers may decide that this gives them better profitability and/or greater control over supplies, specifications and performance. Customers may therefore not buy components or products from an external manufacturer such as us. This could have an adverse impact on our ability to sell our products and our revenues.

We have depended, and expect to continue to depend, on a small number of large customers. The loss of one of these customers or the reduction in purchases by a significant customer could have a material adverse effect on our revenue.

Historically, a substantial portion of our revenue has been derived from large purchases by a small number of OEMs and network equipment providers, systems integrators and distributors. For example, our top three customers accounted for approximately 24.8% of our revenues in 2005, 24.9% of our revenues in 2006 and 26.1% of our revenues in 2007. Sales to Nortel Networks, our largest customer, accounted for 17.0% of our revenues in 2007 compared to 15.2% of our revenues in 2006 and 16.3% of our revenues in 2005. We do not enter into sales agreements in which a customer is obligated to purchase a set quantity of our products. Based on our experience, we expect that our customer base may change from period to period. If we lose a large customer and fail to add new customers there could be a material adverse effect on our results of operations.

We have a limited order backlog. If revenue levels for any quarter fall below our expectations, our results of operations will be adversely affected.

We have a limited order backlog, which makes revenues in any quarter substantially dependent on orders received and delivered in that quarter. A delay in the recognition of revenue, even from one customer, may have a significant negative impact on our results of operations for a given period. We base our decisions regarding our operating expenses on anticipated revenue trends, and our expense levels are relatively fixed, or require some time for adjustment. Because only a small portion of our expenses varies with our revenues, if revenue levels fall below our expectations, our results of operations will be adversely affected.

Generally, we sell to original equipment manufacturers, or OEMs, network equipment providers or system integrator customers, as well as to distributors. As a result, we have less information with respect to the actual requirements of end users and their utilization of equipment. We also have less influence over the choice of equipment by these end users.

We typically sell to OEM customers, network equipment providers, and system integrators, as well as to distributors. Our customers usually purchase equipment from several suppliers and may be trying to fulfill one of their customers' specific technical specifications. We rely heavily on our customers for sales of our products and to inform us about market trends and the needs of their customers. We cannot be certain that this information is accurate. If the information we receive is not accurate, we may be manufacturing products that do not have a customer or fail to manufacture products that end users want. Because we are selling products to OEMs, system integrators and distributors rather than directly to end users, we have less control over the ultimate selection of products by end users.

The markets we serve are highly competitive and many of our competitors have much greater resources, which may make it difficult for us to maintain profitability.

Competition in our industry is intense and we expect competition to increase in the future. Our competitors currently sell products that provide similar benefits to those that we sell. There has been a significant amount of merger and acquisition activity and strategic alliances frequently involving major telecommunications equipment manufacturers acquiring smaller companies, and we expect that this will result in an increasing concentration of market share among these companies, many of whom are our customers.

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Our principal competitors in the sale of signal processing chips are Texas Instruments, Broadcom, Infineon, Centillium, Surf and Mindspeed. Several large manufacturers of generic signal processors, such as Motorola, Agere Systems, which merged with LSI Corporation in April 2007, and Intel have begun, or are expected to begin, marketing competing processors. Our principal competitors in the communications board market are NMS Communications, Intel, Motorola, Cantata Technology, Aculab and PIKA Technologies, Inc.

Our principal competitors in the area of analog media gateways (2 to 24 ports) for access and enterprise are Cisco Systems Inc., Mediatrix Telecom, Inc., Vega Stream Limited, Samsung, Innovaphone AG, Quintum Technologies, Tainet Communication System Corp., Welltech, Ascii Corp., D-Link Systems, Inc., Multitech Inc., Inomedia, OKI and LG. In addition we face competition in low, mid and high density gateways from internal development at companies such as Nortel, Alcatel-Lucent, Nokia-Siemens, Huawei, Ericsson, UTstarcom, ZTE and from Cisco Systems, Inc., Veraz Networks, Sonus Networks, General Bandwidth, Dialogic/Cantat Technologies and Commatch (Telrad).

Our principal competitors in the media server market segment are Cantata Technology, NMS Communications, Convedia/Radisys, IP Unity Glenayre, Cognitronics and Aculab. In addition, we face competition in software-based and hardware-based media servers from internal development at companies such as Hewlett-Packard, Comverse-NetCentrex, Nortel, Alcatel - Lucent, Nokia Siemens and Ericsson.

With respect to session border controllers, we compete against Acme Packets, Nextone/Nexpoint, Juniper and Sonus Networks. In the security gateway market, we compete against private companies such as Reefpoint/Nexpoint and Azaire.

We also face significant and increasing competition in the market for products utilized in the VoIP market. Our competitors in the market for VoIP products include telecommunications companies, data communication companies and companies specializing in voice over IP products, some of which have greater name recognition, larger installed customer bases and significantly greater financial, technical, sales and marketing resources than we do.

Many of our competitors have the ability to offer complete network solutions and vendor-sponsored financing programs to prospective customers. Some of our competitors with broad product portfolios may also be able to offer lower prices on products that compete with ours because of their ability to recoup a loss of margin through sales of other products or services. Additionally, voice, audio and other communications alternatives that compete with our products are being continually introduced.

In the future, we may also develop and introduce other products with new or additional telecommunications capabilities or services. As a result, we may compete directly with our customers with respect to sales to telephone companies and other telecommunications infrastructure providers. Additional competitors may include companies that currently provide computer software products and services, such as telephone, media, publishing and cable television. The ability of some of our competitors to bundle other enhanced services or complete solutions with VoIP products could give these competitors an advantage over us.

Offering to sell system level products that compete with the products manufactured by our customers could negatively affect our business.

Our product offerings range from media gateway building blocks, such as chips and boards, to media gateways, media servers and session border control products (systems). These products could compete with products offered by our customers. These customers could decide to decrease purchases from us because of this competition. This could result in a material adverse effect on our results of operations.

Offering to sell directly to carriers or service providers may expose us to requirements for service which we may not be able to meet.

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