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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**FORM 20-F**

**REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR 12(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, 2013

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 No. 000-51694

**Perion Network Ltd.**

(Exact Name of Registrant as specified in its charter)

N/A

(Translation of Registrant's name into English)

**Israel**

(Jurisdiction of incorporation or organization)

**4 HaNechoshet Street**

**Tel Aviv, Israel 69710**

(Address of principal executive offices)

**Yacov Kaufman, CFO**

**Tel: +972-3-7696-109; Fax: +972-3-644-5502**

**4 HaNechoshet Street**

**Tel Aviv, Israel 69710**

(Name, Telephone, E-mail and /or Facsimile Number and Address of Company Contact Person)

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

Title of Each Class  
Ordinary shares, par 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  
(Title of Class)

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

None  
(Title of Class)

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

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As of December 31, 2013, the Registrant had outstanding 12,501,237 ordinary shares, par 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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

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:

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.

Item 17

Item 18

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

Yes  No

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## PRELIMINARY NOTES

### Terms

As used herein, and unless the context suggest otherwise, the terms "Perion", "Company", "we", "us" or "ours" refer to Perion Network Ltd. and subsidiaries. References to "dollar" and "\$" are to U.S. dollars, the lawful currency of the United States, and references to "NIS" are to New Israeli Shekels, the lawful currency of the State of Israel. This annual report contains translations of certain NIS amounts into U.S. dollars at specified rates solely for your convenience. These translations should not be construed as representations by us that the NIS amounts actually represent such U.S. dollar amounts or could, at this time, be converted into U.S. dollars at the rate indicated. Unless otherwise indicated, we have translated NIS amounts into U.S. dollars at an exchange rate of NIS 3.471 to \$1.00, the representative exchange rate reported by the Bank of Israel on December 31, 2013.

### Trademarks

Perion™, IncrediMail™, PhotoJoy™, Smilebox Teeth Design™, Smilebox™, SWEETPACKS™ and SWEETIM™ are our registered trademarks. All other registered trademarks and trade names appearing in this annual report are owned by their respective holders.

### Forward-Looking Statements

This annual report on Form 20-F contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Forward-looking statements relate to future events or our future financial performance and involve known and unknown risks, uncertainties and other factors that may cause our, or our industry's, actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed, implied or inferred by these forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as "may", "will", "should", "could", "would", "expects", "plans", "intends", "anticipates", "believes", "estimates", "predicts", "projects", "potential" or "continue" or the negative of such terms and other comparable terminology.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we do not know whether we can achieve positive future results, levels of activity, performance, or goals. Actual events or results may differ materially from our current expectations. All forward-looking statements included in this report are based on information available to us on the date of this report. Except as required by applicable law, we undertake no obligation to update or revise any of the forward-looking statements after the date of this annual report to conform those statements to reflect the occurrence of unanticipated events, new information or otherwise.

You should read this annual report and the documents that we reference in this report completely and with the understanding that our actual future results, levels of activity, performance and achievements may be materially different from what we currently expect.

Factors that could cause actual results to differ from our expectations or projections include certain risks, including but not limited to the risks and uncertainties relating to our business, intellectual property, industry and operations in Israel, as described in this annual report under Item 3.D. – "Key Information – Risk Factors." Assumptions relating to the foregoing involve judgment with respect to, among other things, future economic, competitive and market conditions, and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond our control. In light of the significant uncertainties, inherent in the forward-looking information included herein, the inclusion of such information should not be regarded as a representation by us or any other person that our objectives or plans will be achieved. Moreover, we operate in a very competitive and rapidly changing environment. New risks emerge from time to time and it is not possible for our management to predict all risks, nor can we assess the impact of all risks on our business or the extent to which any risk, or combination of risks, may cause actual results to differ from those contained in any forward-looking statements.

We obtained statistical data, market data and other industry data and forecasts used in preparing this annual report from market research, publicly available information and industry publications. Industry publications generally state that they obtain their information from sources that they believe to be reliable, but they do not guarantee the accuracy and completeness of the information. Similarly, while we believe that the statistical data, industry data and forecasts and market research are reliable, we have not independently verified the data, and we do not make any representation as to the accuracy of the information.

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PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. SELECTED FINANCIAL DATA

The following tables present selected financial data and should be read in conjunction with "Item 5 – Operating and Financial Review and Prospects" and our consolidated financial statements and related notes appearing elsewhere in this annual report. We derived the selected operations data below for the years ended December 31, 2011, 2012 and 2013 and the selected balance sheet data as of December 31, 2012 and 2013 from our audited consolidated financial statements included elsewhere in this report. We derived the selected operations data below for the years ended December 31, 2009 and 2010 and the selected balance sheet data as of December 31, 2009, 2010 and 2011 from our audited consolidated financial statements not included in this report. Our consolidated financial statements are prepared and presented in U.S. dollars and in accordance with U.S. Generally Accepted Accounting Principles ("U.S. GAAP"). This data does not reflect our ClientConnect business, which was transferred by Conduit Ltd. ("Conduit") to ClientConnect Ltd. ("ClientConnect") on December 31, 2013.

We acquired ClientConnect on January 2, 2014 (the "ClientConnect Acquisition"). Shortly after filing this annual report, we expect to submit with the U.S. Securities and Exchange Commission ("SEC") a report on Form 6-K containing the audited consolidated statements of income, change in shareholders' equity and cash flows of ClientConnect for the years ended December 31, 2011, 2012 and 2013 and the audited consolidated balance sheets of ClientConnect as of December 31, 2012 and 2013, as well as pro forma combined financial data of Perion and ClientConnect as though the ClientConnect Acquisition were consummated on January 1, 2013.

Statement of Operations Data:	Year ended December 31,				
	2009	2010	2011	2012	2013
	U.S. dollars in thousands (except share and per share data)				
Revenues					
Search	\$ 20,011	\$ 22,792	\$ 25,466	\$ 38,061	\$ 59,038
Products	6,717	5,404	7,191	17,574	17,818
Advertising and Other	467	1,301	2,816	4,588	10,292
	<u>\$ 27,195</u>	<u>\$ 29,497</u>	<u>\$ 35,473</u>	<u>\$ 60,223</u>	<u>\$ 87,148</u>
Cost of revenues	1,505	1,606	2,840	5,230	11,440
Gross profit	25,690	27,891	32,633	54,993	75,708
Operating expenses:					
Research and development costs, net	6,254	6,607	7,453	10,735	13,393
Selling and marketing expenses	4,616	5,244	12,984	29,517	43,358
General and administrative expenses	3,334	4,741	7,649	8,560	15,077
Total operating expenses	14,204	16,592	28,086	48,812	71,828
Operating income	11,486	11,299	4,547	6,181	3,880
Financial income (expense), net	72	322	1,293	(174)	(1,233)
Income, before taxes on income	11,558	11,621	5,840	6,007	2,647
Taxes on income	3,545	3,232	172	2,473	2,337
Net income	<u>\$ 8,013</u>	<u>\$ 8,389</u>	<u>\$ 5,668</u>	<u>\$ 3,534</u>	<u>\$ 310</u>
Net earnings per share:					
Basic	<u>\$ 0.86</u>	<u>\$ 0.87</u>	<u>\$ 0.58</u>	<u>\$ 0.35</u>	<u>\$ 0.03</u>
Diluted	<u>\$ 0.84</u>	<u>\$ 0.85</u>	<u>\$ 0.57</u>	<u>\$ 0.34</u>	<u>\$ 0.02</u>
Weighted average number of shares used in net earnings per share:					
Basic	9,347,915	9,622,181	9,796,380	10,159,049	12,330,631
Diluted	9,562,721	9,831,628	10,002,171	10,366,808	13,003,334

	As of December 31,				
	2009	2010	2011	2012	2013
	(in thousands)				
<b>Balance Sheet Data:</b>					
Cash and cash equivalents	\$ 24,368	\$ 16,055	\$ 11,260	\$ 21,762	\$ 23,364
Working capital	26,846	28,067	(27)	(4,296)	(2,860)
Total assets	39,894	41,348	54,904	123,159	114,875
Total liabilities	12,892	13,196	23,083	68,449	58,305
Shareholders' equity	27,002	28,152	31,815	54,710	56,570

**B. CAPITALIZATION AND INDEBTEDNESS**

Not applicable.

**C. REASONS FOR OFFER AND USE OF PROCEEDS**

Not applicable.

**D. RISK FACTORS**

*Investing in our ordinary shares involves a high degree of risk. You should consider carefully the following risk factors, as well as the other information in this annual report before deciding to invest in our ordinary shares. Our business, financial condition or results of operations could be affected adversely by any of these risks. The trading price of our ordinary shares could decline due to any of these risks and you might lose all or part of your investment in our ordinary shares.*

**Risks Related to Our Business**

**We are highly dependent on Internet search based revenues.**

Both our legacy business (our business before the ClientConnect Acquisition) and the ClientConnect business are very dependent on search based revenues which are based on the acceptance and subsequent retention of search properties by the users of the software products of these businesses. In 2013, these search based revenues accounted for 68% of the revenues related to our legacy business and 85% of ClientConnect's revenues. In addition, the market for offering and retaining search properties is very competitive. While our strategy is to diversify our revenue streams and limit the dependence on search based revenues, we expect this venue to continue to generate a major portion of our revenues in the foreseeable future. Adverse changes in the search industry or our failure to retain existing users, or attract new users, as well as generate traffic to our search properties, could adversely affect our business, financial condition and results of operations.

**Our business depends heavily upon revenues generated from arrangements with search providers, including Microsoft and Google, and any adverse change in those relationships could adversely affect our business or its financial condition and results of operations.**

The vast majority of our revenues from our legacy business in 2013 were derived from search services agreements with Google Ireland Limited ("Google"), APN LLC ("APN") and Microsoft Online Inc. ("Microsoft"), which expire on April 30, 2015, March 31, 2016 and December 27, 2014, respectively. In 2013, our agreement with Google accounted for 46% of our legacy business revenues, the agreement with APN accounted for 11% of our legacy business and the agreement with Microsoft accounted for 9% of our legacy business revenues. The Perion agreement with Microsoft may be terminated by 30 days' advance notice. As a result of the ClientConnect Acquisition, we also are highly dependent on ClientConnect's agreements with Microsoft and Google, which expire on December 31, 2014 and on August 31, 2015, respectively. In 2013, ClientConnect's agreement with Microsoft accounted for 63% of ClientConnect's revenues, and its agreement with Google accounted for 22% of ClientConnect's revenues.

If any of these agreements is terminated, substantially amended, or not renewed on favorable terms, we could experience a material decrease in our search generated revenues or the profits they create and we could be forced to seek alternative search providers. There are very few companies in the market that provide Internet search and advertising services similar to those provided by Google, Microsoft and Yahoo. These three are the dominant players in this market, particularly on a global scale, and competitors do not offer as much coverage through sponsored links or searches. If we fail to quickly locate, negotiate and finalize alternative arrangements, or if the alternatives do not provide for terms that are as favorable as those provided for by these agreements, or if the alternative arrangements will not attract the same traffic as the traffic attracted by Microsoft or Google, or if the termination by Microsoft or Google affects our ability to contract with other providers, we would experience a material reduction in our revenues and, in turn, our business, financial condition and results of operations would be adversely affected.

**We rely heavily on the ability to offer our search properties to users of consumer downloadable software products and subsequently retain our search properties. Should this offering be blocked, constrained, limited, materially changed, based on change of guidelines or otherwise, or made redundant by any of our search engine providers, including Microsoft and Google, our ability to generate revenues from our users' search activity could be significantly reduced.**

The search services agreement with each of Microsoft, Google and other search partners of ours requires that we comply with certain guidelines promulgated by them for the use of its brands and services, including the manner in which their paid listings are displayed within search results, and that we establish guidelines to govern certain activities of third parties to whom we syndicate paid listings, including the manner in which those parties drive search traffic to their websites and display paid listings. Subject to certain limitations, any one of our search partners may unilaterally update its policies and guidelines, which could in turn require modifications to, or prohibit and/or render obsolete certain of our products, services and/or practices, which could be costly to address or otherwise have an adverse effect on our business, our financial condition and results of operations. Noncompliance with our search partners' guidelines, especially Microsoft's or Google's guidelines, by us or by third parties to which we syndicate paid listings or by the publishers through whom we secure distribution arrangements for our products could, if not cured, result in such companies' suspension of some or all of their services to the websites of our third party publishers, the imposition of additional restrictions on our ability to syndicate paid listings or distribute our products or the termination of the services agreement by our search partners.

The guidelines imposed pursuant to our agreement with Google, with respect to homepage resets, installing toolbars and default search resets to Google services when providing downloadable applications were changed in February 2013, and this had negative revenue implications. Since then, Google has continued instituting other less material changes to its policy governing its relationship with search partners. Should Microsoft, Google or other companies providing Internet browsers, effectively further restrict, discourage, or otherwise hamper companies, like us, from offering or changing the search properties, this would cause a material adverse effect on our revenue and our financial results.

**Should the providers of the underlying platforms, and browsers in particular, further block, constrain, limit, materially change their guidelines or the way they operate, our ability to generate revenues from our users' search activity could be significantly reduced.**

In December 2013, Google announced that it will restrict the ability to install multi-purpose extensions onto its Chrome internet browser starting in June 2014. As most of our offerings offer such multi-purpose extensions, this policy decision is expected to adversely affect our business. Should Microsoft, Google or other companies providing Internet browsers, or other underlying platforms effectively further restrict, discourage, or otherwise hamper companies, like us, from offering or changing the search properties, this would cause a material adverse effect on our revenue and our financial results.

**If we are unable to successfully integrate the recently acquired ClientConnect business and our legacy business, our operating results may be adversely affected.**

On January 2, 2014, we completed the acquisition of the ClientConnect business, which is substantially larger than our legacy business. Achieving the expected benefits of the ClientConnect Acquisition will depend on the timely and efficient integration of ClientConnect's and our operations, technology, business culture and personnel. The integration may not be completed as expected, and if we fail to effectively integrate the operations, we may not achieve the expected benefits of the acquisition. The challenges involved in completing this integration include:

- effectively managing the ClientConnect business independently of Conduit;
- transfer of the ClientConnect business to our brand by the end of the transition period during which we are permitted to utilize the name "Conduit";
- completing the integration of the operations of the ClientConnect business with our legacy operations;

- retaining our legacy customers and sales distribution channels, as well as those of the ClientConnect business;
- fully incorporating ClientConnect's technology and products into our legacy technology and product lines;
- continuing to demonstrate to the customers of the ClientConnect business that the acquisition has not resulted in any adverse changes in customer service standards or product support;
- ensuring that the employees of the legacy business as well as the employees of ClientConnect are comfortable with the business culture of the combined companies; and
- maintaining employee morale and retaining key employees.

**We may become liable to unforeseen risks and liabilities associated with the acquired ClientConnect business.**

In the course of integrating the acquired ClientConnect business into our own business, we may discover risks and liabilities that were not anticipated at the time of the acquisition. We may also become subject to liabilities arising from the conduct of the ClientConnect business prior to the time of acquisition. These risks and liabilities could adversely affect our business, financial condition and results of operations.

**The generation of revenues from search activity has become subject to fierce competition. We obtain a significant portion of our revenues from searches made by users of our search properties. If we cannot compete effectively in this market, our revenues are likely to decline.**

We obtain a significant portion of our revenues through designating the Company as the default search provider during the download of our products and those of our partners. We therefore are constantly looking for ways to convince potential users to accept our offering, designating the Company as its default search provider and accept the other search properties offered. To achieve these goals, we rely heavily on third-party publishers to distribute our search syndication services as a value-added component of their own software product offerings. In exchange, we pay incentive fees based on a number of factors, including our projection of the potential revenues derived from these engagements. There are a growing number of companies that generate an increasing amount of their revenues from searches, some of them with a more significant presence than ours and with greater capability to offer substantially more content, and others utilizing aggressive marketing practices that we are unwilling to use as it detracts from the user experience or are not permitted by our agreements or accepted practices. In addition, with competition growing, even the larger and in the past more conservative companies (such as Google, Microsoft and others) have become increasingly aggressive in their search service offering. Therefore, our ability to attract new users to install our search assets and to retain existing users, could suffer, preventing or delaying our ability to increase our revenues, or even causing them to decline.

**The marketing of our search services significantly relies on our ability to advertise and distribute our products together with the distribution of free software from other companies. Should Microsoft, Google or our other search partners institute material changes in our ability to partner with distribution partners, it would be more difficult to acquire new customers and would adversely affect our revenues.**

Our reliance on advertising for acquiring new customers in conjunction with other companies distributing other free software products has grown and is an integral part of our plans to continue to achieve rapid growth. These distribution partnerships are regulated by our search partners, including Microsoft and Google. While abiding by search providers' policies and guidelines, we seek to optimize the installation process in order to increase users' selection of search services. In particular, we have adopted an "opt out" approach to the installation process in the United States and Canada, pursuant to which, when users install a toolbar or other products containing a search engine, the option to have the search engine serve as their primary search provider is presented as the default option. Users are required to unselect each feature of the toolbar's or other product's search services if they do not wish to install the search functions of the product on their computers. This method of distribution has been very effective for us in the past and has significantly contributed to our growth. Should our search partners continue to implement changes to their guidelines, including the further restriction of the "opt out" feature, or restrict us from working with other distribution partners, our ability to market our products and search services would be limited and our results of operations could be materially adversely affected.



**In order to receive advertisement-generated revenues from our search partners, we depend, in part, on factors outside of our control.**

The amount of revenue we receive from each of our search partners depends upon a number of factors outside of our control, including the amount these search providers charge for advertisements, the efficiency of the search provider's system in attracting advertisers and syndicating paid listings in response to search queries and parameters established by it regarding the number and placement of paid listings displayed in response to search queries. In addition, each of the search partners makes judgments about the relative attractiveness (to the advertiser) of clicks on paid listings from searches performed on a toolbar or other search assets and these judgments factor into the amount of revenue we receive. Changes to search partners' paid listings network efficiency, its judgment about the relative attractiveness of clicks on paid listings from a platform-generated toolbar or the parameters applicable to the display of paid listings could have an adverse effect on our business, financial condition and our results of operations. Such changes could come about for a number of reasons, including general market conditions, competition or policy and operating decisions made by Microsoft or Google or other search partners of ours.

**Our ClientConnect business is highly reliant upon a small number of publishers, who account for the substantial majority of its pay-outs to publishers and, in parallel, its revenues. If the ClientConnect business were to lose all or a significant portion of those publishers as its customers, its revenues and results of operations would be materially adversely affected.**

In 2013, the top 10 publishers who distributed search properties of the ClientConnect business accounted for approximately 69% of its revenues in 2013. There can be no assurance that these existing publishers will continue to distribute our search properties or continue utilizing the revenue generating monetization services. The loss of all or a substantial portion of our relationships with these publishers would cause a material decline in our revenues and profitability.

**Under the pay-per-install ("PPI"), model for payments to publishers, a timing delay between when expenses and related revenues are recorded and if projected revenues are not estimated correctly, or, subsequent to payment, the revenue model changes, could have a material adverse effect on our operating results.**

In order to promote the distribution of our search properties, we to a great extent utilize a PPI model, under which publishers are paid up-front each time they distribute our search properties to an end user who subsequently accepts them. This particular payment model typically has an adverse impact on our results of operations in the short-term, as the traffic acquisition costs related to a given user are recorded as an expense as incurred, when a user accepts our monetization services, whereas the related revenues are generated from that user only when and as long as (if at all) the user performs searches, for which we receive payments from search providers. To the extent we incorrectly estimate the expected revenue from the search activity of the end user over time, for any reason including changes in the market, our operating results will be materially adversely affected.

**In order to maintain revenues and continue to grow, we need to continually acquire new users and maintain user engagement with our search services through technological advantages.**

The market for search services is highly competitive, and we experience significant competition for user engagement with our search services from other participants in the industry who use a similar search advertising business model. We generate the substantial majority of revenues associated with online publishers that distribute our search properties during the first year after installation. In order to maintain current revenues and grow our business, we need to continually maintain the technological advantage of our platform, products and other services, such as our search protect software, which help us maintain user engagement with our search services and assist us in acquiring new users. If we fail to maintain our technological advantage, user engagement may decline materially, which would have a material adverse effect on our operating results.

**Currently most individuals are using non-PC devices to access the Internet, and most of our revenue generation and services are currently not usable on these competing platforms.**

We focus primarily on the market related to personal computers ("PCs"), which has accounted for all the revenues in our legacy business and that of the ClientConnect business. To the extent that there is an even more significant shift by the market from PCs to mobile or tablet devices, we would experience a substantial reduction in revenues. Recently, the number of individuals who access the Internet through devices other than personal computers, such as mobile phones, tablets, etc., has increased dramatically. While we have begun developing solutions for mobile platforms, our services, for the most part are not yet compatible with these alternative platforms and devices and we have not yet implemented revenue generation models for mobile applications. If this trend accelerates, we may fail to capture a sufficient share of an increasingly important portion of the market for online services, our services will become less relevant and may fail to attract advertisers and web traffic. In addition, even if consumers do use our services, our revenue growth will still be adversely affected if we do not successfully implement revenue generating models for our mobile applications.

**The market for desktop software products and services is declining, as web-based solutions for the desktop are gaining in popularity.**

Our revenues are generated by virtue of the end user downloading software to the desktop. Web (or “cloud”) based software and solutions do not require the user to download software, and thus provides a very mobile and accessible alternative to downloadable software. While there are advantages and disadvantages to each method and system and the markets for each of them remain large, the market for web based systems is growing at the expense of downloadable software.

Should this trend accelerate faster than our partners’ ability to provide differentiating advantages in their downloadable solutions, this could result in fewer downloads of their products and lower search revenues generated through the download of these products. See “Item 4.B Business Overview — Competition” for additional discussion of our competitive market.

**We rely significantly on our and those of our partners ability to advertise through the Google AdWords network for marketing and acquiring new users of our products. Should Google make additional substantial changes to this network or if it becomes substantially more expensive, it would be more difficult and expensive to acquire new customers and would negatively affect our revenues.**

Over the last few years our reliance and that of our partners on advertising for acquiring new customers has grown dramatically and is an integral part of our plans to continue to achieve accelerated growth. One of the main venues for advertising downloadable software products is Google’s AdWords network. Google sets the standards and the pricing for using this network. Although there are alternative networks and platforms for advertising, none are currently as popular as Google’s. Should Google continue to further change the rules for using this network and the way distributors of downloadable software products interact with it, or if the cost of advertising our products increases more than it already has, our ability to market our products would be limited, which would negatively affect our results of operations.

**We have acquired and intend to continue to acquire other businesses. These acquisitions divert a substantial part of our resources and management attention, could cause dilution to our shareholders and adversely affect our financial results.**

We acquired Smilebox in August 2011, SweetIM in November 2012, and ClientConnect in January 2014, and we intend to continue to acquire complementary products, technologies or businesses. Prior to these acquisitions our management had limited experience together as a team in making acquisitions or integrating acquired businesses. Seeking and negotiating potential acquisitions to a certain extent diverts our management’s attention from other business concerns, is expensive and time-consuming. New acquisitions could expose our business to unforeseen liabilities or risks associated with the business or assets acquired or with entering new markets. In addition, we might lose key employees while integrating new organizations and we might not effectively integrate the acquired products, technologies or businesses or achieve anticipated revenues or cost benefits. Future acquisitions could result in customer dissatisfaction, performance problems with an acquired product, technology or company. Paying the purchase price for acquisitions in the form of cash, debt or equity securities could weaken our cash position, increase our leverage or dilute our existing shareholders, as the case may be. Furthermore, a substantial portion of the cost of these acquisitions is typically for intangible assets. We may incur contingent liabilities, amortization expenses related to intangible assets, or possible impairment charges related to goodwill or other intangible assets or other unanticipated events or circumstances relating to the acquisition, and we may not have, or may not be able to enforce, adequate remedies in order to protect our Company. If any of these or similar risks relating to acquiring products, technologies or businesses should occur in the future on a scale that is larger than the effect of the acquisition described above, our business could be materially harmed.

**We are effectively limited in our ability to issue ordinary shares or effect significant corporate transaction with respect to ClientConnect until the end of 2015.**

As a result of the Israeli tax ruling obtained by Conduit in connection with the Conduit Split and the ClientConnect Acquisition, from January 2, 2014 until December 31, 2015, Conduit and its shareholders would be subject to adverse tax consequences, for which we have undertaken to indemnify them, if we were to:

- issue ordinary shares in a private placement to any single person (or a group of affiliated persons) in excess of 25% of our outstanding ordinary shares, computed prior to the issuance; or

- dilute the holdings of the persons who held 5% or more of our outstanding ordinary shares immediately following the closing of the ClientConnect Acquisition by more than 49% in the aggregate.

These provisions could effectively limit our ability to raise funds in equity financings or issue shares in consideration for the acquisition of other companies or business. This could impair our ability to grow our company by way of acquisitions.

In addition, during the same period, we are effectively subject to the following restrictions with respect to ClientConnect:

- we may not sell a majority of ClientConnect's assets;
- we may not sell more than 10% of ClientConnect's outstanding shares;
- ClientConnect may not issue shares in a private placement to any single person (or a group of affiliated persons) in excess of 25% of its outstanding shares, computed prior to the issuance, or otherwise dilute our holdings by more than 49%; and
- there may be no transfers of cash or other consideration, granting of guaranties or any other activities between Conduit and ClientConnect outside the ordinary course of business.

These provisions could limit our ability to capitalize on opportunities to maximize the value of ClientConnect outside the ordinary course of business.

For more information, see Item 10C. "Material Contracts—Agreements Relating to the ClientConnect Acquisition—Tax-related Restrictions."

**Class action litigation due to share price volatility or other factors could cause us to incur substantial costs and divert our management's attention and resources.**

Historically, public companies that experience periods of volatility in the market price of their securities and/or engage in substantial transactions, are sometimes met with class action litigation. Companies in the Internet and software industry, such as ours, are particularly vulnerable to this kind of litigation as a result of the volatility of their stock prices and their regular involvement in transactional activities. Most recently, we have been named as a defendant in this type of litigation in connection with our decision to acquire ClientConnect. Any litigation of this sort could result in considerable costs and a diversion of management's attention and resources.

**If we are deemed to be not in compliance with applicable data protection laws, our operating results could be materially affected.**

We collect and maintain certain information about our customers in our database. Such collection and maintenance of customer information is subject to data protection laws and regulations in Israel and may be subject to laws and regulations in, the United States, the European Union and other countries as well. A failure to comply with applicable regulations could result in class actions, governmental investigations and orders, and criminal and civil liabilities, which could materially affect our operating results.

Although we strive to comply with the applicable laws and regulations and use our best efforts to comply with the evolving global standards regarding privacy, and inform our customers of our business practices prior to any installations of our product and use of our services, it is possible that these laws may be interpreted and applied in a manner that is inconsistent with our data collection and preservation practices, or that it may be argued that our practices do not comply with other countries' privacy and data protection laws and regulations. In addition to the possibility of fines, such a situation could result in the issuance of an order requiring that we change our data collection or retention practices, which in turn could have a material effect on our business. See "Item 4.B Business Overview — Government Regulation" for additional discussion of applicable regulations.

**If users or third parties express privacy or security concerns regarding our collection, use and handling of personal information, we could incur substantial expenses.**

Although we strive to comply with strict privacy data security requirements and take all reasonable steps to ensure the security of personal information, concerns may be expressed, from time to time, about whether our products compromise the privacy or confidentiality of the information of users and others. Concerns about our collection, use, sharing or handling of personal information or other privacy related matters, even if unfounded, could damage our reputation and operating results. See "Item 4.B Business Overview — Government Regulation" for additional discussion of applicable regulations.

**We depend on a third party Internet and telecommunication providers to operate our websites and web-based services. Temporary failure of these services, including catastrophic or technological interruptions, would reduce our revenues and damage our reputation, and securing alternate sources for these services could significantly increase our expenses.**

Each of our third party Internet and telecommunication providers may not continue to provide services to us without disruptions in services at the current cost or at all. Moreover, as traffic to our websites and applications increases and the number of new (and presumably more complex) products and services that we introduce continues to rise, we will need to upgrade our systems, infrastructures and technologies generally to facilitate this growth. Although there is certain overlap between the companies that provide such services, such a disruption in services by any one of them, even if temporary, would reduce our revenues from product sales, and possibly even from search, depending on the extent of disruption. We also rent the services of approximately 260 servers located around the world, mainly through Amazon Web Services and Microsoft Windows Azure cloud services. While we believe that there are many alternative providers of hosting and other communication services available to us, the costs associated with any transition to a new service provider could be substantial and require us to reengineer our computer systems and telecommunications infrastructure to accommodate a new service provider. Such processes could be both expensive and time consuming and could result in lost business both during the transition period and after.

Our servers and communications systems could be damaged or interrupted by fire, flood, power loss, telecommunications failure, earthquakes, acts of war or terrorism, acts of God, computer viruses, physical or electronic break-ins and similar events or disruptions. Although we maintain back-up systems for our servers, any of these events could cause deterioration in performance or interruption in these systems, delays, loss of critical data and lost registered users and revenues.

We currently rely solely on the Internet as a means to sell our products. Accordingly, if we, or our customers, are unable to utilize the Internet due to a failure of technology or infrastructure, hacking, terrorist activity or other reasons, we could lose current or potential customers and revenues. While we have backup systems for most aspects of our operations, our systems are not fully redundant and our disaster recovery planning may not be sufficient for all eventualities. In addition, we may have inadequate insurance coverage to compensate us for losses from a major interruption. Furthermore, interruptions in our website could materially impede our ability to attract new companies to advertise on our website and to maintain relationships with current advertisers. Difficulties of this kind could damage our reputation, be expensive to remedy and curtail our growth.

**Our products operate in a variety of computer configurations and could contain undetected errors or defects that could result in product failures, lost revenues and loss of market share.**

Our software may contain undetected errors, failures or defects, especially when the products are first introduced or when new versions are released. Our customers' computer environments are often characterized by a wide variety of standard and non-standard configurations that make pre-release testing for programming or compatibility errors very difficult and time-consuming. Therefore, there could be errors or failures in our products. In addition, despite testing by us and beta testing by some of our registered users, errors, failures or bugs may not be found in new products or releases until after commencement of commercial sales. In the past, we have discovered software errors, failures and defects in certain of our product offerings after their full introduction and have likely experienced delayed or lost revenues during the period required to correct these errors.

Errors, failures or defects in products released by us could result in negative publicity, product returns, loss of or delay in market acceptance of our products, loss of competitive position or claims by customers. Alleviating any of these problems could require significant expense and could cause interruptions.

**Due to our evolving business model and rapid changes in the Internet, we may not be able to accurately predict our future performance or continue our revenue growth or profitability.**

Since beginning operations in 2000, we have introduced many new products and initiatives, some of which have been unsuccessful. In addition, our revenue mix between products, search generated revenue and other advertising revenue has changed dramatically over the years. Consequently, in some cases, we have a limited history of ongoing operations from which to predict our future performance and making such predictions is very complex and challenging, particularly with regard to aggressively increasing the distribution and profitability of search generated revenue, new products and initiatives and scaling existing business. The future viability of our business will greatly depend on our ability to increase search generated revenues with a sufficient return on investment, offer a competitive suite of services to our partners, including adapting and creating products for new platforms such as mobile platforms, appeal to the Internet market, increase search generated, affiliate and advertising revenues, exploit our brand name and control our costs, which we may be unable to do. As a result, we may not be able to continue our revenue growth or profitability.

**We may have difficulty managing our growth, which could limit our ability to increase our sales and control our costs.**

We have invested heavily to increase the organic growth of our operations in recent years. These investments have included recruiting of experienced personnel, investments in infrastructures, advertising and the acquisition of new businesses and products. This strategy for emphasizing accelerated growth is required in order to achieve our business objectives, and is placing increased demands on our management and on our operational resources. This growth has, and continues to increase the challenges involved in:

- implementing appropriate operational and financial systems and controls;
- expanding our sales and marketing infrastructure and capabilities;
- expanding our infrastructures and technological capabilities; and
- maintaining the commitment of our employees.

If we cannot scale and manage our business appropriately, we will not experience our projected growth and our financial results will suffer.

**A decline in market acceptance for Microsoft technologies on which our products rely could have a material adverse affect on us.**

Most of our products and those of our partners currently run or are based on Microsoft Windows operating systems. Recently the Android and Apple operating systems have gained popularity and market share, particularly in the mobile market, although still accounting for only a small part of the desktop market. A decline in market acceptance of Microsoft technologies or the increased acceptance of other operating systems without products that work on these competing operating systems in a timely fashion could have a material adverse effect on our ability to market our products. Consumers are adopting these alternative technologies in increasing numbers and are migrating to other computing technologies that we do not currently support. In addition, our products and technologies must continue to be compatible with new developments in Microsoft technologies. Microsoft could introduce new features that would make it more difficult to install our search services, to the extent that the toolbar is kept as a browser extension or add on. We cannot assure you that we can maintain such compatibility or that we will not incur significant expenses in connection therewith.

**The introduction of new operating systems, browsers and other popular software products may materially adversely affect user engagement with our search services.**

Users typically install new software and update their existing software as new or updated software is introduced online by third-party developers. In particular, Microsoft's recent introduction of Windows 8.1 may prompt many of our users to upgrade their operating systems or computers. In addition, when a user purchases a new computing device or installs a new Internet browser, it generally uses the Internet search services that are typically pre-installed on the new device or Internet browser. Our products are distributed online, and are usually not pre-installed on computing devices. Further, as many software vendors that distribute their solutions online also offer search services alongside their primary software product, users often replace our search services with those provided by these vendors in the course of installing new software or updating existing software. Any event that results in a significant number of users changing or upgrading their computing device operating systems or Internet browsers after installing the search solutions offered by us could result in the failure to generate the revenues that we anticipate from our users and could result in a decline in our user base. Finally, although we constantly monitor the compatibility of our Internet search services and related solutions with such new versions and upgrades, we may not be able to make the required adjustments to ensure constant availability and compatibility of such solutions.

**Our results of operations and financial condition may be adversely impacted by worldwide economic conditions.**

Our primary user base is composed of individual consumers and for the most part their discretionary purchase habits. In the event that the United States or Europe experiences an economic downturn, or the current economic climate worsens, our current and potential software license subscribers may be unable or unwilling to purchase our products or use our service. This would also have a negative impact on consumer Internet spending and search generated revenues. A reduction in the purchasing of our products or use of our services, consumer internet spending and search generated revenues have had a negative impact in the past, and may possibly have a greater negative impact in the future, on our sales and revenue generation, margins and operating expenses, and consequently have a material adverse effect on our business, results of operations and financial condition.

**Exchange rate fluctuations may harm our earnings if we are not able to hedge our currency exchange risks effectively.**

A majority of our revenues are denominated in U.S. dollars. However, a significant portion of our sales is in currencies other than the U.S. dollar, either received directly by us in these currencies or received by our search partner in other currencies, but first converted into U.S. dollars prior to being transferred to us. In 2013, approximately 9% of our revenue was received directly by us in non-U.S. currencies and an estimated 49% of our revenue was received by our search partners in non-U.S. currencies, although converted by our search partners into U.S. dollars prior to being transferred to us. As a majority of the sums received in non-U.S. currencies, their precise currency, timing or amounts received by our partner is not known by us, we are unable to hedge against the risk of fluctuations in these exchange rates and we bear a foreign currency fluctuation risk. In addition, a substantial part of our costs, mainly personnel expenses, are incurred in NIS. Inflation in Israel may have the effect of increasing the U.S. dollar cost of our operations in Israel. Further, whenever the U.S. dollar declines in value in relation to the NIS, it will become more expensive for us to fund our operations in Israel. A revaluation of one percent of the NIS as compared to the U.S. dollar could reduce our income before taxes by approximately \$0.03 million. The exchange rate of the U.S. dollar to the NIS has been very volatile in the past three fiscal years, decreasing by approximately 4% in 2011, increasing by approximately 8% in 2012, and decreasing by approximately 6% in 2013. As of December 31, 2013, we had a foreign currency net liability of approximately \$0.1 million and our total foreign exchange income was approximately \$69,000 for the year ended December 31, 2013. In addition, in market territories where our prices are based on local currencies, fluctuations in the dollar exchange rate could affect our gross profit margin. To assist us in assessing whether or not, and how to, hedge risks associated with fluctuations in currency exchange rates, we have contracted a consulting firm proficient in this area, and are generally implementing their proposals. Based on the advice received from this firm, we are advised that we are unable to hedge exchange risks associated with revenues indirectly originating in non-U.S. dollar currencies, but received in U.S. dollars. We do not hedge the exchange risk from revenues received directly by us in non-U.S. currencies, as the amounts of these revenues are not material. However, due to market conditions, volatility and other factors, we do not always implement our consultant's proposals in full and our consultant's proposals do not always prove to be effective and may even prove harmful. We may incur losses from unfavorable fluctuations in foreign currency exchange rates. See "Item 11 Quantitative and Qualitative Disclosure of Market Risks" for further discussion of the effects of exchange rate fluctuations on earnings.

**A loss of the services of our senior management and other key personnel could adversely affect execution of our business strategy.**

We depend on the continued services of our senior management, particularly Josef Mandelbaum, our Chief Executive Officer. Our current strategy is to a great extent a function of his capabilities and experience, together with the experience and knowledge of our other senior management. The loss of the services of these personnel could create a gap in management and could result in the loss of expertise necessary for us to execute our business strategy and thereby adversely affect our business. We do not currently have "key person" life insurance with respect to any of our senior management.

Further, our ability to execute our business strategy also depends on our ability to continue to attract, retain and motivate qualified and skilled technical and creative personnel and skilled management, marketing and sales personnel. Competition for well-qualified employees in our industry is intense and our continued ability to compete effectively depends, in part, upon our ability to retain existing key employees and to attract new skilled employees as well. If we cannot attract and retain additional key employees or lose one or more of our current key employees, our ability to develop or market our products and attract or acquire new users could be adversely affected. Although we have established programs to attract new employees and provide incentives to retain existing employees, particularly senior management, we cannot be assured that we will be able to retain the services of senior management or other key employees as we continue to integrate the ClientConnect business into our business, or that we will be able to attract new employees in the future who are capable of making significant contributions. See "Item 6 Directors, Senior Management and Employees."

**Under current Israeli law, we may not be able to enforce non-competition covenants and, therefore, may be unable to prevent our competitors from benefiting from the expertise of some of our former employees.**

We have entered into non-competition agreements with most of our professional employees. These agreements prohibit our employees, if they cease working for us, from competing directly with us or working for our competitors for a limited period. Under current Israeli law, we may be unable to enforce these agreements, in whole or in part, and it may be difficult for us to restrict our competitors from gaining the expertise that our former employees gained while working for us. For example, Israeli courts have required employers seeking to enforce non-compete undertakings of a former employee to demonstrate that the competitive activities of the former employee will harm one of a limited number of material interests of the employer which have been recognized by the courts, such as the secrecy of a company's confidential commercial information or its intellectual property. If we cannot demonstrate that harm would be caused to us, we may be unable to prevent our competitors from benefiting from the expertise of our former employees.

**Our international operations involve special risks that could increase our expenses, adversely affect our operating results and require increased time and attention of our management.**

We derive and expect to continue to derive a substantial portion of our revenues from users outside the United States. Our international sales and related operations are subject to a number of inherent risks, including risks with respect to:

- potential loss of proprietary information due to piracy, misappropriation or laws that may be less protective of our intellectual property rights than those of the United States;
- costs and delays associated with translating and supporting our products in multiple languages;
- foreign exchange rate fluctuations and economic instability, such as higher interest rates and inflation, which could make our products more expensive in those countries;
- costs of compliance with a variety of laws and regulations;
- restrictive governmental actions such as trade restrictions;
- limitations on the transfer and repatriation of funds and foreign currency exchange restrictions;
- compliance with different consumer and data protection laws and restrictions on pricing or discounts;
- lower levels of adoption or use of the Internet and other technologies vital to our business and the lack of appropriate infrastructure to support widespread Internet usage;
- lower levels of consumer spending on a per capita basis and fewer opportunities for growth in certain foreign market segments compared to the United States;
- lower levels of credit card usage and increased payment risk;
- changes in domestic and international tax regulations; and
- geopolitical events, including war and terrorism.

#### ***Risks Related to Our Intellectual Property***

**Unlawful copying of our products or other third party violations of existing legal protections or reductions in the legal protection for intellectual property rights of software developers or use of open source software could adversely affect our distribution and revenue.**

The software products that we sell incorporate a technology that reduces the ability of third parties to copy the software without having paid for it. In addition, certain of our products may now or in the future incorporate open source software, which may obligate us to pass on to our licensees — at no cost— the rights to use, copy, modify, and redistribute the underlying code. Use of open source software, unlicensed copying and use of software and intellectual property rights lead to a loss of potential users and revenue to us, which could be more significant in countries where laws are less protective of intellectual property rights. Continued educational and enforcement efforts by governmental authorities may not adequately address this problem, and further deterioration in compliance with existing legal protections or reductions in the legal protection for intellectual property rights of software developers could adversely affect our revenue.

Additionally, no assurances can be given that any of the patent applications that we have filed will result in a patent being issued, or that any existing or future patents will afford adequate protection against competitors and similar technologies.

**We use certain "open source" software tools that may be subject to intellectual property infringement claims or that may subject our derivative products to unintended consequences, possibly impairing our product development plans, interfering with our ability to support our clients or requiring us to allow access to our products or necessitating that we pay licensing fees.**

Certain of our software products contain a limited amount of open source code and we may use more open source code in the future. In addition, certain third party software that we embed in our products contains open source code. Open source code is code that is covered by a license agreement that permits the user to liberally use, copy, modify and distribute the software without cost, provided that users and modifiers abide by certain licensing requirements. The original developers of the open source code provide no warranties on such code.

As a result of our use of open source software, we could be subject to suits by parties claiming ownership of what we believe to be open source code and we may incur expenses in defending claims that we did not abide by the open source code license. In addition, third party licensors do not provide intellectual property protection with respect to the open source components of their products, and we may be unable to be indemnified by such third party licensors in the event that we or our customers will be held liable in respect of the open source software contained in such third party software. If we are not successful in defending against any such claims that may arise, we may be subject to injunctions and/or monetary damages or be required to remove the open source code from our products. Such events could disrupt our operations and the sales of our products, which would negatively impact our revenues and cash flow.

Moreover, under certain conditions, the use of open source code to create derivative code may obligate us to make the resulting derivative code available to others at no cost. The circumstances under which our use of open source code would compel us to offer derivative code at no cost are subject to varying interpretations. If we are required to publicly disclose the source code for such derivative products or to license our derivative products that use an open source license, our previously proprietary software products may be available to others without charge. If this happens, our customers and our competitors may have access to our products without cost to them, which could harm our business.

We monitor our use of such open source code to avoid subjecting our products to conditions we do not intend. The use of such open source code, however, may ultimately subject some of our products to unintended conditions so that we are required to take remedial action that may divert resources away from our development efforts.

**If we fail to detect and stop misrepresentations of our site and products, are unsuccessful in preventing and combating the onset of malicious applications in our products, or for some reason are perceived as promoting malware or "spamming" or unjustly changing the user's computer settings, we could lose the confidence of the users of our products and services, or our software or provision of search services or advertising could be blocked by software or utilities designed to detect such practices, thereby causing our business to suffer.**

We are exposed to the risk of domains using our brand names (such as "CodeFuel" "ClientConnect", "IncrediMail", "Molto", "PhotoJoy", "Smilebox", "SweetIM", etc.) in various ways, and attracting in this manner our potential or existing users. These domains often engage in fraudulent or spam activities and their use of our brand names can result in damage to our reputation and loss of our clients' confidence in our products. In addition, downloadable applications through which a toolbar may be installed by an end-user are also subject to attack by viruses, worms and other malicious software programs, which could jeopardize the security of information stored in users' computers or in our systems and networks. Additionally, search websites to which end users may be directed may be adversely affected by such attacks resulting in changes to users' computers and interference with the overall experience of our products and services, such as the hijacking of queries to these websites or the modification or replacement of search results generated. No assurances can be given that our efforts to combat these malicious applications will be successful and/or that our products and services will not have (or will not be perceived to have) vulnerabilities in this regard. Furthermore, if we or our products were for some reason perceived as promoting or as being "malware or "spamming", or unjustly changing the user's computer settings, our software or provision of search services or advertising could be blocked by software or utilities designed to detect such practices. If we are unable to effectively detect and terminate this misrepresentation activity of others or the way that we and our products are perceived, we may lose users and our ability to produce revenues will be harmed.



**Third party claims of infringement or other claims against us could require us to redesign our products, seek licenses, or engage in costly intellectual property litigation, which could adversely affect our financial position and our ability to execute our business strategy.**

The appeal of some of our products is largely the result of the graphics, sound and multimedia content that we incorporate into our products. We enter into licensing arrangements with third parties for these uses. However, other third parties may from time to time claim that our current or future use of content, sound and graphics infringe their intellectual property rights, and seek to prevent, limit or interfere with our ability to make, use or sell our products. We have experienced such claims in the past although ultimately with no material consequence.

If it appears necessary or desirable, we may seek to obtain licenses for intellectual property rights that we are allegedly infringing, may infringe or desire to use. Although holders of these types of intellectual property rights often offer these licenses, we cannot assure you that licenses will be offered or that the terms of any offered licenses will be acceptable to us. Our failure to obtain a license for key intellectual property rights from a third party for technology or content, sound or graphic used by us could cause us to incur substantial liabilities and to suspend the development and sale of our products. Alternatively, we could be required to expend significant resources to re-design our products or develop non-infringing technology. If we are unable to re-design our products or develop non-infringing technology, our revenues could decrease and we may not be able to execute our business strategy.

In November 2013, MyMail, Ltd., a non-practicing entity, filed a lawsuit against ClientConnect alleging that ClientConnect's toolbar software infringes one of its U.S. patents. For more information, see Item 8.A below under "Legal Proceedings." If we do not prevail in this case or in any future third-party action for infringement, we may be required to pay substantial damages and be prohibited from using intellectual property essential to our products. We may become involved in litigation not only as a result of alleged infringement of a third-party's intellectual property rights, but also to protect our own intellectual property rights.

We may also become involved in litigation in connection with the brand name rights associated with our Company name or the names of our products. We do not know whether others will assert that our Company name or brand name infringes their trademark rights. In addition, names we choose for our products may be claimed to infringe names held by others. If we have to change the name of our Company or products, we may experience a loss in goodwill associated with our brand name, customer confusion and a loss of sales. Any lawsuit, regardless of its merit, would likely be time-consuming, expensive to resolve and require additional management time and attention.

#### ***Risks Related to Our Industry***

**As a considerable portion of our revenues are derived from online advertising, any reduction in spending on online advertising by advertisers could adversely impact our business and results of operations.**

In addition to revenue generated under the various agreements with our search partners, such as Microsoft and Google, we generate a portion of our revenues from users' clicks on text-based links to advertisers' websites, or sponsored links. When users click on a sponsored link, the search provider receives a payment from the sponsor of that link and pays a portion of that amount to us. Spending by advertisers tends to be cyclical, reflecting overall economic conditions and budgeting and buying patterns, as well as levels of consumer confidence and discretionary spending. Adverse economic conditions can have a material negative impact on the demand for advertising and cause advertisers to reduce the amounts they spend on advertising, particularly online advertising, which could negatively impact our revenues.

Small and local businesses with which we interact are particularly sensitive to these events and trends, given that they are not as well-situated to weather adverse economic conditions as their larger competitors, which are generally better capitalized and have greater access to credit. In the recent past, adverse economic conditions have caused, and if such conditions were to recur in the future they could cause, decreases and/or delays in advertising expenditures, which would reduce our revenues and adversely affect our business, financial condition and results of operations.

Advertisers typically do not have long-term advertising commitments with search providers or advertisement networks. A decrease in overall advertising may adversely affect our results of operations.

In addition, the rates advertisers pay for each click on a sponsored link on a cost-per-click (CPC) basis or for each time an advertisement is displayed on a cost-per-thousand impressions (CPM) basis are negotiated between the search providers or advertisement networks and advertisers and depend on a number of factors over which we have no control. If search providers or advertisement networks decrease the rates charged to advertisers, this would decrease the advertising revenues they share with us. In such an event, there could be no assurance that we would be able to adjust the fees that we pay to publishers in order to acquire users in order to maintain its current levels of profitability.

**The online advertising market is very concentrated, with search in general, and Google in particular, playing a substantial role in that market, limiting our flexibility to operate in this market.**

In 2013, online advertising continued to grow globally and in the United States in particular. Advertising through search accounted for the largest portion of online advertising and in the United States accounted for approximately 40% of all money spent on online advertising. Google as an advertising publisher accounted for most U.S. online ad revenues. This high market concentration causes us to be subject to unilateral changes set by Google, with limited ability to respond to and adjust for those changes. Although we utilize other methods of advertising and partnering with other companies, these are currently not as lucrative as search advertising in general and affiliation with Google in particular. Continued unilateral changes could adversely affect our revenues and performance.

**The acceptance of online advertising, particularly paid listings, as an effective alternative to more traditional advertising is limited and heavily dependent on the continued commercial use of the Internet.**

Many advertisers still have limited experience with online advertising and may continue to devote significant portions of their advertising budgets to traditional advertising media. Accordingly, we continue to compete with traditional advertising media, including television, radio and print, in addition to a multitude of websites with high levels of traffic and online advertising networks, for a share of available advertising expenditures and expect to face continued competition as more emerging media and traditional offline media companies enter the online advertising market. The continued growth and continued acceptance of online advertising generally is likely to depend, to a large extent, on its perceived effectiveness and the acceptance of related advertising models (particularly in the case of models that incorporate user targeting and/or utilize mobile devices), the continued growth in commercial use of the Internet (particularly outside of the United States), the extent to which web browsers, software programs and/or other applications that limit or prevent advertising from being displayed become commonplace and the extent to which the industry is able to effectively manage click fraud. Any lack of growth in the market for online advertising, particularly for paid listings, or any decrease in the effectiveness and value of online advertising (whether due to the passage of laws requiring additional disclosure and/or opt-in policies for advertising that incorporates user targeting or other developments) would have an adverse effect on our business, its financial condition and our results of operations.

**Our business, and in particular, the portion of our business devoted to search-monetization, is significantly reliant on the North American market. Any material adverse change in that market could have a material adverse effect on our results of operations.**

Our revenues have historically been concentrated within the North American market, accounting for 46% of our search-monetization based revenues for the year ended 2013. A significant reduction in the revenues generated by such market, whether as a result of a recession that causes a reduction in advertising expenditures generally, or otherwise, which causes a decrease in our Microsoft or Google-based North American revenues could have a material adverse effect on our results of operations.

**The browser extension and toolbar industry is susceptible to obsolescence with the continued advent of alternative Internet based innovations which may become more attractive to users.**

The development of new products and services in response to the evolving trends and technologies of the Internet, as well as the identification of new business opportunities in this dynamic environment, requires significant time and resources. We may not be able to adapt quickly enough (and/or in a cost-effective manner) to these changes, appropriately time the introduction to the market of new applications and features for our platform or for other products and services or identify new business opportunities in a timely manner. Also, these changes could require us to modify related infrastructures, and the failure to do so could render our, or those of our partners, existing websites, applications, services and proprietary technologies obsolete. The failure to respond to any of these changes appropriately (and/or in a cost effective manner) could adversely affect us, our financial condition and our results of operations.

In the case of certain of the applications available via our platform, third parties have introduced (and continue to introduce) new or updated technologies, applications and policies that may interfere with the ability of our publishers or end users to access or utilize these applications generally or otherwise make publishers or users less likely to use our services (such as through the introduction of features and/or processes that disproportionately and adversely impact the ability of publishers or end users to access and use these applications relative to those of competitors). For example, third parties continue to introduce technologies and applications (including new and enhanced web browsers and operating systems) that may limit or prevent certain types of applications from being installed and/or have features and policies that significantly lower the likelihood that end users will install the applications generated from the platform, or that previously-installed applications will remain in active use. In addition, there are technologies and applications that interfere with the functionality of (or settings changes made by) toolbar and/or platform applications. For example, there are technologies and applications that interfere with search boxes embedded within our toolbars and the maintenance of home page and web browser search settings previously selected by end users of the toolbar. These technologies, applications and policies adversely impact the ability of users to generate search queries through our applications, which in turn adversely impacts revenues. Technologies have also been introduced that can block the display of advertisements on web pages and that provide users with the ability to opt out of our advertising products. Our failure to successfully modify our toolbars and related applications in a cost-effective manner in response to the introduction and adoption of these new technologies and applications could adversely affect our business, financial condition and our results of operations.

**Our reputation may be adversely impacted by the negative reputation of toolbar businesses generally and other factors.**

Our reputation could be negatively impacted by a number of factors, including the negative reputation associated with toolbars (which are often downloaded, except under Google's new guidelines, on an opt-out basis, without the knowledge of the end user), product and service quality concerns, complaints by publishers or end users or actions brought by them or by governmental or regulatory authorities and related media coverage and data protection and security breaches. Moreover, the inability to develop and introduce monetization products and services that resonate with consumers and/or the inability to adapt quickly enough (and/or in a cost effective manner) to evolving changes to the Internet and related technologies, applications and devices, could adversely impact our reputation, and, in turn, our business, financial condition and our results of operations.

**Our financial performance may be materially adversely affected by information technology, insufficient cyber security and other business disruptions.**

Our business is constantly challenged and may be impacted by disruptions, including information technology attacks or failures. Cybersecurity attacks, in particular, are evolving and include, but are not limited to, malicious software, attempts to gain unauthorized access to data, and other electronic security breaches that could lead to disruptions in systems, unauthorized release of confidential or otherwise protected information and corruption of data, and overloading our servers and systems with communications and data. Unidentified groups recently hacked numerous Internet websites and servers, including our own, for various reasons, political, commercial and other. Given the unpredictability of the timing, nature and scope of such disruptions, we could potentially be subject to substantial system downtimes, operational delays, other detrimental impacts on our operations or ability to provide products and services to our customers, the compromising of confidential or otherwise protected information, destruction or corruption of data, security breaches, other manipulation or improper use of our systems and networks, financial losses from remedial actions, loss of business or potential liability, and/or damage to our reputation, any of which could have a material adverse effect on our cash flows, competitive position, financial condition or results of operations. Although these attacks, while causing certain difficulties, have not had a material effect on our business, financial condition or results of operations, there can be no assurance that such incidents will not have a material adverse effect on us in the future.

**New laws and regulations applicable to e-commerce, Internet advertising, privacy and data collection and protection, and uncertainties regarding the application or interpretation of existing laws and regulations, could harm our business.**

Our business is conducted through the Internet and therefore, among other things, we are subject to the laws and regulations that apply to e-commerce and online businesses around the world. These laws and regulations are becoming more prevalent in the United States, Europe, Israel and elsewhere and may impede the growth of the Internet; and consequently our services. These regulations and laws may cover user privacy, data collection and protection, content, use of "cookies", access changes, "net neutrality," pricing, advertising, distribution of "spam", intellectual property, distribution, protection of minors, consumer protection, taxation and online payment services.

Many areas of the law affecting the Internet remain largely unsettled, even in areas where there has been some legislative action. This uncertainty can be compounded when services hosted in one jurisdiction are directed at users in another jurisdiction. For instance, the European Commission is currently considering data protection regulations that may include operational requirements for companies that receive personal data that are different than those currently in place in the European Union and that may also include significant penalties for non-compliance. To further complicate matters in Europe, Member States may not adopt relevant European Directives or may adopt differing laws in their respective jurisdictions. Similarly, there have been laws and regulations adopted in Israel and throughout the United States that would impose new obligations in areas such as privacy, in particular protection of personally identifiable information, and liability for copyright infringement by third parties. Therefore, it is difficult to determine whether and how existing laws, such as those governing intellectual property, privacy and data collection and protection, libel, marketing, data security and taxation, apply to the Internet and our business.

Due to rapid changes in technology and the inconsistent interpretations of privacy and data protection laws, we may be required to materially change the way we do business. For example, we may be required to implement physical, administrative and technological security measures different from those we have now, such as different data access controls or encryption technology. In addition, we use cloud based computing, which is not without substantial risk, particularly at a time when businesses of almost every kind are finding themselves subject to an ever expanding range of state and federal data security and privacy laws, document retention requirements, and other standards of accountability. Compliance with such existing and proposed laws and regulations can be costly and can delay, or impede the development of new products, result in negative publicity, increase our operating costs, require significant management time and attention, and subject us to inquires or investigations, claims or other remedies, including fines or demands that we modify or cease existing business practices.

For more information regarding government regulations we are subject to, see "Item 4.B Business Overview — Government Regulation" for additional discussion of applicable regulations affecting our business.

***Risks Related to Our Operations in Israel***

**Political, economic and military instability in the Middle East may impede our ability to operate and harm our financial results.**

Our principal executive offices are located in Israel. Accordingly, political, economic and military conditions in the Middle East may affect our business directly. Since the establishment of the State of Israel in 1948, a number of armed conflicts have occurred between Israel and its Arab neighbors, Hamas (an Islamist militia and political group in the Gaza Strip) and Hezbollah (an Islamist militia and political group in Lebanon). Recent political uprisings, social unrest and violence in various countries in the Middle East and North Africa, including Israel's neighbors Egypt and Syria, are affecting the political stability of those countries. This instability may lead to deterioration of the political relationships that exist between Israel and these countries and have raised concerns regarding security in the region and the potential for armed conflict. In addition, Iran has threatened to attack Israel and is widely believed to be developing nuclear weapons. Iran is also believed to have a strong influence among the Syrian government, Hamas and Hezbollah. These situations may potentially escalate in the future to more violent events which may affect Israel and us. These situations, including conflicts which involved missile strikes against civilian targets in various parts of Israel, have in the past negatively affected business conditions in Israel. Any hostilities involving Israel or the interruption or curtailment of trade between Israel and its present trading partners could have a material adverse effect on our business, operating results and financial condition. Although such hostilities did not in the past have a material adverse impact on our business, we cannot guarantee that hostilities will not be renewed and have such an effect in the future. Ongoing and revived hostilities and the attempts to resolve the conflict between Israel and its Arab neighbors often results in political instability that affects the Israeli capital markets and can cause volatility in interest rates, exchange rates and stock market quotes. The political and security situation in Israel may result in parties with whom we have contracts claiming that they are not obligated to perform their commitments under those agreements pursuant to force majeure provisions. These or other Israeli political or economic factors could harm our operations and product development and cause our sales to decrease. Any hostilities involving Israel or the interruption or curtailment of trade between Israel and its present trading partners could adversely affect our operations and could make it more difficult for us to raise capital. Furthermore, several countries, principally those in the Middle East, still restrict business with Israel and Israeli companies and, although the impact of these restrictions is not as important for a company such as ours that sells its products through the Internet, it may nevertheless have an adverse effect on our results of operations. Since many of our facilities are located in Israel, we could experience serious disruptions if acts associated with this conflict result in any serious damage to our facilities. Our business interruption insurance may not adequately compensate us for losses that may occur and any losses or damages incurred by us could have a material adverse effect on our business. Any future armed conflicts or political instability in the region would likely negatively affect business conditions and harm our results of operations.

**Our operations may be disrupted by the obligations of our personnel to perform military service.**

All non-exempt male adult citizens and permanent residents of Israel under the age of 40, or older for reserves officers or citizens with certain occupations, as well as certain female adult citizens and permanent residents of Israel, are obligated to perform military reserve duty and may be called to active duty under emergency circumstances. In recent years, there have been significant call-ups of military reservists, and it is possible that there will be additional call-ups in the future. Many of our male employees in Israel, including members of senior management, are obligated to perform up to 36 days of military reserve duty annually until they reach the relevant age of discharge from army service and, in the event of a military conflict, could be called to active duty. While we have operated effectively despite these conditions in the past, we cannot assess what impact these conditions may have in the future, particularly if emergency circumstances arise. Our operations could be disrupted by the absence of a significant number of our employees related to military service or the absence for extended periods of military service of one or more of our executive officers or key employees. Any disruption in our operations would harm our business.

**Investors and our shareholders generally may have difficulties enforcing a U.S. judgment against us, our executive officers and our directors or asserting U.S. securities laws claims in Israel.**

We are incorporated under the laws of the State of Israel. Service of process upon us, our Israeli subsidiaries, our directors and officers and the Israeli experts, if any, named in this annual report, substantially all of whom reside outside the United States, may be difficult to obtain within the United States.

Furthermore, because the majority of our assets and investments, and substantially all of our directors, officers and such Israeli experts are located outside the United States, any judgment obtained in the United States against us or any of them may be difficult to collect within the United States.

We have been informed by our legal counsel in Israel that it may also be difficult to assert U.S. securities law claims in original actions instituted in Israel. Israeli courts may refuse to hear a claim based on an alleged violation of U.S. securities laws reasoning that Israel is not the most appropriate forum to bring such a claim. In addition, even if an Israeli court agrees to hear a claim, it may determine that Israeli law and not U.S. law is applicable to the claim. There is little binding case law in Israel addressing these matters. If U.S. law is found to be applicable, the content of applicable U.S. law must be proved as a fact, which can be a time-consuming and costly process. Certain matters of procedure will also be governed by Israeli law.

Subject to specified time limitations and legal procedures, under the rules of private international law currently prevailing in Israel, Israeli courts may enforce a U.S. judgment in a civil matter, including a judgment based upon the civil liability provisions of the U.S. securities laws, as well as a monetary or compensatory judgment in a non-civil matter, provided that the following key conditions are met:

- subject to limited exceptions, the judgment is final and non-appealable;
- the judgment was given by a court competent under the laws of the state of the court and is otherwise enforceable in such state;
- the judgment was rendered by a court competent under the rules of private international law applicable in Israel;
- the laws of the state in which the judgment was given provide for the enforcement of judgments of Israeli courts;
- adequate service of process has been effected and the defendant has had a reasonable opportunity to present his arguments and evidence;
- the judgment and its enforcement are not contrary to the law, public policy, security or sovereignty of the State of Israel;
- the judgment was not obtained by fraud and does not conflict with any other valid judgment in the same matter between the same parties; and
- an action between the same parties in the same matter was not pending in any Israeli court at the time the lawsuit was instituted in the U.S. court.

**The tax benefits available to us require us to meet several conditions and may be terminated or reduced in the future, which would increase our costs and taxes.**

We have benefited or currently benefit from a variety of government programs and tax benefits that generally carry conditions that we must meet in order to be eligible to obtain any benefit. Our tax expenses and the resulting effective tax rate reflected in our financial statements may increase over time as a result of changes in corporate income tax rates, other changes in the tax laws of the countries in which we operate, non-deductible expenses, loss and timing differences, or changes in the mix of countries, where we generate profit.

If we fail to meet the conditions upon which certain favorable tax treatment is based, we would not be able to claim future tax benefits and could be required to refund tax benefits already received. Any of the following could have a material effect on our overall effective tax rate:

- we may be unable to meet the requirements for continuing to qualify for some programs;
- these programs and tax benefits may be unavailable at their current levels; or
- we may be required to refund previously recognized tax benefits if we are found to be in violation of the stipulated conditions.

Additional details are provided in "Item 5 – Operating and Financial Review and Products" under the caption "Taxes on income", in "Item 10 – Additional Information" under the caption "Israeli taxation, foreign exchange regulation and investment programs" and in note 10 to our consolidated financial statements.

**If we are characterized as a passive foreign investment company, our U.S. shareholders may suffer adverse tax consequences.**

Non-U.S. corporations generally may be characterized as a passive foreign investment company ("PFIC") for any taxable year, if, after applying certain look through rules, either (1) 75% or more of such company's gross income is passive income, or (2) at least 50% of the average value of all such company's assets (determined on an average quarterly basis) are held for the production of, or produce, passive income.

If we are characterized as a PFIC, our U.S. shareholders may suffer adverse tax consequences, including having gains realized on the sale of our ordinary shares taxed at ordinary income rates, rather than capital gain rates. Similar rules apply to distributions that are "excess distributions." In addition, both gains upon disposition and amounts received as excess distributions could be subject to an additional interest charge. A determination that we are a PFIC could also have an adverse effect on the price and marketability of our ordinary shares.

We believe that in 2013 we were not a PFIC. Whether we are a PFIC is based upon such factual matters as the valuation of our assets. In calculating the value of our assets, we value our total assets, in part, based on our total market capitalization. We believe this valuation approach is reasonable. There is no assurance that the IRS will not challenge our valuations. If the IRS were to successfully challenge such valuations, we may potentially be classified as a PFIC for the 2013 taxable year or prior taxable years. Furthermore, there can be no assurance that we will not become a PFIC in the future. See a discussion of our PFIC status in Item 10.E under "U.S. Federal Income Tax Considerations – Passive Foreign Investment Company Considerations."

***Risks Related to our Ordinary Shares***

**We do not intend to pay cash dividends.**

Although we have paid cash dividends in the past, our current policy is to retain future earnings, if any, for funding growth. If we do not pay dividends, you will generate a return on your investment only if our stock price appreciates between your date of purchase and your date of sale of our shares.

See "Item 8.A Consolidated Statements and Other Financial Information — Policy on Dividend Distribution" for additional information regarding the payment of dividends.

**Several shareholders may be able to control us.**

As a result of the ClientConnect Acquisition, several shareholders of Conduit became significant shareholders of Perion, including three shareholders that each beneficially own approximately 14% of our outstanding shares. See Item 7.A for more information. To our knowledge, these shareholders are not party to a voting agreement with respect to our shares. However, should they decide to act together, they may have the power to control the outcome of matters submitted for the vote of shareholders. In addition, such share ownership may make certain transactions more difficult and result in delaying or preventing a change in control of us unless approved by them. Each of these three shareholders has signed a standstill agreement with us providing that until the earlier of (i) the last business day preceding our 2015 annual shareholder meeting or (ii) December 30, 2015, such shareholder will not vote in favor of any proposal to change the size or structure of our board of directors or to shorten or terminate the term of service of any member of our board of directors, unless such proposal is recommended by our board of directors. The standstill agreements will expire if any person (other than a Conduit shareholder as of September 16, 2013 or a person who is subject to similar standstill provisions) becomes the beneficial owner of 24.9% or more of our outstanding shares or if there occurs a change in our board of directors of the type described in the standstill agreements despite the compliance of the parties to the standstill agreements with the provisions thereof.

**We are subject to ongoing costs and risks associated with complying with extensive corporate governance and disclosure requirements.**

As an Israeli public company, we incur significant legal, accounting and other expenses. We incur costs associated with our public company reporting requirements as well as costs associated with corporate governance and public disclosure requirements, including requirements under the Sarbanes-Oxley Act of 2002, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, the Listing Rules of the NASDAQ Stock Market, regulations of the SEC, the provisions of the Israeli Securities Law that apply to dual listed companies (companies that are listed on the Tel Aviv Stock Exchange ("TASE") and another recognized stock exchange located outside of Israel) and the provisions of the Israeli Companies Law 5759-1999 (the "Companies Law") that apply to us. For example, as a public company, we have created additional board committees and are required to have at least two external directors, pursuant to the Companies Law. We have also contracted an internal auditor and a consultant for implementation of and compliance with the requirements under the Sarbanes-Oxley Act. Section 404 of the Sarbanes-Oxley Act requires an annual review and evaluation of our internal control over financial reporting of the effectiveness of these controls by our management. There is no guarantee that these efforts will result in management assurance that our internal control over financial reporting is adequate in future periods. In connection with our compliance with Section 404 and the other applicable provisions of the Sarbanes-Oxley Act, our management and other personnel devote a substantial amount of time, and we may need to hire additional accounting and financial staff, to assure that we continue to comply with these requirements. The additional management attention and costs relating to compliance with the foregoing requirements could materially and adversely affect our financial results. See "Item 5 Operating and Financial Review and Prospects — Overview — General and Administrative Expenses" for a discussion of our increased expenses as a result of being a public company.

**If we were not considered a foreign private issuer status under U.S. federal securities laws, we would incur additional expenses associated with compliance with the U.S. securities laws applicable to U.S. domestic issuers.**

We are a foreign private issuer, as such term is defined under U.S. federal securities laws, and, therefore, we are not required to comply with all of the periodic disclosure and current reporting requirements applicable to U.S. domestic issuers. If we did not have this status, we would be required to comply with the reporting and other requirements applicable to U.S. domestic issuers, which are more detailed and extensive than the requirements for foreign private issuers. The regulatory and compliance costs to us under U.S. securities laws, if we are required to comply with the reporting requirements applicable to a U.S. domestic issuer, may be significantly higher than the cost we currently incur as a foreign private issuer.

**The rights and responsibilities of our shareholders are governed by Israeli law and differ in some respects from the rights and responsibilities of shareholders under U.S. law.**

We are incorporated under Israeli law. The rights and responsibilities of holders of our ordinary shares are governed by our memorandum of association, articles of association and by Israeli law. These rights and responsibilities differ in some respects from the rights and responsibilities of shareholders in typical U.S. corporations. In particular, a shareholder of an Israeli company has a duty to act in good faith in exercising his or her rights and fulfilling his or her obligations toward the company and other shareholders and to refrain from abusing his power in the company, including, among other things, in voting at the general meeting of shareholders on certain matters. Israeli law provides that these duties are applicable in shareholder votes at the general meeting with respect to, among other things, amendments to a company's articles of association, increases in a company's authorized share capital, mergers and actions and transactions involving interests of officers, directors or other interested parties which require shareholders' approval. There is little case law available to assist in understanding the implications of these provisions that govern shareholder behavior.

**As a foreign private issuer whose shares are listed on NASDAQ, we follow certain home country corporate governance practices instead of certain NASDAQ requirements.**

As a foreign private issuer whose shares are listed on NASDAQ, we are permitted to follow certain home country corporate governance practices instead of certain requirements contained in the NASDAQ listing rules. We follow the requirements of the Companies Law in Israel, rather than comply with the NASDAQ requirements, in certain matters, including with respect to the quorum for shareholder meetings, sending annual reports to shareholders, and shareholder approval with respect to certain issuances of securities. See "Item 16.G – Corporate Governance" in this Annual Report for a more complete discussion of the NASDAQ Listing Rules and the home country practices we follow. As a foreign private issuer listed on NASDAQ, we may also elect in the future to follow home country practice with regard to other matters as well. Accordingly, our shareholders may not be afforded the same protection as provided under NASDAQ's corporate governance rules to shareholders of U.S. domestic companies.

**Provisions of our articles of association and Israeli law may delay, prevent or make an acquisition of our Company difficult, which could prevent a change of control and, therefore, depress the price of our shares.**

Israeli corporate law regulates mergers, requires tender offers for acquisitions of shares above specified thresholds, requires special approvals for transactions involving directors, officers or significant shareholders and regulates other matters that may be relevant to these types of transactions. In addition, our articles of association contain provisions that may make it more difficult to acquire our Company, such as provisions establishing a classified board. Furthermore, Israeli tax considerations may make potential transactions unappealing to us or to some of our shareholders. See "Item 10.B Memorandum and Articles of Association — Approval of Related Party Transactions" and "Item 10.E – Taxation — Israeli Taxation" for additional discussion about some anti-takeover effects of Israeli law.

These provisions of Israeli law may delay, prevent or make difficult an acquisition of our Company, which could prevent a change of control and therefore depress the price of our shares.

**Future sales of our ordinary shares could reduce our stock price.**

At the closing of the ClientConnect Acquisition on January 2, 2014, we issued 54.75 million of our ordinary shares to the ClientConnect shareholders and granted options to purchase 2.82 million of our ordinary shares to the ClientConnect employees. The ordinary shares were issued pursuant to an exception from registration under the Securities Act and are not subject to any resale restrictions under U.S. law, except for the volume limitations under Rule 144 applicable to our affiliates. Such shareholders are entitled to registration rights, as described in Item 10.C "Material Contracts—Agreements Relating to the ClientConnect Acquisition—Registration Rights Undertaking". While the resale of such ordinary shares are subject to the Contractual Lock-up, such lock-up restrictions could be relaxed in certain circumstances, as described in Item 10.C "Material Contracts—Agreements Relating to the ClientConnect Acquisition—Lock-up Arrangements". The Tax Lock-up applicable to our three largest individual shareholders, as described in Item 10.C "Material Contracts—Agreements Relating to the ClientConnect Acquisition—Tax-related Restrictions", might be insufficient to protect the market price of our ordinary shares.

Sales by shareholders of substantial amounts of our ordinary shares, or the perception that these sales may occur in the future, could materially and adversely affect the market price of our ordinary shares. Furthermore, the market price of our ordinary shares could drop significantly if our executive officers, directors, or certain large shareholders sell their shares, or are perceived by the market as intending to sell them.

**Our ordinary shares are traded on more than one market and this may result in price variations.**

Our ordinary shares are traded on the NASDAQ Global Select Market and on the TASE. Trading in our ordinary shares on these markets is effected in different currencies (U.S. dollars on NASDAQ and NIS on the TASE) and at different times (resulting from different time zones, different trading days and different public holidays in the United States and Israel). Consequently, the trading prices of our ordinary shares on these two markets often differ, resulting from the factors described above as well as differences in exchange rates and from political events and economic conditions in the United States and Israel. Any decrease in the trading price of our ordinary shares on one of these markets could cause a decrease in the trading price of our ordinary shares on the other market.



#### ITEM 4. INFORMATION ON THE COMPANY

##### A. HISTORY AND DEVELOPMENT OF THE COMPANY

###### Our History

We were incorporated in the State of Israel in November 1999 under the name Verticon Ltd. and changed our name to Incredimail Ltd. in November 2000. In November 2011, we changed our name to Perion Network Ltd., to better reflect the diverse nature of our business. We operate under the laws of the State of Israel. Our headquarters are located at 4 HaNechoshet Street, Tel-Aviv 69710, Israel. Our phone number is (972-3) 769-6100. Our website address is [www.perion.com](http://www.perion.com). The information on our website does not constitute a part of this annual report. Our agent for service in the United States is Smilebox Inc., which is located at 15809 Bear Creek Parkway, Suite 320, Redmond, WA 98052.

We completed the initial public offering of our ordinary shares in the United States on February 3, 2006.

Since November 20, 2007, our ordinary shares are also traded on the Tel Aviv Stock Exchange.

On August 31, 2011, we completed the purchase of Smilebox Inc., a Washington corporation.

On November 30, 2012, we completed the purchase of SweetIM Ltd., a Belize company that wholly owns SweetIM Technologies Ltd., an Israeli company.

On January 2, 2014, we completed the purchase of ClientConnect Ltd., an Israeli company that wholly owns ClientConnect Inc., a Delaware corporation, and ClientConnect B.V., a Netherlands company. See "Recent Developments" below.

###### Principal Capital Expenditures

We had capital expenditures of \$2.3 million in 2013, \$45.7 million in 2012 and \$32.7 million in 2011. We currently expect that outside of possible acquisitions of products and companies, our capital expenditures will be approximately \$13 million in 2014. To date, we have financed our general capital expenditures with cash generated from operations.

In 2011, capital expenditures consisted of \$31.5 million for the acquisition of Smilebox and \$1.2 million for investment in computer hardware and software, leasehold improvements and furnishings. In 2012, capital expenditures consisted of \$44.2 million in connection with the acquisition of SweetIM Ltd., and \$1.5 million for investment in computer hardware and software, leasehold improvements and furnishings. In 2013, capital expenditures consisted of \$2.3 million for investment in computer hardware and software, leasehold improvements and furnishings.

In 2014, we expect to continue our growth strategy for acquiring products and businesses, in addition to organic capital investments. Our organic investments are expected to consist primarily of leasehold improvement costs related to moving our headquarter office to Holon, acquiring computer hardware, software, peripheral equipment and installation, all which are expected to be financed by our existing resources. To the extent we acquire new products and businesses, these acquisitions may be financed by any of, or a combination of, cash generated from operations, or issuances of equity or debt securities.

###### Recent Developments

On September 16, 2013, we entered into a Share Purchase Agreement (the "Share Purchase Agreement"), by and among Perion, Conduit Ltd., an Israeli company ("Conduit"), and ClientConnect Ltd., an Israeli company ("ClientConnect"), providing for our acquisition of all the outstanding shares of ClientConnect in exchange for our ordinary shares (the "ClientConnect Acquisition"). On the same date, Conduit and ClientConnect entered into a Split Agreement pursuant to which on December 31, 2013, the entire activities and operations, and related assets and liabilities, of Conduit's ClientConnect business were transferred to ClientConnect on a cash-free and debt-free basis and the Conduit shareholders became the shareholders of ClientConnect in proportion to their ownership of Conduit (the "Conduit Split").

Upon the consummation of the ClientConnect Acquisition, which took place on January 2, 2014, each ClientConnect ordinary share was exchanged for approximately 0.2387 of our ordinary shares, as a result of which ClientConnect became a wholly owned subsidiary of ours. In addition, we granted options to purchase our ordinary shares to ClientConnect employees in exchange for their options to purchase ClientConnect shares that were issued to them upon the consummation of the Conduit Split as a roll-over of their then existing options to purchase ordinary shares of Conduit. Accordingly, we issued 54.75 million of our ordinary shares to the ClientConnect shareholders and granted options to purchase 2.82 million of our ordinary shares to the ClientConnect employees. Immediately, following the closing, we were owned approximately 81% by the former ClientConnect shareholders and option holders and 19% by our pre-closing shareholders and option holders, on a fully diluted basis (as determined by the treasury stock method, together with an adjustment for an assumed issuance of our ordinary shares at a reference price of \$10.49 per share based on the Black Scholes values of out-of-the-money Perion options and ClientConnect options).

ClientConnect offers, inter alia, a proprietary cloud-based platform, which allows online publishers to create, implement and distribute web browser toolbars and other monetization tools and services to targeted audiences, and to subsequently administer this platform. The platform includes software applications and tools that provide comprehensive solutions for the full customization of the various aspects of the monetization platforms graphical user interface ("GUI"), including a toolbar, as well as additional features, tools and services (such as a search box, home page takeover, web applications, search protect and value apps), through a user-friendly online drag and drop system.

Publishers distribute their monetization platform together with features, tools and services made available via the platform, including additional third party content features or services that publishers decide to offer to end users, who can then choose to download and install the toolbars and the related features or services (as applicable). End users may also utilize the toolbars for Internet searches that are powered by search providers with which ClientConnect contracts. As part of the monetization platform installation process, end users are able to (i) replace their home page with the ClientConnect home page, where users may conduct searches or follow links to advertisements that advertisers may display; (ii) install ClientConnect search protect software, which may be distributed also on a stand alone basis, which is designed to maintain the end user's selected browser settings and to prevent third party software downloads from changing such settings; and (iii) use the value apps tool (a tool developed by ClientConnect for the aggregation and optimization of ClientConnect and third party applications, services and offers), which is offered as a toolbar feature or as a standalone software product to end users.

In addition, ClientConnect allows online publishers to set up syndicated searches on their individual websites, and to monetize their users' other search assets, such as browser default search, new tab search, and error page redirection.

The main operations of ClientConnect are located in Ness-Ziona, Israel, and it has wholly owned subsidiaries in San Francisco, California and Amsterdam, Netherlands.

## **B. BUSINESS OVERVIEW**

### **Overview**

Our legacy software applications offer advantages for consumers and are designed to make various aspects of their online experience simpler, safer and more enjoyable. Our CodeFuel solution, which we launched following our acquisition of ClientConnect in January 2014, is targeted at digital businesses, and empowers them to optimize their distribution and maximize revenue. Servicing software developers, while being one ourselves, we understand the needs of publishers, and our solution enables developers to focus on creating high-quality digital product and content. The Perion team brings decades of experience in operating and investing in digitally-enabled businesses, and we continue to innovate and create value for the application ecosystem. Today, we have contracted with over 260,000 online publishers and developers in over 120 countries who utilize our solutions for distribution and monetization of their offerings.

Our legacy applications are designed to enhance our users' online experience in a variety of ways. IncrediMail is a unified messaging application that enables consumers to manage multiple email accounts and Facebook messages in one place with an easy-to-use interface and extensive personalization features, and is available in over 100 countries in 8 languages. Smilebox is a leading photo sharing and social expression product and service that quickly turns life's moments into digital keepsakes for sharing and connecting with friends and family in a fun and personal way. SweetIM is an instant messaging application, enabling consumers to personalize their everyday communications with free, fun and easy-to-use content.

All of our legacy products were initially offered for use on desktop computers. In line with the emergence and increasing importance of mobile platforms over the last few years, we have developed and marketed products for use on mobile platforms as well. In September 2011, we introduced Smilebox for the iPhone, which has since recorded 2.0 million downloads. In March 2013, we introduced a mobile e-mail client, now available for the iPad, iPhone and most recently for Android and have so far registered over 0.7 million downloads.

In the past we relied primarily on "viral marketing" to increase the popularity of our legacy products. When an existing user sends an email with *IncrediMail* or *Molto*, or an instant message enriched by SweetIM content, or digital photo creations generated by our Smilebox software, there is an embedded link that allows the recipient to download our products. We also acquire users from downloads initiated through word of mouth. Although viral marketing is still a contributor to the overall growth in popularity of our legacy products, its effectiveness has declined over time, and in 2011 we began investing in advertising to continue to grow our user base.

In January 2014, following the acquisition of ClientConnect, we launched our CodeFuel solution. CodeFuel is a leading self-service platform with simple integration and robust, built-in analytics that empower digital businesses to optimize distribution and maximize revenue. With the launch of our CodeFuel solution, we have evolved into a global media and Internet company that powers innovation. We now focus on providing online publishers and app developers advanced technology and a variety of intelligent data-driven solutions to monetize their applications or content and expand their outreach to larger audiences. Consequently, we have refocused our marketing strategy on increasing developer and advertiser awareness of our CodeFuel solution.

We believe that our historical track record of converting registered users to transacting customers represents a convincing validation of our experience and know-how as developers, and in doing so confirms our position as providing effective solutions to our developer clients. When we use the term "registered user" in this annual report, we mean a user who has downloaded a product and completed the registration process. Registrations are not necessarily indicative of the number of individuals using the product or services, as a user may register more than one time and a particular product or service may be resident on a computer but not actually be used.

For a breakdown of total revenues of our legacy business by category of activity, see Item 5.A "Operating Results — Revenues."

## Markets

In the past, our legacy desktop products primarily serviced consumers coined "second wave adopters", characterized as individuals who are over 40 years old and who are looking for computer applications that assist them in effectively utilizing their time while being simple and safe. With the shift in focus to mobile products, we have extended our market to younger consumers who are excited about new technology offerings and extremely responsive to the quality of the particular offering.

With our acquisition of ClientConnect and the subsequent launch of our new CodeFuel solution, we have concentrated our focus on targeting software developers and digital businesses, providing effective distribution, monetization, and optimization solutions. These developers and digital businesses, in turn, target consumers.

*Our Opportunity.* Our experience and success as developers allow us to best understand the needs of publishers and to enable other developers to succeed. Honed through our own products, our technology-based solutions platform provides us with the opportunity to allow developers to focus on what they do best, creating great digital content and applications. Our team brings decades of experience, operating and investing in diversified digitally-enabled businesses, and we continue to innovate and create value for developers.

*Productivity tools.* We aim to maintain and enrich our legacy product suite, which will serve as a real-world testing grounds and proof of concept for the solutions we provide to other software developers.

## Strategy

Our Life Cycle Management ("LCM") solutions currently encompass the entire lifecycle of online publishers' and developers' content and applications. Our objective is to become a market leader of LCM solutions for online publishers and developers. To achieve this goal, we intend to enhance our existing business and extend it by way of acquisitions. To enhance our existing business, we intend to:

- broaden our software developer base and deepen our connections with existing developers, by increasing marketing efforts and adding methods of advertising to reach out to more software developers of high-quality digital content and products;
- expand our existing LCM platform and develop new platforms that will offer an even wider array of applications and features to software developers for distribution, monetization and optimization of their offerings;
- advance our technological capabilities by continuing to invest in research and development efforts, which serve as the basis for our efforts to further enhance our existing LCM platform and develop new platforms for software developers; and
- broaden the platform for our solutions by embracing mobile platforms.

In the past, we predominantly defined ourselves as a business-to-consumer company, offering quality software directly to consumers. Today, we view ourselves as a business-to-business-to-consumer company, empowering other software companies in effectively distributing and monetizing the products they offer to consumers. We plan to leverage our core assets and competencies as software developers to expand into programmatic data-driven advertising. Additionally, we plan to focus on provision of mobile, social, and video monetization solutions in light of the growing popularity for these outlets.

In order to extend our business beyond organic growth and accelerate our ability to bring new solutions and products to our clients and consumers, we have adopted a strategy to invest in acquiring new technologies and business platforms. This strategy most recently resulted in the transformative acquisition of ClientConnect in January 2014. This strategy will enable us to further diversify our revenue base, better serve the needs of our clients and consumers, and reduce the time required to bring new services and solutions to market.

We believe we will be able to further grow our business by:

- *Growing our client base organically and through acquisitions.* Our historical growth has been driven by our success in providing tailored answers to our clients' need for fast, flexible, and data-driven solutions, either developed organically or through the acquisition of products or businesses.
- *Increasing the frequency of use by our clients and their consumers.* By focusing on the needs of our clients and their consumers, we believe we can increase the use of our clients' offerings and subsequently the search capabilities offered, as well as advertising revenues, thereby increasing our revenues.
- *Enhancing the client experience.* We have always focused on providing a positive experience to our clients. We understand that each client has unique needs, and we tailor our solutions to account for this reality. We employ a staff of friendly account managers who are dedicated to the success of our clients. Additionally, the results of our powerful analytics are displayed in an easily readable and well-organized fashion, enabling an easy access point to relevant and useful data and analytics.
- *Continuing to focus on the online consumer market.* Our LCM platform particularly suits online software developers. As developers ourselves, we have seen first-hand the increasing popularity of mobile and social product markets and have successfully broadened our products to account for this new reality. The Internet and the available application stores enable online publishers and developers to reach potential users throughout the world quickly and easily as well as reduce the costs associated with sales and distribution of their products and services. We therefore have developed solutions that enable our clients to take full advantage of these new markets.
- *Enhancing the consumer experience.* We have always attempted to provide a positive experience to users of our legacy products. As we further emphasize this aspect, we will continue to design our products and services and market them to address users' aversion to offensive Internet marketing tools, which we believe encourages more use of our products and solutions and increases user loyalty.

#### **Search generated revenues**

We generate the majority of our revenues from services agreements with our search partners. Search generated revenues accounted for 72%, 63% and 68% of our revenues in 2011, 2012 and 2013, respectively. Through our search syndication technology, we offer end users the ability to search the internet via easily embedded search boxes powered by premium search companies, including Microsoft, Google, APN, LLC ("Ask") and Yahoo, and depending on the search partner powering the search or location in which the search was initiated, we receive either a fixed price, pay-per-search fee or portion of the revenues generated by these companies through the search process.

In the past, Google's coverage and service offering was the one most suited to our global distribution and provided the best monetization opportunity for our products. As such, we have been working with Google since 2007, and renewed our agreement with Google for another two years effective May 1, 2013. Nonetheless, in adapting to the changes in the search marketplace, particularly in 2013, we were successful in engaging other search providers. On December 28, 2012, we signed a one year renewable agreement with Microsoft's Bing (which was amended on March 18, 2013 and September 15, 2013). On April 29, 2013, we signed a three year agreement with Ask (which was amended on January 17, 2014 and February 3, 2014), with auto-renewal for additional one year periods. On April 19, 2013, we signed a two year agreement with Yahoo, with auto-renewal for additional one year periods. In addition, prior to the ClientConnect Acquisition, on August 12, 2013 we signed a search distribution partnership with Conduit (the "Conduit Commercial Agreement").

With the acquisition of ClientConnect, we assumed ClientConnect's search services agreements, including an agreement with each of Microsoft and Google. Based on the reports received from Conduit, search generated revenues accounted for 85% of ClientConnect's revenues in 2013. The agreement with Microsoft (the "Microsoft Agreement"), entered into in November 2010 and subsequently amended in May 2011, runs through December 31, 2014, and accounted for 89%, 81% and 63% of ClientConnect's revenues in 2011, 2012 and 2013, respectively. The fees payable by Microsoft under the Microsoft Agreement are payable based on either a fixed price, pay-per-search basis that is tied to the number of searches conducted by end users, or in certain instances on a share of the revenue generated as a result of searches conducted by end users who utilize the search engine that appears on toolbars created by publishers through ClientConnect's platform. The fees payable by Microsoft vary annually over the term of the agreement, decreasing significantly during the last two years (2013 and 2014) of the term of the agreement compared to the first two years (2011 and 2012). To a lesser extent, we also syndicate Microsoft-provided searches through publishers' websites with which the business enters into syndication agreements. Under the agreement, Microsoft had exclusivity in 2011 and 2012 in providing search services and search monetization services through platform-generated toolbars in the United States. Despite the termination of the exclusivity period under the Microsoft Agreement, Microsoft Bing currently remains the effective main search provider of ClientConnect for searches conducted through platform-generated toolbars in the United States and Canada.

ClientConnect's agreement with Google, entered into in 2011, and subsequently replaced by a substantially similar agreement entered into on September 1, 2013 for a term of two years, has historically been the second largest source of revenue for ClientConnect, accounting for 9%, 15% and 22% of ClientConnect's revenues in 2011, 2012 and 2013, respectively. Google serves as the main provider of ClientConnect of search services to end users of platform-generated toolbars in all locations outside of the United States and Canada. Revenues are paid on the basis of a revenue-sharing arrangement with Google, entitling us to a percentage of the revenues generated by Google as a result of searches conducted by end users through search engines integrated by search our syndication solutions.

#### **Advertising and other revenues**

As part of our CodeFuel solution, we offer publishers and developers monetization opportunities through DisplayFuel, our innovative browser extension that offers recommendations, deals, coupons and relevant content to users as they browse online. Additionally, through our InstallFuel platform, we offer developers the ability to easily incorporate ads into the download and installation process of their software, thereby further increasing monetization opportunities. Through these tools, we receive a fee from our ad partners.

#### **Developer Products and Solutions**

Our LCM platform provides solutions for the challenges that exist at every stage of the application life cycle. Particularly, our solutions tackle developers' three main challenges: distribution, monetization and optimization, each as described below.

##### **Distribution**

As the vast majority of apps remain largely undiscovered, developers are initially met with distribution challenges. Buying traffic is necessary but extremely complicated, and developers often find themselves lost between different technologies and platforms.

InstallFuel is our powerful, self-service installation platform that enhances the integrity of the installation process. With over 900,000 different download managers created to date, InstallFuel is HTML-based and fully customizable. In addition, InstallFuel incorporates a unique proprietary accelerator for faster downloads and higher conversion. The platform also includes built-in A/B testing capabilities enabling developers to adjust their install funnels and increase completion rates.

In addition to our InstallFuel installation platform, we offer our clients a wide range of competitive marketing services to further increase the distribution of their offerings. We employ a highly skilled search engine marketing and partnership team to personalize and enhance the distribution process. Additionally, we employ sophisticated business intelligence systems to monitor the loan-to-value ("LTV") and return on investment ("ROI") performance, allowing us to measure and analyze the success of various marketing tactics at any given time. Based on this analysis, our marketing team creates and updates individual marketing plans to help optimize distribution.

## Monetization

Publishers and developers face increasing challenges monetizing their offerings. This is partly because most consumers find that the free version of a given software product adequately meets their needs. Accordingly, most app developers do not earn sufficient revenue to sustain a standalone business.

We provide a broad spectrum of solutions for our clients' monetization challenges. Through a sophisticated, data driven recommendation engine, we offer clients the ability to easily incorporate targeted ads into the download and installation process of their products thereby further increasing monetization opportunities. The engine allows for funnel monetization opportunities on post-install and uninstall pages, as well. Altogether, the engine provides end users with more relevant offers, ultimately increasing end user satisfaction and monetization.

Our DisplayFuel tool aggregates and optimizes applications, services, and offers. The tool scours the web and recommends the most relevant, highest quality deals, price comparisons, coupons and content. The tool can be easily incorporated during the installation process of our clients' products as standalone software for use by end users. This serves as an effective monetization mechanism, as we compensate clients either based on a fixed fee per installation or via a revenue sharing arrangement for revenue generated when end users follow the links related to the applications, services and offers included in the tool.

Through our close partnerships with the world's leading search providers such as Microsoft, Google, Yahoo and Ask, we enable our clients to monetize their search assets. Publishers and developers may incorporate a search box into their offerings that is powered by our search providers, who in turn pay us fees for searches emanating from such search boxes. Depending on the payment model adopted, we pay our clients a fee on a pay-per-search or revenue sharing basis for search activity emanating from the incorporated search boxes.

## Optimization

Most app developers are small businesses without analytical capabilities or the required funds to improve funnel conversion, create the necessary systems for tracking revenue per user, or implement traffic acquisition with positive ROI.

Control Center is our analytics platform that enables our clients to manage their distribution and monetization activities and better optimize their offerings. Through the platform, we provide our clients with real-time analytics, custom reports, and advanced optimization and editing tools, which together act as a springboard to higher conversions and increased ROI.

## Legacy Products

Our legacy consumer products are currently available in seven languages in addition to English. Prices and license fees for our premium products range between \$5 and \$40, varying based on market, length of license period and whether the products are offered together. Our legacy product line crosses several vertical markets and consists of the following products, all of which may be downloaded over the Internet:

- Incredimail is our communication client. Its basic version can be downloaded free of charge. Incredimail is used for managing email messages and Facebook feeds, and offers various graphic and personalizing capabilities. In addition, it is safe, simple and easy to use. The premium version of this software offers, for an annual subscription fee, VIP support and enhanced graphic capabilities, as well as advanced anti-spam software for a separate annual subscription fee.

In March 2013, we introduced Incredimail for the iPad, which has been rebranded as Molto. We launched Molto for the iPhone in October 2013 and for Android phones in January 2014. Molto is one of the first email applications truly adapted for touch-screen devices. It redesigns the inbox, unifies multiple email accounts, creates a photo inbox from friends and family Facebook photos, and elevates messages so their contents can easily be seen by users at a glance, in an intuitive "magazine-by-touch" format. With its sleek interface, Molto transforms organizing email on iPhone, iPad and Android phones and tablets into a simpler, more visual experience that allows our users to navigate, read and enjoy emails in a fun and innovative manner.

- SweetIM is free downloadable and easy-to-use software that enables users to enhance their messaging experience and express themselves in creative ways across online platforms, such as messenger, email, etc.
- Smilebox is an Internet photo sharing service available for the desktop and smart-phone.

On the desktop, Smilebox can be used both on the PC and the Mac, making it easy to create digital creations from personal photos using a range of digital designs including invitations, greetings, collages, scrapbooks, photo albums and slideshows. These creations can then be shared free of charge via email, Facebook, Twitter, Print, DVD or photo frames. Revenues are generated from subscriptions for premium content and features, advertising from creations that are shared for free, printing revenues from creations that are printed to store or printed and shipped to home and search revenues for consumers that elect to have Smilebox provide their default search results.

Smilebox is also available free of charge for the iPhone, making it easy to personalize and share photos in real time, directly from the device. Personalization options include captions, stickers and frames, and sharing options include email, Facebook and SMS.

#### Products under Development

Our research and development activities are primarily conducted internally, focusing on the development of new platform-based solutions that will offer developers (i) effective distribution tools, (ii) increased monetization capabilities, and (iii) enhanced optimization via powerful, reliable, and easy-to-use analytics. Additionally, we focus our research and development efforts on developing new products and improving existing products through software updates and upgraded features. Our Research & Development department is divided into groups based on scientific disciplines and types of applications and products.

#### Breakdown of Revenues

Our solutions and products are distributed and sold throughout the world in more than 100 countries. The following table shows the revenues generated by our legacy business and by the ClientConnect business, by territory, in 2013:

	<b>Legacy Search- Generated and Related Advertising Revenues</b>	<b>Legacy Product Revenues</b>	<b>ClientConnect Search- Generated Revenue</b>
Tier 1 – North America	35%	86%	70%
Tier 2 – Europe	47%	10%	23%
Tier 3 – Other	18%	4%	7%

In previous years, we divided our sales regions somewhat differently, as set forth below:

In 2012, legacy search and product revenues in the United States, Canada, United Kingdom and Australia represented 47% and 84% of revenues, respectively, in France, Germany, Italy, Spain, Netherlands, Belgium and Switzerland represented 35% and 8% of revenues, respectively, and in the rest of the world represented 18% and 8% of revenues, respectively.

In 2011, legacy search and product revenues in the United States, Canada, United Kingdom and Australia represented 42% and 66% of revenues, respectively, in France, Germany, Italy, Spain, Netherlands, Belgium and Switzerland represented 43% and 23% of revenues, respectively, and in the rest of the world represented 15% and 11% of revenues, respectively.

#### Intellectual Property

Although we have a number of patents, copyrights, trademarks and trade secrets and confidentiality and invention assignment agreements to protect our intellectual property rights, we believe that our competitive advantage depends primarily on our marketing, business development, applications, know-how and ongoing research and development efforts. Accordingly, we believe that the expiration of any of our patents or patent licenses, or the failure of any of our patent applications to result in issued patents, would not be material to our business or financial position.

Most of the components of our software products were developed solely by us. We have licensed certain components of our software from third parties. Except for our agreements regarding anti-spam software and some of our content licenses, most of these licenses entailed a one-time fee or are "freeware". We believe that these components are not material to the overall performance of our software and may be replaced without significant difficulty.

We have six patents in the United States and one in Israel, as well as several patent applications pending in the United States, Israel the European Union.

We enter into licensing arrangements with third parties for the use of software components, graphic, sound and multimedia content integrated into our products.

We have registered: (i) "Perion" as a trademark in the United States, Israel and the European Community (a community trademark); (ii) "IncrediMail" and "PhotoJoy" as trademarks in the United States, the European Community (a community Trademark) and China and we have a pending application for IncrediMail in Israel that has already been allowed; (iii) "Smilebox Teeth Design" in the United States; (iv) "Smilebox" in Australia, Canada, China, France, Germany, Japan, Korea, United Kingdom and the United States; and (v) "SWEETPACKS" and "SWEETIM" in the United States.

In addition, we are the owner of a U.S. trademark application for "Codefuel".

All employees and consultants are required to execute confidentiality covenants in connection with their employment and consulting relationships with us. In addition, our consulting agreements contain assignment and waiver provisions relating to the consultant's rights in respect of inventions. However, there can be no assurance that these arrangements will provide us with adequate protection. Although our employment agreements contain assignment and waiver provisions relating to the employee's rights in respect of inventions created within the course of their employment with us, including in respect of "Service Inventions", as defined under the Israeli Patents Law, 5727-1967, we cannot guarantee that such waiver of rights to receive compensation for Service Inventions will be upheld by Israeli courts, due to a recent ruling by the Israeli Supreme Court which left the validity of such a waiver to further judicial review.

#### **Competition**

The markets in which we are active are subject to intense competition. We compete with many other companies offering solutions for online publishers and developers, including search services and other software in conjunction with changing a user's default search settings.

As a major part of our revenues stem from our offering of search properties, we compete with search engine providers themselves such as Google, Microsoft, Yahoo, Ask and others. We also compete with many other companies offering consumer downloadable software, albeit totally different software, utilizing the same strategy, to offer their search properties, such as Interactive Corporation, AOL, Blucora, AVG Technologies and others.

The market ClientConnect operates in -- providing distribution, monetization and analytical solutions to software developers and publishers -- is very competitive as well, with companies such as Google, Interactive Corporation, Blucora and others providing competing solutions.

Many of our current and potential competitors have significantly greater financial, research and development, back-end analytical systems, manufacturing, and sales and marketing resources than we have. These competitors could use their greater financial resources to acquire other companies to gain even further enhanced name recognition and market share, as well as to develop new technologies, enhanced systems and analytical capabilities, products or features that could effectively compete with our existing solutions, products and search services. Demand for our solutions, products and search services could be diminished by solutions, products, services and technologies offered by competitors, whether or not their solutions, products, services and technologies are equivalent or superior.

Finally, our ability to attract developers is largely dependent on our ability to pay higher rates to our publishers and developers, our success in creating strong commercial relationships with developers that have successful software, websites or distribution channels, and our ability to differentiate our distribution, monetization, and optimization tools from those of our competitors, primarily through our Life Cycle Management platform.

#### **Government Regulation**

We are subject to a number of U.S. federal and state and foreign laws and regulations that affect companies conducting business on the Internet. The manner in which existing laws and regulations will be applied to the Internet in general, and how they will relate to our business in particular is unclear. Accordingly, we cannot be certain how existing laws will be interpreted or how they will evolve in areas such as user privacy, data protection, content, use of "cookies", access changes, "net neutrality", pricing, advertising, distribution of "spam", intellectual property, distribution, protection of minors, consumer protection, taxation and online payment services.

In particular, we are subject to U.S. federal and state laws regarding copyright infringement, privacy and protection of user data, many of which are subject to regulation by the Federal Trade Commission. These laws include the Digital Millennium Copyright Act, which aims to reduce the liability of online service providers for listing or linking to third-party websites that include materials that infringe copyrights or the rights of others, and other federal laws that restrict online service providers' collection of user information on minors as well as distribution of materials deemed harmful to minors. Many U.S. states, such as California, are adopting statutes that require online service providers to report certain security breaches of personal data and to report to consumers when personal data will be disclosed to direct marketers. There are also a number of legislative proposals pending before the U.S. Congress and various state legislative bodies concerning data protection which could affect us.



Foreign data protection, privacy and other laws and regulations may affect our business, and such laws can be more restrictive than those in the United States. For example, in Israel, privacy laws require that any request for information for use or retention in a database be accompanied by a notice that indicates: whether a person is legally required to disclose such information or that such disclosure is subject to such person's consent; the purpose for which the information is requested; and to whom the information is to be delivered. A breach of privacy under such laws is considered a civil wrong and subject to a significant fines and civil damages. Certain violations of the law are considered criminal offences punishable by imprisonment. In the European Union and the United Kingdom, privacy legislation has tightened the restrictions around accessing and using data stored in a subscriber's terminal equipment and requires the consent of the subscriber before accessing such information. Further, the European Commission is currently considering a data protection regulation that may include operational requirements for companies that receive personal data that are different than those currently in place in the European Union, and that may also include significant penalties for non-compliance. To further complicate matters in Europe, Member States may not adopt relevant European Union Directives or may adopt differing laws in their respective jurisdictions.

These regulations result in significant compliance costs and could result in restricting the growth and profitability of our business.

#### **C. ORGANIZATIONAL STRUCTURE**

IncrediMail, Inc., our wholly-owned Delaware subsidiary, owns all of the outstanding shares of common stock of Smilebox Inc., a Washington corporation.

SweetIM Ltd., our wholly-owned Belize subsidiary, owns all of the outstanding ordinary shares of SweetIM Technologies Ltd., an Israeli company.

ClientConnect Ltd., our wholly owned Israeli subsidiary, owns all of the outstanding shares of common stock of ClientConnect, Inc., a Delaware corporation, and all of the outstanding ordinary shares of ClientConnect B.V., a Netherlands company.

#### **D. PROPERTY, PLANTS AND EQUIPMENT**

We lease five facilities, three located in Israel (Tel Aviv, Ness Ziona and Holon) and three located in the United States (Redmond, Washington, and San Francisco, California).

The lease in Tel Aviv covers a total area of 30,000 square feet and expires in 2015, with an annual cost of approximately \$1.1 million. In Ness Ziona, we lease an area of 2,850 square feet, which expires in 2015, and an additional area of 900 square feet, which expires in 2014, with a total annual cost of approximately \$0.1 million. During the third quarter of 2014, we plan to move all of our Israeli personnel to Holon. The lease in Holon covers a total area of 101,500 square feet and expires in 2024, with an option to extend for two additional two-year periods. Annual cost is approximately \$3.1 million.

The lease in Redmond covers a total area of 8,300 square feet, with an annual cost of approximately \$0.3 million, expiring in 2015, with an option to extend for another 2 to 5 years. The Company's office moved to new a space in San Francisco, leasing a total of approximately 4,658 square feet, with an annual cost of approximately \$0.3 million and expiring in 2019.

We believe that our current facilities, particularly the space we plan to occupy in Holon, Israel, during the third quarter of 2014, are adequate to meet our current needs, and we believe that suitable additional space will be available as needed to accommodate ongoing operations and any such growth.

We own approximately 520 servers located in Israel, Europe and the United States. We also rent the services of approximately 260 additional servers located around the world, mainly through Amazon Web Services, and Microsoft Windows Azure cloud services. Our servers include mainly web servers, application servers, mail servers and database servers. Bezeq and Cellcom Israel Ltd. provide our Internet and related telecommunications services in Israel, including hosting and co-location facilities, needed to operate our websites. Bezeq is Israel's largest provider of such services and is a member of Bezeq Group, Israel's incumbent national telecommunications provider. In the United States CenturyLink, and in Europe Evoswitch, is our co-location provider. Our ISPs are CenturyLink, NTT Communication, Level3 Communication and Colt. Bezeq and Cellcom are the two largest providers of such services in Israel. All other Internet Service Providers ("ISPs") are tier-1 worldwide providers in this area. All co-location and telecommunication services are provided through standard purchase orders and invoices. We add servers and expand our systems located at their facilities as our operations require. We believe there are many alternative providers of these services both within and outside of Israel.

**ITEM 4.A UNRESOLVED STAFF COMMENTS**

None.

**ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS**

*The following discussion of our financial condition and results of operations should be read in conjunction with our financial statements and the related notes to the financial statements included elsewhere in this annual report. In addition to historical financial information, the following discussion and analysis contains forward looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Exchange Act, including, without limitation, statements regarding the Company's expectations, beliefs, intentions, or future strategies that are signified by the words "expects," "anticipates," "intends," "believes," or similar language. These forward looking statements involve risks, uncertainties and assumptions. Our actual results and timing of selected events may differ materially from those anticipated in these forward looking statements as a result of many factors, including those discussed under "Item 3.D Risk Factors" and elsewhere in this annual report.*

**A. OPERATING RESULTS**

**Overview**

In our legacy business (our business before the ClientConnect Acquisition) we design and market a suite of downloadable consumer products that are simple, safe and useful. These include primarily customized and entertaining email software products, software for sharing digital photo creations, instant messaging enhancement software and a variety of free, fun, easy-to-use and safe application and downloadable expression content. We believe that the user experience we have created has been successful in attracting a unique underserved demographic segments seeking software applications that make their lives a little simpler and more enjoyable. In addition, together with our products we offer users consumer software products owned by other companies, which are distributed in conjunction with our products, and search services powered by our search engine partners.

In the last quarter of 2013, we recorded an average of approximately 6.5 million installs each month. As of December 31, 2013, we had an installed base of approximately 3.8 million users, including 537,000 subscribers to our premium products. In addition, based on information received from Conduit, ClientConnect had an install base totaling 14.8 million users as of December 31, 2013. Included in our "installed base" are users who have our software installed on their computer on the measurement date. The length of use varies dramatically based on the product, whether the version of such product is the free version or the one for which users are required to pay, when the product was downloaded, and other factors. We believe our historical track record of our users accepting and utilizing the search properties we offer, as well as our history of converting registered users to purchasing customers, represents a convincing validation of our business strategy.

Prices and license fees for our products vary based on market, length of license period and whether the products are offered together. Our prices and fees range from less than \$5 to approximately \$40, with subscription periods varying between one month and one year. These prices are subject to market conditions and can vary in the currencies in which they are paid. Because a significant portion of our revenues come through other aggregators it is difficult for us to know whether and to what extent inflation or a fluctuation in foreign currency exchange rates have had a material effect on our revenues, and therefore we are limited in what we can do to address these potential risks.

**Recent Acquisitions**

The following acquisitions were accounted for by the acquisition method of accounting, and, accordingly, the purchase price was allocated to the assets acquired and liabilities assumed based on their respective fair values. The results of operations related to each acquisition are included in our consolidated statement of income from the date of acquisition.

On August 31, 2011, we completed the acquisition of Smilebox Inc., a Washington corporation, through our Delaware subsidiary, by way of a reverse triangular merger. Smilebox is an Internet photo sharing service available for the desktop and smart-phone, with an easy-to-use, downloadable desktop application that allows consumers to use personal photos and videos to construct unique creations, including: greeting cards, invitations, slideshows, scrapbooks and photo albums. The acquisition added another major product to our portfolio of products, significantly diversifying our revenue mix. We paid \$25 million, substantially in cash, at the closing, and an additional payment of \$7 million, substantially in cash, seven months after the closing.

On November 30, 2012, we completed the purchase of all the outstanding shares of SweetIM Ltd., a Belize company that wholly owns SweetIM Technologies Ltd., an Israeli consumer internet company ("SweetIM"). SweetIM produces a variety of free, fun, easy-to-use and safe applications and downloadable content for everyday use under the "SweetPacks" trade name. SweetIM generates a significant majority of its revenues through the Google AdSense program. We paid \$10 million in cash and 1.99 million of our ordinary shares at the closing. In June 2013, we paid \$2.7 million as a result of a working capital adjustment. A deferred payment of \$5.6 million in cash was paid in December 2013, and a contingent payment of up to \$7.5 million in cash is due in May 2014, if certain milestones are met. The milestones are based on our revenues in the fiscal year of 2013 and the absence of certain changes in the industry in which we operate. We believe that the terms of the Share Purchase Agreement will require us to pay \$2.5 million with respect to the contingent payment.

On January 2, 2014, we completed the purchase of all the outstanding shares of ClientConnect. On December 31, 2013, pursuant to a Split Agreement, Conduit transferred to ClientConnect the entire activities and operations, and related assets and liabilities, of its ClientConnect business on a cash-free and debt-free basis and the Conduit shareholders became the shareholders of ClientConnect in proportion to their ownership of Conduit. Upon the consummation of the ClientConnect Acquisition, each ClientConnect ordinary share was exchanged for approximately 0.2387 of our ordinary shares, as a result of which ClientConnect became a wholly owned subsidiary of ours. In addition, we granted options to purchase our ordinary shares to ClientConnect employees in exchange for their options to purchase ClientConnect shares that were issued to them upon the consummation of the Conduit Split as a roll-over of their then existing options to purchase ordinary shares of Conduit. Accordingly, we issued 54.75 million of our ordinary shares to the ClientConnect shareholders and granted options to purchase 2.82 million of our ordinary shares to the ClientConnect employees. Immediately, following the closing, we were owned approximately 81% by the former ClientConnect shareholders and option holders and 19% by our pre-closing shareholders and option holders, on a fully diluted basis (as determined by the treasury stock method, together with an adjustment for an assumed issuance of our ordinary shares at a reference price of \$10.49 per share based on the Black Scholes values of out-of-the-money Perion options and ClientConnect options). ClientConnect provides distribution, monetization and analytical services to software developers, distributors and publishers.

The financial statements included in this annual report do not reflect the ClientConnect business. However, we have included certain information about the ClientConnect business in this Item 5. In addition, shortly after filing this annual report, we expect to submit with the SEC a report on Form 6-K containing the audited consolidated statements of income, change in shareholders' equity and cash flows of ClientConnect for the years ended December 31, 2011, 2012 and 2013 and the audited consolidated balance sheets of ClientConnect as of December 31, 2012 and 2013, as well as pro forma combined financial data of Perion and ClientConnect as though the ClientConnect Acquisition were consummated on January 1, 2013.

Commencing in 2014, the ClientConnect Acquisition will be reflected in our financial statements as a reverse acquisition of all of our outstanding shares and options by ClientConnect in accordance with Accounting Standards Codification Topic 805, "Business Combinations" ("ASC 805"), using the acquisition method of accounting whereby ClientConnect will be deemed the accounting acquirer and we will be deemed accounting acquiree. In accordance with the ASC 805 presentation requirements, following the acquisition, our 2014 financial statements will include ClientConnect's comparative numbers, namely, consolidated balance sheets as of December 31, 2013, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for each of the two years in the period ended December 31, 2013.

### Revenues

We generate our revenues primarily from three major sources: (i) search generated revenues, (ii) sale of premium software products and solutions, and (iii) advertising and other. The following table shows our revenues by category (in thousands of U.S. dollars):

	<b>Year Ended December 31,</b>		
	<b>2011</b>	<b>2012</b>	<b>2013</b>
Search	\$ 25,466	\$ 38,061	\$ 59,038
Products	7,191	17,574	17,818
Advertising and Other	2,816	4,588	10,292
<b>Total revenues</b>	<b>\$ 35,473</b>	<b>\$ 60,223</b>	<b>\$ 87,148</b>

### ***Cost of Revenues***

Cost of revenues consists primarily of salaries and related expenses, license fees, amortization of acquired technology, amortization of capitalized research and development costs and payments for content and server maintenance, all related to our product revenues and communicating with our users. The direct cost relating to search and advertising revenues are immaterial. The number of employees included in the calculation of cost of goods sold was 14, 11, and 13 at the end of 2011, 2012 and 2013, respectively.

### ***Research and Development Expenses, net***

Our research and development expenses consist primarily of salaries and other personnel-related expenses for employees primarily engaged in research and development activities, allocated facilities costs, subcontractors and consulting fees. Our research and development expenditures in 2013 increased compared to the prior year but decreased as a percentage of sales. The increase was primarily due to costs associated with our continued mobile product development for Smilebox on the iPhone, IncrediMail for the iPad, iPhone and Android, which were released in 2013, and Guardiis, which is an application that enhances the speed and security of the browser. We expect this trend to continue in 2014, with our research and development costs continuing to increase in nominal dollars, while decreasing as a percentage of sales, as our sales continue to grow at an accelerated pace due largely to the ClientConect Acquisition. The nominal increase will enable us to continue to enrich our product pipeline going forward, particularly on mobile platforms. The number of employees in research and development were 69, 117, and 105 at the end of 2011, 2012 and 2013, respectively.

### ***Selling and Marketing Expenses***

Our selling and marketing expenses consist primarily of customer acquisition costs, as well as salaries and other personnel-related expenses for employees primarily engaged in marketing activities, allocated facilities costs, as well as other outsourced marketing activity. As part of our strategy to accelerate growth, we increased customer acquisition costs dramatically, both nominally and as a percentage of sales, every year since 2011 and expect to continue increasing the rate of investment in customer acquisition even further in 2014. With this investment we aim to increase the number of product downloads, users, search queries generated by those downloading our software or that of our partners, and subsequently, revenue from search, premium subscriptions and advertising. Customer acquisition costs were \$8.0 million, \$22.1 million and \$32.3 million in 2011, 2012 and 2013, respectively. The number of employees in sales and marketing was 32, 50, and 49 at the end of 2011, 2012 and 2013, respectively.

### ***General and Administrative Expenses ("G&A")***

Our general and administrative expenses consist primarily of salaries and other personnel-related expenses for executive and administrative personnel, allocated facilities costs, professional fees and other general corporate expenses. In order to facilitate our strategy for accelerated organic and non-organic growth, we continue to enhance our management team with experienced professionals capable of managing constant change and rapid organic and acquired growth. As a result, G&A expenses increased nominally in 2011, 2012 and in 2013. In each of those years, on a GAAP basis, G&A expenses also included significant direct acquisition expenses incurred in connection with the acquisitions made in those years. However, excluding acquisition-related expenses, as a percentage of sales, G&A in 2013 was at its lowest level since we went public in 2006. Looking forward, in 2014 we expect G&A expenses (excluding costs stemming from new acquisitions) to continue to increase nominally to accommodate our growth and meet our regulatory requirements without increasing as a percentage of sales. The number of employees in G&A was 24, 30, and 36 at the end of 2011, 2012 and 2013, respectively.

### ***Income Tax Expense***

For our Israeli operations we have elected to implement a tax incentive program pursuant to a 2011 Israeli tax reform, referred to as a "Preferred Enterprise", starting with our 2011 "preferred income", according to which a reduced tax rate of 15% is applied to our preferred income. A distribution from a Preferred Enterprise out of the preferred income would be subject to 15% withholding tax for Israeli-resident individuals and non-Israeli residents (subject to applicable treaty rates).

See Item 10.E "Taxation - Israeli Taxation - Law for the Encouragement of Capital Investments, 1959" and Item 8. "Financial Information - Consolidated Statements and Other Financial Information - Policy on Dividend Distribution" for more information about this program and the Company's dividend policy.

## Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operation are based on our financial statements, which have been prepared in conformity with U.S. GAAP. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We evaluate these estimates on an on-going basis. We base our estimates on our historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying amount values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. Under U.S. GAAP, when more than one accounting method or policy or its application is generally accepted, our management selects the accounting method or policy that it believes to be most appropriate in the specific circumstances. Our management considers some of these accounting policies to be critical.

A critical accounting policy is an accounting policy that management believes is both most important to the portrayal of our financial condition and results and requires management's most difficult subjective or complex judgment, often as a result of the need to make accounting estimates about the effect of matters that are inherently uncertain. While our significant accounting policies are discussed in Note 2 to our financial statements, we believe the following accounting policies to be critical:

### **Revenue recognition**

Search generated and other revenues from advertising, whether from keyword search, advertising on our website or in our email client, are recognized when we are entitled to receive the fee. Advertisers are charged and pay monthly, based on the number of clicks generated by users clicking on these ads. Persuasive evidence of an arrangement exists based upon a written agreement or purchase order with a search provider or display advertiser. Delivery occurs when an advertisement is offered by us and a user clicks on it in the case of a cost-per-click ("CPC") arrangement, or the requisite number of impressions are displayed pursuant to a cost-per-thousand impression ("CPM") arrangement, or when a user installs our software.

In accordance with ASC 605-50, "Customer Payments and Incentives", we account for cash consideration given to customers for which we do not receive a separately identifiable benefit or cannot reasonably estimate fair value as a reduction of revenue rather than as an expense.

Revenues from email software license sales are recognized when all criteria outlined in ASC 985-605, "Software – Revenue Recognition" are met. Such revenues are recognized when persuasive evidence of an agreement exists, delivery of the product has occurred, the fee is fixed or determinable and collectability is probable. For substantially all of our software arrangements, we evaluate each of these criteria as follows:

*Evidence of an arrangement:* We consider a clicking on "acceptance" of the agreement terms to be evidence of an arrangement.

*Delivery:* Delivery is considered to occur when the license key is sent via email to the customer or alternatively the customer is given access to download the licensed key.

*Fixed or determinable fee:* Fees are determinable at the time of sale. Customers are charged immediately through credit cards. In addition, the fees are subject to a refund policy period, currently up to 30 days.

*Collection is probable:* We are subject to a minimal amount of collection risk related to software sold to our customers as these are obtained through credit card sales.

Revenues from licensing of premium products are recognized over the term of the licensing period, which currently are either one month or one year. Until the end of 2011, we offered lifetime licenses for one of our premium products as well. While offered, our estimation of the lifetime usage of that product was six years, based on historical data collected. We no longer offer that service, offering all users who had purchased the service in the past to download to their local computer all the premium content previously included in the service. Any user that did not download the content may still contact us and receive a copy of the premium content. As the service has been terminated, that premium content collection is no longer updated, nor can it be accessed through our software. The balance of revenues previously deferred over the remaining lifetime of the service was truncated and recognized as revenues in the beginning of 2012.

The amount of revenues derived from multiple element arrangements is not material to our results of operations.

### ***Stock-Based Compensation***

We account for share-based payment awards made to employees, non-employees and directors in accordance with ASC 718, "Compensation – Stock Compensation", which requires the measurement and recognition of compensation expense based on estimated fair values. Determining the fair value of stock-based awards at the grant date requires the exercise of judgment, as well as the determination of the amount of stock-based awards that are expected to be forfeited. If actual forfeitures differ from our estimates, stock-based compensation expense and our results of operations would be impacted. Expense is generally recognized on a straight-line basis over the service period during which awards are expected to vest, except for awards with market or performance conditions, which are recognized using the accelerated method.

Total stock-based compensation expense recorded during 2013 was \$1.5 million, of which \$0.2 million was included in research and development costs, \$0.2 million in selling and marketing expenses and \$1.1 million in general and administrative expenses.

As of December 31, 2013, the maximum total compensation cost related to options and RSUs granted to employees, non-employees and directors not yet recognized amounted to \$4.8 million. This cost is expected to be recognized over a weighted average period of 2.4 years.

We estimate the fair value of standard stock options granted using the Binomial method option-pricing model and options with exercise that is subject to a stock price target using the Monte Carlo simulations. The option-pricing models require a number of assumptions, of which the most significant are expected stock price volatility and the expected option term. Expected stock price volatility was calculated based upon actual historical stock price movements over the most recent period ending on the grant date, equal to the expected option term. The expected option term was calculated based on our assumptions of early exercise multiples, which were calculated based on comparable companies, and a termination exit rate, which was calculated based on actual historical data. The expected option term represents the period that our stock options are expected to be outstanding. The risk-free interest rate is based on the yield from U.S. Treasury zero-coupon bonds with an equivalent term. The fair value of restricted stock awards is based on the market value of the underlying shares at the date of grant.

In November 2010, our board of directors changed our dividend policy so that we do not distribute any cash dividends.

### ***Taxes on Income***

We are subject to income taxes in Israel and the United States. Significant judgment is required in evaluating our uncertain tax positions and determining our provision for income taxes. Based on the guidance in ASC 740 "Income Taxes", we use a two-step approach to recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon settlement.

Although we believe we have adequately reserved for our uncertain tax positions, no assurance can be given that the final tax outcome of these matters will not be different. We adjust these reserves in light of changing facts and circumstances, such as the closing of a tax audit, the refinement of an estimate or changes in tax laws. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will impact the provision for income taxes in the period in which such determination is made. The provision for income taxes includes the impact of reserve provisions and changes to reserves that are considered appropriate. Interest is recorded within finance income, net.

Accounting for tax positions requires judgments, including estimating reserves for potential uncertainties. We also assess our ability to utilize tax attributes, including those in the form of carry forwards for which the benefits have already been reflected in the financial statements. We record valuation allowances for deferred tax assets that we believe are not more likely than not to be realized in future periods. While we believe the resulting tax balances as of December 31, 2013 are appropriately accounted for, the ultimate outcome of such matters could result in favorable or unfavorable adjustments to our consolidated financial statements and such adjustments could be material. See Note 10 of our consolidated financial statements for further information regarding income taxes. We have filed or are in the process of filing local and foreign tax returns that are subject to audit by the respective tax authorities. The amount of income tax we pay is subject to ongoing audits by the tax authorities, which often result in proposed assessments. In November 2013 we reached a settlement with the Israeli Tax Authorities regarding our corporate tax returns from the years 2009-2012. See Note 10 of our consolidated financial statements for further information regarding such settlement. We believe that we adequately provided for any reasonably foreseeable outcomes related to tax audits and settlement. However, our future results may include favorable or unfavorable adjustments to our estimated tax liabilities in the period the assessments are made or resolved, audits are closed or when statutes of limitation on potential assessments expire.

### ***Business combinations***

We account for business combinations following ASC 805 "Business Combinations", which requires that we allocate the purchase price of acquired companies to the tangible and intangible assets acquired and liabilities assumed, based on their estimated fair values. In addition, we expense acquisition-related expenses as they are incurred. We engage a third-party appraisal firm to assist management in determining the fair values of certain assets acquired and liabilities assumed. Such valuations require management to make significant estimates and assumptions, especially with respect to intangible assets.

Management makes estimates of fair value based upon assumptions it believes to be reasonable. These estimates are based on historical experience and information obtained from the management of the acquired companies and relevant market and industry data and are, inherently, uncertain. Critical estimates made in valuing certain of the intangible assets include, but are not limited to, the following: (i) future expected cash flows from license sales, maintenance agreements, customer contracts and acquired developed technologies and patents; (ii) the acquired company's brand and market position as well as assumptions about the period of time the acquired brand will continue to be used in the combined company's product portfolio; (iii) expected costs to develop the in-process research and development into commercially viable products and estimating cash flows from the projects when completed; and (iv) discount rates. Unanticipated events and circumstances may occur which may affect the accuracy or validity of such assumptions, estimates or actual results. Changes to these estimates, relating to circumstances that existed at the acquisition date, are recorded as an adjustment to goodwill during the purchase price allocation period (generally within one year of the acquisition date) and as operating expenses, if otherwise.

In connection with purchase price allocations, we estimate the fair value of the support obligations assumed in connection with acquisitions. The estimated fair value of the support obligations is determined utilizing a cost build-up approach. The cost build-up approach determines fair value by estimating the costs related to fulfilling the obligations plus a normal profit margin. The sum of the costs and operating profit approximates, in theory, the amount that we would be required to pay a third party to assume the support obligation. See Note 3 to our consolidated financial statements for additional information on accounting for our acquisitions in 2011 and 2012.

### ***Goodwill***

Goodwill is measured as the excess of the cost of acquisition over the sum of the amounts assigned to tangible and identifiable intangible assets acquired less liabilities assumed. We review goodwill for impairment annually in October each year, and whenever events or changes in circumstances indicate its carrying value may not be recoverable in accordance with ASC 350 "Intangibles – Goodwill and other". Goodwill impairment is deemed to exist if the carrying value of a reporting unit exceeds its fair value. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, then we would record an impairment loss equal to the difference.

We operate in one operating segment, and this segment comprises our only reporting unit. In calculating the fair value of the reporting unit, we used our market equity capitalization.

If the carrying value of a reporting unit exceeds its fair value, we then calculate the goodwill's implied fair value by performing a hypothetical allocation of the reporting unit's fair value to the underlying assets and liabilities, with the residual being the implied fair value of goodwill. This allocation process involves using significant estimates, including estimates of future cash flows, future short-term and long-term growth rates, weighted average cost of capital and assumptions about the future deployment of the long-lived assets of the reporting unit. Other factors we consider are the brand awareness and the market position of the reporting unit and assumptions about the period of time we will continue to use the brand in our product portfolio. If these estimates or their related assumptions change in the future, we may be required to record impairment charges for our goodwill.

Our most recent annual goodwill impairment analysis, which was performed in 2013, did not result in impairment. As of December 31, 2013, our market capitalization was significantly higher than our equity book value.

### Impairment of Long-Lived Assets

We are required to assess the impairment of tangible and intangible long-lived assets subject to amortization, under ASC 360 "Property, Plant and Equipment", on a periodic basis and when events or changes in circumstances indicate that the carrying value may not be recoverable. Impairment indicators include any significant changes in the manner of our use of the assets or the strategy of our overall business, significant negative industry or economic trends and significant decline in our share price for a sustained period.

Upon determination that the carrying value of a long-lived asset may not be recoverable based upon a comparison of aggregate undiscounted projected future cash flows from the use of the asset or asset group to the carrying amount of the asset, an impairment charge is recorded for the excess of carrying amount over the fair value. We measure fair value using discounted projected future cash flows. We base our fair value estimates on assumptions we believe to be reasonable, but these estimates are unpredictable and inherently uncertain. If these estimates or their related assumptions change in the future, we may be required to record impairment charges for our tangible and intangible long-lived assets subject to amortization. No impairment charges were recognized during 2011, 2012, or 2013.

### Research and Development Expenses, Net

Research and development costs incurred in the process of software development before establishment of technological feasibility are charged to expenses as incurred. Costs of the production of a detailed program design incurred subsequent to the establishment of technological feasibility are capitalized. Based on our product development process, technological feasibility is established upon completion of a detailed program design.

Capitalized software development costs are amortized commencing with general product release by the straight-line method over the estimated useful life of the software product.

At each balance sheet date, we assess the recoverability of this intangible asset by comparing the unamortized capitalized software costs to the net realizable value on a product by product basis. Should the amount of the unamortized capitalized costs of a computer software product exceed the net realizable value, these products will be written down by the excess amount.

### Results of Operations

The following table sets forth, for the periods indicated, our statements of operations expressed as a percentage of total revenues (the percentages may not equal 100% because of the effects of rounding):

	Year Ended December 31,		
	2011	2012	2013
<b>Revenues:</b>			
Search	72%	63%	68%
Products	20	29	20
Advertising and Other	8	8	12
Total revenues	100%	100%	100%
Cost of revenues	8	9	13
<b>Gross profit</b>	<b>92</b>	<b>91</b>	<b>87</b>
Operating expenses			
Research and development, net	21	18	15
Selling and marketing	37	49	50
General and administrative	22	14	17
Total operating expenses	80	81	82
<b>Operating income</b>	<b>12</b>	<b>10</b>	<b>4</b>
Financial income (expense), net	4	0	(1)
<b>Income before taxes on income</b>	<b>16</b>	<b>10</b>	<b>3</b>
Income tax expense	-	4	3
<b>Net income</b>	<b>16%</b>	<b>6%</b>	<b>0%</b>

As shown in the above table, our operations are generally characterized by high gross profit margins, which are attributable mainly to two factors: (i) we do not have manufacturing costs for our products, and (ii) our search generated revenues have virtually no direct cost associated with them. Starting in the second half of 2011, we dramatically increased our investment in customer acquisition costs to fuel future growth. These expenses increased from \$8.1 million in 2011 to \$22.1 million in 2012 to \$32.3 million in 2013. This was the primary reason for the increase in selling and marketing expenses in 2012, both nominally and as a percentage of sales, resulting in lower operating and net income margins in 2012 and 2013. We expect to further increase our customer acquisition costs in 2014, increasing our sales and marketing expenses, both nominally and as a percentage of sales. In addition, general and administrative expenses included expenses related to the acquisition of subsidiaries of \$1.1 million, \$2.1 million and \$6.2 million in 2011, 2012 and 2013, respectively. However, as a result of these acquisitions, we expect increased revenues and improved operating margins in 2014.



*Year Ended December 31, 2013 Compared to Year Ended December 31, 2012*

*Revenues.* Revenues increased by 45% in 2013, from \$60.2 million in 2012 to \$87.1 million in 2013. This increase was a result of increases in each of our revenue streams, as discussed below:

*Search revenues.* Search revenues increased by 55% in 2013, from \$38.1 million in 2012 to \$59.0 million in 2013. This increase was due to an increase in the number of downloads and subsequently the number of users using our search service. This increase was due to organic growth, as well as the acquisition in the latter part of 2012 of SweetIM's activity, which too was based on search generated revenues and which has since been fully integrated into our business. We offer our search service in conjunction with our products, including our toolbars, powered primarily by Google, Microsoft and Ask. Search revenues included revenues derived from the Conduit Commercial Agreement between Perion and Conduit entered into in August 2013. Sales generated by us under the agreement were \$7.1 million in the period of August-October 2013 and \$10.8 million during the period of November-December 2013. The direct customer acquisition costs ("CAC") associated with those revenues were \$6.6 million and \$7.7 million in those periods, respectively. Due to the proximity in time of the ClientConnect Acquisition and the signing of the Conduit Commercial Agreement and the nature of the transactions, we recorded the effect of the Conduit Commercial Agreement on a net basis. Accordingly, with regard to the activity during the period of August-October 2013, \$0.5 million was recognized as search revenues on our 2013 statement of income. The net effect of the transactions with Conduit under the Conduit Commercial Agreement during November-December 2013 of \$3.1 million, which was not recognized as revenue on a consolidated basis in light of the closing of the ClientConnect Acquisition in the beginning of January 2014, is reflected as deferred revenues on our balance sheet as of December 31, 2013. Based on reports received from Conduit, the revenues of the ClientConnect business in 2013 were \$325.5 million, most of which were from search. As a result, we expect our search revenues to increase significantly in 2014 and to continue to be the main source of our revenues.

*Product revenues.* Product revenues increased a nominal 1% in 2013, from \$17.6 million in 2012 to \$17.8 million in 2013.

*Advertising and Other revenues.* Advertising and other revenues increased 124% in 2013, from \$4.6 million in 2012 to \$10.3 million in 2013. This increase is attributable to increased distribution of display advertising in conjunction with software of our partners and offering of our homepage, which includes display advertising, and the subsequent acceptance of this offer by our users. We believe these revenues will continue to increase in 2014 as our distribution increases. In the ClientConnect business, advertising and other revenues accounted for 15% of revenues in 2013 and is increasing, and therefore we expect this too will contribute to the expected increase in this revenue stream in 2014.

*Cost of revenues.* Cost of revenues in 2013 was \$11.4 million, as compared to \$5.2 million in 2012. Amortization of intangible assets increased by \$5.9 million due to the acquisition of SweetIM in 2012. The increase in amortization expenses caused a decrease in gross profit margin from 91% in 2012 to 87% in 2013. As we expect revenues to grow significantly in 2014 as a result of the acquisition of ClientConnect, without a proportionate increase in the cost of revenues, we expect the gross profit margin to increase and be above 90%.

*Research and development expenses, net ("R&D").* R&D increased by \$2.7 million in 2013, from \$10.7 million in 2012 to \$13.4 million in 2013, decreasing as a percentage of sales from 18% in 2012 to 15% in 2013. The increase was as a result of our investing in enriching our product pipeline in 2013, primarily by making our products available on mobile platforms. In 2013, we continued to invest in the mobile version of Smilebox, released Molto, a mobile version of our email product for the iPad, iPhone and Android platform, and created Guardius for enhancing the user browser experience. Based on reports received from Conduit, the R&D expenses of the ClientConnect business in 2013 were \$22.4 million, including \$18.3 million related to the Conduit business not acquired by us. In 2014 we intend to develop analytical tools to service mobile applications as ClientConnect services desktop software developers. In addition, we plan on developing tools and platforms to enhance our ability to increase advertising revenues, independent of our search offering. As a result, we expect the R&D expenditure to continue and increase nominally although decrease as a percentage of sales.

*Selling and marketing expenses.* Selling and marketing expenses increased 47%, from \$29.5 million in 2012 to \$43.4 million in 2013. This increase was primarily attributable to the increased investment in customer acquisition costs, which increased from \$22.1 million in 2012 to \$32.3 million in 2013. This increase does not include the \$14.3 million of customer acquisition costs associated with revenues from our Commercial Agreement with Conduit and netted from revenues. Based on reports received from Conduit, in 2013 the ClientConnect business had \$185.4 million in customer acquisition costs, including \$18.0 million incurred in connection with the Conduit Commercial Agreement. We therefore expect this expense to increase significantly in 2014, even as a percentage of sales, to fuel future growth. At the same time, we continue to condition this investment on a positive return on investment ("RoI") within one year, and to the extent we cannot maintain a positive RoI, we may curtail this expenditure. In addition, other marketing expenses increased by \$3.6 million, or 48%, primarily due to personnel costs incurred by increasing the size of our marketing department as we added the SweetIM marketing department in 2013 and amortization of acquisition-related intangible assets. Based on reports received from Conduit, in 2013 the ClientConnect business had other sales and marketing expenses of \$10.3 million, including \$9.1 million related to the Conduit business not acquired by us. We expect these expenses, excluding the customer acquisition costs, to grow only nominally from the level established in 2013, while decreasing as a percentage of sales.

*General and administrative expenses ("G&A").* G&A increased from \$8.6 million in 2012, to \$15.1 in 2013. This increase was primarily due to costs associated with the acquisition of companies in 2013, which increased by \$4.0 million, compared to those expenses in the previous year. G&A expenses from organic operations in 2013 increased by \$2.5 million and were equal to 10% of sales, compared to 11% in 2012. Based on reports received from Conduit, in 2013 the ClientConnect business had \$19.1 million in G&A expenses, including \$6.5 million related to the Conduit business not acquired by us. With the exception of costs that could be incurred in connection with future acquisitions, although we expect G&A cash expenses to increase nominally, we expect these cash expenses to decrease as a percentage of sales in 2014.

*Taxes on Income.* Income tax in 2013 was \$2.3 million, compared to \$2.5 million in 2012. While nominally taxes on income declined, the effective income tax rate increased primarily as a result of the significant increase in expenses not deductible for tax purposes in 2013, particularly \$6.2 million of acquisition-related costs and \$1.5 million in employee stock-based compensation. Based on reports received from Conduit, in 2013 the ClientConnect business had tax expenses of \$22.6 million and an effective tax rate of 27%.

*Net Income.* Net income in 2013 was \$0.3 million, compared to \$3.5 million in 2012. As described above, this decrease was primarily a result of an increase of \$4.0 million in acquisition-related costs that did not contribute to the current operations. Based on reports received from Conduit, in 2013 the ClientConnect business had \$28.6 million in net income.

#### ***Year Ended December 31, 2012 Compared to Year Ended December 31, 2011***

*Revenues.* Revenues increased by 70% in 2012, from \$35.5 million in 2011 to \$60.2 million in 2012. This increase was a result of increases in each of our revenue streams, as discussed below:

*Search revenues.* Search revenues increased by 49% in 2012, from \$25.5 million in 2011 to \$38.1 million in 2012. This increase was due to an increase in the number of downloads and subsequently the number of users using our search service. We offer our search service in conjunction with our products and toolbar, with Google powering the search service for substantially all our users in such years. In addition, our SweetIM acquisition contributed one month of search revenues from the acquired company in 2012.

*Products revenues.* Product revenues increased by 144% in 2012, from \$7.2 million in 2011 to \$17.6 million in 2012. This increase was primarily attributable to the addition of Smilebox to our product portfolio in September 2011, and the subsequent growth in sales of our Smilebox product. Revenues from our Smilebox product in 2012 were \$11.6 million, compared to \$2.2 million in 2011. IncredIMail product revenues increased by \$1.0 million in 2012, as a result of our discontinuing the Gold Gallery Lifetime subscription.

*Advertising and Other revenues.* Advertising and other revenues increased 63% in 2012, from \$2.8 million in 2011 to \$4.6 million in 2012. This increase is attributable to increased distribution of our software and to the offering of our homepage, which includes display advertising, and the subsequent acceptance of this offer by our users.

*Cost of revenues.* Cost of revenues in 2012 was \$5.2 million, as compared to \$2.8 million in 2011. Amortization of intangible assets increased by \$1.2 million due to the acquisition of SweetIM, and the balance was due to the inclusion of Smilebox for a full year in 2012 and additional infrastructure costs. The increase in amortization expenses stemming from the SweetIM acquisition caused a slight decrease in gross profit margin from 92% in 2011, to 91% in 2012.

*Research and development expenses, net ("R&D").* R&D increased by \$3.2 million in 2012, from \$7.5 million in 2011 to \$10.7 million in 2012, decreasing as a percentage of sales from 21% in 2011 to 18% in 2012. The increase was as a result of our investing in enriching our product pipeline in 2012, primarily by making our products available on mobile platforms. A mobile version of our Smilebox product, available for the iPhone, was announced in the third quarter of 2011 and already has accumulated over 1 million downloads.

*Selling and marketing expenses.* Selling and marketing expenses more than doubled, from \$13.0 million in 2011 to \$29.5 million in 2012. This increase was primarily attributable to the increased investment in customer acquisition costs, which increased from \$8.0 million in 2011 to \$22.1 million in 2012. This increase reflects a ramping up of these expenses all through 2012, reaching \$9.7 million in the fourth quarter of 2012. In addition, marketing expenses increased due to personnel costs incurred by increasing the size of our marketing department as we added the Smilebox marketing department in 2012.

*General and administrative expenses ("G&A").* G&A increased from \$7.6 million in 2011 to \$8.6 million in 2012. This increase was primarily due to costs associated with the acquisition of subsidiaries in 2012, compared to the previous year. G&A expenses from organic operations in 2012 were at a level similar to that of 2011. As a result, and even after the increased in acquisition expenses, G&A as a percentage of sales decreased from 22% in 2011 to 14% in 2012.

*Taxes on Income.* Income tax in 2012 was \$2.5 million, compared to \$0.2 million in 2011. The increase in income tax was primarily a result of a number of tax credits received in 2011 with respect to past years, a tax refund due to the settlement of a tax audit with the Israeli tax authorities and the discontinuation of our dividend distribution policy. In 2012, we did not benefit from these credits, and while our maximum statutory tax rate was 25%, we suffered from non-recurring tax expenses which, coupled with an increase in non-deductible expenses, caused an effective tax rate of 41%.

*Net Income.* Net income in 2012 was \$3.5 million, compared to \$5.7 million in 2011. As described above, this decrease was primarily a result of the \$14.0 million increase in customer acquisition costs, the nominal increases in other operating expenses and the \$2.3 million increase in tax expenses, partially offset by increased profits from the increase in revenues.

## **B. LIQUIDITY AND CAPITAL RESOURCES**

As of December 31, 2013, our working capital was a negative \$2.9 million, consisting of approximately \$47.6 million in current assets, less \$50.4 million in current liabilities, which included \$9.1 million in deferred revenues. As of December 31, 2012, our working capital was a negative \$4.3 million, consisting of approximately \$47.7 million in current assets, less \$52.0 million in current liabilities, which included \$5.1 million in deferred revenues. The increase in working capital was primarily due to trade accounts receivable, less trade accounts payable and accrued expenses increasing \$3.0 million as a result of our higher level of activity, partially offset by other net liabilities. Based on reports received from Conduit, as of December 31, 2013 the ClientConnect business had negative working capital of \$19.7 million, consisting of approximately \$1.3 million in current assets, less \$21.0 million in current liabilities, which included a \$10.8 million payable to Perion in connection with the Conduit Commercial Agreement. Pursuant to the terms of the ClientConnect Acquisition, Conduit agreed to provide ClientConnect a short-term working capital loan of up to \$20 million, as described below under " – Credit Facilities".

As of December 31, 2013, we had cash and cash equivalents of \$23.4 million and bank loans outstanding totaling \$6.6 million to be paid over the next two to three years, including \$4.3 million classified as long term debt and \$2.3 million with current maturities.

We believe that our cash balances and cash generated from operations, including the operations of the ClientConnect business, together with the working capital loan from Conduit, will be sufficient to meet our anticipated cash requirements for operations, as well as our deferred acquisition payments, for at least the next 12 months.

*Net Cash Provided By Operating Activities.* Net cash provided by operating activities was \$7.0 million, \$16.3 million and \$15.9 million for 2011, 2012 and 2013, respectively. The decrease in cash provided by operating activities in 2013 was primarily a result of net income, net of non-cash expenses increasing by \$5.2 million in 2013, compared to 2012, while non-cash net change in operating assets and liabilities increased in 2013 by \$2.5 million, as compared to an \$8.1 million increase in non-cash net change in operating assets and liabilities in 2012.

*Net Cash Used In Investing Activities.* Net cash used in investing activities was \$8.0 million, \$8.1 million and \$2.5 million in 2011, 2012 and 2013, respectively. While in 2011 and 2012 the cash used in investing activities was primarily a result of the acquisition of Smilebox and SweetIM, respectively, in 2013 the cash used in investing activities was primarily a result of \$1.6 million invested in capitalized software (compared to \$0.8 million invested in capitalized software in 2011 and 2012) and \$0.7 million invested in property and equipment.

*Net Cash Provided by (Used In) Financing Activities.* Net cash provided by (used in) financing activities was (\$3.9) million, \$2.3 million and \$11.8 million in 2011, 2012 and 2013, respectively. In 2011, the cash was used primarily for the payment of dividends to shareholders, and since that time we have discontinued our policy of paying dividends to our shareholders. In 2012, the cash was provided by a bank loan, less payments already made on account, providing net cash of \$8.9 million, less \$6.6 million deferred payment for acquisitions. In 2013, the cash was used for payments made for the SweetIM acquisition in an amount of \$9.5 million in addition to \$2.3 million paid on account of the bank loan received.

#### *Credit Facilities*

In September 2011, we entered into an agreement with each of Bank Leumi Le-Israel ("Leumi") and First International Bank of Israel ("FIBI"), to secure a credit facility for up to a total of \$20 million of financing. During the second quarter of 2012, we amended both agreements, and reduced the amount of each credit facility, to \$6 million provided by Leumi, and \$4 million by FIBI. In December 2013, we further amended the agreement with FIBI to remove one of the financial covenants. The repayment of the debt is structured over four and five years from the respective draw date, and we have an option under each agreement for early repayment.

In order to secure our obligations to the banks, we granted to the banks a first priority floating charge on all of our assets and a first priority fixed charge on certain other immaterial assets (namely, rights for unpaid shares, securities and other deposits deposited with the banks from time to time, and rights for property insurance). The pledge agreements contain a number of customary restrictive terms and covenants that limit our operating flexibility, such as (1) limitations on the creation of additional liens, on the incurrence of indebtedness, on the provision of loans and guarantees and on distribution of dividends and (2) the ability of the banks to accelerate repayment in certain events, such as breach of covenants and liquidation events. Such provisions may hinder our future operations or the manner in which we operate our business, which could have a material adverse effect on our business, financial condition or results of operations.

On December 31, 2013, Conduit and ClientConnect entered into the Working Capital Financing Agreement pursuant to which Conduit undertook to make available to ClientConnect a credit line of up to \$20 million. Any amounts withdrawn under the credit line are required to be used solely to finance payment related to the then-current working capital needs of the ClientConnect business. The outstanding principal amount under the credit line bears interest at the annual rate prescribed by Section 3(j) of the Tax Ordinance (currently 4.1% per annum). As of March 31, 2014, ClientConnect has borrowed \$12.5 million under the credit line. The credit line matures in April 2014.

#### **C. RESEARCH, DEVELOPMENT, PATENTS AND LICENSES, ETC.**

Our research and development activities are conducted internally by a 105 person research and development staff.

Research and development expenses, net were \$7.5 million, \$10.7 million and \$13.4 million in the years ended December 31, 2011, 2012 and 2013, respectively. In 2013, our efforts were focused on developing the back-end systems required for tracking the usage of our products and their monetization, as well as continued development of additional mobile versions for our photo sharing product Smilebox, available on the iPhone, as well as the mobile version of our IncrediMail-Molto email client, introduced in the first quarter of 2013, available on iPhone, iPad and Android platforms. In 2014 we plan on focusing our research and development efforts on creating distribution, monetization and analytical services for mobile platforms, as well as tools for increasing advertising revenues.

For a discussion of our intellectual property and how we protect it, see "Business Overview—Intellectual Property" under Item 4.B above.

#### **D. TREND INFORMATION**

*Industry trends expected to affect our revenues, income from continuing operations, profitability and liquidity or capital resources:*

1. In recent months the browser companies, particularly Google's Chrome, as well as other browsers, have been instituting policy changes and regulations making it increasingly difficult to change a browser's settings, including the ability to change a browser's default search settings. Changing such settings has been a major part of the Company's monetization model and until now we have been successful in overcoming these measures; however, it is becoming increasingly difficult to do so. In connection with these efforts by the browser companies, they are also making an effort to reset the applicable browser's settings back to its default setting, causing us to have to recapture our users on a more concurrent basis. These activities have shortened the average lifetime we see from users utilizing our search settings. This has reduced the return on investment from our marketing and distribution efforts, although we believe that they remain sufficiently high for us to grow this part of our business.
2. New regulations governing the ability to download software from the major software depositories such as the Google Store have limited our ability to bundle toolbars and other services with the other software. Until this time, we have been successful in working around these restrictions, but this has negatively affected our distribution to some degree and caused us to find work-arounds and ways for us and our software developer partners to offer and download software from alternative sites.
3. The browsers and certain software depositories have restricted the ability to download multipurpose toolbars. As such, we currently do not distribute toolbars for those browsers and through those venues and currently are not offering toolbars to new users.
4. In 2013, Google continued to institute further changes to its search partner policies, changing the way Google's partners (such as Perion) acquire and retain customers. Although these changes aim to improve the user experience (which is a goal that we share), they reduced our return on investment and we currently do not foresee it rebounding in the near future. In addition, we see these changes having long-term effects on the search market. We believe that our acquisition of ClientConnect has offered a viable alternative to the relationship with Google, due to its special relationship with Microsoft, including a less restrictive policy environment. In addition, our newly attained larger size strengthens our bargaining position in negotiating with the search engine companies. Although we have attained a certain advantage of size and while we have increased our search engine alternatives, the limited number of relevant search engine alternatives limits our marketing abilities, and as a result reduced the return on investment from our marketing efforts. In addition, these policies have limited our ability to partner with software developers and distributors that are non-compliant with the new policies, thereby restricting our ability to grow our business at the pace we have been accustomed to in past years.
5. To address the multiple threats and changes regarding the long-term ability to grow search generated revenues, we are investing internal development efforts as well as focusing some of our acquisition efforts towards creating and acquiring tools and systems that would enable us to leverage the data we accumulate and offer more focused advertisements to users, thereby creating an alternative revenue generation model independent of search generated revenue.
6. There has been a growing usage of portable platforms, including smartphones and tablets, enabling users to enjoy a more graphic and creative experience without a PC, and we believe that mobile platform distribution has already surpassed that of the desktop. This trend is most prominently represented by the popularity of the iPhone and its Android mobile platforms, as well as with the popular iPad and Android tablets. Although this trend is attracting an increasing portion of the market, we believe that the monetization of mobile platforms still lags significantly behind and desktop monetization is still far greater than that for mobile platforms. However, in order to address the trend and what we believe to be the inevitability of increased monetization of mobile platforms, we are investing internally and focusing our acquisition efforts on acquiring technologies enabling us to offer our services on mobile platforms and eventually generate revenues from these services.

For more information on uncertainties, demands, commitments or events that are reasonably likely to have a material effect on our business, see Item 3 "Key Information—Risk Factors."

For additional trend information see the discussion in "Item 5.A Operating and Financial Review and Prospects – Operating Results."

**E. OFF-BALANCE SHEET ARRANGEMENTS**

We do not have off-balance sheet arrangements (as such term is defined by applicable SEC regulations) that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial conditions, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors.

**F. TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS**

The following table summarizes our contractual commitments as of December 31, 2013 and the effect those commitments are expected to have on our liquidity and cash flow in future periods.

Contractual Commitments as of December 31, 2013	Payments Due by Period (U.S. dollars in thousands)				
	Total	Less than 1 year	1-3 Years	3-5 Years	More than 5 Years
Long-term debt, including current portion(*)	\$ 6,550	\$ 2,300	\$ 4,250	-	-
Accrued severance pay(**)	1,093	-	-	-	\$ 1,093
Uncertain income tax positions(***)	574	-	-	-	-
Contingent consideration(****)	7,500	7,500	-	-	-
Operating leases	1,929	1,260	669	-	-
<b>Total</b>	<b>\$ 17,646</b>	<b>\$ 11,060</b>	<b>\$ 4,919</b>	<b>-</b>	<b>\$ 1,093</b>

(\*) Long-term debt obligations represent repayment of principal and do not include interest payments due thereunder.

(\*\*) Severance pay obligations to our Israeli employees, as required under Israeli labor law and as set forth in employment agreements, are payable only upon termination, retirement or death of the respective employee and are for the most part covered by ongoing payments to funds to cover such obligations. Of this amount, only \$ 221 is unfunded.

(\*\*\*) Uncertain income tax positions are due upon settlement and we are unable to reasonably estimate the ultimate amount or timing of settlement. See Note 10i to our consolidated financial statements for further information.

(\*\*\*\*) Contingent consideration represents the maximum cash payments we will be obligated to make under contingent consideration arrangements with former owners of certain entities we acquired if specified conditions are satisfied.

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

A. DIRECTORS AND SENIOR MANAGEMENT

The following table sets forth information regarding our executive officers and directors as of April 3, 2014:

Name	Age	Position
Tamar Gottlieb <sup>*(3) (4)</sup>	57	Chairperson of the Board
Iris Beck <sup>*(2)</sup>	48	Director
Dror Erez <sup>(3)</sup>	45	Director
Alan Gelman <sup>*(1)</sup>	58	Director
Roy Gen <sup>(4)</sup>	42	Director
David Jutkowitz <sup>*(1)(2)(3) (4)</sup>	63	External Director
Avichay Nissenbaum <sup>*(1)(2)(4)</sup>	47	External Director
Josef Mandelbaum	47	Chief Executive Officer
Yacov Kaufman	56	Chief Financial Officer
Limor Gershoni Levy	43	Senior Vice President, General Counsel
Shai Gottesdiener	37	Chief Technology Officer
Yuval Hamudot	40	General Manager, Consumer Product Division
Dana Maor	47	Senior Vice President, Human Resources
Tomer Pascal	35	General Manager, Utilities
Josh Wine	39	President
Mark Ziering	47	Senior Vice President, Corporate Development

\* "Independent" under the NASDAQ Listing Rules.

- (1) Member of the audit committee.
- (2) Member of the compensation committee.
- (3) Member of the nominating and governance committee.
- (4) Member of the investment committee.

There are no arrangements or understandings between any of our directors or executive officers and any other person pursuant to which our directors or executive officers were selected.

*Tamar Gottlieb* has been a director of the Company since 2001 and has served as the Chairperson of the Company's board of directors since the Company's initial public offering in February 2006. Since January 2001, Ms. Gottlieb has served as a Managing Director of Harvest Capital Markets Ltd., an investment banking and financial consulting firm that she founded in January 2001. Prior to 2001, Ms. Gottlieb served as either a managing director or a senior manager at several investment banking institutions, including Investec Clali – Management & Underwriting Ltd. (July 1997 to January 2001), Oscar Gruss (1996) Ltd. (February 1996 to May 1997) and Leumi & Co. Investment Bankers Ltd. (1980 to 1991). From 1991 to 1994, Ms. Gottlieb served as the Founding Managing Director of Maalot – The Israeli Securities Rating Company Ltd., Israel's first credit rating agency. Ms. Gottlieb currently serves as a board member of several Israeli public and private companies, including Albaad Massuot Yitzhak Ltd. (TASE: ALBA), Carasso Motors Ltd. (TASE: CRSO), IDB Development Corporation Ltd. and Reit 1 Ltd. (TASE: RIT1). Ms. Gottlieb has also served as a director of other companies, including El Al Israeli Airlines Ltd. (TASE: ELAL) and "Dan" Public Transportation Company Ltd. Ms. Gottlieb holds a B.A. in International Relations from the Hebrew University of Jerusalem and an M.A. in Economics from Indiana University.

*Iris Beck* has been a director of the Company since November 2011. Since April 2013, she serves as Senior Vice President, Corporate Communications Officer of Teva Pharmaceutical Industries Ltd. From 2008 to 2012, Ms. Beck served as the Chief Executive Officer of McCann Erickson Israel. From 2002 to 2008, she served as the Chief Marketing Officer of Partner Communications Company Ltd. (NASDAQ and TASE: PTNR), and from 2001 to 2002 she served as the Chief Executive Officer of Unilever Israel Ltd. Ms. Beck serves as a director of Golf and Co Israel. Ms. Beck holds a B.A. in Economic Science from Haifa University and an M.B.A. from Bar Ilan University.

*Dror Erez* has been a director of the Company since January 2014. In 2005, Mr. Erez co-founded Conduit and has served as its Chief Technology Officer until January 2014, when he became Conduit's President. Mr. Erez is also a member of the Conduit board of directors. Prior to founding Conduit, he served in various executive roles in private technology companies. He holds a B.A. in Physics and Computer Science from Bar Ilan University.

*Alan Gelman* has been a director of the Company since August 2011. He also serves as a director of Ion Asset Management Ltd. From December 2012 through May 2013, he served as the Global CFO and Deputy CEO of Better Place Inc., (in liquidation). From 2008 to 2012, Mr. Gelman served as the Chief Financial Officer and Deputy Chief Executive Officer of Bezeq the Israeli Telecommunication Corp Ltd. (TASE: BEZQ). From 2006 to 2007, Mr. Gelman served in various positions at the Delek Group Ltd. (TASE: DELKG), including as the Deputy CEO and Chief Financial Officer from 2006 to 2007. From 2001 to 2006, Mr. Gelman served as the Chief Financial Officer of Partner Communications Company Ltd. (NASDAQ and TASE: PTNR), and from 1997 to 2000, he served as the Chief Financial Officer of Barak ITC. He holds a B.A. in Accounting from Queens College and an M.B.A. from Hofstra University. Mr. Gelman is licensed as a Certified Public Accountant in New York (inactive) and in Israel.

*Roy Gen* has been a director of the Company since January 2014. Since 2008, he serves as the Chief Financial Officer of Conduit. Prior to joining Conduit, Mr. Gen served in various executive roles in private technology companies. He is an Israeli Certified Public Accountant and holds a B.A. in Economics and Accounting from Tel Aviv University, as well as an M.B.A. from the Recanati School of Business Administration at Tel Aviv University.

*David Jutkowitz* has been an external director of the Company since December 2007, and in January 2011, he was reelected to serve a third three year term. Mr. Jutkowitz serves as a director of Extal Ltd., and of King Engine Bearings Ltd. From 2006 to 2010, Mr. Jutkowitz served as a director of Arad Investment and Industrial Development Ltd. (TASE: ARAD), and from 2001 to October 2007, Mr. Jutkowitz served as an external director of Carmel Investment Group Ltd., and as a member of the audit, investment and portfolio committees of Carmel Investment Group Ltd. From 2000 to 2003, Mr. Jutkowitz served as the Chief Executive Officer of BXS Ltd. From 1995 to 2002, Mr. Jutkowitz served as the Chief Executive Officer of E.L. Advanced Science Ltd. From 1976 to 2001, Mr. Jutkowitz served as the Chief Financial Officer of Etz Lavud Ltd.

*Avichay Nissenbaum* has been an external director of the Company since July 2009, and in September 2012, he was reelected to serve a second three year term. In 2012, Mr. Nissenbaum co-founded Lool Ventures L.P. and has since served as its general partner. In 2006, Mr. Nissenbaum co-founded Yedda, Inc., which was acquired by AOL, Inc. (NYSE: AOL) in November 2007. He served as Yedda's Chief Executive Officer from 2006 to 2011. In 1996, Mr. Nissenbaum co-founded SmarTeam Corporation Ltd., which was acquired by Dassault Systems, S.A. in 1999. From 1996 to 2005, Mr. Nissenbaum served in various positions at SmarTeam, including as VP Product, Executive VP Sales, Marketing and Business Development. Mr. Nissenbaum serves as a director of Winbuyer Ltd. and Tipa-Corp Ltd., as well as certain portfolio companies of Lool Ventures, including Zooz Ltd., Familio Technologies Ltd., Online Permission Technologies and SharePops. Mr. Nissenbaum also serves as a director of "leaders of the Future" NPO. Mr. Nissenbaum holds a B.Sc. in Computer Science and a B.A. in Economics, both from Bar-Ilan University.

*Josef Mandelbaum* has been the Chief Executive Officer of the Company since July 2010 and served as a director from January 2011 to January 2014. From 1998 to 2010, Mr. Mandelbaum served in various positions at American Greetings Corporation (NYSE: AM), including as Chief Executive Officer of the AG Intellectual Properties group, from 2000 to 2010 and as Senior Vice President of the Sales and Business Development of the AG Interactive group, from 1998 to 2000. Mr. Mandelbaum holds a B.A. in Economics from Yeshiva University and an M.B.A. from the Weatherhead School of Management at Case Western Reserve University.

*Yacov Kaufman* has been the Chief Financial Officer of the Company since November 2005. From 1996 to November 2005, Mr. Kaufman served as the Chief Financial Officer of Acorn Energy Inc. (formerly Data Systems & Software Inc., NASDAQ: ACFN). From 1986 to 1996, Mr. Kaufman served in various positions at dsIT Technologies Ltd., a subsidiary of Acorn, including as its Chief Financial Officer, from 1990 to 1996, and as its comptroller, from 1986 to 1990. From 1993 to 1999, Mr. Kaufman served as a director of Tower Semiconductor Ltd. (NASDAQ: TSEM). Mr. Kaufman is an Israeli Certified Public Accountant and holds a B.A. in Accounting and Economics from the Hebrew University of Jerusalem and an M.B.A. in Business Finance from Bar-Ilan University.

*Limor Gershoni Levy* has been the Senior Vice President, General Counsel and Corporate Secretary of the Company since January 2011. From 2003 to 2010, Ms. Gershoni Levy served as General Legal Counsel at Veraz Networks Inc., a company which was listed on NASDAQ (VRAZ) prior to its merger in 2010 with Dialogic Inc. (NASDAQ: DLGC). From 2000 to 2003, Ms. Gershoni-Levy served as the General Counsel at Medigate Ltd. Ms. Gershoni-Levy holds an L.L.B in Law from Essex University, England and an L.L.M. from Tel Aviv University Law School.

*Shai Gottesdiener* has been our CTO since July 2013. From 2009 until 2013, Mr. Gottesdiener worked at 888, where he served as its Vice President of R&D. Between 2000-2009, Mr. Gottesdiener held various positions in Matrix, including its Development Subdivision Manager. Mr. Gottesdiener holds a B.A. in Logistics and Computer Science from Bar-Ilan University.



*Yuval Hamudot* has been the General Manager of the Consumer Brands division of the Company since September 2012. From September 2011 to September 2012, he served as the Chief Operating Officer of Smilebox Inc. From 2003 to September 2011, Mr. Hamudot served the Company in various positions, including as the Chief Operating Officer from 2010 to 2011, as the Chief Technology Officer from 2007 to 2010, and as a Vice President – Research and Development from 2003 to 2007. From 1994 to 2000, Mr. Hamudot served in the Israeli Defense Force's top computer unit as a project officer responsible for nationwide projects. Mr. Hamudot holds a B.Sc. in Computer Science from Tel Aviv University and an M.B.A. from Bar-Ilan University.

*Dana Maor* has been our Senior Vice President of Human Resources since September 2013. From 2008 to 2013, Ms. Maor served as a Global Vice President of Human Resources at Frutarom Industries. From 2005 to 2008, Ms. Maor served as Vice President of Human Resources of Radvision (currently an Avaya Company). From 2003 to 2005, Ms. Maor served as an independent human resources consultant for high-tech and start-up companies. Prior thereto, she served for almost six years at Amdocs as a divisional Human Resources Vice President and for three years at Telradin in the Technology Division as a Human Resources Manager. Ms. Maor Holds a B.A in Psychology and Criminology and an M.A. in Industrial and Social Psychology, both from Bar Ilan University.

*Tomer Pascal* has been the General Manager of the Utilities Business division of the Company since January 2012. From 2010 to 2012, Mr. Pascal served as the Vice President of Marketing of the Company. In 2005, Mr. Pascal co-founded Interactive Technologies Ltd., and from 2005 to 2009, he served as its Vice President of Marketing and Product Management.

*Josh Wine* has been our President since January 2014. From 2012 to 2014, Mr. Wine served as Chief Revenue Officer of Conduit Ltd. and General Manager of its ClientConnect division. From 2011 to 2012 Mr. Wine served as Chief Operating Officer of Homesun Ltd. in the UK. From 2001 to 2011 Mr. Wine was a consultant at McKinsey & Company, where he was elected partner in 2009. Mr. Wine holds an M.A. in Philosophy, Politics and Economics from Oxford University.

*Mark Ziering* has been the Senior Vice President of Corporate Development of the Company since August 2010. From 1999 to 2008, Mr. Ziering was a partner at Genesis Partners, L.P., a leading Israeli venture capital fund. From 1993 to 1996, Mr. Ziering served as an analyst at Chemical Bank (predecessor to JP Morgan Chase) and, from 1989 to 1991, at the Federal Reserve Bank of New York. Mark holds a B.A. from Yeshiva University and an M.B.A. from Yale University.

There are no family relationships between any of our directors or executive officers.

## **B. COMPENSATION**

The aggregate direct compensation we paid to our officers as a group (8 persons) for the year ended December 31, 2013, was approximately \$2.6 million, which included approximately \$0.3 million that was set aside or accrued to provide for pension, retirement, severance or similar benefits. This amount includes bonuses paid to our officers pursuant to our executive bonus plan based on company performance measures, in accordance with our Compensation Policy for Directors and Officers. This amount does not include expenses we incurred for other payments, including dues for professional and business associations, business travel and other expenses, and other benefits commonly reimbursed or paid by companies in Israel. We did not pay our officers who also serve as directors any separate compensation for their directorship during 2013.

The aggregate compensation we paid to our directors who are not officers for their services as directors as a group for the year ended December 31, 2013 was approximately \$0.4 million. In addition, our directors are reimbursed for expenses incurred in order to attend board or committee meetings.

In the year ended December 31, 2013, we granted (i) options to purchase 285,000 ordinary shares to our directors and officers, at a weighted average exercise price of \$10.59 per share, and the latest expiration date for such options is September 2018, and (ii) 200,000 restricted share units ("RSUs") to our Chief Executive Officer, with a purchase price per share of NIS 0.01. The RSUs automatically vest into our ordinary shares over a period of three years, subject to continued employment, with 20% of each grant vesting on the first anniversary of the applicable date of grant, 30% of each grant vesting on the second anniversary of the applicable date of grant and 50% of each grant vesting on the third anniversary of the applicable date of grant. These options and RSUs were granted under our Equity Incentive Plan, as amended, formerly known as the 2003 Israeli Share Option Plan (the "Incentive Plan").

We pay each of our directors \$40,000 per year, subject to adjustment for changes in the Israeli consumer price index and applicable changes in the Israeli regulations governing the compensation of external directors. Each of our directors also receives an annual grant of options to purchase 10,000 ordinary shares under the Incentive Plan. Each option is exercisable for a term of five years at an exercise price per share equal to the closing price of our ordinary shares on the date of the annual meeting of shareholders on which such option was granted, as reported by the NASDAQ Stock Market. The options vest in three equal installments on each anniversary of date of grant. Following termination or expiration of the applicable director's service with the Company, provided that the termination or expiration is not for "cause" and is not a result of the director's resignation, the options would retain their original expiration dates and, with respect to each grant, the upcoming tranche of options that are scheduled to vest immediately subsequent to the termination date, if any, will automatically vest and become exercisable. All unvested options held by the director will automatically vest and become exercisable upon a change of control of the Company, which is defined for this purpose as (i) a merger, acquisition or reorganization of the Company with one or more other entities in which the Company is not the surviving entity, (ii) a sale of all or substantially all of the assets of the Company; (iii) a transaction or a series of related transactions as a result of which more than 50% of the outstanding shares or the voting rights of the Company are beneficially owned by one person or group (as defined in the SEC rules).

#### **Compensation Terms of our Chief Executive Officer**

Josef Mandelbaum, our Chief Executive Officer since July 2010, is currently entitled to a base salary of NIS 140,000 per month. He is entitled to an annual salary increase at a rate equal to the average rate of the increase in annual salaries of our senior management in the applicable year. In addition, Mr. Mandelbaum is entitled to an annual bonus equal to up to 50% of his base salary, subject to our meeting our annual targets for revenue and EBIT set by our Board of Directors. Half of the bonus depends on meeting the revenue target and half on meeting the EBIT target.

Mr. Mandelbaum's employment agreement provided for a one-time grant of options upon commencement of employment and an annual grant of options thereafter, the terms of which are substantially in accordance with the Incentive Plan and as is customary in the Company. However, the vesting of the one-time grant of options is also subject to our share price reaching a strike price higher than the market price at the time of grant. Following the approval of Mr. Mandelbaum's new compensation package in November 2013, he will not receive such annual grants going forward. In addition, we granted to Mr. Mandelbaum 200,000 RSUs on November 18, 2013 and 232,400 RSUs on January 2, 2014. These RSUs were granted under the Incentive Plan and have a purchase price of NIS 0.01 per share. They vest over a period of three years, subject to continued employment, with 20% of each grant vesting on the first anniversary of the applicable grant date, 30% on the second anniversary and 50% on the third anniversary.

Mr. Mandelbaum's employment agreement does not provide for a specified term and may be terminated by either party. If we terminate his employment, we are required to provide him with twelve month's notice. If Mr. Mandelbaum resigns, he must provide us with six months' notice. During the notice period, Mr. Mandelbaum would be entitled to all payments and benefits pursuant to his then-current compensation terms, including continued vesting of any equity-based awards. As required by Israeli law, we will also remit severance payment to Mr. Mandelbaum in an amount equal to one month's salary for each year of employment with us. Such amount of severance payment will be payable even if he resigns. In the event that Mr. Mandelbaum resigns, his vested options will be exercisable for one year from the termination date, the amount of unvested options equal to the pro rata options (as such term is defined in Mr. Mandelbaum's option agreement) will become vested. In the event that Mr. Mandelbaum's employment is terminated by us without "cause" (as defined in the Incentive Plan), his vested options will be exercisable until the expiration date thereof and the amount of unvested options equal to the pro rata options will become vested.

Mr. Mandelbaum also receives certain additional benefits, such as a company car, health insurance, life insurance and a mobile phone. Mr. Mandelbaum has agreed not to compete with us during his term of employment and for a period of 180 days thereafter. His employment agreement also contains customary confidentiality and intellectual property assignment provisions.

We also have employment agreements with our other executive officers. These agreements do not contain any change of control provisions and otherwise contain salary, benefit and non-competition provisions that we believe to be customary in our industry.

## C. BOARD PRACTICES

### Corporate Governance Practices

We are incorporated in Israel and therefore are subject to various corporate governance practices under the Companies Law, relating to such matters as external directors, the audit committee, the internal auditor and approvals of interested party transactions. These matters are in addition to the ongoing listing conditions of NASDAQ and other relevant provisions of U.S. securities laws. Under the NASDAQ Listing Rules, a foreign private issuer may generally follow its home country rules of corporate governance in lieu of the comparable NASDAQ requirements, except for certain matters such as composition and responsibilities of the audit committee. For further information, see "Item 16.G – Corporate Governance."

### NASDAQ Requirements

Under the NASDAQ Listing Rules, a majority of our directors are required to be "independent directors" as defined in the NASDAQ Listing Rules. Five out of the seven members of our board of directors, namely, Messrs. Tamar Gottlieb, Iris Beck, Alan Gelman, David Jutkowitz and Avichay Nissenbaum, are independent directors under the NASDAQ requirements.

We are also required by the NASDAQ Listing Rules to have an audit committee, all of whose members must satisfy certain independence requirements.

The NASDAQ Listing Rules require that director nominees be selected or recommended for the board's selection either by a committee composed solely of independent directors or by a majority of the independent directors on the board. We have a nominating and governance committee, composed solely of independent directors.

See Item "16.G – Corporate Governance" for exemptions that we have taken from certain NASDAQ Listing Rule requirements.

### Israeli Companies Law

#### Board of Directors

According to the Companies Law and our articles of association, our board of directors is responsible, among other things, for:

- establishing our policies and overseeing the performance and activities of our chief executive officer;
- convening shareholders' meetings;
- approving our financial statements;
- determining our plans of action, principles for funding them and the priorities among them, our organizational structure and examining our financial status; and
- issuing securities and distributing dividends.

Our board of directors may exercise all powers and may take all actions that are not specifically granted to our shareholders. Our board of directors also appoints and may remove our chief executive officer and may appoint or remove other executive officers, subject to any rights that the executive officers may have under their employment agreements.

Our board of directors currently consists of seven directors, two of whom qualify as "external directors" under Israeli law and have also been determined by our board of directors to qualify as "independent" for the purpose of the NASDAQ Listing Rules. Other than external directors, who are subject to special election requirements under Israeli law, our directors are elected in three staggered classes by the vote of a majority of the ordinary shares present and entitled to vote at meetings of our shareholders at which directors are elected. The members of only one staggered class will be elected at each annual meeting for a three-year term, so that the regular term of only one class of directors expires annually. Our annual meeting of shareholders is required to be held at least once during every calendar year and not more than fifteen months after the last preceding meeting. At our 2013 annual meeting of shareholders, held on September 2, 2013, Mr. Josef Mandelbaum was reelected as a director for an additional three-year term and Mr. Alan Gelman was reelected as a director for a three-year term. In connection, with the closing of the ClientConnect Acquisition on January 2, 2014, Mr. Dror Erez replaced Mr. Mandelbaum as a director. At our 2012 annual meeting of shareholders, held on September 27, 2012, Ms. Tamar Gottlieb was reelected as a director for an additional three-year term and Ms. Adi Soffer Teeni was elected as a director for an initial three-year term. In connection, with the closing of the ClientConnect Acquisition on January 2, 2014, Mr. Roy Gen replaced Ms. Adi Soffer Teeni as a director. At our 2011 annual meeting of shareholders, held on October 27, 2011, Ms. Iris Beck was elected as a director for an initial three-year term. The external directors are not assigned to a class and are elected in accordance with the Companies Law. At our 2013 annual meeting of shareholders, held on September 2, 2013, Mr. David Jutkowitz was reelected to serve as an external director for a third three-year term. On September 27, 2012, Mr. Avichay Nissenbaum was reelected to serve as an external director for a second three-year term.

If the number of directors constituting our board of directors is changed, any increase or decrease shall be apportioned among the classes so as to maintain the number of directors in each class as nearly equal as possible, but in no case will a decrease in the number of directors constituting our board of directors reduce the term of any then current director.

Our board of directors may appoint any other person as a director, whether to fill a vacancy or as an addition to the then current number of directors, provided that the total number of directors shall not at any time exceed seven directors. Any director so appointed shall hold office until the annual meeting of shareholders at which the term of his class expires, unless otherwise determined by our board of directors. There is no limitation on the number of terms that a non-external director may serve.

Shareholders may remove a non-external director from office by a resolution passed at a meeting of shareholders by a vote of the holders of more than two-thirds of our voting power.

A resolution proposed at any meeting of our board of directors is deemed adopted if approved by a majority of the directors present and voting on the matter. Under the Companies Law, our board of directors must determine the minimum number of directors having financial and accounting expertise, as defined in the regulations that our board of directors should have. In determining the number of directors required to have such expertise, the board of directors must consider, among other things, the type and size of the company and the scope and complexity of its operations. Our board of directors has determined that we require at least one director with the requisite financial and accounting expertise and that Mr. David Jutkowitz has such expertise.

Under the Companies Law, the chairman of the board of a company is not permitted to hold another position in the company or a subsidiary thereof other than chairman or director of a subsidiary or, if approved by a special majority of shareholders, chief executive officer of the company.

#### External Directors

Under the Companies Law, Israeli companies whose shares have been offered to the public in or outside of Israel are required to appoint at least two individuals to serve as external directors. Our external directors under the Companies Law are Mr. Avichay Nissenbaum, whose second three-year term commenced on September 27, 2012, and Mr. David Jutkowitz, whose third three-year term commenced on January 6, 2014.

External directors are required to possess independence and professional qualifications as set out in the Companies Law and regulations promulgated thereunder. Each committee of a company's board of directors that is authorized to exercise any powers of the board of directors is required to include at least one external director. The audit committee and the compensation committee must include all the external directors.

External directors are elected by a majority vote at a shareholders' meeting, as long as either:

- the majority of shares voted on the matter, including at least a majority of the shares of non-controlling shareholders voted on the matter, vote in favor of election; or
- the total number of shares of non-controlling shareholders voted against the election of the external director does not exceed two percent of the aggregate voting rights in the company.

The initial term of an external director is three years and such director may be reappointed for up to two additional three-year terms. Thereafter, he or she may be reelected by our shareholders for additional periods of up to three years each only if the audit committee and the board of directors confirm that, in light of the external director's expertise and special contribution to the work of the board of directors and its committees, the reelection for such additional period is beneficial to us. Reelection of an external director may be effected through one of the following mechanisms: (1) the board of directors proposed the reelection of the nominee and the election was approved by the shareholders by the majority required to appoint external directors for their initial term; or (2) a shareholder holding 1% or more of the voting rights proposed the reelection of the nominee, and the reelection is approved by a majority of the votes cast by the shareholders of the company, excluding the votes of controlling shareholders and those who have a personal interest in the matter as a result of their relations with the controlling shareholders, provided that the aggregate votes cast in favor of the reelection by such non-excluded shareholders constitute more than 2% of the voting rights in the company. An external director may be removed only in a general meeting, by the same percentage of shareholders as is required for electing an external director, or by a court, and in both cases only if the external director ceases to meet the statutory qualifications for appointment or if he or she has violated the duty of loyalty to us.

An external director is entitled to compensation as provided in regulations under the Companies Law and is otherwise prohibited from receiving any other compensation, directly or indirectly from us. We do not have, nor do our subsidiaries have, any directors' service contracts granting to the directors any benefits upon termination of their service in their capacity as directors.

#### Committees of the Board of Directors

Our board of directors has established an audit committee, a compensation committee, an investment committee and a nominating and governance committee.

#### ***Audit Committee***

Our audit committee is comprised of Mr. David Jutkowitz (Chairman), Mr. Avichay Nissenbaum and Mr. Alan Gelman, and operates pursuant to a written charter.

#### ***NASDAQ Requirements***

Under the listing requirements of the NASDAQ Stock Market, a foreign private issuer is required to maintain an audit committee that has certain responsibilities and authority. The NASDAQ Listing Rules require that all members of the audit committee must satisfy certain independence requirements. We have adopted an audit committee charter as required by the NASDAQ Listing Rules. Our audit committee assists the board of directors in fulfilling its responsibility for oversight of the quality and integrity of our accounting, auditing and financial reporting practices and financial statements. Our audit committee is also responsible for the establishment of policies and procedures for review and pre-approval by the committee of all audit services and permissible non-audit services to be performed by our independent auditor, in order to ensure that such services do not impair our auditor's independence. For more information see Item "16.C – Principal Accountant Fees and Services." Under the NASDAQ Listing Rules, the approval of the audit committee is also required to effect related-party transactions that would be required to be disclosed in our annual report.

#### ***Companies Law Requirements***

Under the Companies Law, the board of directors of a public company must establish an audit committee. The audit committee must consist of at least three directors who meet certain independence criteria and must include all of the external directors. The chairperson of the audit committee must be an external director. The responsibilities of the audit committee under the Companies Law include to identify and address problems in the management of the company, review and approve interested party transactions, establish whistleblower procedures and procedures for considering controlling party transactions and oversee the company's internal audit system and the performance of the internal auditor.

#### ***Compensation Committee***

Our compensation committee consists of Mr. David Jutkowitz (Chairman), Ms. Iris Beck and Mr. Avichay Nissenbaum, all of whom satisfy the respective "independence" requirements of the Companies Law, SEC and NASDAQ Listing Rules for compensation committee members. Our compensation committee meets at least once each quarter, with additional special meetings scheduled when required.

Our compensation committee is authorized to, among other things, review, approve and recommend to our board of directors base salaries, incentive bonuses, including the specific goals and amounts, stock option grants, employment agreements, and any other benefits, compensation or arrangements of our executive officers and directors. Pursuant to the Companies Law, our compensation committee must be comprised of at least three directors, include all of the external directors, its other members must satisfy certain independence standards under the Companies Law, and the chairman is required to be an external director. In addition, our compensation committee is required to propose for shareholder approval by a special majority, a compensation policy governing the compensation of office holders based on specified criteria, to review, from time to time, modifications to the compensation policy and examine its implementation; and to approve the actual compensation terms of office holders prior to approval thereof by the board of directors. Our shareholders approved our Compensation Policy for Directors and Officers on November 18, 2013. Our compensation committee also oversees the administration of our equity based incentive plan.

### **Investment Committee**

Our investment committee is comprised of Tamar Gottlieb (Chairperson), David Jutkowitz, Avichay Nissenbaum and Roy Gen. The Investment Committee is responsible for formulating the overall investment policies of the Company, and establishing investment guidelines in furtherance of those policies. The Committee monitors the management of the portfolio for compliance with the investment policies and guidelines and for meeting performance objectives over time as well as assist the board of directors in fulfilling its oversight responsibility for the investment of assets of the company.

### **Nominating and Governance Committee**

Our nominating and governance committee is comprised of Tamar Gottlieb (Chairperson), David Jutkowitz, and Dror Erez, and operates pursuant to a written charter. It is responsible for making recommendations to the board of directors regarding candidates for directorships and the size and composition of the board. In addition, the committee is responsible for overseeing our corporate governance guidelines and reporting and making recommendations to the board concerning corporate governance matters. Under the Companies Law, the nominations for director are generally made by our directors but may be made by one or more of our shareholders. However, any shareholder or shareholders holding at least 5% of the voting rights in our issued share capital may nominate one or more persons for election as directors at a general meeting only if a written notice of such shareholder's intent to make such nomination or nominations has been given to our secretary and each such notice sets forth all the details and information as required to be provided under our articles of association.

### **Internal Auditor**

Under the Companies Law, the board of directors of a public company must appoint an internal auditor nominated in accordance with the audit committee's recommendation. The role of the internal auditor is to examine whether a company's actions comply with the law and proper business procedure. The internal auditor may be an employee of the company employed specifically to perform internal audit functions but may not be an interested party or office holder, or a relative of any interested party or office holder, and may not be a member of the company's independent accounting firm or its representative. The Companies Law defines an interested party as a substantial shareholder of 5% or more of the shares or voting rights of a company, any person or entity that has the right to nominate or appoint at least one director or the general manager of the company or any person who serves as a director or as the general manager of a company. The internal auditor's term of office shall not be terminated without his or her consent, nor shall he or she be suspended from such position unless the board of directors has so resolved after hearing the opinion of the audit committee and after giving him or her a reasonable opportunity to present his or her position to the board and to the audit committee. Mr. Yuli Yardeni of the accounting firm of Yardeni-Gelfand is our internal auditor.

### **D. EMPLOYEES**

As of December 31, 2013 we had 203 employees. The breakdown of our employees by department and fiscal period is as follows:

	2011	December 31,	
		2012	2013
Management and administration	24	30	36
Support	14	11	13
Research and development	69	117	105
Selling and marketing	32	50	49
Total	139	208	203

As of December 31, 2013, 149 of our employees were located in Israel, and 54 employees were located in the United States. As of December 31, 2012, ClientConnect had 280 employees located in Israel and the United States.

In Israel we are subject to certain labor statutes and national labor court precedent rulings, as well as to some provisions of the collective bargaining agreement between the Histadrut, which is the General Federation of Labor in Israel, and the Coordination Bureau of Economic Organizations, including the Industrialist's Association of Israel. These provisions of collective bargaining agreements apply to our Israeli employees by virtue of extension orders issued in accordance with relevant labor laws by the Israeli Ministry of Industry, Trade and Labor, and which apply such agreement provisions to our employees even though they are not directly part of a union that has signed a collective bargaining agreement. The laws and labor court rulings that apply to our employees principally concern minimum wage laws, procedures for dismissing employees, determination of severance pay, leaves of absence (such as annual vacation or maternity leave), sick pay and other conditions for employment. The extension orders which apply to our employees principally concern the requirement for the length of the workday and the work-week, annual recuperation pay and commuting expenses, compensation for working on the day before and after a holiday and payments to pension funds and other conditions for employment. Furthermore, these provisions provide that the wages of most of our employees are adjusted automatically. The amount and frequency of these adjustments are modified from time to time. Additionally, we are required to insure all of our employees by a comprehensive pension plan or a managers' insurance according to the terms and the rates detailed in the order. In addition, Israeli law determines minimum wages for workers, minimum paid leave or vacation, sick leave, working hours and days of rest, insurance for work-related accidents, determination of severance pay, the duty to give notice of dismissal or resignation and other conditions of employment. In addition, certain laws prohibit or limit the employer's ability to dismiss its employees in special circumstances. We have never experienced a work stoppage, and we believe our relations with our employees are good.

Israeli law generally requires the payment of severance by employers upon the retirement or death of an employee or upon termination of employment by the employer or, in certain circumstances, by the employee. Generally, the amount of severance pay equals one month's salary per each year of employment. We deposit funds into segregated accounts on a monthly basis to cover this liability. As of December 31, 2013, our net accrued unfunded severance obligations totaled \$0.2 million.

Furthermore, Israeli employees and employers are required to pay predetermined sums to the National Insurance Institute, which covers, amongst other benefits, payments for state retirement benefits and survivor benefits, (similar to the United States Social Security Administration) as well as state unemployment benefits. These amounts also include payments for national health insurance. The payments to the National Insurance Institute can equal up to approximately 18.5% of wages subject to a cap if an employee's monthly wages exceed a specified amount, of which the employee contributes approximately 12% and the employer contributes approximately 6.5%.

## E. SHARE OWNERSHIP

### Security Ownership of Directors and Executive Officers

The following table sets forth information regarding the beneficial ownership of our ordinary shares as of April 3, 2014 by all of our directors and executive officers as a group and by each officer and director who beneficially owns 1% or more of our outstanding ordinary shares.

Beneficial ownership of shares is determined in accordance with the rules of the SEC and generally includes any shares over which a person exercises sole or shared voting or investment power. Ordinary shares that are subject to warrants or stock options that are presently exercisable or exercisable within 60 days of a specified date are deemed to be outstanding and beneficially owned by the person holding the stock options for the purpose of computing the percentage ownership of that person, but are not treated as outstanding for the purpose of computing the percentage of any other person.

Except as indicated in the footnotes to this table, each shareholder in the table has sole voting and investment power for the shares shown as beneficially owned by them. Percentage ownership is based on 67,664,679 ordinary shares outstanding as of April 3, 2014.

Name	Number of Ordinary Shares Beneficially Owned	Percentage of Ordinary Shares Outstanding
Dror Erez (1)	9,843,163	14.5%
All directors and officers as a group (16 persons) (2)	11,605,521	16.9%

(1) Based solely upon, and qualified in its entirety with reference to, a Schedule 13D filed with the SEC on January 13, 2014, by Mr. Erez.

(2) Includes options to purchase 952,199 ordinary shares, exercisable within 60 days of April 3, 2014.

### Employee Benefit Plans

The Incentive Plan, our current equity incentive plan, was initially adopted in 2003, providing certain tax benefits in connection with share-based compensation under the tax laws of Israel and the United States. The term of the Incentive Plan will expire on December 9, 2022. Please also see Note 11 to our consolidated financial statements included in this annual report for information on the options issued under the Incentive Plan.

Under the Incentive Plan, we may grant to our directors, officers, employees, consultants, advisers, service providers and controlling shareholders options to purchase our ordinary shares, restricted shares and restricted share units ("RSUs"). As of December 31, 2013, a total of 12,000,000 ordinary shares were subject to the Incentive Plan. As of April 3, 2014, RSUs and options to purchase a total of 6,882,301 ordinary shares were outstanding under our Incentive Plan, of which RSUs and options to purchase a total of 3,540,687 ordinary shares were held by our directors and officers (16 persons) as a group. The outstanding RSUs have a purchase price of NIS 0.01 per share, and outstanding options are exercisable at purchase prices which range from \$0.03 to \$13.54 per share. Any expired or cancelled options are available for reissuance under the Incentive Plan.

Our Israeli employees and directors may be granted awards under Section 102 ("**Section 102**") of the Israeli Income Tax Ordinance (the "**Tax Ordinance**"), which provides them with beneficial tax treatment, and non-employees (such as service providers, consultants and advisers) and controlling shareholders may only be granted awards under another section of the Tax Ordinance, which does not provide for similar tax benefits. To be eligible for tax benefits under Section 102, the securities must be issued through a trustee, and if held by the trustee for the minimum required period, the employees and directors are entitled to defer any taxable event with respect to the award until the earlier of (i) the transfer of securities from the trustee to the employee or director or (ii) the sale of securities to a third party. Our board of directors has resolved to elect the "Capital Gains Route" (under Section 102) for the grant of awards to Israeli grantees under the Incentive Plan. Based on such election, and subject to the fulfillment of the conditions of Section 102, under the Capital Gains Route, gains realized from the sale of shares issued pursuant to the Incentive Plan will generally be taxed at the capital gain rate of 25%, provided the trustee holds the securities for 24 months following the date of grant of the award. To the extent that the market price of the ordinary shares at the time of grant exceeds the exercise price of the award or if the conditions of Section 102 are not met, tax will be payable at the time of sale at the marginal income tax rate applicable to the employee or director (up to 50% in 2013). We are not entitled to recognize a deduction for Israeli tax purposes on the capital gain recognized by the award holder upon the sale of shares pursuant to Section 102. The voting rights of any shares held by the trustee under Section 102 remain with the trustee.

The Incentive Plan contains a U.S. addendum that provides for the grant of awards to U.S. citizens and resident aliens of the United States for U.S. tax purposes. Pursuant to the approval of our board of directors and shareholders, stock options granted to U.S. citizens and resident aliens may be either incentive stock options under the U.S. Internal Revenue Code of 1986, as amended (the "Code") or options that do not qualify as incentive stock options. Subject to the fulfillment of the conditions of the Code, an incentive stock option may provide tax benefits to the holder in that it converts ordinary income into income taxed at long-term capital gain rates and defers the tax until the sale of the underlying share. In that event, we would not recognize a tax deduction with respect to such capital gain.

Our board of directors has the authority to administer, and to grant awards, under the Incentive Plan. However, the compensation committee appointed by the board provides recommendations to the board with respect to the administration of the plan. Generally, RSUs and options granted under the Incentive Plan vest in two or three installments on each anniversary of the date of grant.

See "Item 6.B Compensation" for a description of awards granted under the Incentive Plan to our directors and officers in 2013.

## **ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS**

### **A. MAJOR SHAREHOLDERS**

The following table sets forth information regarding the beneficial ownership of our ordinary shares as of April 3, 2014 by each person or group of affiliated persons that we know beneficially owns more than 5% of our outstanding ordinary shares. Other than with respect to our directors and officers, we have relied on public filings with the SEC.

Beneficial ownership of shares is determined in accordance with the Exchange Act and the rules promulgated thereunder, and generally includes any shares over which a person exercises sole or shared voting or investment power. Ordinary shares that are issuable upon the exercise of warrants or stock options that are presently exercisable or exercisable within 60 days of a specified date are deemed to be outstanding and beneficially owned by the person holding the stock options or warrants for the purpose of computing the percentage ownership of that person, but are not treated as outstanding for the purpose of computing the percentage ownership of any other person.

Except as indicated in the footnotes to this table, to our knowledge, each shareholder in the table has sole voting and investment power for the shares shown as beneficially owned by such shareholder. Our major shareholders do not have different voting rights than our other shareholders.



Name	Number of Ordinary Shares Beneficially Owned	Percentage of Ordinary Shares Outstanding (1)
Ronen Shilo (2)	9,843,163	14.5%
Dror Erez (3)	9,843,163	14.5%
Benchmark Israel II, L.P. (4)	9,649,657	14.3%
Zack and Orli Rinat (5)	6,484,347	9.6%
Project Condor LLC (6)	4,203,067	6.2%

(1) Based upon 67,664,679 ordinary shares outstanding as of April 3, 2014.

(2) Based solely upon, and qualified in its entirety with reference to, a Schedule 13D filed with the SEC on January 13, 2014, by Mr. Shilo.

(3) Based solely upon, and qualified in its entirety with reference to, a Schedule 13D filed with the SEC on January 13, 2014, by Mr. Erez.

(4) Based solely upon, and qualified in its entirety with reference to, a Schedule 13G filed with the SEC on January 13, 2014, by Benchmark Israel II, L.P. BCPI Partners II, L.P. ("BCPI-P"), the general partner of Benchmark Israel II, L.P. ("BI II"), may be deemed to have sole power to vote and dispose of the shares directly held by BI II. BCPI Corporation II ("BCPI-C"), the general partner of BCPI-P, may be deemed to have sole power to vote and dispose of the shares directly held by BI II. Michael A. Eisenberg ("Eisenberg") and Arad Naveh, the directors of BCPI-C, may be deemed to have shared power to vote and dispose of the shares directly held by BI II.

(5) Based solely upon, and qualified in its entirety with reference to, a Schedule 13G filed with the SEC on January 16, 2014, by Zack and Orli Rinat. The Ordinary Shares are held by Zack Rinat and Orli Rinat as community property.

(6) Based solely upon, and qualified in its entirety with reference to, a Schedule 13G filed with the SEC on January 10, 2014, by Project Condor LLC. Project Condor LLC is a member-managed limited liability company. J.P. Morgan Digital Growth Fund L.P. ("DGF") and 522 Fifth Avenue Fund, L.P. ("522 Fund") are the only members of Project Condor LLC. J.P. Morgan Investment Management Inc., a registered investment adviser under the Investment Advisers Act of 1940, is the investment advisor to DGF and 522 Fund. Voting and dispositive power with respect to the shares indirectly held by DGF and 522 Fund through Project Condor LLC reside with J.P. Morgan Investment Management Inc.

On January 16, 2010, Yaron Adler filed a Schedule 13G/A reporting that he had beneficial ownership of 914,562, or 9.5%, of our ordinary shares. On February 7, 2013, Yaron Adler filed a Schedule 13G/A reporting that he had beneficial ownership of 496,453, or 4.1%, of our ordinary shares and therefore he had ceased to be the beneficial owner of more than 5% of our outstanding shares.

On February 3, 2011, Ofer Adler filed a Schedule 13D/A reporting that he had beneficial ownership of 704,456, or 6.98%, of our ordinary shares. On December 5, 2012, Ofer Adler filed a Schedule 13D/A reporting that he had beneficial ownership of 480,746, or 3.98%, of our ordinary shares and therefore he had ceased to be the beneficial owner of more than 5% of our outstanding shares.

On October 4, 2012, CCM Master Qualified Fund, Ltd. ("CCM"), Coghill Capital Management, L.L.C. ("Coghill LLC") and Mr. Clint Coghill jointly filed a Schedule 13G reporting the beneficial ownership of 496,772, or 5.01%, of our ordinary shares. Mr. Coghill is the managing member of Coghill LLC, an entity which serves as the investment manager of CCM. On February 14, 2013, CCM, Coghill LLC and Mr. Coghill jointly filed a Schedule 13G/A reporting the beneficial ownership of 567,616, or 4.72%, of our ordinary shares and therefore they had ceased to be the beneficial owners of more than 5% of our outstanding shares.

On November 9, 2012, Globis Capital Partners, L.P., ("Globis Partners"), Globis Capital Advisors, L.L.C., ("Globis Advisors"), Globis Overseas Fund, Ltd., ("Globis Overseas"), Globis Capital Management, L.P., (the "Investment Manager"), Globis Capital, L.L.C., ("GC"), and Mr. Paul Packer ("Mr. Packer", and together with Globis Partners, Globis Advisors, Globis Overseas, the Investment Manager and GC, the "Globis Reporting Persons") jointly filed a Schedule 13G relating to the beneficial ownership of a total of 535,617, or 5.3%, of our ordinary shares. Globis Advisors serves as the general partner of Globis Partners. The Investment Manager serves as the investment manager to, and has investment discretion over the securities held by, Globis Partners and Globis Overseas. GC serves as the general partner of the Investment Manager. Mr. Packer is the Managing Member of Globis Advisors and GC. Each of Globis Partners and Globis Advisors reported beneficial ownership of 465,097, or 4.6%, of our ordinary shares. Globis Overseas reported beneficial ownership of 70,520, or 0.7%, of our ordinary shares. Each of the Investment Manager, GC and Mr. Packer reported beneficial ownership of 535,617, or 5.3%, of our ordinary shares. On February 14, 2013, the Globis Reporting Persons jointly filed a Schedule 13G/A relating to the beneficial ownership of a total of 519,050, or 4.3%, of our ordinary shares and therefore reporting ceasing to be the beneficial owners of more than 5% of our outstanding shares.

On December 10, 2012, Holine Finance Ltd. filed a Schedule 13G reporting it had beneficial ownership of 1,109,732, or 9.2%, of our ordinary shares. As a result of the ClientConnect Acquisition, Holine Finance's percentage ownership was diluted to less than 5% of our outstanding ordinary shares.

To our knowledge, as of April 3, 2014, we had 17 shareholders of record of which seven (including the Depository Trust Company) were registered with addresses in the United States. These U.S. holders were, as of such date, the holders of record of approximately 98.8% of our outstanding shares. The number of record holders in the United States is not representative of the number of beneficial holders nor is it representative of where such beneficial holders are resident since many of these ordinary shares were held of record by brokers or other nominees.

## **B. RELATED PARTY TRANSACTIONS**

It is our policy that transactions with office holders or transactions in which an office holder has a personal interest will be on terms that, on the whole, are no less favorable to us than could be obtained from independent parties.

See "Item 10.B Memorandum and Articles of Association — Approval of Related Party Transactions" for a discussion of the requirements of Israeli law regarding special approvals for transactions involving directors, officers or controlling shareholders.

### **Agreements with Conduit**

#### Conduit Commercial Agreement

On August 12, 2013, we entered into the Conduit Commercial Agreement, which was in operation until the consummation of the Conduit Split on December 31, 2013. For additional information about this agreement, please see Item 5.A " Operating Results—Year Ended December 31, 2013 Compared to Year Ended December 31, 2012—Revenues".

As a condition precedent to the closing of ClientConnect Acquisition on January 2, 2014, Conduit and ClientConnect effected the Conduit Split and entered into the ancillary agreements described below. As a result of the ClientConnect Acquisition, two office holders of Conduit – Dror Erez and Roy Gen – became members of our Board of Directors and the major shareholders of Conduit also became major shareholders of the Company. For information about additional agreements we entered into in connection with the ClientConnect Acquisition, see Item 10.C "Additional Information—Material Contracts—Agreements Relating to the ClientConnect Acquisition". Such directors and major shareholders are parties to or otherwise bound by some of such agreements, as described therein.

#### Split Agreement

Pursuant to the Split Agreement, dated September 16, 2013, between Conduit and ClientConnect, on December 31, 2013, the entire activities and operations, and related assets and liabilities, of the ClientConnect business were transferred by Conduit to ClientConnect on a cash-free and debt-free basis and the Conduit shareholders became the shareholders of ClientConnect in proportion to their ownership of Conduit (the "Conduit Split"). The assets of Conduit were transferred on an "as is" basis for no consideration. Certain liabilities were retained by Conduit, such as pre-closing taxes and litigation matters. The parties agreed to indemnify each other with respect to any damages incurred by one party with respect to liabilities of the other. During a transitional period, Conduit is entitled to use the transferred intellectual property and third party intellectual property licenses (subject to their terms), create derivative works in respect thereof and integrate, sell and license such intellectual property with Conduit's retained business, subject to non-competition provisions. In addition, during a transitional period, ClientConnect is entitled to use domains and URL addresses that use the word "conduit" for new downloads or installs.

#### Transition Services Agreement

Pursuant to the Transition Services Agreement, dated December 31, 2013, between Conduit and ClientConnect, ClientConnect provides Conduit and its subsidiaries with certain business support services and systems, including data services, information technology, information security and management information systems, for consideration at market terms. The term of the agreement is for a period of eight months, except with respect to the data services to be provided thereunder, for which the term is 16 months, subject to extension by Conduit for an additional eight months (in which case the consideration to be paid for such service would be increased by 20%). Conduit may terminate the agreement or the providing of any specific service upon 30 days' prior notice. The agreement contains certain indemnification provisions pursuant to which the parties agreed to indemnify and hold harmless the other party and its representatives upon the occurrence of certain events. The agreement also contains standard provisions regarding confidentiality and non-solicitation of the other party's officers, employees and consultants during the term of the agreement and for a period of 24 months thereafter.

Office and Administrative Services Agreement

Pursuant to the Administrative Services Agreement, dated December 31, 2013, between Conduit and ClientConnect, Conduit provides ClientConnect with certain services, including office and administrative support services, for consideration on market terms based on the number of employees of ClientConnect as of the last day of each month. The parties also agreed that prior to the termination of the agreement, ClientConnect would offer continued employment to 50% of the employees providing the services from each applicable administrative department or capacity or to 50% of all such employees in the aggregate. The agreement terminates on August 30, 2014. The agreement contains certain indemnification provisions pursuant to which the parties agreed to indemnify and hold harmless the other party and its representatives upon the occurrence of certain events. The agreement also contains standard provisions regarding confidentiality and non-solicitation of the other party's officers, employees and consultants during the term of the agreement and for a period of 24 months thereafter.

Working Capital Financing Agreement

Pursuant to the Working Capital Financing Agreement, dated December 31, 2013, between Conduit and ClientConnect, Conduit undertook to make available to ClientConnect a credit line of up to \$20 million. Any amounts withdrawn under the credit line is required to be used solely to finance payment related to the then-current working capital needs of the ClientConnect business. The outstanding principal amount under the Credit Line bears interest at the annual rate prescribed by Section 3(j) of the Tax Ordinance (currently, 4.1% per annum). As of March 31, 2014, ClientConnect has borrowed \$12.5 million under the credit line. The credit line matures in April 2014.

Search Syndication Agreement

Pursuant to the Search Syndication Agreement, dated December 31, 2013, between Conduit and ClientConnect, ClientConnect undertook to provide Conduit and its affiliates with search monetization services on the most favorable terms that it gives to its other customers. The agreement has an initial term of two years, subject to extension at the request of Conduit for an additional one year.

**C. INTERESTS OF EXPERTS AND COUNSEL**

Not applicable.

**ITEM 8. FINANCIAL INFORMATION**

**A. CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION**

Our audited consolidated financial statements for the year ended December 31, 2013 are included in this annual report pursuant to Item 18. Shortly after filing this annual report, we expect to submit with the SEC a report on Form 6-K containing the audited consolidated statements of income, change in shareholders' equity and cash flows of ClientConnect for the years ended December 31, 2011, 2012 and 2013 and the audited consolidated balance sheets of ClientConnect as of December 31, 2012 and 2013, as well as pro forma combined financial data of Perion and ClientConnect as though the ClientConnect Acquisition were consummated on January 1, 2013.

***Legal Proceedings***

In November 2013, we were served with a lawsuit filed in the Tel Aviv District Court (Economic Department) against us and our directors by an individual claiming to be a holder of 150 of our ordinary shares. The plaintiff alleges certain flaws in the process, price and disclosure in connection with the ClientConnect Acquisition. The plaintiff requested that the court certify the lawsuit as a valid class action, a declaratory judgment confirming the plaintiff's allegations and certain remuneration for the purported plaintiff, including legal fees. We believe that the complaint is without merit and plan to defend against it vigorously.

In November 2013, MyMail, Ltd., a non-practicing entity, filed a lawsuit in the Eastern District of Texas alleging that ClientConnect's toolbar technology infringes one of its U.S. patents issued in September 2012 and demanding an injunction and monetary payments. We believe that we have strong defenses against this lawsuit and we intend to defend against it vigorously.

***Policy on Dividend Distribution***

In November 2010, we announced that as we are focusing on growth and intend to utilize our cash and investments to achieve that growth. Accordingly, we decided to change our dividend policy to no longer distribute dividends.

**B. SIGNIFICANT CHANGES**

Since the date of our audited financial statements included elsewhere in this report, there have not been any significant changes other than as set forth in this report under Item 4.A. – "Recent Developments".

**ITEM 9. THE OFFER AND LISTING**

**A. OFFER AND LISTING DETAILS**

Our ordinary shares have been listed on the NASDAQ Capital Market from January 31, 2006 to June 26, 2007, on the NASDAQ Global Market from June 27, 2007 to December 31, 2013, and on the NASDAQ Global Select Market since January 2, 2014. Our ordinary shares commenced trading on the Tel Aviv Stock Exchange on December 4, 2007. Our trading symbol on NASDAQ is "PERI" and on the TASE is "PERION".

The following table shows, for the periods indicated, the high and low market prices of our ordinary shares as reported on the NASDAQ and the TASE. The TASE prices have been translated from NIS to dollars based on the exchange rate between the NIS and the dollar, as quoted by the Bank of Israel with respect to the date of the applicable high or low market price on the TASE.

	NASDAQ		TASE	
	High (\$)	Low (\$)	High (\$)	Low (\$)
<b>Five most recent full financial years</b>				
2013	14.94	8.19	14.90	8.21
2012	10.50	3.68	10.45	3.85
2011	8.25	3.45	8.20	3.41
2010	10.75	3.85	10.96	4.04
2009	10.89	2.30	10.46	2.48
<b>Financial quarters during the past two recent full financial years and any subsequent period</b>				
First Quarter 2014	14.33	10.65	14.33	10.56
Fourth Quarter 2013	13.89	9.68	13.84	9.74
Third Quarter 2013	13.80	10.03	14.14	10.10
Second Quarter 2013	14.94	9.53	14.90	9.57
First Quarter 2013	13.10	8.19	12.79	8.21
Fourth Quarter 2012	10.50	6.66	10.45	6.65
Third Quarter 2012	7.68	4.04	7.38	4.16
Second Quarter 2012	5.20	3.68	5.13	3.81
First Quarter 2012	5.59	3.90	5.59	3.85
<b>Most recent six months</b>				
March 2014	13.75	10.65	13.89	10.56
February 2014	12.58	11.1	12.48	11.08
January 2014	14.33	11.55	14.33	11.6
December 2013	12.40	9.80	12.42	9.74
November 2013	12.27	9.68	12.11	9.76
October 2013	13.89	11.29	13.84	10.40

The closing prices of our ordinary shares, as reported on the NASDAQ and on the TASE on April 3, 2014, were \$10.84 and NIS 37.9 (equal to \$10.92 based on the exchange rate between the NIS and the dollar, as quoted by the Bank of Israel on April 3, 2014), respectively.

**B. PLAN OF DISTRIBUTION**

Not applicable.

**C. MARKETS**

Our ordinary shares are quoted on the NASDAQ Global Select Market under the symbol "PERI", and on the Tel Aviv Stock Exchange under the symbol "PERION".

**D. SELLING SHAREHOLDERS**

Not applicable.

**E. DILUTION**

Not applicable.

**F. EXPENSES OF THE ISSUE**

Not applicable.

**ITEM 10. ADDITIONAL INFORMATION**

**A. SHARE CAPITAL**

Not applicable

**B. MEMORANDUM AND ARTICLES OF ASSOCIATION**

**Registration Number and Purposes**

Our registration number with the Israeli Companies Registrar is 51-284949-8. Pursuant to Section 3 of our articles of association, our objectives are the development, manufacture and marketing of software and any other objective as determined by our board of directors.

### **Authorized Share Capital**

On November 18, 2013, our shareholders approved amendments to our memorandum and articles of association increasing our authorized share capital to NIS 1,200,000, divided into 120,000,000 ordinary shares, par value NIS 0.01 per share.

### **The Board of Directors**

Under the Companies Law and our articles of association, our board of directors may exercise all powers and take all actions that are not required under the Companies Law or under our articles of association to be exercised or taken by another corporate body, including the power to borrow money for the purposes of our Company. Our directors are not subject to any age limit requirement, nor are they disqualified from serving on our board of directors because of a failure to own a certain amount of our shares. For more information about our Board of Directors, see Item 6.C "Board Practices".

### **Dividend and Liquidation Rights**

The holders of the ordinary shares are entitled to their proportionate share of any cash dividend, share dividend or dividend in kind declared with respect to our ordinary shares on or after the date of this annual report. We may declare dividends out of profits legally available for distribution. Under the Companies Law, a company may distribute a dividend only if the distribution does not create a reasonable risk that the company will be unable to meet its existing and anticipated obligations as they become due. Furthermore, a company may only distribute a dividend out of the company's profits, as defined under the Companies Law. If the company does not meet the profit requirement, a court may allow it to distribute a dividend, as long as the court is convinced that there is no reasonable risk that such distribution might prevent the company from being able to meet its existing and anticipated obligations as they become due.

Under the Companies Law, the declaration of a dividend does not require the approval of the shareholders of a company unless the company's articles of association provide otherwise. Our articles of association provide that the board of directors may declare and distribute dividends without the approval of the shareholders. In the event of our liquidation, holders of our ordinary shares have the right to share ratably in any assets remaining after payment of liabilities, in proportion to the paid-up par value of their respective holdings.

These rights may be affected by the grant of preferential liquidation or dividend rights to the holders of a class of shares that may be authorized in the future.

### **Voting, Shareholder Meetings and Resolutions**

Holders of ordinary shares have one vote for each ordinary share held on all matters submitted to a vote of shareholders. This right may be changed if shares with special voting rights are authorized in the future.

Our articles of association and the laws of the State of Israel do not restrict the ownership or voting of ordinary shares by non-residents of Israel.

Under the Companies Law, an annual meeting of our shareholders should be held once every calendar year, but no later than 15 months from the date of the previous annual meeting. The quorum required under our articles of association for a general meeting of shareholders consists of at least two shareholders present in person or by proxy holding in the aggregate at least 33 1/3% of the voting power. According to our articles of association a meeting adjourned for lack of a quorum generally is adjourned to the same day in the following week at the same time and place or any time and place as the chairperson of the board of directors designates in a notice to the shareholders with the consent of the holders of the majority voting power represented at the meeting voting on the question of adjournment. In the event of a lack of quorum in a meeting convened upon the request of shareholders, the meeting shall be dissolved. At the adjourned meeting, if a legal quorum is not present after 30 minutes from the time specified for the commencement of the adjourned meeting, then the meeting shall take place regardless of the number of members present and in such event the required quorum shall consist of any number of shareholders present in person or by proxy.

Our board of directors may, in its discretion, convene additional meetings as "special general meetings." Special general meetings may also be convened upon shareholder request in accordance with the Companies Law and our articles of association. The chairperson of our board of directors presides at each of our general meetings. The chairperson of the board of directors is not entitled to a vote at a general meeting in his capacity as chairperson.

Most shareholders' resolutions, including resolutions to:

- amend our articles of association (except as set forth below) or our memorandum of association;
- make changes in our capital structure such as a reduction of capital, increase of capital or share split, merger or consolidation;
- authorize a new class of shares;
- elect directors, other than external directors; or
- appoint auditors

will be deemed adopted if approved by the holders of a majority of the voting power represented at a shareholders' meeting, in person or by proxy, and voting on that resolution. Except as set forth in the following sentence none of these actions require the approval of a special majority. Amendments to our articles of association relating to the election and vacation of office of directors, the composition and size of the board of directors and the insurance, indemnification and release in advance of the company's office holders with respect to certain liabilities incurred by them require the approval at a general meeting of shareholders holding more than two-thirds of the voting power of the issued and outstanding share capital of the company.

#### **Notices**

Under the Companies Law, shareholders' meetings generally require prior notice of at least 21 days, or 35 days if the meeting is adjourned for the purpose of voting on any of the following matters:

- (1) appointment and removal of directors;
- (2) approval of certain matters relating to the fiduciary duties of office holders and of certain transactions with interested parties;
- (3) approval of certain mergers; and
- (4) any other matter in respect of which the articles of association provide that resolutions of the general meeting may be approved by means of a voting document.

#### **Modification of Class Rights**

The Companies Law provides that, unless otherwise provided by the articles of association, the rights of a particular class of shares may not be adversely modified without the vote of a majority of the affected class at a separate class meeting.

#### **Election of Directors**

Our ordinary shares do not have cumulative voting rights in the election of directors. Therefore, the holders of ordinary shares representing more than 50% of the voting power at the general meeting of the shareholders, in person or by proxy, have the power to elect all of the directors whose positions are being filled at that meeting, to the exclusion of the remaining shareholders. External directors are elected by a majority vote at a shareholders' meeting, provided that either:

- the majority of shares voted for the election includes at least a majority of the shares held by non-controlling shareholders voted at the meeting and excluding shares held by a person with a personal interest in the approval of the election, excluding a personal interest which is not as a result of his connection with the controlling shareholder (excluding abstaining votes); or
- the total number of shares of non-controlling shareholders voted against the election of the external director does not exceed two percent of the aggregate voting rights in the company.

See "Item 6.C Board Practices" regarding our staggered board.

#### **Transfer Agent and Registrar**

American Stock Transfer and Trust Company is the transfer agent and registrar for our ordinary shares.

#### **Approval of Related Party Transactions**

##### ***Office Holders***

The Companies Law codifies the fiduciary duties that office holders owe to a company. An office holder is defined in the Companies Law as any general manager, chief business manager, deputy general manager, vice general manager, or any other person assuming the responsibilities of any of these positions regardless of that person's title, as well as a director, or a manager directly subordinate to the general manager.

*Fiduciary duties.* An office holder's fiduciary duties consist of a duty of loyalty and a duty of care. The duty of loyalty requires the office holder to act in good faith and to the benefit of the company, to avoid any conflict of interest between the office holder's position in the company and any other of his or her positions or personal affairs, and to avoid any competition with the company or the exploitation of any business opportunity of the company in order to receive personal advantage for himself or others. This duty also requires him or her to reveal to the company any information or documents relating to the company's affairs that the office holder has received due to his or her position as an office holder. The duty of care requires an office holder to act with a level of care that a reasonable office holder in the same position would employ under the same circumstances. This includes the duty to use reasonable means to obtain information regarding the advisability of a given action submitted for his or her approval or performed by virtue of his or her position and all other relevant information pertaining to these actions.

*Compensation.* Every Israeli public company must adopt a compensation policy, recommended by the compensation committee, and approved by the board of directors and the shareholders, in that order. The shareholder approval requires a majority of the votes cast by shareholders, excluding any controlling shareholder and those who have a personal interest in the matter (similar to the threshold described below under " – Shareholders"). In general, all office holders' terms of compensation – including fixed remuneration, bonuses, equity compensation, retirement or termination payments, indemnification, liability insurance and the grant of an exemption from liability – must comply with the company's compensation policy. In addition, the compensation terms of directors, the chief executive officer, and any employee or service provider who is considered a controlling shareholder generally must be approved separately by the compensation committee, the board of directors and the shareholders of the company, in that order. The compensation terms of other officers require the approval of the compensation committee and the board of directors.

*Approvals.* The Companies Law provides that a transaction with an office holder or a transaction in which an office holder has a personal interest may not be approved if it is adverse to the company's interest. In addition, such a transaction generally requires board approval, unless the transaction is an extraordinary transaction, in which case it requires audit committee approval prior to the approval of the board of directors. A person, including a director, who has a personal interest in a matter that is considered at a meeting of the board of directors or the audit committee may not attend that meeting or vote on that matter; however, an office holder who has a personal interest in a transaction may be present during the presentation of the matter if the board or committee chairman determined that such presence is necessary for the presentation of the matter. A director with a personal interest in a matter that is considered at a meeting of the board of directors or the audit committee may attend that meeting or vote on that matter if a majority of the board of directors or the audit committee also has a personal interest in the matter; however, if a majority of the board of director has a personal interest, shareholder approval is also required.

### **Shareholders**

Approval of the audit committee, the board of directors and our shareholders is required for extraordinary transactions with a controlling shareholder or in which a controlling shareholder has a personal interest. For these purposes, a controlling shareholder is any shareholder that has the ability to direct the company's actions, including any shareholder holding 25% or more of the voting rights if no other shareholder owns more than 50% of the voting rights in the company. The shareholdings of two or more shareholders with a personal interest in the approval of the same transaction are aggregated for this purpose.

The shareholder approval must include the majority of shares voted at the meeting. In addition, either:

- the majority must include at least a majority of the shares of the voting shareholders who have no personal interest in the transaction voted at the meeting; or
- the total shareholdings of those who have no personal interest in the transaction and who vote against the transaction must not represent more than 2% of the aggregate voting rights in the company.

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

- any amendment to the articles of association;
- an increase in the company's authorized share capital;
- a merger; or
- approval of related party transactions that require shareholder approval.



A shareholder has a general duty to refrain from depriving any other shareholder of their rights as a shareholder. In addition, any controlling shareholder, any shareholder who knows that it possesses the power to determine the outcome of a shareholder or class vote and any shareholder who, pursuant to the company's articles of association 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.

#### **Anti-Takeover Provisions; Mergers and Acquisitions**

*Merger.* The Companies Law permits merger transactions with the approval of each party's board of directors and shareholders.

Under the Companies Law, a merging company must inform its creditors of the proposed merger. Any creditor of a party to the merger may seek a court order to delay or block the merger, if there is a reasonable concern that the surviving company will not be able to satisfy all of the obligations of the parties to the merger. Moreover, a merger may not be completed until all of the required approvals have been filed by both merging companies with the Israeli Registrar of Companies and (i) 30 days have passed from the time both companies' shareholders resolved to approve the merger, and (ii) at least 50 days have passed from the time that the merger proposal was filed with the Israeli Registrar of Companies.

*Tender Offer.* The Companies Law requires a purchaser to conduct a tender offer in order to purchase shares in publicly held companies, if as a result of the purchase the purchaser would hold more than 25% of the voting rights of a company in which no other shareholder holds more than 25% of the voting rights, or the purchaser would hold more than 45% of the voting rights of a company in which no other shareholder holds more than 45% of the voting rights. The tender offer must be extended to all shareholders, but the offeror is not required to purchase more than 5% of the company's outstanding shares, regardless of how many shares are tendered by shareholders. The tender offer generally may be consummated only if (i) at least 5% of the voting rights in the company will be acquired by the offeror and (ii) the number of shares tendered in the offer exceeds the number of shares whose holders objected to the offer. The requirement to conduct a tender offer shall not apply to (i) the purchase of shares in a private placement, provided that such purchase was approved by the company's shareholders for this purpose; (ii) a purchase from a holder of more than 25% of the voting rights of a company that results in a person becoming a holder of more than 25% of the voting rights of a company, and (iii) a purchase from the holder of more than 45% of the voting rights of a company that results in a person becoming a holder of more than 45% of the voting rights of a company.

Under the Companies Law, a person may not purchase shares of a public company if, following the purchase of shares, the purchaser would hold more than 90% of the company's shares, unless the purchaser makes a tender offer to purchase all of the target company's shares. If, as a result of the tender offer, the purchaser would hold more than 95% of the company's shares and more than half of the offerees that have no personal interest have accepted the offer, the ownership of the remaining shares will be transferred to the purchaser. Alternatively, the purchaser will be able to purchase all shares if the percentage of the offerees that did not accept the offer constitute less than 2% of the company's shares. If the purchaser is unable to purchase 95% or more of the company's shares, the purchaser may not own more than 90% of the shares of the target company.

*Tax Law.* Israeli tax law treats some acquisitions, such as a stock-for-stock swap between an Israeli company and a foreign company, less favorably than U.S. tax law. For example, Israeli tax law may subject a shareholder who exchanges his ordinary shares for shares in a foreign corporation to immediate taxation. Please see "Item 10.E Taxation — Israeli Taxation."

#### **Exculpation, Indemnification and Insurance of Directors and Officers**

Our articles of association allow us to indemnify, exculpate and insure our office holders, which includes our directors, to the fullest extent permitted by the Companies Law (other than with respect to certain expenses in connection with administrative enforcement proceedings under the Israeli Securities Law), provided that procuring this insurance or providing this indemnification or exculpation is duly approved by the requisite corporate bodies (as described above under "Related Party Transactions—Compensation").

Under the Companies Law, a company may indemnify an office holder in respect of some liabilities, either in advance of an event or following an event. If a company undertakes to indemnify an office holder in advance against monetary liability incurred in his or her capacity as an office holder, whether imposed in favor of another person pursuant to a judgment, a settlement or an arbitrator's award approved by a court, the indemnification must be limited to foreseeable events in light of the company's actual activities at the time of the indemnification undertaking and to a specific sum or a reasonable criterion under such circumstances, as determined by the board of directors.

Under the Companies Law, only if and to the extent provided by its articles of association, a company may indemnify an office holder against the following liabilities or expenses incurred in his or her capacity as an office holder:

- any monetary liability whether imposed on him or her in favor of another person pursuant to a judgment, a settlement or an arbitrator's award approved by a court;
- reasonable litigation expenses, including attorneys' fees, incurred by him or her as a result of an investigation or proceedings instituted against him or her by an authority empowered to conduct an investigation or proceedings, which are concluded either (i) without the filing of an indictment against the office holder and without the levying of a monetary obligation in lieu of criminal proceedings upon the office holder, or (ii) without the filing of an indictment against the office holder but with levying a monetary obligation in substitute of such criminal proceedings upon the office holder for a crime that does not require proof of criminal intent; and
- reasonable litigation expenses, including attorneys' fees, in proceedings instituted against him or her by the company, on the company's behalf or by a third-party, or in connection with criminal proceedings in which the office holder was acquitted, or as a result of a conviction for a crime that does not require proof of criminal intent.

Under the Companies Law, a company may obtain insurance for an office holder against liabilities incurred in his or her capacity as an office holder, if and to the extent provided for in its articles of association. These liabilities include a breach of duty of care to the company or a third-party, a breach of duty of loyalty and any monetary liability imposed on the office holder in favor of a third-party.

A company may, in advance only, exculpate an office holder for a breach of the duty of care, except in connection with a distribution of dividends or a repurchase of the company's securities. A company may not exculpate an office holder from a breach of the duty of loyalty towards the company.

Under the Companies Law, however, an Israeli company may only indemnify or insure an office holder against a breach of duty of loyalty to the extent that the office holder acted in good faith and had reasonable grounds to assume that the action would not prejudice the company. In addition, an Israeli company may not indemnify, insure or exculpate an office holder against a breach of duty of care if committed intentionally or recklessly, or an action committed with the intent to derive an unlawful personal gain, or for a fine or forfeit levied against the office holder.

We have purchased liability insurance and entered into indemnification and exculpation agreements for the benefit of our office holders in accordance with the Companies Law and our articles of association.

## **C. MATERIAL CONTRACTS**

### **Agreements Relating to the SweetIM acquisition**

On November 7, 2012, we entered into a Share Purchase Agreement with SweetIM Ltd., SweetIM Technologies Ltd., the shareholders of SweetIM and Nadav Goshen, as Shareholders' Agent, according to which we purchased 100% of the issued and outstanding shares of SweetIM Ltd. These companies operate under the "SweetPacks" trade name. Under the terms of the agreement, we paid \$10 million in cash and 1.99 million of our ordinary shares at closing, which occurred on November 30, 2012. A second payment of \$5.6 in cash was paid in December 2013, and a third payment of up to \$7.5 million in cash is due in May 2014, if certain milestones are met. The milestones are based on our revenues in the fiscal year of 2013 and the absence of certain changes in the industry in which we operate. We believe that that the terms of the Share Purchase Agreement will require us to pay \$2.5 million with respect to the contingent payment.

We funded the cash amount paid upon the closing of this acquisition using cash on hand and expect to fund the follow-on payments from operating cash flow. The Share Purchase Agreement includes customary representations, warranties, covenants and indemnification provisions.

On November 30, 2012, we entered into a Registration Rights Agreement with four former shareholders of SweetIM, with respect to the registration with the SEC of an aggregate of 1,537,546 of our ordinary shares issued for the several benefit of such individuals upon the closing of the acquisition. If we initiate a registered offering of securities, such holders would be entitled to include their registrable shares (as defined in such agreement) in the registration statement effected pursuant to such offering, subject to certain limitations. We are subject to customary indemnification undertakings with respect to any registration effected on behalf of such individuals. The agreement includes an undertaking by the holders not to sell any shares during the 7-day period before, and the 90-day period after, the effective date of an underwritten public offering.

## Agreements Relating to the ClientConnect Acquisition

### *Share Purchase Agreement*

On September 16, 2013, we entered into a Share Purchase Agreement among Perion, Conduit Ltd. and ClientConnect Ltd. providing for our acquisition of all the outstanding shares of ClientConnect in exchange for our ordinary shares. On the same date, Conduit and ClientConnect entered into a Split Agreement pursuant to which, on December 31, 2013, the entire activities and operations, and related assets and liabilities, of the ClientConnect business were transferred to ClientConnect on a cash-free and debt-free basis and the Conduit shareholders became the shareholders of ClientConnect in proportion to their ownership of Conduit. Upon the consummation of the ClientConnect Acquisition, which took place on January 2, 2014, each ClientConnect ordinary share was exchanged for approximately 0.2387 of our ordinary shares, as a result of which ClientConnect became a wholly owned subsidiary of ours. In addition, we granted options to purchase our ordinary shares to ClientConnect employees in exchange for their options to purchase ClientConnect shares that were issued to them upon the consummation of the Conduit Split as a roll-over of their then existing options to purchase ordinary shares of Conduit. Accordingly, we issued 54.75 million of our ordinary shares to the ClientConnect shareholders and granted options to purchase 2.82 million of our ordinary shares to the ClientConnect employees. On November 18, 2013, our shareholders approved the ClientConnect Acquisition and certain related matters, including the increase of our authorized share capital from 40 million ordinary shares to 120 million ordinary shares and the election of Dror Erez and Roy Gen to our Board of Directors.

### Lock-up Arrangements

Pursuant to said Share Purchase Agreement, the former ClientConnect shareholders are subject to lock-up arrangements with respect to the ordinary shares issued to them in consideration for the ClientConnect Acquisition (the "Contractual Lock-up") pursuant to which each of them will not be permitted to sell, offer to sell, grant any option to purchase or otherwise transfer or dispose of (each, a "transfer") any of such shares during an initial period ending on July 2, 2014 and will be subject to conditional transfer restrictions set forth below.

From July 3, 2014 to January 2, 2016, each such shareholder will be permitted to transfer up to 10% of such shareholder's shares that are subject to the Contractual Lock-up.

The Contractual Lock-up contains certain relaxations of the restrictions on transfers during such subsequent period, such that each such shareholder may be able to transfer a greater number of shares based upon the market price of our ordinary shares, as follows:

- If the prevailing market price of our ordinary shares (defined as the closing price on NASDAQ for any consecutive ten trading day period) is equal to or greater than \$15.00 per share (as appropriately adjusted for any stock splits, cash dividends, stock dividends, combinations, recapitalizations or the like) for any ten consecutive trading days, then each such shareholder may transfer up to an aggregate of thirty-three percent (33%) of the shares issued to such shareholder (including any such shares previously transferred by such shareholder);
- If the prevailing market price of our ordinary shares is equal to or greater than \$18.50 per share (as appropriately adjusted as aforesaid) for any ten consecutive trading days, then each such shareholder may transfer up to an aggregate of sixty seven percent (67%) of the shares issued to such shareholder (including any such shares previously transferred by such shareholder); and
- If the prevailing market price of our ordinary shares is equal to or greater than \$22.00 per share (as appropriately adjusted as aforesaid) for any ten consecutive trading days, then each shareholder may transfer up to an aggregate of one hundred percent (100%) of the shares issued to such shareholder (including any such shares previously transferred by such shareholder).

Notwithstanding the foregoing: (i) no such shareholder will be permitted to transfer more than an aggregate of thirty-three percent (33%) of such shareholder's "unlocked" shares in any consecutive four-week period during the period of the Contractual Lock-up; and (ii) the Contractual Lock-up will not apply in a tender offer for our ordinary shares or in a private transfer of our ordinary shares where the transferee agrees in writing to be bound to the Contractual Lock-up.

At any time following the closing of a public offering by us in which shares of such shareholders who are entitled to "piggyback registration rights" pursuant to the Registration Rights Undertaking described below with respect to such offering are in fact included in such offering, the shares sold in such offering and the shares held by the shareholders that are not entitled to such piggyback registration rights will be released from the Contractual Lock-up.

Upon the occurrence of any person (excluding any former ClientConnect shareholder or any person who is subject to transfer restrictions identical to those of the Contractual Lock-up) becoming the beneficial owner of 24.9% or more of our outstanding ordinary shares or at such time as the total number of shares issued to the former shareholders of ClientConnect and still held by them constitutes less than 20% of our outstanding ordinary shares, the Contractual Lock-up will be released.

Finally, upon the occurrence of any issuance of our ordinary shares or securities convertible into our ordinary shares in connection with (x) an acquisition by us of any business, company or assets or (y) a private placement of ordinary shares, that are not subject to more strict or identical transfer restrictions as provided under the Contractual Lock-up, in which the aggregate number of ordinary shares issued (after giving effect to the conversion of all convertible securities issued or issuable thereunder and assuming that all milestones and conditions for issuance thereunder are fulfilled) constitutes 10% or more of our outstanding ordinary shares as of immediately prior to such issuance, the transfer restrictions under the Contractual Lock-up will be further relaxed to be no more restrictive (both in volume and period) than the transfer restrictions imposed on the ordinary shares issued in such transaction.

In order to monitor the transfer restrictions under the Contractual Lock-up and the Tax Lock-up described below, the applicable shares have been deposited with brokerage firms who have undertaken to ensure compliance with such transfer restrictions. UBS Securities LLC has been appointed by us and the holders of a majority of the shares subject to the Contractual Lock-up as an advisor with respect to the Contractual Lock-up. The advisor may determine to relax transfer restrictions under the Contractual Lock-up, for the benefit of all of the shareholders on an equal basis.

The Contractual Lock-up does not apply to shares issued upon exercise of the Perion options issued in exchange for ClientConnect options in the ClientConnect Acquisition. However, each of our CEO, Mr. Mandelbaum and our President, Mr. Wine, have entered into certain lock-up arrangements with respect to our ordinary shares issuable pursuant to his equity grants.

#### Tax-related Restrictions

Pursuant to a tax ruling issued by the Israeli Tax Authorities, the tax events with respect to Conduit and its shareholders arising from the Conduit Split and the ClientConnect Acquisition will be deferred until the sale of our ordinary shares issued at the closing of the acquisition by any holder thereof or the sale of the assets or shares of ClientConnect shares by us. As a result, under Israeli tax law, each of Conduit, ClientConnect, the former shareholders of ClientConnect and we will be required to comply with various restrictions until December 31, 2015, including the following:

- each of Conduit and ClientConnect may not sell a majority of its assets and such assets must be put to reasonable use under the circumstances in the course of its business;
- each of Conduit and ClientConnect must continue the principal business activities in which Conduit was engaged during the two years preceding the Conduit Split;
- there may be no transfers of cash or other consideration, granting of guaranties or any other activities between Conduit and ClientConnect outside the ordinary course of business;
- the shareholders of Conduit are required to retain their same respective interests in Conduit as they had in Conduit prior to the Conduit Split, and the 5% shareholders of Conduit are required to maintain their same respective interests in the Company as they held immediately following the closing of the ClientConnect Acquisition (the "Tax Lock-up"). Accordingly, the Tax Lock-up with respect to our ordinary shares applies to Ronen Shilo, Dror Erez, and Zack and Orli Rinat. If any of the funds that became 5% shareholders of the Company as a result of the ClientConnect Acquisition fail to comply with certain conditions set by the Israeli Tax Authorities, the Tax Lock-up with respect to our ordinary shares will apply to such funds, as well; and
- subject to certain exceptions detailed below, we are required to maintain our interests in ClientConnect.

Nevertheless, the following transactions will not be deemed prohibited changes in ownership, provided that each of the shareholders of Conduit, with respect to their respective interests in Conduit, each of our restricted 5% shareholders, with respect to their respective interests in the Company, and we, with respect to our interest in ClientConnect, retain ownership of at least 51% of the applicable interests:

- the sale of up to 10% of the restricted interests in Conduit, ClientConnect or the Company to a person who was not a security holder of the relevant company prior to the Conduit Split and the ClientConnect Acquisition;
- the issuance of shares of Conduit, ClientConnect or the Company in a private placement to any single person (or a group of related persons) of up to 25% of the relevant company's outstanding shares, measured prior to the issuance, provided such person (or persons) was not a security holder of the relevant company prior to the Conduit Split and the ClientConnect Acquisition;
- a public offering of Conduit, ClientConnect or the Company pursuant to which the offered shares will be listed on a stock market; or
- an involuntary sale, such as by inheritance or in liquidation.

In the event of a violation of the foregoing restrictions by any person that is subject to the above restrictions, including by Conduit, by ClientConnect or by the Company, Conduit, its shareholders and ClientConnect could be subject to tax on any gains derived from the Conduit Split and the ClientConnect Acquisition, which would otherwise be deferred under the tax ruling. If the Tax Lock-up is breached by any Conduit shareholders, they will be required to indemnify the injured parties for the damages caused by such breach. Each of Conduit, ClientConnect and the Company has undertaken to indemnify the other parties and their respective affiliates for any damages caused to them by its actions that breach the foregoing restrictions.

#### *Registration Rights Undertaking*

Pursuant to the Registration Rights Undertaking, dated January 2, 2014, which we entered into with certain former shareholders of ClientConnect with respect to our ordinary shares issued to them in the ClientConnect Acquisition, we have the following general obligations:

- **Form F-3 Shelf Registration Rights.** We are required to file a "shelf" registration statement on Form F-3, as soon as practicable following the filing of this annual report and in any event within the earlier of (i) 30 days following the filing of this annual report and (ii) May 30, 2014, to register the resale from time to time by the holders thereof whose resale of shares would otherwise be subject to volume limitations set forth in SEC Rule 144. The holders of an aggregate of approximately 46.2 million ordinary shares have requested to include such shares in such registration statement, including Ronen Shilo, Dror Erez, Benchmark Israel, Zack and Orli Rinat, Project Condor and Roy Gen. We undertook to use our commercially reasonable efforts to cause the registration statement to become effective as soon as possible and maintain the effectiveness of the registration statement until the earliest of (i) five years following effectiveness, (ii) the resale of all the shares covered thereby and (iii) with respect to any shareholder, the ability of such shareholder to sell all of its shares under SEC Rule 144 without any volume limitations. For a period of three years following the expiration of such registration statement, at the request of holders whose resale of shares would otherwise be subject to volume limitations under SEC Rule 144, we would be required to file additional shelf registration statements and maintain the effectiveness thereof until the disposition of all the shares covered thereby. Such shelf registration rights are limited to four requests during such three-year period. Such registration will not derogate from the Tax Lock-up or the Contractual Lock-up that applies to the shares issued in the ClientConnect Acquisition.
- **Piggyback Registration Rights.** If we effect a registered offering of securities, the holders of registrable securities consisting of at least 3% of our outstanding share capital at the relevant time (or 2% in the case of W Capital Engage, L.P.) or a holder whose resale of registrable securities would otherwise be subject to volume limitations set forth in SEC Rule 144 will have the right to include its shares in the registration effected pursuant to such offering. Each such holder will be afforded this right regardless of the Contractual Lock-up that may apply to such holder's shares. The number of piggyback registrations is unlimited.
- All reasonable expenses incurred in connection with any such registrations, other than underwriting discounts and commissions, will be borne by us. We are subject to customary indemnification undertakings with respect to any registration effected pursuant to the Registration Rights Undertaking.

### Standstill Agreements

In connection with the ClientConnect Acquisition, several large shareholders of Conduit, including Ronen Shilo, Dror Erez and Benchmark Israel II, have each entered into a Standstill Agreement providing that for a period commencing on January 2, 2014 and ending on the earlier of (i) the last business day preceding our 2015 annual shareholder meeting or (ii) December 30, 2015, they will not vote in favor of (x) any change in the size of our Board of Directors, (y) any amendment to our Articles of Association to change the staggered structure of our Board of Directors or to shorten or terminate the term of service of any member of our Board of Directors, or (z) any proposal to shorten or terminate the term of service of any member of our Board of Directors (each, a "Fundamental Board Event"), in each case unless our Board of Directors recommends an affirmative vote in favor of the Fundamental Board Event. The obligations pursuant to the Standstill Agreements will expire if (i) any person (excluding any shareholder of Conduit as of September 16, 2013 and any person who is subject to standstill obligations similar to those set forth in the Standstill Agreements) becomes the beneficial owner of 24.9% or more of our outstanding ordinary shares or (ii) a Fundamental Board Event occurs despite such shareholder's compliance with its obligations thereunder and the compliance of all other shareholders of our company that are subject to standstill obligations similar to those set forth in the Standstill Agreement with such obligations. For information regarding our credit facilities, see Item 5.B "Operating and Financial Review and Prospects – Liquidity and Capital Resources – Credit Facilities."

#### **D. EXCHANGE CONTROLS**

Non-residents of Israel who hold our ordinary shares are able to receive any dividends, and any amounts payable upon the dissolution, liquidation and winding up of our affairs, freely repatriable in non-Israeli currency at the rate of exchange prevailing at the time of conversion. However, Israeli income tax is required to have been paid or withheld on these amounts. In addition, the statutory framework for the potential imposition of exchange controls has not been eliminated, and may be restored at any time by administrative action.

#### **E. TAXATION**

The following is a general summary only and should not be considered as income tax advice or relied upon for tax planning purposes.

#### **ISRAELI TAXATION**

THE FOLLOWING DESCRIPTION IS NOT INTENDED TO CONSTITUTE A COMPLETE ANALYSIS OF ALL TAX CONSEQUENCES RELATING TO THE OWNERSHIP OR DISPOSITION OF OUR ORDINARY SHARES. YOU SHOULD CONSULT YOUR OWN TAX ADVISOR CONCERNING THE TAX CONSEQUENCES OF YOUR PARTICULAR SITUATION, AS WELL AS ANY TAX CONSEQUENCES THAT MAY ARISE UNDER THE LAWS OF ANY STATE, LOCAL, FOREIGN OR OTHER TAXING JURISDICTION.

The following is a summary of the material Israeli tax laws applicable to us, and some Israeli Government programs benefiting us. This section also contains a discussion of some Israeli tax consequences to persons acquiring our ordinary shares. This summary does not discuss all the acts of Israeli tax law that may be relevant to a particular investor in light of his or her personal investment circumstances or to some types of investors subject to special treatment under Israeli law. Examples of this kind of investor include residents of Israel or traders in securities who are subject to special tax regimes not covered in this discussion. Since some parts of this discussion are based on new tax legislation that has not yet been subject to judicial or administrative interpretation, we cannot assure you that the appropriate tax authorities or the courts will accept the views expressed in this discussion.

*The discussion below should not be construed as legal or professional tax advice and does not cover all possible tax considerations. Potential investors are urged to consult their own tax advisors as to the Israeli or other tax consequences of the purchase, ownership and disposition of our ordinary shares, including, in particular, the effect of any foreign, state or local taxes.*

#### **General Corporate Tax Structure in Israel**

Taxable income of Israeli companies is generally subject to corporate tax at the rate of 25% for the 2013 tax year and 26.5% for the 2014 tax year. The corporate tax rate is scheduled to remain at a rate of 26.5% for future tax years. However, the effective tax rate payable by a company that derives income from a Preferred Enterprise (as further discussed below) may be considerably lower.

## Foreign Currency Regulations

We are permitted to measure our Israeli taxable income in U.S. dollars pursuant to regulations published by the Israeli Minister of Finance, which provide the conditions for doing so. We believe that we meet and will continue to meet, the necessary conditions and as such, we measure our results for tax purposes based on the U.S. dollar/NIS exchange rate as of December 31st of each year.

## Law for the Encouragement of Capital Investments, 1959

The Law for Encouragement of Capital Investments, 1959 (the "Investment Law") provides tax benefits for income of Israeli companies meeting certain requirements and criteria. The Investment Law has undergone certain amendments and reforms in recent years.

The Israeli parliament enacted a reform to the Investment Law, effective January 2011. According to the reform, a flat rate tax applies to companies eligible for the "Preferred Enterprise" status. In order to be eligible for Preferred Enterprise status, a company must meet minimum requirements to establish that it contributes to the country's economic growth and is a competitive factor for the Gross Domestic Product (a competitive enterprise).

We elected "Preferred Enterprise" status commencing in 2011.

Benefits granted to a Preferred Enterprise include reduced tax rates. In peripheral regions (Development Area A) the reduced tax rate was 10% in 2011 and 2012, 7% in 2013 and will be 9% starting from 2014. In other regions the tax rate was 15% in 2011 and 2012, 12.5% in 2013 and will be 16% starting from 2014. Preferred Enterprises in peripheral regions will be eligible for Investment Center grants, as well as the applicable reduced tax rates.

A distribution from a Preferred Enterprise out of the "Preferred Income" would be subject to 15% withholding tax for Israeli-resident individuals and non-Israeli residents (subject to applicable treaty rates), or 20% for dividends which are distributed on or after January 1, 2014 and from preferred income that was produced or accrued after such date.

A distribution from a Preferred Enterprise out of the "Preferred Income" would be exempt from withholding tax for an Israeli-resident company. A company electing to waive its Beneficiary Enterprise or Approved Enterprise status, which relate to tax incentive programs afforded under previous versions of the Investment Law, through June 30, 2015 may distribute "Approved Income" or "Beneficiary Income" subject to 15% withholding tax for Israeli resident individuals and non-Israeli residents (subject to applicable treaty rates) and exempt from withholding tax for an Israeli-resident company. Nonetheless, a distribution from income exempt under Beneficiary Enterprise and Approved Enterprise programs will subject the exempt income to tax at the reduced corporate income tax rates pertaining to the Beneficiary Enterprise and Approved Enterprise programs upon distribution, or complete liquidation in the case of a Beneficiary Enterprise's exempt income.

Pursuant to a recent amendment to the Investments Law which became effective on November 12, 2012 ("Amendment 69"), a company that elects by November 11, 2013 to pay a corporate tax rate as set forth in that amendment (rather than the regular corporate tax rate applicable to Approved Enterprise income) with respect to undistributed exempt income accumulated by the company up until December 31, 2011, will be entitled to distribute a dividend from such income without being required to pay additional corporate tax with respect to such dividend. A company that has so elected must make certain qualified investments in Israel over the five-year period commencing in 2013. A company that has elected to apply the amendment cannot withdraw from its election.

During 2013, we applied the provisions of Amendment 69 to all undistributed exempt profits accrued prior to 2011 by us and our Israeli subsidiary. Consequently, we paid NIS 6.3 million corporate tax on exempt income of NIS 63.2 million. This income is available to be distributed as dividends in future years with no additional corporate tax liability. As a result, we are required to invest NIS 4.7 million in our industrial enterprises in Israel over a five year period. Such investment may be in the form of the acquisition of industrial assets (excluding real estate assets), investment in R&D in Israel, or payroll payments to new employees to be hired by the enterprise.

## Law for the Encouragement of Industry (Taxes), 1969

We believe that we currently qualify as an "Industrial Company" within the meaning of the Law for the Encouragement of Industry (Taxes), 1969, or the Industry Encouragement Law. The Industry Encouragement Law defines "Industrial Company" as a company resident in Israel, of which 90% or more of its income in any tax year, other than of income from defense loans, capital gains, interest and dividends, 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.

The following corporate tax benefits, among others, are available to Industrial Companies:

- amortization of the cost of purchased know-how and patents, which are used for the development or advancement of the company, over an eight-year period;
- accelerated depreciation rates on equipment and buildings;
- under specified conditions, an election to file consolidated tax returns with additional related Israeli Industrial Companies; and
- expenses related to a public offering are deductible in equal amounts over three years.

Eligibility for the benefits under the Industry Encouragement Law is not subject to receipt of prior approval from any governmental authority. We cannot assure that we qualify or will continue to qualify as an "Industrial Company" or that the benefits described above will be available in the future.

#### **Transfer Pricing**

In accordance with Section 85A of the Israeli Tax Ordinance, if in an international transaction (where at least one party is a non-Israeli or all or part of the income from such transaction is to be taxed abroad as well as in Israel) there is a special relationship between the parties (including but not limited to family relationship or a relationships of control between companies), and due to this relationship the price set for an asset, right, service or credit was determined or other conditions for the transaction were set such that a smaller profit was realized than what would have been expected to be realized from a transaction of this nature, then such transaction shall be reported in accordance with customary market conditions and tax shall be charged accordingly. The assessment of whether a transaction falls under the aforementioned definition shall be implemented in accordance with one of the procedures mentioned in the regulations and is based, among others, on comparisons of characteristics which portray similar transactions in ordinary market conditions, such as profit, the area of activity, nature of the asset, the contractual conditions of the transaction and according to additional terms and conditions specified in the regulations.

#### **Taxation of our Shareholders**

Starting in 2012, dividends paid to Israeli individuals, are subject to 25% or 30% withholding tax depending on ownership percentage, unless reduced by an applicable tax treaty. Capital gains derived by Israeli resident individuals, on sale of our shares are subject to tax at a 25% or 30% rate unless an exemption is available under domestic law or an applicable tax treaty.

*Capital Gains Taxes Applicable to Israeli Resident Shareholders.* An individual is subject to a 25% 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 30% 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.

As of January 1, 2013, shareholders that are individuals who have taxable income that exceeds NIS 800,000 in a tax year (linked to the CPI each year), will be subject to an additional tax, referred to as High Income Tax, at the rate of 2% on their taxable income for such tax year which is in excess of NIS 800,000. For this purpose taxable income will include taxable capital gains from the sale of our shares and taxable income from dividend distributions.

Israeli corporations are generally subject to the corporate tax rate (25% in 2013, and 26.5 % in 2014) on capital gains derived from the sale of shares.

*Capital Gains Taxes Applicable to Non-Israeli Resident Shareholders.* Shareholders that are not Israeli residents are generally exempt from Israeli capital gains tax on any gains derived from the sale, exchange or disposition of our ordinary shares, provided that (1) such shareholders did not acquire their shares prior to our initial public offering, (2) the shares are listed for trading on the Tel Aviv Stock Exchange and/or a foreign exchange, and (3) such gains did not derive from a permanent establishment of such shareholders in Israel. However, non-Israeli corporations will not be entitled to the foregoing exemptions if Israeli residents (i) have a controlling interest of more than 25% in such non-Israeli corporation, or (ii) are the beneficiaries of or are entitled to 25% or more of the revenues or profits of such non-Israeli corporation, whether directly or indirectly. In certain instances, where our shareholders may be liable to 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.



Under the U.S.-Israel Tax Treaty, the sale, exchange or disposition of our ordinary shares by a shareholder who is a U.S. resident (for purposes of the U.S.-Israel Tax Treaty) holding the ordinary shares as a capital asset is exempt from Israeli capital gains tax unless either (i) the shareholder holds, directly or indirectly, shares representing 10% or more of our voting capital during any part of the 12-month period preceding such sale, exchange or disposition, or (ii) the capital gains arising from such sale are attributable to a permanent establishment of the shareholder located in Israel.

*Taxation of Non-Israeli Shareholders on Receipt of Dividends.* Non-residents of Israel are generally subject to Israeli income tax on the receipt of dividends paid on our ordinary shares at the rate of 25%, which tax will be withheld at source, unless a different rate is provided in a treaty between Israel and the shareholder's country of residence. With respect to a substantial shareholder (which is someone who alone, or together with another person, holds, directly or indirectly, at least 10% in one or all of any of the means of control in the corporation at the time of distribution or at any time during the preceding 12 months period), the applicable tax rate will be 30%.

Under the U.S.-Israel Tax Treaty, the maximum rate of tax withheld in Israel on dividends paid to a holder of our ordinary shares who is a U.S. resident (for purposes of the U.S.-Israel Tax Treaty) is 25%. However, generally, the maximum rate of withholding tax on dividends, not generated by our Approved, Beneficiary or Preferred Enterprises that are paid to a U.S. corporation holding 10% or more of our outstanding voting capital throughout the tax year in which the dividend is distributed as well as the previous tax year, is 12.5%. The lower 12.5% rate does not apply if the company has more than 25% of its gross income derived from certain types of passive income. Furthermore, dividends paid from income derived from our Approved, Beneficiary or Preferred Enterprise are subject, under certain conditions, to withholding at the rate of 15% or 20%. We cannot assure you that we will designate the profits that are being distributed in a way that will reduce shareholders' tax liability. A non-resident of Israel who receives dividends from which tax was withheld is generally exempt from the duty to file returns in Israel in respect of such income, provided such income was not derived from a business conducted in Israel by the taxpayer, and the taxpayer has no other taxable sources of income in Israel.

#### **U.S. FEDERAL INCOME TAX CONSIDERATIONS**

The following discussion is a description of certain U.S. federal income tax considerations applicable to an investment in our ordinary shares by U.S. Holders (defined below) who acquire our ordinary shares and hold them as capital assets for U.S. federal income tax purposes (generally, for investment). As used in this section, the term "U.S. Holder" means a beneficial owner of an ordinary share who is:

- an individual citizen or resident of the United States;
- a corporation (or entity classified as a corporation for U.S. federal income tax purposes) created or organized in or under the laws of the United States, any state of the United States or the District of Columbia;
- an estate, the income of which is subject to U.S. federal income taxation regardless of its source; or
- a trust if (i) a court within the United States is able to exercise primary supervision over its administration and one or more U.S. persons have the authority to control all of its substantial decisions or (ii) that has in effect a valid election under applicable U.S. Treasury Regulations to be treated as a U.S. person.

The term "Non-U.S. Holder" means a beneficial owner of an ordinary share who is not a U.S. Holder. The tax consequences to a Non-U.S. Holder may differ substantially from the tax consequences to a U.S. Holder. Certain limited aspects of U.S. federal income tax relevant to a Non-U.S. Holder are also discussed below.

This discussion is based on provisions of the U.S. Internal Revenue Code of 1986, as amended (the "Code"), current and proposed U.S. Treasury Regulations and administrative and judicial interpretations, each in effect as of the date hereof, all of which are subject to change, possibly on a retroactive basis. This description does not discuss all aspects of U.S. federal income taxation that may be applicable to investors in light of their particular circumstances or to investors who are subject to special treatment under U.S. federal income tax laws, including:

- insurance companies;
- dealers in stocks, securities or currencies;
- financial institutions and financial services entities;
- regulated investment companies or real estate investment trusts;
- grantor trusts;
- S corporations;

- persons that acquire ordinary shares upon the exercise of employee stock options or otherwise as compensation;
- tax-exempt organizations;
- persons that hold ordinary shares as a position in a straddle or as part of a hedging, conversion or other integrated instrument;
- individual retirement and other tax-deferred accounts;
- certain former citizens or long-term residents of the United States;
- persons (other than Non-U.S. Holders) having a functional currency other than the U.S. dollar; and
- persons that own directly, indirectly or constructively 10% or more of our voting shares.

Additionally, the tax treatment of persons who are, or hold our ordinary shares through, a partnership or other pass-through entity is not discussed, and such persons should consult their advisor as to their tax consequences. The possible application of the alternative minimum tax, U.S. federal estate or gift taxes and any aspect of state, local or non-U.S. tax laws are also not considered in this discussion.

We urge you to consult with your own tax advisor regarding the tax consequences of investing in the ordinary shares, including the effects of U.S. federal, state, local, and foreign or other tax laws.

#### **Distributions Paid on the Ordinary Shares**

Subject to the discussion below under "Passive Foreign Investment Company Considerations," a U.S. Holder generally will be required to include in gross income as ordinary dividend income the amount of any distributions paid by us on the ordinary shares, including the amount of any non-U.S. income taxes withheld, to the extent that those distributions are paid out of our current or accumulated earnings and profits as determined for U.S. federal income tax purposes. Distributions in excess of our earnings and profits will be applied against and will reduce the U.S. Holder's tax basis in its ordinary shares and, to the extent they exceed that tax basis, will be treated as gain from a sale or exchange of those ordinary shares. Our dividends generally will not qualify for the dividends-received deduction applicable, in some cases, to U.S. corporations. Dividends paid in NIS, including the amount of any non-U.S. income taxes withheld, will be includible in the income of a U.S. Holder in a U.S. dollar amount calculated by reference to the exchange rate in effect on the date they are included in income by the U.S. Holder, regardless of whether the payment in fact is converted into U.S. dollars. A U.S. holder that receives dividends paid in NIS (or any other foreign currency) and converts the NIS (or other foreign currency) into dollars after the date such dividends are included in income may have foreign exchange gain or loss based on any appreciation or depreciation in the value of the NIS (or other foreign currency) against the dollar, which will generally be U.S. source ordinary income or loss.

A non-corporate U.S. holder's "qualified dividend income" may be taxed at reduced rates (currently, a maximum rate of 20% applies). For this purpose, "qualified dividend income" generally includes dividends paid by a non-U.S. corporation if either:

- (a) the stock of that corporation with respect to which the dividends are paid is readily tradable on an established securities market in the United States, or
- (b) that corporation is eligible for the benefits of a comprehensive income tax treaty with the United States which includes an information exchange program and is determined to be satisfactory by the United States Secretary of the Treasury. The Internal Revenue Service has determined that the United States-Israel Tax Treaty is satisfactory for this purpose.

In addition, a U.S. Holder generally must hold its ordinary shares for less than 61 days during the 121-day period beginning on the date that is 60 days prior to the ex-dividend date with respect to such dividend, excluding for this purpose, under the rules of Code section 246(c), any period during which the U.S. Holder has an option to sell, is under a contractual obligation to sell, has made and not closed a short sale of, is the grantor of a deep-in-the-money or otherwise nonqualified option to buy, or has otherwise diminished its risk of loss by holding other positions with respect to, such ordinary share (or substantially identical securities) or (2) the U.S. Holder is under an obligation (pursuant to a short sale or otherwise) to make related payments with respect to positions in property substantially similar or related to the ordinary share with respect to which the dividend is paid.

In addition, a non-corporate U.S. Holder will be able to take a qualified dividend into account in determining its deductible investment interest (which is generally limited to its net investment income) only if it elects to do so; in such case the dividend will be taxed at ordinary income tax rates. Dividends paid by a non-U.S. corporation will not be qualified dividend income and thus, not qualify for reduced rates, if such corporation is, for the tax year in which the dividend is paid or the preceding tax year, a "passive foreign investment company" for U.S. federal income tax purposes.

Subject to certain conditions and limitations, non-U.S. income tax as withheld on dividends may be deducted from taxable income or credited against a U.S. Holder's U.S. federal income tax liability. The limitation on foreign taxes eligible for credit is calculated separately with respect to specific classes of income. Dividends paid by us generally will be foreign source "passive income" for U.S. foreign tax credit purposes. U.S. Holders that do not elect to claim a foreign tax credit may generally instead claim a deduction for the non-U.S. income taxes withheld if such U.S. Holders itemize their deductions for U.S. federal income tax purposes. The rules relating to the determination of foreign source income and the foreign tax credit are complex, and the availability of a foreign tax credit depends on numerous factors. U.S. holders should consult their tax advisors regarding the application of the foreign tax credit rules.

A U.S. holder will be denied a foreign tax credit for non-U.S. income taxes withheld from a dividend received on the ordinary shares (i) if the U.S. holder has not held the ordinary shares for at least 16 days of the 31-day period beginning on the date which is 15 days before the ex-dividend date with respect to such dividend or (ii) to the extent the U.S. holder is under an obligation (whether pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property. Any days during which a U.S. holder has substantially diminished its risk of loss on the ordinary shares are not counted toward meeting the required 16-day holding period.

#### **Disposition of Ordinary Shares**

Upon the sale or other disposition of ordinary shares, subject to the discussion below under "Passive Foreign Investment Company Considerations," a U.S. Holder generally will recognize capital gain or loss equal to the difference between the amount realized on the disposition and the holder's adjusted tax basis in the ordinary shares. Gain or loss upon the disposition of the ordinary shares will be treated as long-term if, at the time of the sale or disposition, the ordinary shares were held for more than one year. Long-term capital gains realized by non-corporate U.S. Holders generally are subject to reduced rates of tax (currently, a maximum rate of 20% applies). The deductibility of capital losses by a U.S. Holder is subject to limitations.

A U.S. holder that uses the cash method of accounting calculates the dollar value of the proceeds received on the sale as of the date that the sale settles. However, a U.S. holder that uses the accrual method of accounting is required to calculate the value of the proceeds of the sale as of the trade date and may therefore realize foreign currency gain or loss. A U.S. holder may avoid realizing foreign currency gain or loss by electing to use the settlement date to determine the proceeds of sale for purposes of calculating the foreign currency gain or loss. In addition, a U.S. holder that receives foreign currency upon disposition of ordinary shares and converts the foreign currency into dollars after the settlement date or trade date (whichever date the U.S. holder is required to use to calculate the value of the proceeds of sale) may have foreign exchange gain or loss based on any appreciation or depreciation in the value of the foreign currency against the dollar, which will generally be U.S. source ordinary income or loss.

#### **Passive Foreign Investment Company Considerations**

Special U.S. federal income tax rules apply to U.S. Holders owning shares of a passive foreign investment company or "PFIC." A non-U.S. corporation will be considered a PFIC for any tax year in which, after applying certain look-through rules, 75% or more of its gross income consists of specified types of passive income, or 50% or more of the average value of its assets (determined on an average quarterly basis) consists of passive assets, which generally means assets that generate, or are held for the production of, passive income.

If we were classified as a PFIC, a U.S. Holder could be subject to increased tax liability upon the sale or other disposition of ordinary shares or upon the receipt of amounts treated as "excess distributions." Under these rules, the excess distribution and any gain would be allocated ratably over the U.S. Holder's holding period for the ordinary shares, and the amount allocated to the current taxable year and any taxable years prior to the first taxable year in which we were a PFIC would be taxed as ordinary income. The amount allocated to each of the prior taxable years would be subject to tax at the highest marginal rate in effect for the applicable class of taxpayer for that year, and an interest charge for the deemed deferral benefit would be imposed on the resulting tax allocated to such prior taxable years. The tax liability with respect to the amount allocated to taxable years prior to the year of the disposition, or "excess distribution," cannot be offset by any net operating losses. In addition, holders of stock in a PFIC may not receive a "step-up" in basis on shares acquired from a decedent. U.S. Holders who hold ordinary shares during a period when we are a PFIC will be subject to the foregoing rules even if we cease to be a PFIC. Unless otherwise provided by the IRS, if a non-U.S. corporation is a PFIC, a U.S. Holder generally is required to file an annual informational return with the IRS.

As an alternative to the tax treatment described above, a U.S. Holder could elect to treat us as a “qualified electing fund” (“QEF”), in which case the U.S. Holder would be required to include in income, for each taxable year that we are a PFIC, its pro rata share of our ordinary earnings as ordinary income and its pro rata share of our net capital gains as capital gain, subject to a separate election to defer payment of taxes where such deferral is subject to an interest charge. A U.S. Holder may make a QEF election only if we furnish such U.S. Holder with certain tax information. We currently do not provide this information, and we do not intend to take any actions that would be necessary to permit U.S. Holders to make a QEF election in the event we become a PFIC.

As an alternative to making a QEF election, a U.S. Holder of PFIC stock which is “marketable stock” (e.g., “regularly traded” on the Nasdaq Global Select Market) may in certain circumstances avoid certain of the tax consequences generally applicable to holders of stock in a PFIC by electing to mark the stock to market as of the beginning of such U.S. Holder’s holding period for the ordinary shares. As a result of such election, in any taxable year that we are a PFIC, a U.S. Holder generally would be required to report gain or loss to the extent of the difference between the fair market value of the ordinary shares at the end of the taxable year and such U.S. Holder’s tax basis in its ordinary shares at that time. Any gain under this computation, and any gain on an actual disposition of the ordinary shares in a year in which we are a PFIC, would be treated as ordinary income. Any loss under this computation, and any loss on an actual disposition of the ordinary shares in a year in which we are a PFIC, generally would be treated as ordinary loss to the extent of the cumulative net-mark-to-market gain previously included. Any remaining loss from marking ordinary shares to market will not be allowed, and any remaining loss from an actual disposition of ordinary shares generally would be capital loss. A U.S. Holder’s tax basis in its ordinary shares is adjusted annually for any gain or loss recognized under the mark-to-market election. There can be no assurances that there will be sufficient trading volume with respect to the ordinary shares in order for the ordinary shares to be considered “regularly traded” or that our ordinary shares will continue to trade on the Nasdaq Global Select Market. Accordingly, there are no assurances that our ordinary shares will be marketable stock for these purposes. As with a QEF election, a mark-to-market election is made on a shareholder-by-shareholder basis, applies to all ordinary shares held or subsequently acquired by an electing U.S. Holder and can only be revoked with consent of the IRS (except to the extent the ordinary shares no longer constitute “marketable stock”).

Based on our income, assets, activities and market capitalization, we do not believe that we were a PFIC for the taxable year ended December 31, 2013 for U.S. federal income tax purposes. Our belief that we were not a PFIC for the 2013 taxable year is based on our estimate of the fair market value of our assets, including our intangible assets and goodwill, which are not reflected in our financial statements under U.S. GAAP. In calculating the value of our assets, we value our total assets, in part, based on our total market capitalization. We believe this valuation approach is reasonable. However, there can be no assurances that the IRS could not successfully challenge our valuations or methods, which could result in our classification as a PFIC. While we intend to manage our business so as to avoid PFIC status, to the extent consistent with our other business goals, we cannot predict whether our business plans will allow us to avoid PFIC status or whether our business plans will change in a manner that affects our PFIC status determination. In addition, because the market price of our ordinary shares is likely to fluctuate and because that market price may affect the determination of whether we will be considered a PFIC, we cannot be certain that we will not be a PFIC in 2014 or become a PFIC in any other future taxable year.

The rules applicable to owning shares of a PFIC are complex, and each prospective purchaser who would be a U.S. Holder should consult with its own tax advisor regarding the consequences of investing in a PFIC.

#### **Medicare Tax**

For tax years beginning after December 31, 2012, certain non-corporate U.S. Holders will be subject to an additional 3.8% Medicare tax on all or a portion of the “net investment income,” which may include dividends on, or capital gains recognized from the disposition of, our ordinary shares. U.S. Holders are urged to consult their own tax advisors regarding the applicability of the Medicare tax to their investment in our shares.

#### **Tax Consequences for Non-U.S. Holders of Ordinary Shares**

Except as described in “Information Reporting and Back-up Withholding” below, a Non-U.S. Holder of our ordinary shares will not be subject to U.S. federal income or withholding tax on the payment of dividends on, and the proceeds from the disposition of, our ordinary shares, unless, in the case of U.S. federal income taxes:

- the item is effectively connected with the conduct by the Non-U.S. Holder of a trade or business in the United States and (i) in the case of a resident of a country which has a treaty with the United States, the item is attributable to a permanent establishment, or (ii) in the case of an individual, the item is attributable to a fixed place of business in the United States; or

- the Non-U.S. Holder is an individual who holds the ordinary shares as a capital asset and is present in the United States for 183 days or more in the taxable year of the disposition, and certain other conditions are met.

#### **Information Reporting and Backup Withholding**

U.S. Holders generally are subject to information reporting requirements with respect to dividends on, or proceeds from the disposition of, our ordinary shares. In addition, a U.S. Holder may be subject, under certain circumstances, to backup withholding (currently, at a rate of up to 28%) with respect to dividends paid on, or proceeds from the disposition of, our ordinary shares unless the U.S. Holder provides proof of an applicable exemption or correct taxpayer identification number, and otherwise complies with the applicable requirements of the backup withholding rules. A U.S. Holder of our ordinary shares who provides an incorrect taxpayer identification number may be subject to penalties imposed by the IRS. Amounts withheld under the backup withholding rules are not an additional tax and may be refunded or credited against the U.S. Holder's U.S. federal income tax liability, provided the required information is furnished to the IRS.

Certain individuals who are U.S. Holders may be required to file a Form 8938 to report their ownership of specified foreign financial assets, which may include our ordinary shares, if the total value of those assets exceed certain thresholds. U.S. Holders are urged to consult their tax advisors regarding their tax reporting obligations, including the requirement to file a Form 8938.

Non-U.S. Holders generally are not subject to information reporting or backup withholding, provided that the Non-U.S. Holder provides a taxpayer identification number, certifies to its foreign status, or establishes another exemption to the information reporting or backup withholding requirements.

#### **F. DIVIDENDS AND PAYING AGENTS**

Not applicable.

#### **G. STATEMENT BY EXPERTS**

Not applicable.

#### **H. DOCUMENTS ON DISPLAY**

You may request a copy of our U.S. SEC filings, at no cost, by writing or calling us at Perion Network Ltd., 4 HaNechoshet Street, Tel-Aviv 69710, Israel, Attention: Yacov Kaufman, Telephone: +972-3-7696100. A copy of each report submitted in accordance with applicable U.S. law is available for public review at our principal executive offices. In addition, our filings with the SEC may be inspected without charge at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Information on the operation of the Public Reference Room can be obtained by calling the SEC at 1-800-SEC-0330. Our SEC filings are also available to the public from the SEC's website at [www.sec.gov](http://www.sec.gov).

A copy of each document (or a translation thereof to the extent not in English) concerning Perion that is referred to in this annual report on Form 20-F, is available for public view (subject to confidential treatment of agreements pursuant to applicable law) at our principal executive offices at Perion Network Ltd., 4 HaNechoshet Street, Tel-Aviv 69710, Israel.

#### **I. SUBSIDIARY INFORMATION**

Not applicable.

#### **ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

*Exchange Rate Risk.* A significant portion of our revenues and expenses are in foreign currencies. As a result numerous balances are denominated or linked to these currencies. Foreign currency related fluctuations resulted in \$69,000 and \$170,000 financial income in 2013 and 2012, respectively. These results are components of the exchange rate differences set forth in Note 13 (a) to our financial statements.

As of December 31, 2013, balance sheet financial items in U.S. dollars, our functional currency, and those currencies other than the U.S. dollars were as follows:

	U.S. dollars	NIS	Other Currencies	Total
	In thousands of U.S. dollars			
Current assets	38,508	6,994	2,083	47,585
Long-term assets	63,632	3,658	-	67,290
Current liabilities	37,267	11,605	1,573	50,445
Long-term liabilities	7,831	29	-	7,860
Total	57,042	(982)	510	56,570

The fair value of firmly committed transactions denominated in currencies other than our functional currency, as of December 31, 2013, was a liability of \$1.3 million for less than one year and \$0.7 million for more than one year, all denominated in NIS.

The fair value of derivative instruments and the notional amount of the hedged instruments in NIS, as of December 31, 2013 were as follows:

	Notional Amount	Fair Value
	In thousands of U.S. dollars	
Zero-cost collar contracts to hedge payroll expenses	2,500	113

In addition, in territories where our prices are based on local currencies, fluctuations in the dollar exchange rate could affect our gross profit margin. We may compensate for such fluctuations by changing product prices accordingly. We also hold a small part of our financial investments in other currencies, mainly NIS and Euro. The dollar value of those investments may decline. A revaluation of 1% of the foreign currencies (i.e. other than U.S. dollar) would not have a material effect on our income before taxes possibly reducing it by less than \$0.1 million.

A significant portion of our costs, including salaries and office expenses are incurred in NIS. Inflation in Israel may have the effect of increasing the U.S. dollar cost of our operations in Israel. If the U.S. dollar declines in value in relation to the New Israeli Shekel, it will become more expensive for us to fund our operations in Israel. A revaluation of 1% of the New Israeli Shekel will affect our income before tax by less than one percent (1%). The exchange rate of the U.S. dollar to the New Israeli Shekel, based on exchange rates published by the Bank of Israel, was as follows:

	Year Ended December 31,		
	2011	2012	2013
Average rate for period	3.578	3.855	3.610
Rate at year-end	3.821	3.733	3.471

Since 2006 we've engaged a firm to analyze our exposure to the fluctuation in foreign currency exchange rates and are implementing their recommendations since then. However, due to the market conditions, volatility and other factors, its proposals and their implementation occasionally prove to be ineffective or can cause additional finance expenses.

**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

(a) Disclosure Controls and Procedures. Our management, including our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our "disclosure controls and procedures" (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of December 31, 2013. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of December 31, 2013, our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports we file or submit under the Exchange Act and the rules thereunder, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

(b) 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. Our internal control over financial reporting is a process to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes those policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Our management recognizes that there are inherent limitations in the effectiveness of any system of internal control over financial reporting, including the possibility of human error and the circumvention or override of internal control. Accordingly, even effective internal control over financial reporting can provide only reasonable assurance with respect to financial statement preparation, and may not prevent or detect all misstatements. Further, because of changes in conditions, the effectiveness of internal control over financial reporting may vary over time.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2013. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in "Internal Control – Integrated Framework" (1992 framework). Our management has concluded, based on its assessment, that our internal control over financial reporting was effective as of December 31, 2013.

(c) Attestation Report of Registered Public Accounting Firm: Our independent registered public accounting firm, Kost, Forer, Gabbay & Kasierer, a member of Ernst & Young Global independently assessed the effectiveness of our internal control over financial reporting and has issued an attestation report, which is included under Item 18 on page F-3 of this annual report.

(d) Changes in Internal Control Over Financial Reporting: During the period covered by this report, no changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) have occurred that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERTS**

Our board of directors has determined that each of Mr. David Jutkowitz and Mr. Alan Gelman, who is an independent director (as defined in the NASDAQ Listing Rules) and serves on our audit committee, qualifies as an "audit committee financial expert" as defined in Item 16A of Form 20-F.

**ITEM 16B. CODE OF ETHICS**

Our board of directors has adopted a code of conduct applicable to all of our directors, officers and employees as required by the NASDAQ Listing Rules, which also complies with the definition of a "code of ethics" set out in Section 406(c) of the Sarbanes-Oxley Act of 2002. A copy of the code of ethics can be found on our website at: [www.perion.com](http://www.perion.com).

**ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

Fees for the professional services rendered by our independent accountants Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global, for each of the last two fiscal years were as follows (in thousands):

	2012	2013
Audit Fees	\$ 181	\$ 254
Tax Fees	105	106
Audit Related fees	15	91
Other	-	38
<b>Total</b>	<b>\$ 301</b>	<b>\$ 490</b>

Audit fees include fees for professional services rendered by our principal accountant in connection with the annual audit, review of quarterly consolidated financial statements, internationally required statutory audits, consents and assistance with review of documents filed with the SEC. The fee for 2013 includes the audit of internal control over financial reporting.

Audit-related fees principally include due diligence in connection with acquisitions and accounting consultation.

Tax fees include services related to tax compliance, including the preparation of tax returns and claims for refunds, tax planning and advice, including assistance with tax audits and appeals, advice related to mergers and acquisitions and assistance with respect to requests for rulings from tax authorities.

All other fees principally include advisory services.

Our audit committee is responsible for the establishment of policies and procedures for review and pre-approval by the committee of all audit services and permissible non-audit services to be performed by our independent auditor, in order to ensure that such services do not impair our auditor's independence. Pursuant to the pre-approval policy adopted by our audit committee, certain enumerated audit, audit-related and tax services have been granted general pre-approval by our audit committee and need not be specifically pre-approved. Pre-approval fee levels or budgeted amounts for all services to be provided by the independent auditor will be established annually by the audit committee and the committee may also determine the appropriate ratio between the total amount of fees for audit, audit-related, tax services and other services. All requests for services to be provided by the independent auditor will be submitted to our Chief Financial Officer, who will determine whether such services are included within the enumerated pre-approved services. The audit committee will be informed on a timely basis of any pre-approved services that were performed by the auditor. Requests for services that require specific pre-approval will be submitted to the audit committee with a statement as to whether, in the view of the Chief Financial Officer and the independent auditor, the request is consistent with the SEC's rules on auditor independence. The Chief Financial Officer will monitor the performance of all services and determine whether such services are in compliance with the policy.

**ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES**

None.

**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**

We are a foreign private issuer whose ordinary shares are listed on the NASDAQ Global Select Market. As such, we are required to comply with U.S. federal securities laws, including the Sarbanes-Oxley Act, and the NASDAQ Listing Rules, including the NASDAQ corporate governance requirements. The NASDAQ Listing Rules provide that foreign private issuers may follow home country practice in lieu of certain qualitative listing requirements subject to certain exceptions and except to the extent that such exemptions would be contrary to U.S. federal securities laws, so long as the foreign issuer discloses that it does not follow such listing requirement and describes the home country practice followed in its reports filed with the SEC. Below is a concise summary of the significant ways in which our corporate governance practices differ from the corporate governance requirements of NASDAQ applicable to domestic U.S. listed companies:

*Shareholder Approval.* Although the NASDAQ Listing Rules generally require shareholder approval of equity compensation plans and material amendments thereto, we follow Israeli practice, which is to have such plans and amendments approved only by the board of directors, unless such arrangements are for the compensation of chief executive officer or directors, in which case they also require the approval of the compensation committee and the shareholders.

In addition, rather than follow the NASDAQ Listing Rules requiring shareholder approval for the issuance of securities in certain circumstances, we follow Israeli law, under which a private placement of securities requires approval by our board of directors and shareholders if it will cause a person to become a controlling shareholder (generally presumed at 25% ownership) or if:

- the securities issued amount to 20% or more of our outstanding voting rights before the issuance;
- some or all of the consideration is other than cash or listed securities or the transaction is not on market terms; and
- the transaction will increase the relative holdings of a shareholder that holds 5% or more of our outstanding share capital or voting rights or will cause any person to become, as a result of the issuance, a holder of more than 5% of our outstanding share capital or voting rights.

*Shareholder Quorum.* The NASDAQ Listing Rules require that an issuer have a quorum requirement for shareholders meetings of at least one-third of the outstanding shares of the issuer's common voting stock. We have chosen to follow home country practice with respect to the quorum requirements of an adjourned shareholders meeting. Our articles of association, as permitted under the Companies Law, provide that if at the adjourned meeting a legal quorum is not present after 30 minutes from the time specified for the commencement of the adjourned meeting, then the meeting shall take place regardless of the number of members present and in such event the required quorum shall consist of any number of shareholders present in person or by proxy.

*Annual Reports.* While the NASDAQ Listing Rules generally require that companies send an annual report to shareholders prior to the annual general meeting, we follow the generally accepted business practice for companies in Israel. Specifically, we file annual reports on Form 20-F, which contain financial statements audited by an independent accounting firm, electronically with the SEC and post a copy on our website.

*Executive Sessions.* While the NASDAQ Listing Rules require that "independent directors," as defined in the NASDAQ Listing Rules, must have regularly scheduled meetings at which only "independent directors" are present. Israeli law does not require, nor do our independent directors necessarily conduct, regularly scheduled meetings at which only they are present.

*Approval of Related Party Transactions.* Although the NASDAQ Listing Rules require the approval of the audit committee or another independent body of a company's board of directors for all "related party transactions" required to be disclosed pursuant to Item 7.B. of Form 20-F, we follow the provisions of the Israeli Companies Law. Specifically, that 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, and the regulations promulgated thereunder, which allow for the approval of certain related party transactions, which are immaterial, in the normal course of business and on market terms, by the board of directors. Other specified transactions can require audit committee approval and shareholder approval, as well as board approval. See also "Item 10.B Memorandum and Articles of Association — Approval of Related Party Transactions" for the definition and procedures for the approval of related party transactions.

*Compensation Committee.* The NASDAQ Listing Rules require a listed company to have a compensation committee composed entirely of independent directors that operates pursuant to a written charter addressing its purpose, responsibilities and membership qualifications and may receive counseling from independent consultants, after evaluating their independence. We have a compensation committee whose purpose, responsibilities and membership qualifications are governed by the Israeli Companies Law, as described under Item 6.C "Board Practices—Committees of the Board of Directors—Compensation Committee". There are no specific independence evaluation requirements for outside consultants.

**ITEM 16H. MINE SAFETY DISCLOSURE**

Not applicable.

PART III

ITEM 17. FINANCIAL STATEMENTS

Not applicable.

ITEM 18. FINANCIAL STATEMENTS

The following financial statements and related auditors' report are filed as part of this annual report:

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**ITEM 19. EXHIBITS:**

<u>No.</u>	<u>Description</u>
1.1	Memorandum of Association of Perion, as amended and restated (translated from Hebrew).
1.2	Articles of Association of Perion, as amended and restated.
4.1	Commitment Letter and Financial Covenants Letter among the Company and Bank Leumi Le-Israel, B.M., dated September 6, 2011 (1), and an amendment thereto dated May 10, 2012 (2).
4.2	Commitment Letter and Financial Covenants Letter among the Company and the First International Bank of Israel, B.M., dated September 6, 2011 (1), an amendment thereto dated April 15, 2012 (2), and an amendment thereto dated December 3, 2013 (each translated from Hebrew)
4.3	Share Purchase Agreement by and among Perion Network Ltd., SweetIM Ltd., SweetIM Technologies Ltd., the Shareholders of SweetIM Ltd. and Nadav Goshen as Shareholders' Agent, dated as of November 7, 2012, and Amendment No. 1, dated as of November 30, 2012. (2)
4.4	Registration Rights Agreement among the Company and the investors listed therein, dated as of November 7, 2012. (2)
4.5	Share Purchase Agreement by and among Perion Network Ltd., Conduit Ltd. and ClientConnect Ltd., dated as of September 16, 2013. (3)
4.6	Form of Standstill Agreement between Perion Network Ltd. and certain shareholders thereof, dated as of September 16, 2013. (3)
4.7	Form of Registration Rights Undertaking of the Company dated January 2, 2014. (3)
4.8	Search Services Agreement by and between Conduit Ltd. and Microsoft Online, Inc., dated November 19, 2010, as amended on May 11, 2011.*
4.9	Perion 2003 Israeli Share Option Plan and U.S. Addendum. (2)
4.10	Perion Equity Incentive Plan. (3)
4.11	Compensation Policy for Directors and Officers, adopted November 18, 2013. (3)
8	List of subsidiaries.
12.1	Certification required by Rule 13a-14(a) or Rule 15d-14(a) executed by the Chief Executive Officer of the Company.
12.2	Certification required by Rule 13a-14(a) or Rule 15d-14(a) executed by the Chief Financial Officer of the Company.
13.1	Certification required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code.
13.2	Certification required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code.
15.1	Consent of Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global, Independent Auditors.
101	The following financial information from Perion Network Ltd.'s Annual Report on Form 20-F for the year ended December 31, 2013, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets at December 31, 2012 and 2013; (ii) Consolidated Statements of Income for the years ended December 31, 2011, 2012 and 2013; (iii) Consolidated Statements of Comprehensive Income for the years ended December 31, 2011, 2012 and 2013; (iv) Statements of Changes in Shareholders' Equity and Comprehensive Income for the years ended December 31, 2011, 2012 and 2013; (v) Consolidated Statements of Cash Flows for the years ended December 31, 2011, 2012 and 2013; and (vi) Notes to Consolidated Financial Statements. (4)

(1) Previously filed with the SEC on March 22, 2012 as an exhibit to our annual report on Form 20-F, and incorporated herein by reference.

(2) Previously filed with the SEC on April 29, 2013 as an exhibit to our annual report on Form 20-F, and incorporated herein by reference.

(3) Previously filed with the SEC on October 15, 2013 as an exhibit to our Report on Form 6-K, and incorporated herein by reference. .

(4) In accordance with Rule 406T of Regulation S-T, the information in Exhibit 101 is furnished and deemed not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of Section 18 of the Exchange Act of 1934, and otherwise is not subject to liability under these sections and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, as amended, except as expressly set forth by specific reference in such filing.

\* Confidential treatment was requested with respect to certain portions of this exhibit pursuant to 17.C.F.R. §§ 230.406 and 200.83. Omitted portions were filed separately with the SEC.

PERION NETWORK LTD. AND ITS SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2013

IN U.S. DOLLARS

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**To the Shareholders and Board of Directors of**

**PERION NETWORK LTD.**

We have audited the accompanying consolidated balance sheets of Perion Network Ltd. ("the Company") and its subsidiaries as of December 31, 2012 and 2013, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2013. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with 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 includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2012 and 2013, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2013, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated April 10, 2014 expressed an unqualified opinion thereon.

/s/ KOST FORER GABBAY & KASIERER  
KOST FORER GABBAY & KASIERER  
A Member of Ernst & Young Global

Tel-Aviv, Israel  
April 10, 2014



**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**To the Shareholders and Board of Directors of**

**PERION NETWORK LTD.**

We have audited Perion Network Ltd.'s ("the Company") internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control–Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("the COSO criteria"). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report on internal control over financial reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit 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 effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.



In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company and its subsidiaries as of December 31, 2013 and 2012, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2013 and our report dated April 10, 2014 expressed an unqualified opinion thereon.

Tel-Aviv, Israel  
April 10, 2014

/s/ KOST FORER GABBAY & KASIERER  
KOST FORER GABBAY & KASIERER  
A Member of Ernst & Young Global



CONSOLIDATED BALANCE SHEETS

PERION NETWORK LTD. AND ITS SUBSIDIARIES

U.S. dollars in thousands

	As of December 31,	
	2012	2013
<b>Assets</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$ 21,762	\$ 23,364
Restricted cash	10,260	1,837
Trade receivables (net of allowance for doubtful accounts and sales reserves in a total amount of \$ 108 and \$ 192 in 2012 and 2013, respectively)	10,246	18,665
Other receivables and prepaid expenses	5,424	3,719
<b>Total current assets</b>	<b>47,692</b>	<b>47,585</b>
Property and equipment, net	1,522	1,377
Other intangible assets, net	35,295	27,040
Goodwill	37,435	37,435
Other assets	1,215	1,438
<b>Total assets</b>	<b>\$ 123,159</b>	<b>\$ 114,875</b>

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

U.S. dollars in thousands

	As of December 31,	
	2012	2013
<b>Liabilities and shareholders' equity</b>		
<b>Current liabilities:</b>		
Current maturities of long term debt	\$ 2,300	\$ 2,300
Trade payables	9,560	13,900
Deferred revenues	5,132	9,052
Payment obligation related to acquisition	20,317	8,773
Accrued expenses and other liabilities	14,679	16,420
<b>Total current liabilities</b>	<b>51,988</b>	<b>50,445</b>
Long-term debt	6,550	4,250
Contingent purchase consideration	6,078	-
Other long term liabilities	3,833	3,610
<b>Total liabilities</b>	<b>68,449</b>	<b>58,305</b>
<b>Commitments and contingent liabilities</b>		
<b>Shareholders' equity:</b>		
Ordinary shares of NIS 0.01 par value - Authorized: 40,000,000 and 120,000,000 shares at December 31, 2012 and 2013, respectively; Issued and outstanding: 12,064,510 and 12,501,237 shares at December 31, 2012 and 2013, respectively	28	29
Additional paid-in capital	45,069	46,618
Retained earnings	10,615	10,925
Treasury stock	(1,002)	(1,002)
<b>Total shareholders' equity</b>	<b>54,710</b>	<b>56,570</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 123,159</b>	<b>\$ 114,875</b>

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

## CONSOLIDATED STATEMENTS OF INCOME

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

	Year ended December 31,		
	2011	2012	2013
Revenues:			
Search	\$ 25,466	\$ 38,061	\$ 59,038
Products	7,191	17,574	17,818
Advertising and other	2,816	4,588	10,292
	35,473	60,223	87,148
Cost of revenues	2,840	5,230	11,440
Gross profit	32,633	54,993	75,708
Operating expenses:			
Research and development, net	7,453	10,735	13,393
Selling and marketing	12,984	29,517	43,358
General and administrative	7,649	8,560	15,077
Total operating expenses	28,086	48,812	71,828
Operating income	4,547	6,181	3,880
Financial income (expense), net	1,293	(174)	(1,233)
Income before taxes on income	5,840	6,007	2,647
Taxes on income	172	2,473	2,337
Net income	\$ 5,668	\$ 3,534	\$ 310
Net earnings per share:			
Basic	\$ 0.58	\$ 0.35	\$ 0.03
Diluted	\$ 0.57	\$ 0.34	\$ 0.02

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

## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

U.S. dollars in thousands

	Year ended December 31,		
	2011	2012	2013
Net income	\$ 5,668	\$ 3,534	\$ 310
Other comprehensive income:			
Reclassification adjustments to income on marketable securities, net of tax	(100)	-	-
Other comprehensive income, net of tax	(100)	-	-
Comprehensive income	<u>\$ 5,568</u>	<u>\$ 3,534</u>	<u>\$ 310</u>

## STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. dollars in thousands

	Share Capital	Additional paid-in capital	Accumulated other comprehensive income	Retained earnings	Treasury stock	Total shareholders' equity
Balance as of December 31, 2010	\$ 22	\$ 23,734	\$ 100	\$ 5,298	\$ (1,002)	\$ 28,152
Stock based compensation expense	-	1,200	-	-	-	1,200
Exercise of share options	(*)	30	-	-	-	30
Dividends	-	-	-	(3,885)	-	(3,885)
Issuance of shares related to acquisition	(*)	750	-	-	-	750
Other Comprehensive income	-	-	(100)	-	-	(100)
Net income	-	-	-	5,668	-	5,668
Balance as of December 31, 2011	22	25,714	-	7,081	(1,002)	31,815
Stock based compensation expense	-	1,085	-	-	-	1,085
Exercise of share options	1	75	-	-	-	76
Issuance of shares related to acquisitions	5	18,195	-	-	-	18,200
Net income	-	-	-	3,534	-	3,534
Balance as of December 31, 2012	28	45,069	-	10,615	(1,002)	54,710
Stock based compensation expense	-	1,550	-	-	-	1,550
Exercise of share options	1	(1)	-	-	-	-
Net income	-	-	-	310	-	310
Balance as of December 31, 2013	\$ 29	\$ 46,618	\$ -	\$ 10,925	\$ (1,002)	\$ 56,570

(\*) Represent amount of less than \$1

## CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2011	2012	2013
<b>Operating activities:</b>			
Net income	\$ 5,668	\$ 3,534	\$ 310
Adjustments required to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	1,388	3,572	10,719
Stock based compensation expense, net	1,183	1,056	1,526
Accretion of payment obligation related to acquisitions	100	177	1,131
Amortization of premium and accrued interest on marketable securities and deposits	(16)	-	(33)
Realized loss from marketable securities, net	100	-	-
Deferred taxes, net	(1,140)	(172)	(356)
Accrued severance pay, net	(40)	(3)	64
Net changes in operating assets and liabilities:			
Trade receivables	(383)	491	(8,419)
Other receivables and prepaid expenses	(1,100)	1,658	1,455
Other long-term assets	60	82	110
Trade payables	108	4,035	4,340
Deferred revenues	998	(268)	3,920
Accrued expenses and other liabilities	112	2,101	1,129
Net cash provided by operating activities	<u>7,038</u>	<u>16,263</u>	<u>15,896</u>
<b>Investing activities:</b>			
Purchase of property and equipment	(316)	(662)	(671)
Proceeds from sale of property and equipment	-	-	4
Restricted cash	90	-	(171)
Capitalization of software development and content costs	(829)	(819)	(1,627)
Cash paid by employees on previously exercised options of acquired company	-	727	-
Cash paid in connection with acquisitions, net of cash acquired	(21,712)	(7,307)	-
Proceeds from sales of marketable securities	26,704	-	-
Investment in marketable securities	(11,915)	-	-
Net cash used in investing activities	<u>(7,978)</u>	<u>(8,061)</u>	<u>(2,465)</u>

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

## CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2011	2012	2013
<b>Financing activities:</b>			
Exercise of share options	30	76	-
Payments made in connection with acquisitions	-	(6,626)	(9,529)
Proceeds from long-term loans	-	10,000	-
Repayment of long-term loans	-	(1,150)	(2,300)
Dividend paid	(3,885)	-	-
Net cash provided by (used in) financing activities	(3,855)	2,300	(11,829)
Increase (decrease) in cash and cash equivalents	(4,795)	10,502	1,602
Cash and cash equivalents at beginning of year	16,055	11,260	21,762
Cash and cash equivalents at end of year	\$ 11,260	\$ 21,762	\$ 23,364
<b>Supplemental disclosure of cash flow activities:</b>			
<b>Cash paid during the year for:</b>			
Income taxes	\$ 3,200	\$ 2,828	\$ 6,131
Interest paid	\$ -	\$ 291	\$ 363
<b>Supplemental disclosure of non-cash investing activities:</b>			
Issuance of shares in connection with the acquisitions	750	18,200	-
Stock-based compensation that was capitalized as part of capitalization of software development costs	17	29	24

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

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 1:- GENERAL**

Perion Network Ltd. ("Perion") and its wholly-owned subsidiaries (collectively referred to as the "Company"), is a digital media company that provides products and services to consumers, focusing on second wave adopters. The Company generates revenues primarily through search, the sale of premium products and services, and advertising. The Company's products include primarily: IncrediMail, a communication client; Smilebox, a photo sharing and social expression product and service; and Sweet IM, an instant messaging application.

The Company was incorporated under the laws of Israel in 1999 and commenced operations in 2000.

On January 2, 2014 the Company completed the acquisition with Client Connect (refer to note 14 for further discussion). In connection with the acquisition, the Company incurred expenses in the amount of \$6,200. These expenses are included in the general and administration expenses.

Commencing in 2014, the ClientConnect acquisition will be reflected in the Company's financial statements as reverse acquisition of all of Perion's outstanding shares and options by ClientConnect in accordance with Accounting Standards Codification Topic 805, "Business Combinations," ("ASC 805") using the acquisition method of accounting whereby ClientConnect will be deemed the accounting acquirer and the Company will be deemed the accounting acquiree. In accordance with the ASC 805 presentation requirement, following the acquisition, the Company's 2014 financial statements will include Clientconnect's comparative numbers, namely, consolidated balance sheets as of December 31, 2013, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for each of the two years in the period ended December 31, 2013.

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES****a. Use of estimates:**

The preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates, judgments and assumptions. The Company's management believes that the estimates, judgments and assumptions used are reasonable based upon information available at the time they are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. On an ongoing basis, the Company's management evaluates estimates, including those related to fair values and useful lives of intangible assets, fair values of stock-based awards, income taxes, and contingent liabilities. Such estimates are based on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities.

**b. Financial statements in U.S. dollars:**

The reporting currency of the Company is the U.S. dollar. Most of the Company's revenues are generated in U.S. dollars ("dollar"). In addition, a substantial portion of the Company's costs are incurred in dollars. The Company's management believes that the dollar is the currency of the primary economic environment in which it operates. Thus, the Company's functional currency is the dollar.

Accordingly, monetary accounts maintained in currencies other than the dollar are remeasured into dollars, in accordance with Accounting Standards Codification ("ASC") 830, "Foreign Currency Matters". All transaction gains and losses of the remeasured monetary balance sheet items are reflected in the statement of income as financial income or expenses, as appropriate.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

## c. Principles of consolidation:

The consolidated financial statements include the accounts of Perion and its subsidiaries. Intercompany balances and transactions have been eliminated upon consolidation.

## d. Cash equivalents:

The Company considers short-term unrestricted highly liquid investments that are readily convertible into cash, purchased with original maturities of three months or less to be cash equivalents.

## e. Restricted cash:

Restricted cash as of December 31, 2012 and December 31, 2013 is primarily due to the payment to former shareholders of SweetIM (refer to Note 3 for further details).

## f. Property and equipment:

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

	%
Computers and peripheral equipment	33
Office furniture and equipment	7 - 15

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

## g. Impairment of long-lived assets and intangible assets subject to amortization:

Property and equipment and intangible assets subject to amortization are reviewed for impairment in accordance with ASC 360, "Accounting for the Impairment or Disposal of Long-Lived Assets", whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. For each of the three years in the period ended December 31, 2013, no impairment losses have been identified.

In determining the fair values of long-lived assets for purpose of measuring impairment, Company's assumptions include those that market participants will consider in valuations of similar assets.

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

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

h. Goodwill and other intangible assets:

Goodwill reflects the excess of the purchase price of business acquired over the fair value of net assets acquired. Goodwill is not amortized but instead is tested for impairment at least annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

The Company operates in one operating segment and this segment comprises the only reporting unit

In accordance with ASC No. 350 the Company performs an annual impairment test at December 31 each year. The first step, identifying a potential impairment, compares the fair value of the reporting unit with its carrying amount. If the carrying amount exceeds its fair value, the second step would need to be performed; otherwise, no further step is required. The second step, measuring the impairment loss, compares the implied fair value of the goodwill with the carrying amount of the goodwill. Any excess of the goodwill carrying amount over the applied fair value is recognized as an impairment loss, and the carrying value of goodwill is written down to fair value. During the years ended December 31, 2011, 2012 and 2013, no impairment losses were recorded.

Intangible assets that are not considered to have an indefinite useful life are amortized over their estimated useful lives, which range from 3 to 10.25 years. The acquired customer arrangements, technology and logo are amortized over their estimated useful lives in proportion to the economic benefits realized. This accounting policy results in accelerated amortization of such intangible assets as compared to the straight-line method.

i. Revenue recognition:

The Company generates revenues from three major sources; search related advertising, product sales and other advertising.

Search related advertising revenues are generated by receiving a share of the advertising revenues from companies providing search capabilities and are recognized when the Company is entitled to receive the fee. Advertisers are charged and pay monthly, based on the number of clicks generated by users clicking on these ads. Persuasive evidence of an arrangement exists based upon a written agreement or purchase order with a search provider or display advertiser. Delivery occurs when a user clicks on the ad in the case of a cost-per-click (CPC) arrangement, or the requisite number of impressions is displayed pursuant to a cost-per-thousand impression (CPM) arrangement.

In addition, the Company also derives revenues from: (i) product sales (ii) other. Revenues from products include licensing the right to use its email software, content database, photo sharing and social expression product and e-mail anti-spam. Revenues from other services include search related advertising and other advertising. In accordance with ASC 605-50, "Customer Payments and Incentives", the Company accounts for cash consideration given to customers, for whom it does not receive a separately identifiable benefit or cannot, reasonably estimate fair value, as a reduction of revenue rather than as an expense.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Revenues from software license products are recognized when all criteria outlined in ASC 985-605, "Software - Revenue Recognition" are met. Revenues from software license products are recognized when persuasive evidence of an agreement exists, delivery of the product has occurred, the fee is fixed or determinable, and collectability is probable. Company's e-mail product users may also purchase a license to its content database. This content database provides additional Perion Network content files in the form of email background, animation sounds, graphics and e-mail notifies. Content database licensing fees are recognized over the license period. Lifetime licensing revenues were recognized over the estimated usage period of the content database. Since May 2011 the Company no longer offers lifetime licensing. In accordance with its policy, the Company reviewed the estimated usage period of the lifetime licensing on an ongoing basis. During 2012, the Company notified customers owning its lifetime licenses that they will no longer be able to access the Company's site for downloading content, requesting they download all the content to their own computer. As result of such change, the Company is no longer required to make content available under those arrangements. Therefore, the remaining deferred revenues balance in the amount of \$ 1,443 associated with these arrangements, was immediately recognized in 2012.

Revenues from email anti-spam license fees, photo sharing, social expression product and service are recognized ratably over the term of the license.

Deferred revenues include upfront payments received from customers, for whom revenues have not yet been recognized.

Finally, the Company offers advertisers the ability to place text-based ads on its home page and website and banners in its email clients. Advertisers are charged monthly based on the number of times a user clicks on one of the ads. The Company recognizes revenue from advertisement at that time.

In parallel with the business combination with ClientConnect, as further described in Note 14, in August 2013, the Company and Conduit entered into commercial agreement. Under the agreement, the Company provides Conduit publisher services based on "pay per installation" fee. The agreement was amended on November 18, 2013, effective November 1, 2013. Sales generated by the Company under the agreement and the direct customer acquisition costs ("CAC") amounted to:

	August through October 2013	November through December 2013
Sales	\$ 7,166	\$ 10,848
CAC	(6,633)	(7,702)
Sales, net	\$ 533	\$ 3,146

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

Due to the proximity of the business combination and the commercial agreement, the nature of the transactions, management concluded that the effect of transactions with Conduit will be recorded on a net basis. Therefore, with regard to the activity during the period of August through October the net amount of \$ 533, which were realized, are included within 2013 search revenues on the statement of income. In light of the agreement closing in the beginning of January 2014, the net effect of November through December transactions with Conduit, of \$ 3,146 which was not realized on as if consolidated basis as of December 31, 2013, is included within deferred revenues on the balance sheet.

j. Cost of revenues:

Cost of revenues consists primarily of salaries and related expenses, license fees, amortization of acquired technology, amortization of capitalized research and development costs and payments for content and server maintenance, all related to its product revenues and communicating with its users. The direct cost relating to search and advertising revenues is immaterial.

k. Research and development costs:

Research and development costs incurred in the process of software production before establishment of technological feasibility, are charged to expenses as incurred. Costs of the production of a product master incurred subsequent to the establishment of technological feasibility are capitalized according to the principles set forth in ASC 985-20, "Software - Costs of Software to Be Sold, Leased, or Marketed". Based on the Company's product development process, technological feasibility is established upon completion of the detailed program design ("DPD") (the DPD of a computer software product that takes product function, feature, and technical requirements to their most detailed, logical form and is ready for coding).

Costs incurred by the Company between completion of the DPD and the point at which the product is ready for general release, are capitalized unless considered immaterial.

Capitalized software development costs are amortized commencing with general product release by the straight-line method over the estimated useful life of the software product, which is generally 3 - 5 years.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

## l. Income taxes:

The Company accounts for income taxes in accordance with ASC 740, "Income Taxes". This Statement prescribes the use of the liability method whereby deferred tax assets and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company provides a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

The Company accounts for uncertain tax positions in accordance with ASC 740, which contains a two-step approach for recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position taken or expected to be taken in a tax return by determining if the weight of available evidence indicates that it is more likely than not that, on an evaluation of the technical merits, the tax position will be sustained on audit, including resolution of any related appeals or litigation processes. The second step is to measure the tax benefit as the largest amount that is more than 50% likely to be realized upon ultimate settlement.

The Company accrued interest and penalties related to unrecognized tax benefits in its financial expenses.

## m. Advertising costs:

Advertising costs are expensed as incurred and consist primarily of customer acquisition cost. Advertising costs for each of the three years in the period ended December 31, 2013 amounted to \$ 8,136, \$ 22,270 and \$ 32,561, respectively.

## n. Concentrations of credit risk:

Financial instruments that potentially subject the Company to a concentration of credit risk consist primarily of cash and cash equivalents, restricted cash and trade receivables.

The majority of the Company's cash and cash equivalents and restricted cash are invested in dollar instruments with major banks in Israel and the U.S. deposits in the U.S. may be in excess of insured limits and are not insured in other jurisdictions. Generally, these deposits may be redeemed upon demand and, therefore, bear minimal risk.

The Company is subject to a low amount of credit risk with respect to sales of the Company's software products and content database, as these sales are primarily obtained through credit card sales. The Company's major customers are financially sound, and the Company believes low credit risk is associated with these customers. To date, the Company has not experienced any material bad debt losses.

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

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

o. Severance pay:

The Company's liability for severance pay is calculated pursuant to Israel's Severance Pay Law based on its employees' most recent monthly salaries, multiplied by the number of years of their employment, or a portion thereof, as of the balance sheet date.

This liability is fully provided for by monthly deposits in insurance policies and by an accrual.

The deposited funds include profits (losses) accumulated up to the balance sheet date. The deposited funds may be withdrawn only upon the fulfillment of the obligation pursuant to Israel's Severance Pay Law or labor agreements.

The Company's agreements with employees in Israel, joining the Company since February 2, 2008, are in accordance with section 14 of the Severance Pay Law, 1963, where the Company's contributions for severance pay shall be instead of its severance liability. Upon contribution of the full amount of the employee's monthly salary, and release of the policy to the employee, no additional calculations shall be conducted between the parties regarding the matter of severance pay and no additional payments shall be made by the Company to the employee. Further, the related obligation and amounts deposited on behalf of such obligation are not stated on the balance sheet, as the Company is legally released from obligation to employees once the deposit amounts have been paid.

Severance expenses for the years ended December 31, 2011, 2012 and 2013 amounted to \$ 586, \$ 589 and \$ 992, respectively.

p. Net earnings per ordinary share:

Basic net earnings per ordinary shares are computed based on the weighted average number of ordinary shares outstanding during each year. Diluted net earnings per ordinary share are computed based on the weighted average number of ordinary shares outstanding during each year, plus dilutive potential ordinary shares considered outstanding during the year, in accordance with ASC 260, "Earnings Per Share".

The weighted average number of ordinary shares related to the outstanding options and restricted shares excluded from the calculations of diluted net earnings per ordinary share, as these securities are anti-dilutive, was 1,266,919, 1,315,106 and 522,281 for the years ended December 31, 2011, 2012 and 2013, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

## q. Accounting for stock-based compensation:

The Company accounts for stock-based compensation under ASC 718, "Compensation - Stock Compensation", which requires the measurement and recognition of compensation expense based on estimated fair values for all share-based payment awards made to employees and directors.

ASC 718 requires companies to estimate the fair value of equity-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as an expense over the requisite service periods in the Company's consolidated statement of income. ASC No. 718 requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

The Company recognizes compensation expenses for the value of its awards, which have graded vesting based on service conditions, using the straight line method, over the requisite service period of each of the awards, net of estimated forfeitures. Estimated forfeitures are based on actual historical pre-vesting forfeitures.

The Company estimates the fair value of standard stock options granted using the Binomial option-pricing model. The option-pricing models require a number of assumptions, of which the most significant are; volatility and the expected option term. Expected volatility was calculated based upon actual historical stock price movements. The expected option term was calculated based on the Company's assumptions of early exercise multiples which were calculated based on comparable companies and termination exit rate which was calculated based on actual historical data. The expected option term represents the period that the Company's stock options are expected to be outstanding. The risk-free interest rate is based on the yield from U.S. Treasury zero-coupon bonds with an equivalent term. The fair value of the RSU's is based on the market value of the underlying shares at the date of grant.

In November 2010 the Company's Board decided to change its dividend policy so that beginning with earnings of 2011 and beyond, the Company does not intend to declare and distribute any dividends.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The fair value of the Company's stock options granted to employees and directors was estimated using the following assumptions:

	Year ended December 31,		
	2011	2012	2013
Risk-free interest rate	2.23%	0.75%	1.04%
Expected volatility	47.31%-65.27%	45.60%-61.90%	45.57% - 57.42%
Weighted average volatility	56.29%	53.76%	51.49%
Expected term (years)	3.75	4.09	3.80
Dividend yield	0.00%	0.00%	0.00%

## r. Derivative instruments:

The Company accounts for derivatives and hedging based on ASC No. 815, "Derivatives and Hedging". ASC No. 815 requires the Company to recognize all derivatives on the balance sheet at fair value. The accounting for changes in the fair value (i.e., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship.

In order to reduce the impact of changes in foreign currency exchange rates on its results, the Company enters into foreign currency exchange forward contracts and options contracts to purchase and sell foreign currencies to hedge a portion of its foreign currency net exposure resulting from payroll expenses denominated in NIS.

These instruments were not designated as cash flow hedge as defined by ASC 815, "Derivative and Hedging" and, therefore, the Company recognized the changes in fair value of these instruments in the statement of income as financial income or expense, as incurred. Gains or losses on these derivatives, which partially offset the foreign currency impact from the underlying exposures, and amounted to \$ (25), \$ 238 and \$ 300 for the years ended December 31, 2011, 2012 and 2013, respectively.

The notional value of the Company's derivative instruments as of December 31, 2012 and 2013 amounted to \$ 6,891 and \$ 2,500, respectively. Notional values are U.S. dollar translated and calculated based on forward rates for forward contracts and based on spot rates for options. Gross notional amounts do not quantify risk or represent assets or liabilities of the Company, but are used in the calculation of settlements under the contracts. The Company measured the fair value of these contracts in accordance with ASC No. 820 and they were classified as level 2.



NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

## s. Fair value of financial instruments:

The carrying amounts of financial instruments carried at cost, including cash and cash equivalents, restricted cash, trade receivables, other receivables, trade payables and other liabilities approximate their fair value due to the short-term maturities of such instruments.

The Company follows the provisions of ASC 820, "Fair Value Measurements and Disclosures". Under this standard, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., the "exit price") in an orderly transaction between market participants at the measurement date.

In determining fair value, the Company uses various valuation approaches. ASC 820 establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company's assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the observability of inputs as follows:

- Level 1 - Valuations based on quoted prices in active markets for identical assets that the Company has the ability to access.
- Level 2 - Valuations based on one or more quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.
- Level 3 - Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The following table present assets and liabilities measured at fair value on a recurring basis at December 31, 2013 and 2012:

	2013			
	Fair value measurements using input type			
	Level 1	Level 2	Level 3	Total
<b>Cash equivalents:</b>				
Money market funds	\$ 10	\$ -	\$ -	\$ 10
<b>Other receivables and prepaid expenses:</b>				
Derivative assets	-	113	-	113
<b>Total financial assets</b>	<u>10</u>	<u>113</u>	<u>-</u>	<u>123</u>
Payment obligation related to acquisition:	-	-	7,239	7,239
<b>Total financial liabilities</b>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 7,239</u>	<u>\$ 7,239</u>
	2012			
	Fair value measurements using input type			
	Level 1	Level 2	Level 3	Total
<b>Cash equivalents:</b>				
Money market funds	\$ 10	\$ -	\$ -	\$ 10
<b>Other receivables and prepaid expenses:</b>				
Derivative assets	-	248	-	248
<b>Total financial assets</b>	<u>10</u>	<u>248</u>	<u>-</u>	<u>258</u>
Payment obligation Sweet IM former shareholders:	-	-	16,427	16,427
<b>Total financial liabilities</b>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 16,427</u>	<u>\$ 16,427</u>

## t. Treasury shares:

In the past the Company repurchased its Ordinary shares on the open market and holds those shares as treasury shares. The Company presents the cost to repurchase treasury shares as a reduction of shareholders' equity.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

## u. Comprehensive income:

The Company accounts for comprehensive income in accordance with ASC 220, "Comprehensive Income". This statement establishes standards for the reporting and display of comprehensive income and its components in a full set of general purpose financial statements. Comprehensive income generally represents all changes in shareholders' equity during the period except those resulting from investments by, or distributions to, shareholders. The Company determined that its items of other comprehensive income relates to unrealized gains and losses on available for sale securities.

## v. Business combinations:

The Company accounted for business combination in accordance with ASC No. 805, "Business Combinations". ASC No. 805 requires recognition of assets acquired, liabilities assumed, and any non-controlling interest at the acquisition date, measured at their fair values as of that date. Any excess of the fair value of net assets acquired over purchase price and any subsequent changes in estimated contingencies are to be recorded in earnings. In addition, changes in valuation allowance related to acquired deferred tax assets and in acquired income tax position are to be recognized in earnings.

Acquisition related costs are expensed to the statement of income in the period incurred.

**NOTE 3:- ACQUISITIONS**

## a. Acquisition of Sweet IM Ltd.

On November 30, 2012 ("Closing Date") the Company completed the acquisition of 100% of the shares of Sweet IM Ltd. ("SweetIM"), an Israeli-based consumer internet company that produces a variety of applications. The financial results of SweetIM are included in the consolidated financial statements from the Closing Date. The total consideration was composed as follows:

- \$ 13,054 in cash, including \$ 3,014 for working capital acquired from Sweet IM;
- 1,990,000 ordinary shares of the Company issued at closing for total value of \$17,863, which considered the market restrictions on these shares;
- \$ 7,500 in cash ("Second installment") subject to certain adjustments, payable within 12 months following the Closing Date (December 2013). In connection with this consideration, the Company recorded a \$ 7,324 liability; and
- A milestones-based contingent cash payment of up to \$ 7,500 payable in May 2014. In connection with this contingent payment consideration, the Company recorded at the Closing Date, an estimated liability of \$ 5,992. (Refer to note 8b for further details)

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 3- ACQUISITIONS (Cont.)

In addition, the Company incurred acquisition related costs in a total amount of \$ 1,593, which are included in general and administrative expenses for the year ended December 31, 2012. Acquisition related costs include legal, accounting fees and other costs directly related to the acquisition.

Prior to the acquisition of SweetIM Ltd. its board of directors approved a cash dividend of \$ 13,000 (the "Dividend"). However, the Dividend was not distributed to the shareholders prior to closing of the transaction. As part of the Share Purchase Agreement (the "SPA") between the Company and SweetIM's shareholders, it was agreed that upon request by the designated representative of SweetIM's shareholders to distribute the Dividend, the Company may withhold certain amounts from such an amount, including on account of certain tax liabilities of SweetIM, and distribute the balance. Upon execution of the SPA, the Company estimated such tax liabilities in an amount of \$ 3,076. The balance of \$ 9,960 was classified previously as restricted cash by the Company.

In December 2013, the Company signed a final tax assessment agreement with the Israeli Tax Authorities with respect to SweetIM's tax liabilities for the years 2008-2012 (the "Tax Agreement"), in the amount of \$ 1,692 (the "Tax Agreement Amount").

In June 2013, the Company paid an additional \$ 2,711 to SweetIM's shareholders pursuant to the terms of the SPA, as a result of a working capital adjustment.

Pursuant to the terms of the SPA, the Company was obligated to pay SweetIM's shareholders a second installment in December 2013, on account of the purchase price, in an overall amount of \$ 7,500 (the "Second Installment").

The Company and the representative of SweetIM's shareholders agreed to deduct the Tax Agreement Amount from the Second Installment instead of from the Dividend. As a result thereof, the Company paid on account of the Second Installment, an amount of \$5,572 (\$ 7,500 minus the Tax Agreement Amount and other adjustments).

In December 2013, the Company paid \$ 11,500 to SweetIM's shareholders on account of the Dividend. The balance of the Dividend in the amount \$ 1,500 million still remains with the Company and is included within restricted cash.

The primary reasons for this acquisition include; SweetIM's back-end systems, the talent and professional background of its employees, and its product suite, so as to include other consumer products that bear similar characteristics appealing to its unique demographic segment. A significant amount of the acquisition was recorded as goodwill due to the synergies with SweetIM.

Under business combination accounting, the total purchase price was allocated to Sweet IM's net tangible and intangible assets based on their estimated fair values as set forth below. The excess of the purchase price over the net tangible and identifiable intangible assets was recorded as goodwill.

Cash	2,733
Restricted cash	10,260
Trade receivables	7,473
Other receivables and prepaid expenses	1,253
Property and equipment	216
Long-term prepaid expenses and other	70
Trade payables	(2,318)
Accrued expenses and other liabilities	(5,148)
Payment obligation related to acquisition	(9,958)
Intangible assets	30,756
Deferred tax liability	(3,786)
Goodwill	12,682
Total purchase price	<u>44,233</u>

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

## NOTE 3- ACQUISITIONS (Cont.)

Intangible assets:

In performing the purchase price allocation, the Company considered, among other factors, analysis of historical financial performance, highest and best use of the acquired assets and estimates of future performance of SweetIM's products. The fair value of intangible assets was based on market participant approach to valuation, performed by a third party valuation firm using estimates and assumptions provided by management. The following table sets forth the components of intangible assets associated with SweetIM acquisition:

	<u>Fair value</u>	<u>Useful life</u>
Technology	\$ 20,066	5 years
Logo	5,242	4 years
IP R&D	5,448	(*)
<b>Total intangible assets</b>	<b>\$ 30,756</b>	

(\*) Will be determined upon completion of the development

The following unaudited condensed combined pro forma information for the years ended December 31, 2011 and 2012, gives effect to the acquisition of SweetIM as if the acquisition had occurred on January 1, 2011. The pro forma information is not necessarily indicative of the results of operations, which actually would have occurred if the acquisition had been consummated on that date, nor does it purport to represent the results of operations for future periods. For the purposes of the pro forma information, the Company has assumed that net income includes additional amortization of intangible assets related to the acquisition of \$ 6,484 and \$ 6,345 in 2011 and 2012, respectively and related tax effects .

	<u>Year ended December 31,</u>	
	<u>2011</u>	<u>2012</u>
	<u>Unaudited</u>	<u>Unaudited</u>
Revenues	\$ 51,190	\$ 79,254
Net income	\$ 1,154	\$ 4,887
Basic earnings per share	\$ 0.12	\$ 0.48
Diluted earnings per share	\$ 0.12	\$ 0.47

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 3- ACQUISITIONS (Cont.)

## b. Acquisition of Smilebox Inc

On August 31, 2011, the Company completed the acquisition of all of the outstanding shares of Smilebox Inc. ("Smilebox"). The Company included the financial results of Smilebox in its consolidated financial statements from the date of acquisition. Under the Purchase Agreement, the total consideration is composed of cash and Ordinary shares of the Company, as follows:

- \$ 24,269 in cash;
- 128,538 Ordinary shares of the Company issuable at closing at fair value of \$ 750;
- \$ 7,000 in cash and in Ordinary shares of the Company (subject to certain adjustments), payable within 7 months following the closing (March 2013). In connection with this consideration, the Company recorded a \$ 6,474 liability at closing. This amount was paid in full in 2013, including \$ 6,266 paid in cash and 65,720 shares issued at value of \$ 337 and;
- A milestone-based contingent cash and ordinary shares of the Company payment ("Contingent Payment") of up to \$ 8,000 payable in September 2013. The Company recognized a liability of zero with respect to this Contingent Payment, which represents its fair value. No payment was made in September 2013 as the milestones were not met.

In addition, the Company incurred acquisition related costs in a total amount of \$ 1,069, which are included in general and administrative expenses for the year ended December 31, 2011.

Smilebox provides a subscription allowing people to connect with family and friends in a creative and personal way. Smilebox enable users to personalize hundreds of unique, multimedia designs with their photos, videos, and music and then share them via print, email, blog or DVD. The main reason for this acquisition was to enrich the Company's product suite to include other consumer products that bear similar characteristics appealing to its unique demographic segment. A significant amount of the acquisition was recorded as goodwill due to the synergies with Smilebox.

Under business combination accounting, the total purchase price was allocated to Smilebox's net tangible and intangible assets based on their estimated fair values as set forth below. The excess of the purchase price over the net tangible and identifiable intangible assets was recorded as goodwill.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 3- ACQUISITIONS (Cont.)

Cash	\$ 2,100
Trade receivables	87
Other receivables and prepaid expenses	616
Property and equipment	191
Long-term prepaid expenses and other	449
Trade payables	(1,268)
Accrued expenses and other liabilities	(1,171)
Deferred revenues	(622)
Intangible assets	6,358
Goodwill	24,753
Total purchase price	<u>\$ 31,493</u>

## Intangible assets:

In performing the purchase price allocation, the Company considered, among other factors, analysis of historical financial performance, highest and best use of the acquired assets and estimates of future performance of Smilebox's products. The fair value of intangible assets was based on market participant approach to valuation, performed by a third party valuation firm using estimates and assumptions provided by management. The following table sets forth the components of intangible assets associated with Smilebox acquisition:

	<u>Fair value</u>	<u>Useful life</u>
Customer relationships	\$ 1,488	4.3-6.3 years
Technology	3,000	3 years
Trade name	1,870	10.25 years
Total intangible assets	<u>\$ 6,358</u>	

## NOTE 4- OTHER RECEIVABLES AND PREPAID EXPENSES

	<u>December 31,</u>	
	<u>2012</u>	<u>2013</u>
Government authorities	\$ 3,661	\$ 2,672
Prepaid expenses	1,079	779
Deferred tax asset, net	360	110
Other	324	158
	<u>\$ 5,424</u>	<u>\$ 3,719</u>

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

## NOTE 5- PROPERTY AND EQUIPMENT, NET

	December 31,	
	2012	2013
Cost:		
Computers and peripheral equipment	\$ 3,745	\$ 4,220
Office furniture and equipment	670	796
Leasehold improvements	618	677
	<u>5,033</u>	<u>5,693</u>
Accumulated depreciation	<u>3,511</u>	<u>4,316</u>
Property and equipment, net	<u>\$ 1,522</u>	<u>\$ 1,377</u>

Depreciation expenses totaled \$ 588, \$ 657 and \$ 813, for the years ended December 31, 2011, 2012 and 2013, respectively.

During 2012 the Company recorded a reduction of \$ 846 to the cost and accumulated depreciation for fully depreciated equipment no longer in use. During 2013 the Company recorded a reduction of \$ 11 to the cost and a reduction of \$ 8 to accumulated depreciation for depreciated equipment no longer in use.

## NOTE 6- GOODWILL AND OTHER INTANGIBLE ASSETS, NET

## a. Goodwill:

The changes in the carrying amount of goodwill for the years ended December 31, 2012 and 2013 are as follows:

	2012	2013
Balance as of January 1	\$ 24,753	\$ 37,435
Changes during year	<u>12,682</u>	<u>-</u>
Balance as of December 31	<u>\$ 37,435</u>	<u>\$ 37,435</u>



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 6- GOODWILL AND OTHER INTANGIBLE ASSETS, NET (Cont.)

## b. Other intangible assets, net

	Useful Life	December 31,	
		2012	2013
Original amount:			
Capitalized software development costs	3-5	\$ 1,587	\$ 3,228
Capitalized content costs and domain	3-5	556	566
Technology	3-5	23,066	23,066
Trade name	10.25	1,870	1,870
Customer relationship	4.3-6.3	1,488	1,488
Logo	5	5,242	5,242
IP R&D		5,448	5,448
		<u>39,257</u>	<u>40,908</u>
Accumulated amortization:			
Capitalized software development costs		398	930
Capitalized content costs and domain		485	546
Technology		1,822	9,251
Trade name		243	426
Customer relationship		913	1,234
Logo		101	1,481
		<u>3,962</u>	<u>13,868</u>
		<u>\$ 35,295</u>	<u>\$ 27,040</u>

c. Amortization expense amounted to \$ 800, \$2,915 and \$9,906 for the years ended December 31, 2011, 2012 and 2013, respectively.

d. The estimated future amortization expense of other intangible assets as of December 31, 2013 is as follows:

2014	9,306
2015	8,075
2016	5,761
2017	3,184
2018	182
Thereafter	532
	<u>\$ 27,040</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 7:- ACCRUED EXPENSES AND OTHER LIABILITIES

	December 31,	
	2012	2013
Employees and payroll accruals	\$ 3,865	\$ 3,021
Government authorities	3,812	7,046
Uncertain tax position liability (refer to note 10i)	3,952	574
Deferred tax liabilities, net	971	659
Accrued expenses and other	2,079	5,120
	<u>\$ 14,679</u>	<u>\$ 16,420</u>

## NOTE 8:- COMMITMENTS AND CONTINGENT LIABILITIES

## a. Lease commitments

The facilities of the Company are rented under lease operating agreements that expire in 2015. The Company leases its motor vehicles and servers under cancelable operating lease agreements.

Aggregate minimum lease commitments under operating leases as of December 31, 2013 were as follows:

2014	1,260
2015	669
	<u>1,929</u>

Subsequent to December 31, 2013, the Company leased additional space in Holon, Israel. The lease expires in 2024, with an option to extend for two additional periods of 24 months. The monthly lease payment for this facility is \$ 256. The Company plans to move all of its Israeli personnel to Holon during the third quarter of 2014.

Total rent expenses for the years ended December 31, 2011, 2012 and 2013 amounted to \$586, \$967 and \$1,073, respectively.

Total lease expenses for motor vehicles for the years ended December 31, 2011, 2012 and 2013 amounted to \$ 349 \$ 234 and \$ 284, respectively.

## b. Contingent purchase obligation

Pursuant to the terms of the SPA between the Company and SweetIM, the Company is obligated to pay SweetIM's shareholders a payment of up to \$ 7,500 in cash 18 months after closing, May 2014, if certain milestones are met. The milestones are based on the Company's revenues in the fiscal year of 2013, and the absence of certain changes in the industry in which the Company operates. The Company believes that the terms of the SPA will require the Company to pay \$2,500 with respect to the contingent payment.

## c. Legal Matters

On November 10, 2013, the Company was served with a lawsuit filed in the Tel Aviv District Court (Economic Department) against the Company and its directors by an individual claiming to be a holder of 150 of the Company's ordinary shares. The plaintiff alleges certain flaws in the process, price and disclosure in connection with the ClientConnect Acquisition. The plaintiff requested that the court certify the lawsuit as a valid class action, a declaratory judgment confirming the plaintiff's allegations and certain remuneration for the purported plaintiff, including legal fees. The Company believes that the complaint is without merit and plan to defend against it vigorously.

## NOTE 9:- LONG-TERM LOAN

- a. On May 17, 2012 the Company entered into Loan Agreements (the "Agreements"), with two Israeli Banks (the "Banks"), based on which the Company borrowed a total of \$ 10,000.

The Agreements contain various provisions including a pledge of all the Company's assets under a floating charge, compliance with certain financial covenants, restrictive covenants, including negative pledges, and other commitments, typically contained in facility agreements of this type. In December 2013, the Company amended the agreement with one of the Banks to remove one of the financial covenants. As of December 31, 2013, the Company was in compliance with all covenants.

The loans are repaid in 16 and 20 equal quarterly installments, respectively starting July 17, 2012. Interest rates applicable are 4.35% and 4.64%, payable monthly starting May 17, 2012.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 9:- LONG-TERM LOAN (Cont.)

- b. As of December 31, 2013, the aggregate principal annual maturities according to the loan agreement are as follows:

	<b>Repayment amount</b>
2014 (current maturities)	2,300
2015	2,300
2016	1,550
2017	400
	<hr/>
Total	<u>6,550</u>

## NOTE 10:- INCOME TAXES

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

Commencing 2011, the Company elected to apply the new Preferred Enterprise benefits. Benefits granted to a Preferred Enterprise include reduced tax rates. The tax rate is 15% in 2011 and 2012, 12.5% in 2013 and 16% starting from 2014.

A distribution from a Preferred Enterprise out of the "Preferred Income" would be subject to 15% withholding tax for Israeli-resident individuals and non-Israeli residents (subject to applicable treaty rates).

Pursuant to Amendment 69 to the Israeli Investment Law ("Amendment 69"), a company that elected by November 11, 2013 to pay a reduced corporate tax rate as set forth in that amendment (rather than the regular corporate tax rate applicable to Approved Enterprise income) with respect to undistributed exempt income accumulated by the company until December 31, 2011 is entitled to distribute a dividend from such income without being required to pay additional corporate tax with respect to such dividend. A company that has so elected must make certain qualified investments in Israel over the five-year period commencing in 2013. A company that has elected to apply the amendment cannot withdraw from its election.

During 2013, the Company applied the provisions of Amendment 69 to all undistributed exempt profits accrued prior to 2011 by the Company and its Israeli subsidiary. Consequently, the Company paid ILS 6.3 million (\$ 1.8) corporate tax on exempt income of ILS 63.2 million (\$ 18.2). This income is available to be distributed as dividends in future years with no additional corporate tax liability. As a result, the Company is required to invest ILS 4.7 million (\$ 1.4) in its industrial enterprises in Israel over a five year period. Such investment may be in the form of the acquisition of industrial assets (excluding real estate assets), investment in R&D in Israel, or payroll payments to new employees to be hired by the enterprise.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 10:- INCOME TAXES (Cont.)

## b. Corporate tax rates in Israel:

Taxable income of Israeli companies is subject to tax at the rate of 25% in 2013 and in 2012 and 24% in 2011. On July 2013 the economic plan for 2013-2014 was approved. Its main purpose is to deepen collecting taxes in those years. It includes among other fiscal changes, raising taxable income of Israeli companies from 25% to 26.5% in 2014 and onwards.

## c. Income taxes of non-Israeli subsidiaries:

Non-Israeli subsidiaries are taxed according to the tax laws in their respective countries of residence.

## d. Tax reports filed by the Company and its subsidiaries in Israel through the year ended December 31, 2011 are considered final. The U.S tax returns of the U.S subsidiaries Smilebox and Incredimail Inc. remain subject to examination by the U.S tax authorities for the tax years beginning on December 31, 2010.

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

## NOTE 10:- INCOME TAXES (Cont.)

## e. Tax loss carry-forwards:

The Company has a Net operating loss carry-forwards in the United States as of December 31, 2013 of \$ 14,800.

Net operating losses in the U.S. may be carried forward through periods which will expire in the years starting from 2026 up to 2031. Utilization of U.S. net operating losses may be subject to substantial annual limitation due to the "change in ownership" provisions of the Internal Revenue Code of 1986 and similar state provisions. The annual limitation may result in the expiration of net operating losses before utilization.

## f. Deferred tax assets, net:

Deferred taxes reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes.

Components of the Company's deferred tax assets (liabilities) are as follows:

	December 31,	
	2012	2013
Deferred tax assets:		
Net operating loss carry forwards	\$ 5,498	\$ 4,931
Other	500	920
Deferred tax assets, before valuation allowance	5,998	5,851
Valuation allowance	(3,952)	(3,984)
Total deferred tax assets, net of valuation allowance	2,046	1,867
Deferred tax liabilities:		
Intangible assets	(5,248)	(4,523)
Capitalized software development costs	(148)	(338)
Total deferred tax liabilities	(5,396)	(4,861)
Deferred tax liability, net	<u>\$ (3,350)</u>	<u>\$ (2,994)</u>

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

## NOTE 10:- INCOME TAXES (Cont.)

## Domestic:

	December 31,	
	2012	2013
Current deferred tax asset, net	\$ 360	\$ 110
Current deferred tax liability	(971)	(659)
Non-current deferred tax asset, net	140	73
Long-term deferred tax liability	(2,879)	(2,518)
	<u>\$ (3,350)</u>	<u>\$ (2,994)</u>

Current deferred tax assets, net, is included within other receivables and prepaid expenses in the balance sheets. Current deferred tax liability, net, is included within accrued expenses and other liabilities in the balance sheets. Non-current deferred tax asset, net is included within other assets on the balance sheets. Long term deferred tax is included within other long term liabilities on the balance sheet.

- g. Reconciliation of the Company's effective tax rate to the statutory tax rate in Israel:

	Year ended December 31,		
	2011	2012	2013
Income before taxes on income	\$ 5,840	\$ 6,007	\$ 2,647
Statutory tax rate in Israel	24%	25%	25%
Theoretical income tax expense	\$ 1,402	\$ 1,502	\$ 662
Increase (decrease) in tax expenses resulting from:			
"Preferred Enterprise" benefits (*)	(1,751)	(1,369)	(1,091)
Non-deductible expenses	78	757	2,406
Previous years taxes	(156)	-	(672)
Tax on previously distributed dividend from tax-exempt income	-	812	-
Loss and timing differences for which no deferred taxes were recorded	994	1,009	247
Change in statutory tax rate	-	-	757
Tax adjustment in respect of different tax rate of foreign subsidiaries	(400)	(151)	78
Other	5	(87)	(50)
Taxes on income	<u>172</u>	<u>2,473</u>	<u>2,337</u>
(*) Benefit per Ordinary share, resulting from " Preferred Enterprise " status:			
Basic	\$ 0.18	\$ 0.13	\$ 0.18
Diluted	\$ -	\$ 0.13	\$ 0.17

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 10:- INCOME TAXES (Cont.)

h. Income taxes are comprised as follows:

	Year ended December 31,		
	2011	2012	2013
Deferred tax benefit	\$ (1,140)	\$ (172)	\$ (356)
Current taxes	1,312	2,645	2,693
	<u>\$ 172</u>	<u>\$ 2,473</u>	<u>\$ 2,337</u>

i. Uncertain tax position:

Reconciliation of the beginning and ending balances of unrecognized tax benefits

	December 31,	
	2012	2013
Balance at January 1	\$ 2,151	\$ 3,952
Additions for prior year tax positions	622	115
Decrease related to settlement with tax authorities (refer to note 21)	-	(3,844)
Additions in tax positions for current year	1,179	351
Balance at December 31	<u>\$ 3,952</u>	<u>\$ 574</u>

As of December 31, 2013, the entire amount of the unrecognized tax benefits could affect the Company's income tax provision and the effective tax rate.

During the years ended December 31, 2013, 2012 and 2011 an amount of \$ 14, \$ 161 and \$ 18, respectively, was added to the unrecognized tax benefits derived from interest and exchange rate differences expenses related to prior years' uncertain tax positions. As of December 31, 2013 and 2012, the Company had accrued interest liability related to uncertain tax positions in the amounts of \$ 14 and \$ 246 respectively, which is included within income tax accrual on the balance sheets.

In December 2013 the Company reached settlements with the Israeli Tax Authorities regarding the Company's and its Israeli subsidiary's corporate tax returns from the years 2009-2011 and 2009-2012, respectively. The settlements amounted to a total payment of NIS 10,295 (\$ 2,966) including payments for corporate tax on exempt income (refer to above). The Company had provisions for the related years in the amount of NIS 13,343 (\$ 3,844).

The Company believes that it has adequately provided for any reasonably foreseeable outcome related to tax audits and settlements. The final tax outcome of its tax audits could be different from that which is reflected in the Company's income tax provisions and accruals. Such differences could have a material effect on the Company's income tax provision and net income in the period in which such determination is made.

i. Income before taxes on income is comprised as follows:

	Year ended December 31,		
	2011	2012	2013
Domestic	\$ 8,325	\$ 8,530	\$ 3,253
Foreign - U.S.A	(2,485)	(2,523)	(606)
	<u>\$ 5,840</u>	<u>\$ 6,007</u>	<u>\$ 2,647</u>

## NOTE 11:- SHAREHOLDERS' EQUITY

a. Ordinary share:

The Ordinary shares entitle their holders to voting rights, the right to receive cash dividend and the right to a share in excess assets upon liquidation of the Company. In November 18, 2013 the shareholders resolved to increase the authorized share capital of the Company to 120,000,000 ordinary shares with a nominal value of NIS 0.01 each.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 11:- SHAREHOLDERS' EQUITY (Cont.)

## b. Share option plans:

The Company's Incentive Plan (including the U.S. Addendum) (the "Plan") was initially adopted in 2003. The Plan had an initial term of ten years from adoption.

On December 9, 2012, our Board of Directors extended the term of the Plan for an additional ten years. In addition, on August 7, 2013, our Board of Directors approved amendments to the Plan, which include the ability to grant RSUs and restricted stock.

The vesting period of the outstanding options and RSUs is generally 3 years from the date of grant. The rights of the ordinary shares obtained from the exercise of options or RSUs are identical to those of the other ordinary shares of the Company. The contractual term of these options is five years.

The maximum number of ordinary shares currently authorized to be granted under the Plan is 12,000,000.

At December 31, 2013, 10,062,780 ordinary Shares remained available for future equity awards.

A summary of the activity in the share options granted to employees, non-employees and directors for the year ended December 31, 2013 and related information is as follows:

		<u>Weighted average</u>		
	<u>Number of options</u>	<u>Exercise price</u>	<u>Remaining contractual term (in Years)</u>	<u>Aggregate intrinsic value</u>
Outstanding at January 1, 2013	2,323,634	\$ 6.09	3.38	6,971
Granted	628,375	\$ 9.87		
Exercised *)	(744,858)	\$ 5.54		
Cancelled	(492,848)	\$ 8.53		
Forfeited	(750)	\$ 4.16		
Outstanding at December 31, 2013 **)	<u>1,713,553</u>	<u>\$ 7.01</u>	<u>3.03</u>	<u>8,782</u>
Exercisable at December 31, 2013	<u>676,203</u>	<u>\$ 5.67</u>	<u>2.09</u>	<u>4,341</u>

\*) During 2013, 744,845 share options were exercised under net-share settlement.

\*\*) Represents intrinsic value of 1,589,178 outstanding options that are in-the-money as of December 31, 2013. The remaining 124,375 outstanding options are out of the money as of December 31, 2013, and their intrinsic value was considered as zero.



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

**NOTE 11:- SHAREHOLDERS' EQUITY (Cont.)**

The weighted-average grant-date fair value of options granted during the years 2011, 2012 and 2013 was \$ 2.3, \$ 1.8 and \$ 3.1, respectively.

Aggregate intrinsic value of options exercised in 2011, 2012 and 2013 amounted to \$ 580, \$ 555 and \$ 5,437, respectively.

The options outstanding under the Company's Stock Option Plan as of December 31, 2013 have been separated into ranges of exercise price as follows:

Ranges of exercise price	Outstanding			Exercisable	
	Number of options	Weighted average remaining contractual life (years)	Weighted average exercise price	Number of options	Weighted average exercise price
4.04-4.38	584,866	2.99	4.06	308,421	4.07
5.12-5.99	174,865	2.74	5.38	140,363	5.38
6.04-6.93	143,003	1.24	6.68	99,669	6.74
7.11-7.85	198,444	2.48	7.54	91,083	7.68
8.67	269,500	4.09	8.67	-	-
9.14-9.98	77,500	2.63	9.68	36,666	9.48
10.23-10.65	141,000	4.36	10.42	-	-
12.56-13.54	124,375	4.63	13.14	-	-
	<u>1,713,553</u>			<u>676,203</u>	

RSUs:

In addition to granting stock options, starting 2013 the Company started to grant Restricted Stock Units ("RSUs"). The Company records compensation expenses based over the vesting period.

RSUs vest over three year period of employment.

RSUs that are cancelled or forfeited become available for future grants.

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

## NOTE 11:- SHAREHOLDERS' EQUITY (Cont.)

The following table summarizes information relating to RSUs, as well as changes to such awards during 2013:

	<u>Year ended December 31, 2013</u>
Outstanding at the beginning of year	-
Granted	200,000
Vested	-
Forfeited	-
	<u>200,000</u>

The weighted average fair values at grant date of RSUs for the year ended December 31, 2013 was \$ 10.85.

As of December 31, 2013, there were \$ 4,797 of unrecognized compensation cost related to options and unvested RSUs. This amount is expected to be recognized over a weighted-average period of 2.4 years.

The total stock-based compensation related to stock options and RSUs was recorded in the following items:

	<u>Year ended December 31,</u>		
	<u>2011</u>	<u>2012</u>	<u>2013</u>
Cost of sales	\$ 10	\$ 16	\$ 9
Research and development	108	221	255
Selling and marketing	78	168	181
General and administrative	987	651	1,081
Total Expenses	<u>\$ 1,183</u>	<u>\$ 1,056</u>	<u>\$ 1,526</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 12:- MAJOR CUSTOMER

The following table sets forth the customers that represented 10% or more of the Company's total revenues in each of the periods set forth below:

	Year ended December 31,		
	2011	2012	2013
Customer A	67%	63%	46%
Customer B	*)	*)	11%

\*) Less than 10%

The following is a summary of customers that accounted for at least 10% of the total trade receivables as of December 31, 2013 and December 31, 2012:

	As of December 31	
	2012	2013
Customer A	72%	*)
Customer B	*)	10%
Customer C	*)	69%

\*) Less than 10%

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 13:- SUPPLEMENTARY DATA ON SELECTED CONSOLIDATED STATEMENTS OF INCOME ITEMS

- a. Financial income (expense), net:

	Year ended December 31,		
	2011	2012	2013
Financial income:			
Interest from bank deposits and marketable securities	\$ 304	\$ 29	\$ 33
Gains from marketable securities, net	71	-	7
Exchange rate differences, net	102	170	69
Interest from government authorities, net	988	225	273
Financial expenses:	1,465	424	382
Accretion of payment obligation related to acquisitions	100	177	1,131
Interest with respect to long-term loans	-	373	363
Other	72	48	121
	172	598	1,615
	\$ 1,293	\$ (174)	\$ (1,233)

- b. Research and development costs, net:

	Year ended December 31,		
	2011	2012	2013
Total costs	\$ 8,192	\$ 11,583	\$ 15,044
Capitalized software development costs	(739)	(848)	(1,651)
	\$ 7,453	\$ 10,735	\$ 13,393

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

## NOTE 13:- SUPPLEMENTARY DATA ON SELECTED CONSOLIDATED STATEMENTS OF INCOME ITEMS (Cont.)

## c. Net earnings per Ordinary share

Computation of basic and diluted net earnings per share is as follows:

## 1 Numerator:

	Year ended December 31,		
	2011	2012	2013
Net income available to Ordinary shareholders	\$ 5,668	\$ 3,534	\$ 310

## 2 Denominator:

	Year ended December 31,		
	2011	2012	2013
Weighted average number of Ordinary shares, net of treasury stock	9,796,380	10,159,049	12,330,631
Effect of dilutive securities: Add - stock options and RSU	205,791	207,759	672,703
Adjusted weighted average shares	10,002,171	10,366,808	13,003,334

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 14:- Subsequent Events

- a) On September 16, 2013, the Company announced an agreement to combine Conduit's Client Connect business ("ClientConnect") with the Company in an all-stock transaction. On December 31, 2013 Conduit spun off its ClientConnect business, which includes its monetization and distribution platform for publishers and developers. On January 2, 2014 (the "closing date") the Company issued 54,753,582 shares to ClientConnect's selling shareholders, and 2,820,141 options to ClientConnect's option holders. Upon closing, the Company was owned 81% by the existing Conduit shareholders and option holders and 19% by existing Perion shareholders and option holders, on a fully diluted basis using the treasury stock method as defined in the agreement. The transaction has been accounted for as an acquisition of Perion by ClientConnect in accordance with Accounting Standards Codification Topic 805, "Business Combinations," using the acquisition method of accounting with ClientConnect as the accounting acquirer. Under these accounting standards, the total purchase price is calculated as follows:

	(in thousands, except price per share)
Number of shares of Perion ordinary shares outstanding on January 2, 2014	12,524,000
Perion closing price on January 2, 2014 (closing date)	\$ 12.64
Total fair value of stock consideration	\$ 158,303
Fair value of vested (for accounting purposes only) Perion options	7,281
Total purchase price	\$ 165,584

Fair value of Perion vested options represent the fair value of such options attributable to service prior to the closing date using the stock price on the closing date as an input to the Binomial option-pricing model to determine the fair value of the options.

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

## NOTE 14:- Subsequent Events (Cont.)

Under the acquisition method of accounting, the total purchase price is allocated to the net tangible and intangible assets of Perion acquired in the acquisition, based on their fair values at the closing date. The estimated fair values are preliminary and based on the information that was available as of the closing date. The Company believes that the information provides a reasonable basis for estimating the fair values, but the Company is waiting for additional information necessary to finalize these amounts, particularly with respect to the estimated fair value of intangible assets. Thus the preliminary measurements of fair value reflected are subject to changes and such changes could be significant. The Company expects to finalize the valuation and complete the purchase price

allocation as soon as practicable, but no later than one year from the closing date. The preliminary allocation of the purchase price to assets acquired and liabilities assumed is as follows (in thousands):

Amortizable intangible assets:	
Acquired technology	\$ 28,392
IP R&D	8,092
Tradename and other	13,439
Net assets assumed	4,568
Deferred tax liabilities	(7,584)
Net assets acquired	46,907
Goodwill	118,677
Total fair value considerations	<u>\$ 165,584</u>

- b) On December 31, 2013, Conduit and ClientConnect entered into the Working Capital Financing Agreement pursuant to which Conduit undertook to make available to ClientConnect a credit line of up to \$20 million. Any amounts withdrawn under the credit line are required to be used solely to finance payment related to the then-current working capital needs of the ClientConnect business. The outstanding principal amount under the credit line bears interest at the annual rate prescribed by Section 3(j) of the Tax Ordinance (currently 4.1% per annum). As of March 31, 2014, ClientConnect has borrowed \$ 12.5 million under the credit line. The credit line matures in April 2014.
- c) In November 2013, MyMail, Ltd., a non-practicing entity, filed a lawsuit in the Eastern District of Texas alleging that ClientConnect's toolbar technology infringes one of its U.S. patents issued in September 2012 and demanding an injunction and monetary payments. The Company believes that it has strong defenses against this lawsuit and intends to defend against it vigorously.
- d) Related party transactions

As a condition precedent to the closing of ClientConnect Acquisition on January 2, 2014, Conduit and ClientConnect entered into ancillary agreements. As a result of the ClientConnect Acquisition, two office holders of Conduit became members of the Company's Board of Directors and the major shareholders of Conduit also became major shareholders of the Company. Such directors and major shareholders are parties to or otherwise bound by some of such agreements.

**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.

Perion Network Ltd.

/s/ Josef Mandelbaum

Josef Mandelbaum  
Chief Executive Officer

Date: April 10, 2014



## EXHIBIT INDEX

<u>No.</u>	<u>Description</u>
1.1	Memorandum of Association of Perion, as amended and restated (translated from Hebrew).
1.2	Articles of Association of Perion, as amended and restated.
4.2	An amendment to the Commitment Letter and Financial Covenants Letter among the Company and the First International Bank of Israel, B.M., dated September 6, 2011, from December 3, 2013 (translated from Hebrew).
4.8	Search Services Agreement by and between Conduit Ltd. and Microsoft Online, Inc., dated November 19, 2010, as amended on May 11, 2011.*
8	List of subsidiaries.
12.1	Certification required by Rule 13a-14(a) or Rule 15d-14(a) executed by the Chief Executive Officer of the Company.
12.2	Certification required by Rule 13a-14(a) or Rule 15d-14(a) executed by the Chief Financial Officer of the Company.
13.1	Certification required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code.
13.2	Certification required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code.
15.1	Consent of Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global, Independent Auditors.
101	The following financial information from Perion Network Ltd.'s Annual Report on Form 20-F for the year ended December 31, 2013, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets at December 31, 2012 and 2013; (ii) Consolidated Statements of Income for the years ended December 31, 2011, 2012 and 2013; (iii) Consolidated Statements of Comprehensive Income for the years ended December 31, 2011, 2012 and 2013; (iv) Statements of Changes in Shareholders' Equity and Comprehensive Income for the years ended December 31, 2011, 2012 and 2013; (v) Consolidated Statements of Cash Flows for the years ended December 31, 2011, 2012 and 2013; and (vi) Notes to Consolidated Financial Statements. (1)

(1) In accordance with Rule 406T of Regulation S-T, the information in Exhibit 101 is furnished and deemed not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of Section 18 of the Exchange Act of 1934, and otherwise is not subject to liability under these sections and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, as amended, except as expressly set forth by specific reference in such filing.

\* Confidential treatment was requested with respect to certain portions of this exhibit pursuant to 17.C.F.R. §§ 230.406 and 200.83. Omitted portions were filed separately with the SEC.

*[Convenience translation from Hebrew]*

PERION NETWORK LTD.  
AMENDED AND RESTATED MEMORANDUM OF ASSOCIATION

1. Name of the Company: Perion Network Ltd.
  2. The objective for which the Company was formed:
    - (a) The development, manufacture and marketing of software.
    - (b) Any other objective determined by the Company's board of directors.
  3. The liability of the shareholders is limited.
  4. The share capital of the Company shall be NIS 1,200,000, consisting of 120,000,000 ordinary shares, each having a nominal value of NIS 0.01.
  5. Amendments to this Memorandum of Association shall be adopted if approved by the holders of a simple majority of the voting power of the Company represented at the meeting, in person or by proxy, and voting thereon.
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THE COMPANIES LAW, 5759-1999

A COMPANY LIMITED BY SHARES

**AMENDED AND RESTATED ARTICLES OF ASSOCIATION**

**OF**

**PERION NETWORK LTD.**

**PRELIMINARY**

1. In these Articles, unless the context otherwise requires:

“Articles” shall mean the Articles of Association of the Company as shall be in force from time to time.

The “Board” shall mean the Company’s board of directors.

The “Company” shall mean Perion Network Ltd.

“External Directors” shall mean directors appointed and serving in accordance with Part VI, Chapter 1, Article E of the Law.

The “Law” shall mean the Companies Law, 5759-1999, as it may be amended from time to time, and any regulations promulgated thereunder.

The “Office” shall mean the registered Office of the Company as it shall be from time to time.

“Office Holder” shall have the meaning ascribed to such term under the Law.

The “Ordinance” shall mean the Companies Ordinance (New Version) 1983, as amended, and any regulations promulgated thereunder, that are still in effect from time to time.

“Seal” shall mean any of: (1) the rubber stamp of the Company; (2) the facsimile signature of the Company, or (3) the electronic signature of the Company as approved by the Board.

A “Shareholder” shall mean any person that is the owner of at least one share, or any fraction thereof, in the Company, in accordance with Section 177 of the Law.

The “Shareholders Register” shall mean the register of Shareholders kept pursuant to Section 127 of the Law or, if the Company shall keep branch registers, any such branch register, as the case may be.

“Writing” shall mean handwriting, typewriting, facsimile, print, email, lithographic printing and any other mode or modes of presenting or reproducing words in visible form.

In these Articles, subject to this Article and unless the context otherwise requires, expressions defined in the Law or any modification thereof in force at the date on which these Articles become binding on the Company, shall have the meaning so defined; and words importing the singular shall include the plural, and vice versa; words importing the masculine gender shall include the feminine; and words importing persons shall include companies, partnerships, associations and all other legal entities. The titles of the Articles or of a chapter containing a number of Articles are for convenience of reference only and are not to be considered in constructing these Articles.

**PUBLIC COMPANY; LIMITED LIABILITY AND COMPANY OBJECTIVES**

2. The Company is a public company as such term is defined in Section 1 of the Law. The liability of the Company's Shareholders is limited and, accordingly, each Shareholder's responsibility for the Company's obligations shall be limited to the payment of the nominal value of the shares held by such Shareholder, subject to the provisions of these Articles and the Law.
3. The Company's objectives are:
  - 3.1. The development, manufacture and marketing of software;
  - 3.2. Any other objective as determined by the Board.

**CAPITAL**

4. Share Capital

The share capital of the Company shall be NIS 1,200,000, consisting of 120,000,000 ordinary shares, each having a nominal value of NIS 0.01 (the "Ordinary Shares"), each having a nominal value of NIS 0.01. The powers, preferences, rights, restrictions, and other matters relating to the Ordinary Shares are as set forth in the Articles. Warrants and options shall not be considered as shares for purposes of the Articles.

The Ordinary Shares will rank *pari passu* with one another in all respects. Each Ordinary Share shall confer on the holder thereof the right to receive dividends in cash, shares or other securities or assets, the right to participate in a distribution of the Company's assets at the time of its winding-up and the right to receive notices to and to attend and vote (one vote in respect of each Ordinary Share) in every vote at each general meeting of the Shareholders.

5. Allotment of Shares

Subject to the Law and the Articles and to the terms of any resolution creating new shares, (a) the unissued shares from time to time shall be under the control of the Board, which may allot the same to such persons, against cash, or for such other consideration that is not cash, with such restrictions and conditions, in excess of their nominal value, at their nominal value, or at a discount to their nominal value and/or with payment of commission, and at such times as the Board shall deem appropriate and (b) the Board shall have the power to cause the Company to grant to any person the option to acquire from the Company any unissued shares, in each case on such terms as the Board shall deem appropriate.

6. Bearer Shares

The Company shall not issue bearer shares or exchange a share certificate for a bearer share certificate.

7. Special Rights

Subject to the Law and the Articles, and without prejudice to any special rights previously conferred upon the holders of any existing shares or class of shares, the Company may, by resolution of the Shareholders, from time to time, create shares with such preferential, deferred, qualified or other special rights, privileges, restrictions or conditions, whether in regard to dividends, voting, return of capital of otherwise as may be stipulated in the resolution or other instrument authorizing such new shares.

8. Consolidation and Subdivision: Fractional Shares

With regard to its capital the Company may:

8.1. From time to time, by resolution of the Shareholders, subject to the Articles and the Law:

- 8.1.1. Consolidate all or any of its issued or unissued share capital into shares bearing a per share nominal value that is larger than the per share nominal value of its existing shares;
- 8.1.2. Cancel any shares that at the date of the adoption of such resolution have not been acquired or agreed to be acquired by any person, and reduce the amount of its share capital by the amount of the shares so cancelled;
- 8.1.3. Subdivide its shares (issued or unissued) or any of them, into shares of smaller per share nominal value than is fixed by these Articles. The resolution pursuant to which any share is subdivided may determine that, as among the holders of the shares resulting from such subdivision, one or more of such shares may, as compared with the others, have special rights, or be subject to any such restrictions, as the Company has power to attach to unissued or new shares;

- 8.1.4. Reduce its share capital in any manner, including with and subject to any incidental authorities and/or consents required by law.
- 8.2. Upon any consolidation or subdivision of shares that may result in fractional shares, the Board may settle any difficulty that may arise with regard thereto as it deems fit, including, without limitation, by:
  - 8.2.1. Allotting, in contemplation of, or subsequent to, such consolidation or other action, such shares or fractional shares sufficient to preclude or remove fractional shareholdings;
  - 8.2.2. Notwithstanding Section 295 of the Law, making such arrangements for the sale or transfer of the fractional shares to such other shareholders of the Company at such times and at such price as the Board deems fit so as to most expeditiously preclude or remove any fractional shareholdings and cause the transferees of such fractional shares to pay the full fair market value thereof to the transferors, and the Board is hereby authorized to act as agent for the transferors and transferees with power of substitution and off-setting for purposes of implementing the provisions of this sub-Article 8.2.2.
  - 8.2.3. To the extent as may be permitted under the Law, redeeming or purchasing such fractional shares sufficient to preclude and remove such fractional shareholding; and
  - 8.2.4. Determining, as to the holders of shares so consolidated, which issued shares shall be consolidated into each share of a larger nominal value.

## INCREASE OF CAPITAL

### 9. Increase of Capital

- 9.1. The Company, by resolution of the Shareholders, may from time to time, whether or not all the shares then authorized have been issued, and whether or not all the shares theretofore issued have been fully called up for payment, increase its authorized share capital. Any such new share capital shall be of such amount and divided into shares of such nominal values and (subject to any special rights then attached to any existing class of shares) bear such rights or preferences or be subject to such conditions or restrictions (if any) as the resolution approving such share capital increase shall provide.
- 9.2. Except so far as otherwise provided in such resolution or pursuant to the Articles, such new shares shall be subject to all the provisions of the Articles applicable to the shares of such class included in the existing share capital.

### 10. Modification of Class Rights

- 10.1. If at any time the share capital of the Company is divided into different classes of shares, the right attached to any class (unless otherwise provided by the terms of issue of the shares of that class) may be modified only upon consent of a separate general meeting of the holders of the shares of that class. The provisions of these Articles relating to general meetings of Shareholders shall apply *mutatis mutandis* to every such separate general class meeting.
- 10.2. Unless otherwise provided by these Articles, the increase in an authorized class of shares, or the issuance of additional shares thereof out of the authorized and unissued share capital, shall not be deemed, for the purposes of Article 10.1 to vary, modify or abrogate the rights attached to previously issued shares of such class or of any other class of shares.

### 11. Redeemable Shares

The Company shall have the power to issue redeemable shares and redeem the same all in accordance with, and subject to, the provisions of the Law.

## SHARES

### 12. Issuance of Share Certificates; Replacement of Lost Certificates

- 12.1. Share certificates, when issued, shall be issued, upon the written request of a Shareholder, under the Seal and shall bear the signature of any person or persons so authorized by the Board.
- 12.2. Each Shareholder shall be entitled to one or more numbered certificate(s) for all the shares of any class registered in his name, each of which shall state the number of shares represented by the certificate, their serial numbers and the amount paid on account of their nominal value.

12.3. A share certificate registered in the Shareholders Register in the names of two or more persons shall be delivered to the person first named in the Shareholders Register in respect of such co-ownership and the Company shall not be obligated to issue more than one certificate to all of the joint holders.

12.4. A share certificate that has been defaced, lost or destroyed, may be replaced, and the Company shall issue a new certificate to replace such defaced, lost or destroyed certificate upon payment of such fee, and upon the furnishing of such evidence of ownership and such indemnity, as the Board, in its discretion, deems fit.

13. Registered Holder

Except as otherwise provided in these Articles, the Company shall be entitled to treat each Shareholder identified on the Shareholders Register as the absolute owner of the shares registered in his name, and accordingly, shall not, except as ordered by a court of competent jurisdiction, or as required by statute, be obligated to recognize any equitable or other claim to, or interest in, such share on the part of any other person.

14. Payment in Installment

If, pursuant to the terms of allotment or issue of any share and unless determined otherwise in such terms, all or any portion of the price thereof shall be payable in installments, every such installment shall be paid to the Company on the due date thereof by the then registered holder(s) of the share or the person(s) then entitled thereto.



15. Calls on Shares

- 15.1. The Board may, from time to time, as in its discretion it deems fit, make calls for payment upon Shareholders in respect of any sum which has not been paid up in respect of shares held by such Shareholders and that is not, pursuant to the terms of allotment or issue of such shares or otherwise, payable at a fixed time. Each Shareholder shall pay the amount of every call so made upon him (and of each installment thereof if the same is payable in installments), to the person(s) and at the time(s) and place(s) designated by the Board. Unless otherwise stipulated in the resolution of the Board (and in the notice referred to below), each payment in response to a call shall be deemed to constitute a pro rata payment on account of all the shares in respect of which such call was made.
- 15.2. Notice of any call for payment by a Shareholder shall be given in writing to such Shareholder not less than 14 days prior to the time of payment fixed in such notice, and shall specify the time and place of payment, and the person to whom such payment is to be made. Prior to the time for any such payment fixed in a notice of a call given to a Shareholder, the Board may in its discretion, by notice in writing to such Shareholder, revoke such call in whole or in part, extend the time fixed for payment thereof, or designate a different place of payment or person to whom payment is to be made. In the event of a call payable in installments, only one notice thereof need be given.
- 15.3. If, pursuant to the terms of allotment or issue of a share or otherwise, an amount is made payable at a fixed time (whether on account of such share or by way of premium), such amount shall be payable at such time as if it were payable by virtue of a call made by the Board and for which notice was given in accordance with this Article 15, and the provisions of these Articles with regard to calls (and the non-payment thereof) shall be applicable to such amount (and the non-payment thereof).
- 15.4. Joint holders of a share shall be jointly and severally liable to pay all calls for payment in respect of such share and all interest payable thereon.
- 15.5. Any amount called for payment that is not paid when due shall bear interest from the date fixed for payment until actual payment thereof, at such rate and payable at such time(s) as the Board may prescribe.
- 15.6. The Board may provide for differences among the allottees of such shares as to the amounts and times for payment of calls for payment in respect of such shares.

16. Prepayment

With the approval of the Board, any Shareholder may pay to the Company any amount not yet payable in respect of his shares, and the Board may approve the payment by the Company of interest on any such amount until the same would be payable if it had not been paid in advance, at such rate and time(s) as may be approved by the Board. The Board may at any time cause the Company to repay all or any part of the money so advanced, without premium or penalty. Nothing in this Article 16 shall derogate from the right of the Board to make any call for payment before or after receipt by the Company of any such advance.

17. Forfeiture and Surrender

- 17.1. If any Shareholder fails to pay an amount payable by virtue of a call, or interest thereon as provided for in accordance herewith, on or before the day fixed for payment of the same, the Board may, at any time after the day fixed for such payment, so long as such amount (or any portion thereof) or interest thereon (or any portion thereof) remains unpaid, forfeit all or any of the shares in respect of which such payment was called for. All expenses incurred by the Company in attempting to collect any such amount or interest thereon, including, without limitation, attorneys' fees and costs of legal proceedings, shall be added to, and shall, for all purposes (including the accrual of interest thereon), constitute a part of, the amount payable to the Company in respect of such call.
- 17.2. Upon the adoption of a resolution as to the forfeiture of a Shareholder's share, the Board shall cause notice thereof to be given to such Shareholder, which notice shall state the place that payment is to be made and that, in the event of the failure to pay the entire amount so payable by a date specified in the notice (which date shall be not less than seven days after the date such notice is given and which may be extended by the Board), such shares shall be *ipso facto* forfeited; *provided, however*, that, prior to such date, the Board may nullify such resolution of forfeiture, but no such nullification shall prevent the Board from adopting a further resolution of forfeiture in respect of the non-payment of the same amount.
- 17.3. Without derogating from Articles 17.1 and 17.2 hereof, whenever shares are forfeited as herein provided, any and all dividends declared in respect of such shares and not actually paid shall be deemed to have been forfeited at the same time as the forfeiture of such shares.
- 17.4. The Company, by resolution of the Board, may accept the voluntary surrender of any share. A surrendered share shall be treated as if it had been forfeited.
- 17.5. Any share forfeited or surrendered as provided herein shall become the property of the Company, and the same, subject to the provisions of these Articles, may be sold, re-allotted or otherwise disposed of, as the Board deems fit.

- 17.6. Any Shareholder whose shares have been forfeited or surrendered shall cease to be a Shareholder in respect of the forfeited or surrendered shares, but shall, notwithstanding, be liable to pay, and shall forthwith pay, to the Company, all calls, interest and expenses owing upon or in respect of such shares at the time of forfeiture or surrender, together with interest thereon from the time of forfeiture or surrender until actual payment, at the rate prescribed in Article 15.5 above, and the Board, in its discretion, may, but shall not be obligated to, enforce the payment of such monies, or any part thereof. In the event of such forfeiture or surrender, the Company, by resolution of the Board, may accelerate the date(s) of payment of any or all amounts then owing to the Company by the Shareholder in question (but not yet due) in respect of all shares owned by such Shareholder, solely or jointly with another.
- 17.7. The Board may at any time, before any share so forfeited or surrendered shall have been sold, re-allotted or otherwise disposed of, nullify the forfeiture or surrender on such conditions as it deems fit, but no such nullification shall prevent the Board from re-exercising its powers of forfeiture pursuant to this Article 17.
- 17.8. A declaration in writing by a director or secretary of the Company that a share in the Company has been duly forfeited on the date stated in the declaration shall be conclusive evidence of the facts therein stated against all persons claiming to be entitled to the share.
- 17.9. The provisions of these Articles as to forfeiture shall apply in the case of non-payment of any sum which, by the terms of issue of a share, becomes payable at a fixed time, whether on account of the amount of the share, or by way of premium, as if the same had been payable by virtue of a call duly made and notified.
18. Lien
- 18.1. Except to the extent the same may be waived or subordinated in writing, the Company shall have a first and paramount lien upon all the shares registered in the name of each Shareholder (without regard to any equitable or other claim or interest in such shares on the part of any other person), and upon the proceeds of the sale thereof, for his debts or other liabilities to the Company arising from any amount payable by such Shareholder in respect of any unpaid or partly paid share, whether or not such debt or other liability has matured. Such lien shall extend to all dividends from time to time declared or paid in respect of such share. Unless otherwise provided, the registration by the Company of a transfer of shares shall be deemed to be a waiver on the part of the Company of the lien (if any) existing on such shares immediately prior to such transfer.
- 18.2. The Board may cause the Company to sell a share subject to such a lien when the debt or other liability giving rise to such lien has matured, in such manner and for such sums as the Board deems fit, but no such sale shall be made unless such debt or other liability has not been satisfied within seven days after written notice of the intention to sell shall have been served on such Shareholder, his executors or administrators.

18.3. The net proceeds of any such sale, after payment of the costs thereof, shall be applied in or toward satisfaction of the debts or other liabilities of such Shareholder in respect of such share (whether or not the same have matured), and the remainder (if any) shall be paid to the Shareholder, his executors, administrators or assigns.

19. Sale After Forfeiture or Surrender or in Enforcement of Lien

Upon any sale of a share after forfeiture or surrender or for enforcing a lien, the Board may appoint any person to execute an instrument of transfer of the share so sold and cause the purchaser's name to be entered in the Shareholders Register in respect of such share and the seller's name to be stricken off of the Shareholders Register with respect to such share. The purchaser shall be registered as the Shareholder and shall not be obligated to supervise the application of the proceeds of such sale and after his name has been entered in the Shareholders Register in respect of such share, the validity of the sale shall not be affected by any defect or illegality in the sale proceedings. The sole remedy of any person aggrieved by any such sale shall be in damages only and against the Company exclusively.

20. Purchase of the Company's Shares

The Company may, subject to and in accordance with the provisions of the Law, purchase or undertake to purchase, provide finance and or assistance or undertake to provide finance and/or assistance directly or indirectly, with respect to the purchase of its shares or securities that may be converted into shares of the Company or that confer rights upon the holders thereof to purchase shares of the Company.

**TRANSFER OF SHARES**

21. Registration of Transfer

21.1. No transfer of shares shall be registered unless a proper writing or instrument of transfer (in any customary form or any other form satisfactory to the Board) has been submitted to the Company (or its transfer agent), together with the share certificate(s) or such other evidence of title as the Board may reasonably require.

21.2. The Board may, in its discretion to the extent it deems necessary and subject to any restrictions in the Law or the rules of any stock exchange upon which the Ordinary Shares are listed or included for quotation, close the Shareholders Register for registrations of transfers of shares during any year for periods to be determined by the Board, and no registrations in the Shareholders Register of transfers of shares shall be made by the Company during any such period during which the Shareholders Register is so closed.

22. Decedents' Shares

- 22.1. In case of a share registered in the name of two or more shareholders, the Company may recognize the survivor(s) as the sole owner(s) thereof unless and until the provisions of Article 22.2 have been effectively invoked.
- 22.2. Any person becoming entitled to a share in consequence of the death of any person, upon producing evidence of the grant of probate or letters of administration or declaration of succession (or such other evidence as the Board may reasonably deem sufficient), shall be registered as a Shareholder in respect of such share, or may, subject to the regulations as to transfer herein contained, transfer such share. However, nothing herein shall release the estate of a deceased Shareholder (whether sole or joint) of a share from any obligation to the Company with respect to any share held by the deceased.

23. Receivers and Liquidators

- 23.1. The Company may recognize any receiver, liquidator or similar official appointed to wind-up, dissolve or otherwise liquidate a Shareholder that is an entity, and a trustee, manager, receiver, liquidator or similar official appointed in bankruptcy or in connection with the reorganization of, or similar proceeding with respect to, a Shareholder or its properties, as being entitled to the shares registered in the name of such Shareholder.
- 23.2. Any such receiver, liquidator or similar official appointed to wind-up, dissolve or otherwise liquidate a Shareholder that is an entity and any such trustee, manager, receiver, liquidator or similar official appointed in bankruptcy or in connection with the reorganization of, or similar proceedings with respect to, a Shareholder or its properties, upon producing such evidence as the Board may deem sufficient as to his authority to act in such capacity or under this Article, shall with the consent of the Board (which the Board may grant or refuse in its discretion), be registered as a Shareholder in respect of such shares, or may, subject to the provisions as to transfer herein contained, transfer such shares.

**BRANCH REGISTERS**

24. Branch Registers

Subject to and in accordance with the provisions of the Law and to all orders and regulations issued thereunder, the Company may cause branch registers to be kept in any place outside Israel as the Board may think fit, and, subject to all applicable requirements of Law, the Board may from time to time adopt such rules and procedures as it may think fit in connection with the keeping of such branch registers.

**RECORD DATE FOR NOTICES OF GENERAL MEETINGS  
AND OTHER ACTION**

25. Record Date for Notices of General Meetings

- 25.1. Notwithstanding any provision of these Articles to the contrary and subject to applicable law, the Board may fix a date, not exceeding 40 days, and not less than four days, prior to the date of any general meeting of the Shareholders, as the date of which Shareholders entitled to participate and to vote at such meeting shall be determined, and all persons who were holders of record of voting shares on such date and no others shall be entitled to notice of, participate in and to vote at such meeting. A determination of Shareholders of record entitled to participate and to vote at any meeting shall apply to any adjournment of such meeting; *provided, however*, that the Board may fix a new record date for the adjourned meeting.
- 25.2. Any Shareholder or Shareholders of the Company holding at least one percent of the voting rights in the issued share capital of the Company may, subject to the Law, request that the Board include a subject in the agenda of a general meeting to be held in the future. Any such request (i) must be in writing, (ii) must include all information related to the subject matter and the reason that such subject is proposed to be brought before the general meeting and (iii) must be signed by the Shareholder or Shareholders making such request. In addition, subject to the Law, the Board may include such subject in the agenda of a general meeting only if the request has been delivered to the secretary of the Company at least 75 days and not more than 120 days prior to the date set for the relevant Annual General Meeting or Extraordinary General Meeting, as applicable. Each such request shall also set forth: (a) the name and address of the Shareholder making the request; (b) a representation that the Shareholder is a holder of shares of the Company entitled to vote at such meeting and intends to appear in person or by proxy at the meeting; (c) a description of all arrangements or understandings between the Shareholder and any other person or persons (naming such person or persons) in connection with the subject which is requested to be included in the agenda; and (d) a declaration that all the information that is required under the Law and any other applicable law to be provided to the Company in connection with such subject, if any, has been provided. In addition, if such subject includes a nomination to the Board in accordance with the Articles, the request shall also set forth the consent of each nominee to serve as a director of the Company if so elected and a declaration signed by each of the nominees declaring that there is no limitation under applicable law for the appointment of such a nominee. Furthermore, the Board may, in its discretion, to the extent it deems necessary, require that the Shareholders making the request provide additional information so as to include a subject in the agenda of a general meeting.

## GENERAL MEETINGS

26. Annual Meetings

A general meeting shall be held at least once in every year at such time, being not more than 15 months after the last preceding Annual General Meeting (as such term is defined hereunder), and at such place, within or out of the State of Israel, as may be prescribed by the Board. Such general meetings shall be called "Annual General Meetings."

27. Extraordinary General Meetings

All general meetings of Shareholders other than Annual General Meetings shall be called "Extraordinary General Meetings." The Board may, whenever it thinks fit, convene an Extraordinary General Meeting, at such time and place, within or out of the State of Israel, as may be determined by the Board, and shall be obligated to do so upon a request in writing in accordance with Section 63 of the Law.

28. Powers of the General Meeting

Subject to the provisions of the Articles and the Law, the function of the General Meeting shall be to elect the members of the Board, including External Directors; to appoint and/or ratify the Company's auditor; to approve acts and transactions that require approval by a general meeting under the provisions of the Law or these Articles; to increase and reduce the authorized share capital, in accordance with the provisions of the Law; to approve any amendment to these Articles (subject to the special majority requirements contained in Article 34 below); and to approve a resolution to consummate a merger (as defined in Section 1 of the Law).

29. Notice of General Meetings: Omission to Give Notice

Subject to these Articles, applicable law and regulations, including the applicable laws and regulations of any stock market on which the Company's shares are listed or included for quotation, prior notice of at least 21 days of any general meeting, specifying the place, date and hour of the meeting, the agenda, proposed resolutions and voting arrangements shall be given as, hereinafter provided, to the Shareholders thereunto entitled pursuant to these Articles and the Law. Non-receipt of any such notice shall not invalidate any resolution passed or the proceedings held at that meeting.

30. Manner of Meeting

The Board may, in its absolute discretion, resolve to enable persons entitled to attend a general meeting to do so by simultaneous attendance and participation at the principal meeting place and a satellite or Internet meeting place or places anywhere in the world and the Shareholders present in person, by proxy or by written ballot at satellite or Internet meeting places shall be counted in the quorum for and entitled to vote at the general meeting in question, and that meeting shall be duly constituted and its proceedings valid, provided that the chairperson of the general meeting is satisfied that adequate facilities are available throughout the general meeting to ensure that Shareholders attending at all the meeting places are able to: (a) hear all persons who speak (whether by the use of microphones, loudspeakers audio-visual communications equipment or otherwise) in the principal meeting place and any satellite meeting place, and (b) be heard by all other persons so present in the same way.

PROCEEDINGS AT GENERAL MEETINGS

31. Quorum

- 31.1. No business shall be transacted at any general meeting unless a quorum is present when the meeting commences. For all purposes, the quorum shall be at least two Shareholders present in person, or by proxy, holding in the aggregate at least 33 1/3% (thirty three percent and one-third of a percent) of the voting rights in the issued share capital of the Company.
- 31.2. If within 30 minutes from the time appointed for the meeting a quorum is not present, the meeting, if convened upon the request of the Shareholders, shall be dissolved; if the meeting is not convened upon the request of a Shareholder it shall stand adjourned to the same day in the next week at the same place and time, or to such day and at such time and place as the chairperson may determine with the consent of the holders of a majority of the voting power represented at the meeting in person or by proxy and voting on the question of adjournment. No business shall be transacted at any adjourned meeting except business that might lawfully have been transacted at the meeting as originally called. If at the adjourned meeting a legal quorum is not present after 30 minutes from the time specified for the commencement of the adjourned meeting, then the meeting shall take place regardless of the number of members present and in such event the required quorum shall consist of any number of shareholders present in person or by proxy.

32. Chairperson

The chairperson, if any, of the Board shall preside as chairperson at every General Meeting of the Company. If there is no such chairperson, or if at any meeting he is not present within 15 minutes after the time fixed for holding the meeting or is unwilling to act as chairperson, the Shareholders present shall choose one of the Shareholders present to be chairperson. The chairperson of any general meeting shall not, by virtue of such office, be entitled to vote at any general meeting nor shall the chairperson of a meeting have a second or casting vote (without derogation, however from the rights of such chairperson to vote as a Shareholder or proxy of a Shareholder if, in fact, he is also a Shareholder or a duly appointed proxy).

33. Adoption of Resolutions at General Meetings

- 33.1. Subject to Article 34 below, resolutions of the Shareholders with respect to all matters shall be deemed adopted if approved by the holders of a simple majority of the voting power of the Company represented at the meeting in person or by proxy and voting thereon, other than as specified in the Articles or otherwise required by the Law.
- 33.2. Every question submitted to a general meeting shall be decided by a show of hands, but if a written ballot is demanded by any Shareholder present in person or by proxy and entitled to vote at the meeting, the same shall be decided by such ballot. A written ballot may be demanded before the voting on a proposed resolution or immediately after the declaration by the chairperson of the meeting of the results of the vote by a show of hands. If a vote by written ballot is taken after such declaration, the results of the vote by a show of hands shall be of no effect, and the proposed resolution shall be decided by such written ballot. The demand for a written ballot may be withdrawn at any time before the same is conducted, in which event another Shareholder may then demand such written ballot. The demand for a written ballot shall not prevent the continuance of the meeting for the transaction of business other than the question on which the written ballot was demanded.



33.3. A declaration by the chairperson of the meeting that a resolution was carried unanimously, or carried by a particular majority, or did not receive the required majority in order to be carried, and an entry to that effect in the minute book of the Company, shall be prima facie evidence of the fact without proof of the number or proportion of the votes recorded in favor of or against such resolution.

34. Special Resolution

Notwithstanding anything in these Articles to the contrary, the provisions of Articles 34, 40, 43.1, 43.3, 49, 52, 79, and 80 may not be amended without a resolution of the general meeting of the Company approved by Shareholders holding more than two-thirds of the voting power of the issued and outstanding share capital of the Company.

**VOTES OF SHAREHOLDERS**

35. Voting Power

Subject to the provisions of Article 36 and subject to any provision in the Articles conferring special rights as to voting, or restricting the right to vote, every Shareholder shall have one vote for each share held by him of record, on every resolution, without regard to whether the vote thereon is conducted by a show of hands, by written ballot or by any other means.

36. Voting Rights

36.1. In the case of joint holders, the vote of the senior holder to tender a vote, whether in person or by proxy, shall be accepted to the exclusion of the votes of the other joint holders. For the purpose of this Article, seniority shall be determined by the order in which the names appear in the Shareholders Register (or in the Company's transfer agent records). The appointment of a proxy to vote on behalf of a jointly held share shall be executed by the senior holder.

- 36.2. No Shareholder shall be entitled to vote at any general meeting (or be counted as a part of the quorum thereat), unless all calls and other sums then payable by him in respect of his shares in the Company have been paid.
- 36.3. Any Shareholder entitled to vote may vote either personally or by proxy (who need not be a shareholder of the Company), or, if the Shareholder is a company or other entity, by a representative authorized pursuant to Article 36.4.
- 36.4. A company or other corporate body that is a Shareholder of the Company may, by resolution of its directors or any other managing body thereof, authorize any person to be or to appoint its representative at any meeting of the Company. Any person so authorized shall be entitled to exercise on behalf of such Shareholder all the power that the latter could have exercised if it were an individual shareholder. Upon the request of the chairperson of the meeting, written evidence of such authorization (in form reasonably acceptable to the chairperson) shall be delivered to him.

#### **PROXIES**

37. Instrument of Appointment

- 37.1. The instrument appointing a proxy shall be in writing in such form as may be approved by the Board from time to time in compliance with applicable law.
- 37.2. The instrument appointing a proxy (and the power of attorney or other authority, if any, under which such instrument has been signed) shall either be delivered to the Company (at its Registered Office, at its principal place of business, at such place as the Board may specify, or by any other means, including electronic form, all in compliance with applicable law) not less than the close of business on the business day preceding the time fixed for the meeting at which the person named in the instrument proposes to vote, or presented to the chairperson at such meeting.
- 37.3. The Board may cause the Company to send, by mail or otherwise, instruments of proxy to Shareholders for use at any general meeting.

38. Effect of Death of Appointer or Revocation of Appointment

A vote cast pursuant to an instrument appointing a proxy shall be valid notwithstanding the death of the appointing Shareholder (or of his attorney-in-fact, if any, who signed such instrument), or the revocation of the appointment or the transfer of the share in respect of which the vote is cast, provided no written notification of such death, revocation or transfer shall have been received by the Company or by the chairperson of the meeting before such vote is cast and provided, further, that an appointing Shareholder, if present in person at such meeting, may revoke the appointment by means of a writing, oral notification to the chairperson, or otherwise.

39. Multiple Proxies

A Shareholder is entitled to vote by a separate proxy with respect to each share held by him provided that each proxy shall have a separate letter of appointment containing the serial number of the share(s) with respect to which the proxy is entitled to vote. Where valid but differing instruments of proxy are delivered in respect of the same share for use at the same meeting, the instrument that is delivered last (regardless of its date or of the date of its execution) shall be treated as replacing and revoking the others as regards that share. However, if the Board, or some other person as may be authorized by the Board for such purpose, is unable to determine which was the last instrument delivered, none of them shall be treated as valid in respect of that share. Delivery of an instrument appointing a proxy or any other instrument, as aforesaid, shall not preclude a Shareholder from attending and voting in person at the meeting.

**DIRECTORS**

40. Number of Directors

The Board shall be composed of seven (7) members including two External Directors.

41. Qualification of Directors

No person shall be disqualified from serving as a director by reason of not holding shares in the Company.

42. Continuing Directors in the Event of Vacancies

In the event of one or more vacancies in the Board, the continuing directors may continue to act in every matter; *provided, however*, that if they number less than a majority of the number of directors set by the Board to hold office pursuant to Article 40 hereof, they may only act in an emergency, and may call a general meeting of the Company for the purpose of electing directors to fill any or all vacancies, or appoint any other person as a director pursuant to Article 53, so that at least a majority of the number of directors set by the Board to hold office pursuant to Article 40 hereof are in office as a result of such meeting.

43. Vacation of Office; Removal of Directors

- 43.1. The office of a director shall be vacated, *ipso facto*, upon his death or if he be found legally incompetent; if he becomes bankrupt, if he is prevented by applicable law or listing requirements from serving as a director of the Company, if the Board terminates his office according to Section 231 of the Law, if a court order is given in accordance with Section 233 of the Law, or if under the Law his term otherwise automatically terminates.
- 43.2. The office of a director shall be vacated by his written resignation. Such resignation shall become effective on the date fixed therein, or upon the delivery thereof to the Company, whichever is later.
- 43.3. A director shall be removed from office only pursuant to the provisions of Article 43.1 or by a resolution of the general meeting of the Company approved by Shareholders holding more than two-thirds of the voting power of the issued and outstanding share capital of the Company.

44. Remuneration of Directors

Subject to the provisions of the Law, a director may be paid remuneration by the Company for his services as director to the extent such remuneration shall have been approved in accordance with the Law.

45. Conflict of Interests: Approval of Related Party Transactions

45.1. Subject to the provisions of the Law and the Articles, the Company may enter into any contract or otherwise transact any business with any director in which contract or business such director has a personal interest, directly or indirectly; and may enter into any contract of otherwise transact any business with any third party in which contract or business a director has a personal interest, directly or indirectly.

45.2. A director or other Office Holder, shall not participate in deliberations concerning, nor vote upon a resolution approving, a transaction with the Company in which he has a personal interest, except as otherwise provided for in the Law.

**POWERS AND DUTIES OF DIRECTORS**

46. Powers of the Board of Directors

46.1. General

In addition to all powers and authorities of the Board as specified in the Law, the determination of the Company's policies, and the supervision of the Chief Executive Officer of the Company (as defined herein) and the Company's officers shall be vested in the Board. In addition, the Board may exercise all such powers and do all such acts and things as the Company is authorized to exercise and do, and are not hereby or by law required to be exercised or done by the Company in a general meeting or by the Chief Executive Officer under his express or residual authority. The authority conferred on the Board by this Article shall be subject to the provisions of the Law, the Articles and any regulation or resolution consistent with the Articles adopted from time to time by the Company in a general meeting; *provided, however*, that no such regulation or resolution shall invalidate any prior act done by or pursuant to a decision of the Board that would have been valid if such regulation or resolution had not been adopted.

46.2. Borrowing Power

The Board may from time to time, in its discretion, cause the Company to borrow or secure the payment of any sum or sums of money for the purposes of the Company, and may secure or provide for the repayment of such sum or sums in such manner, at such times and upon such terms and conditions in all respects as it thinks fit, and, in particular, by the issuance of bonds, perpetual or redeemable debentures, debenture stock, or any mortgages, charges, or other securities on the undertaking or the whole or any part of the property of the Company, both present and future, including its uncalled or called but unpaid capital for the time being.

46.3. Reserves

The Board may, from time to time, set aside any amount(s) out of the profits of the Company as a reserve or reserves for any purpose(s) that the Board, in its discretion, shall think fit, and may invest any sum so set aside in any manner and from time to time deal with and vary such investments, and dispose of all or any part thereof, and employ any such reserve or any part thereof in the business of the Company without being bound to keep the same separate from other assets of the Company, and may subdivide or redesignate any reserve or cancel the same or apply the funds therein for another purpose, all as the Board may from time to time think fit.

47. Exercise of Powers of Directors

- 47.1. A meeting of the Board at which a quorum is present shall be competent to exercise all the authorities, powers and discretions vested in or exercisable by the Board.
- 47.2. Except as otherwise specifically set forth in these Articles or as required by the Law, a resolution proposed at any meeting of the Board shall be deemed adopted if approved by a majority of the directors present when such resolution is put to a vote and voting thereon.
- 47.3. A resolution in writing signed by all directors then in office and lawfully entitled to vote thereon, or to which all such directors have given their written consent (by letter, telegram, email, facsimile, telecopier, email, or otherwise), shall be deemed to have been unanimously adopted by a meeting of the Board duly convened and held.

48. Delegation of Powers

- 48.1. The Board may, subject to the provisions of the Law and any other applicable law, delegate any or all of its powers to committees, and it may from time to time revoke such delegation or alter the composition of any such committee. Any Committee so formed (in these Articles referred to as a "Committee of the Board"), shall, in the exercise of the powers so delegated, conform to any regulations imposed on it by the Board. The meetings and proceedings of any Committee of the Board shall be governed, with the relevant changes, by the provisions herein contained for regulating the meetings of the Board, so far as not superseded by any regulations adopted by the Board under this Article. Unless otherwise expressly provided by the Board in delegating powers to a Committee of the Board, such Committee shall not be empowered to further delegate such powers. In accordance with and subject to Section 271 of the Law, the Compensation Committee of the Board (if any) shall have the full power and authority to approve the terms of compensation of the Office Holders of the Company, other than Office Holders who are also directors.

- 48.2. Without derogating from the provisions of Article 48.1, the Board may, subject to the provisions of the Law, from time to time appoint a secretary to the Company, as well as officers, agents, employees and independent contractors, as the Board may deem fit, and may terminate the service of any such person. The Board may, subject to the provisions of the Law, determine the powers and duties, as well as the salaries and emoluments, of all such persons, and may require security in such cases and in such amounts as it thinks fit.
- 48.3. The Board may from time to time, by power of attorney or otherwise, appoint any person, company, firm or body of persons to be the attorney or attorneys of the Company at law or in fact for such purpose(s) and with such powers, authorities and discretions, and for such period and subject to such conditions, as it thinks fit, and any such power of attorney or other appointment may contain such provisions for the protection and convenience of persons dealing with any such attorney as the Board may think fit, and may also authorize any such attorney to delegate all or any of the powers, authorities and discretions vested in him.

#### **ELECTION OF DIRECTORS**

49. Other than External Directors, the directors will be elected in three staggered classes by the vote of a majority of the ordinary shares present and entitled to vote. The directors of only one class will be elected at each annual meeting for a three year term, so that the regular term of only one class of directors expires annually. The directors serving as of the date these Articles become effective will be classified as shall be determined by a resolution of the Board. At the Company's Annual General Meeting to be held in 2006, the term of the first class, consisting of two directors will expire, and the directors elected at that meeting will be elected for a three-year term. At the Company's Annual General Meeting to be held in 2007, the term of the second class, consisting of two directors, will expire and the directors elected at that meeting will be elected for a three-year term. At the Company's Annual General Meeting to be held in 2008, the term of the third class, consisting of one director, will expire and the director elected at that meeting will be elected for a three-year term. The External Directors will not be assigned a class.

If the number of directors constituting the Board is changed, any increase or decrease shall be apportioned among the classes so as to maintain the number of directors in each class as nearly equal as possible, but in no case will a decrease in the number of directors constituting the Board shorten the term of any incumbent director.

50. Subject to Article 49, directors shall be elected at the Annual General Meeting or an Extraordinary General Meeting of the Company by the vote of the holders of a majority of the voting power represented at such meeting in person or by proxy and voting on the election of directors.
51. Notwithstanding the provisions of Article 49, External Directors shall be elected and hold office in accordance with the provisions of the Law.
52. Nominations to the Board
- 52.1. Nominations for the election of directors may be made by the Board or a Committee of the Board or, subject to the Law, by any Shareholder. Any Shareholder or Shareholders holding at least five percent of the voting rights in the issued share capital of the Company may nominate one or more persons for election as directors at a general meeting only if a written notice of such Shareholder's intent to make such nomination or nominations has been given to the secretary of the Company and each such notice sets forth all the details and information set forth in Article 25.2. The chairperson of the meeting may refuse to acknowledge the nomination of any person not made in compliance with the foregoing procedure.
- 52.2. Notwithstanding the provisions of Articles 52.1 and 51, no person shall be nominated or appointed to the office of a director if such person is disqualified under the Law from being appointed as a director.
- 52.3. A director's term (including External Directors) shall begin either on the date of his appointment to the Board or at such later date designated in the resolution appointing such director.
53. Subject to the provisions of Article 49, the Board may at any time appoint any other person as a director, whether to fill a vacancy or as an addition to the then current number of directors, provided that the total number of directors shall not at any time exceed seven directors. Any director so appointed shall hold office until the Annual General Meeting at which the term for the other directors of his class expires, unless otherwise stated in the appointing resolution.
54. Subject to the provisions of the Law, a director may appoint an alternate director to attend a meeting in his or her place, but an alternate director so appointed must be approved by the board prior to the relevant meeting.

## PROCEEDINGS OF DIRECTORS

### 55. Meetings of the Board

- 55.1. The Board may meet and adjourn its meetings at such places either within or out the State of Israel and otherwise regulate such meetings and proceedings as the directors think fit, provided that meetings shall be convened at least once every three months. Subject to all of the other provisions of the Articles concerning meetings of the Board, the Board may meet by telephone conference call or other communication equipment so long as each director participating in such call can hear, and be heard by, each other director participating in such call. The directors participating in this manner shall be deemed to be present in person at such meeting and shall be entitled to vote or be counted in a quorum accordingly.
- 55.2. Board meetings may be convened at any time by the chairperson of the Board. The chairperson of the Board shall convene a Board meeting upon the written request of any two directors (or one director if the Board is comprised of fewer than seven directors) as soon as practicable after receiving such request and shall otherwise convene a Board meeting as provided by the Law.

### 56. Notice

- 56.1. Notice of a Board meeting shall contain the information required by the Law and shall be delivered to the directors not less than three days before such meeting.
- 56.2. Notice of a meeting of the Board shall be given in writing, and may be sent by hand, post, facsimile or electronic mail to a director at the address, facsimile number or electronic mail address given by such director to the Company for such purpose. Any such notice shall be deemed duly received, if sent by post, three days following the day when any such notice was duly posted and if delivered by hand or transmitted by facsimile transmission or electronic mail, such notice shall be deemed duly received by the director on the date of delivery or, as the case may be, transmission of the same.
- 56.3. Notwithstanding anything contained to the contrary herein, failure to deliver notice to a director of any such meeting in the manner required hereby may be waived (in advance or retroactively) by such director and a meeting shall be deemed to have been duly convened notwithstanding such defective notice if such failure or defect is waived (in advance or retroactively), by all directors entitled to participate at such meeting and to whom notice was not duly given. The presence of a director at any such meeting shall be deemed due receipt of prior notice or a waiver of any such notice requirement by such director.



57. Quorum

- 57.1. A quorum at a meeting of the Board shall be constituted by the presence in person, or by telephone or similar communication equipment of a majority of the directors then in office who are lawfully entitled to participate and vote at the meeting. If within 30 minutes (or within such longer time as the chairperson of the meeting may decide) from the time appointed for the holding of the Board meeting a quorum is not present, the Board meeting shall stand adjourned to the date, time, and place determined by the chairperson. No business shall be transacted at a meeting of the Board unless the requisite quorum is present.
- 57.2. If at any adjourned Board meeting a quorum is not present within 30 minutes (or within such longer time as the chairperson of the meeting may decide) from the time appointed for holding the meeting, then the quorum at such meeting shall be constituted by the presence in person, or by telephone or similar communication equipment of two of the directors then in office who are lawfully entitled to participate and vote at the meeting. If at such meeting such quorum is not present within the above mentioned time frame, the Board meeting shall be adjourned in accordance with the provisions of this Article 57. No business shall be transacted at a meeting of the Board unless the requisite quorum is present.

58. Chairperson

The Board may from time to time elect by resolution or otherwise appoint a director to be chairperson or deputy chairperson and determine the period for which each of them is to hold office. The chairperson, or in his absence the deputy chairperson, shall preside at meetings of the Board, but if no such chairperson or deputy chairperson shall be elected or appointed, or if at any meeting the chairperson or deputy chairperson shall not be present within 15 minutes after the time appointed for holding such meeting, or if the chairperson, or, if applicable, deputy chairperson, is unwilling or unable to chair such meeting, the directors present shall choose one of their number to be chairperson of such meeting. The chairperson shall not have a second or casting vote at any Board meeting. The Chief Executive Officer of the Company may not serve as the chairperson of the Board, other than pursuant to Section 121 of the Law.

59. Validity of Acts

Subject to the provisions of the Law, all *bona fide* actions of any meeting of the Board, or of a Committee of the Board, or of any person acting as a director or a member of such Committee shall, notwithstanding that it be afterwards discovered that there was some defect in the appointment of any such director or such committee or person acting as aforesaid, or that they or any of them were disqualified, be as valid as if every such person or committee had been duly appointed or had duly continued in office and was qualified.

#### CHIEF EXECUTIVE OFFICER

60. Subject to the Articles and the Law, the Board may from time to time appoint one or more persons, whether or not directors, as the General Manager, Chief Executive Officer, and/or President of the Company (the "Chief Executive Officer"). Subject to the Law, the powers, authorities and responsibilities any such Chief Executive Officer shall have shall be those that the Board may, at its discretion, lawfully confer on the same. The Board may, from time to time, as the Board may deem fit, modify or revoke, such title(s), duties and authorities the Board conferred as aforesaid. Subject to the Articles and the Law, any such appointment(s) and any such powers, authorities and responsibilities may be either for a fixed term or without any limitation of time, and may be made upon such conditions and subject to such limitations and restrictions as the Board may, from time to time, determine. In addition, the Board may from time to time (subject to the provisions of any applicable law or the rules of any stock exchange upon which securities of the Company are listed or included for quotation and of any contract between any such person(s) and the Company) determine the salary of any such person(s) and remove or dismiss any such person(s) from office and appoint another or others in his or their place.
61. The management and the operation of the Company's affairs and business in accordance with the policies determined by the Board shall be vested in the Chief Executive Officer, in addition to all powers and authorities of the Chief Executive Officer, as specified in the Law. Without derogating from the above, all powers of management and executive authority that are not vested by the Law or by the Articles in another organ of the Company shall be vested in the Chief Executive Officer.

#### MINUTES

62. The Company shall cause minutes to be recorded of all general meetings of the Company and also of all appointments of directors and Office Holders and of the proceedings of all meetings of the Board and any Committees thereof. Such minutes shall set forth the names of persons present and all business transacted at such meetings. Any such minutes of any meeting, if purporting to be signed by the chairperson of such meeting or of the next succeeding meeting, or by the chairperson of the Board or the secretary of the Company, shall be *prima facie* evidence of the facts therein stated. Minutes of a meeting shall be kept at the Office for the period, and in the manner, prescribed in the Law.

## DIVIDENDS AND RESERVES

63. Declaration of Dividends

Subject to the provisions of the Law, the Board may from time to time declare such dividends and cause the Company to pay such dividends. The Board shall have the full authority to determine the time for payment of such dividends, and the record date for determining the Shareholders entitled thereto, provided such date is not prior to the date of the resolution to distribute the dividend and no Shareholder who shall be registered in the Shareholders Register with respect to any shares after the record date so determined shall be entitled to share in any such dividend with respect to such shares.

64. Funds Available for Payment of Dividends

Dividends shall be paid out of the profits of the Company, as defined in the Law, or in accordance with Section 303 of the Law.

65. Amount Payable by Way of Dividends

Subject to any special or restricted rights conferred upon the holders of shares as to dividends, any dividend paid by the Company shall be allocated among the Shareholders entitled thereto in proportion to the sums paid up or credited as paid up on account of the nominal value of their respective holdings of the shares in respect of which such dividend is being paid without taking into account the premium paid up for the shares. The amount paid up on account of a share that has not yet been called for payment or fallen due for payment and upon which the Company pays interest to the shareholder shall not be deemed, for the purposes of this Article, to be a sum paid on account of the share.

66. Interest

No dividend shall bear interest as against the Company.

67. Payment in Kind

67.1. A dividend may be paid, wholly or partly, by the distribution of specific assets, and, in particular, by distribution of paid-up shares, debentures of the Company or debentures of any other company, or in any one or more such ways.

67.2. The Board may resolve that: (a) any monies, investments, or other assets forming part of the undivided profits of the Company standing to the credit of the reserve fund, or to the credit of any reserve fund for the redemption of capital, or to the credit of a reserve fund for the revaluation of real estate or other assets of the Company or any other reserve fund or investment funds or assets in the hands of the Company and available for dividends, or representing premiums received on the issue of shares and standing to the credit of the share premium account, be capitalized and distributed among such of the Shareholders as would be entitled to receive the same if distributed by the way of dividend and in the same proportion on the basis that they become entitled thereto as capital; (b) all or any part of such capitalized fund be applied on behalf of such Shareholders in paying up in full, either at nominal or at such premiums as the resolution may provide, any unissued shares or debentures of the Company that shall be distributed accordingly or in or towards the payment, in full or in part, of the uncalled liability on any issued shares or debentures of the Company; and (c) such distribution or payment shall be accepted by such Shareholders in full satisfaction of their share and interest in the said capitalized sum.

68. Implementation of Powers under Article 67

For the purpose of giving full effect to any resolution under Article 67 and without derogating from the provisions of Article 8.2 hereof, the Board may settle any difficulty that may arise in regard to the distribution as it thinks expedient, and, in particular, may issue certificates for fractional amounts of shares or other securities, and may fix the value for distribution of any specific assets, and may determine that cash payments shall be made to any shareholder upon the footing of the value so fixed, or that fractions of less value than the nominal value of one share may be disregarded in order to adjust the rights of all parties, and may vest any such cash, shares, debentures, debenture stock or specific assets in trustees upon such trusts for the persons entitled to the dividend or capitalized fund as may seem expedient to the Board. Where required, a proper contract shall be filed in accordance with Section 291 of the Law, and the Board may appoint any person to sign such contract on behalf of the persons entitled to the dividend or capitalized fund.

69. Dividends on Unpaid Shares

69.1. Without derogating from Article 65 hereof, the Board may give an instruction that shall prevent the distribution of a dividend to the holders of shares for which the full amount payable has not been paid.

69.2. The Board may deduct from any dividend payable to any Shareholder all sums of money, if any, presently payable by such Shareholder to the Company on account of calls or otherwise in relation to the shares of the Company. The Board may retain any dividend or other moneys payable on or in respect of a share on which the Company has a lien, and may apply the same in or toward the satisfaction of the debts, liabilities or engagement in respect of which the lien exists.

70. Retention of Dividends

70.1. The Board may retain any dividend or other monies payable or property distributable in respect of a share on which the Company has a lien, and may apply the same in or toward satisfaction of the debts, liabilities, or engagements in respect of which the lien exists.

70.2. The Board may retain any dividend or other monies payable or property distributable in respect of a share in respect of which any person is, under Article 21 entitled to become a Shareholder, or which any person is, under such Article, entitled to transfer, until such person shall become a shareholder in respect of such share or shall transfer the same.

71. Unclaimed Dividends

All unclaimed dividends or other money payable in respect of a share may be invested or otherwise made use of by the Board for the benefit of the Company until claimed. The payment by the Board of any unclaimed dividend or such other moneys into a separate account shall not constitute the Company a trustee in respect thereof, and any dividend unclaimed after a period of seven years from the date of declaration of such dividend, and any such other moneys unclaimed after a like period from the date the same were payable, shall be forfeited and shall revert to the Company; *provided, however*, that the Board may, at its discretion, cause the Company to pay any such dividend or such other moneys, or any part thereof, to a person who would have been entitled thereto had the same not reverted to the Company.

72. Payment

Any dividend or other money payable in cash in respect of a share may be paid by check or warrant sent through the post to, or left at, the registered address of the person entitled thereto or by transfer to a bank account specified by such person (or, if two or more persons are registered as joint holders of such share or are entitled jointly thereto in consequence of the death or bankruptcy of the holder or otherwise, to any one of such persons or to his bank account), or to such person and at such address as the person entitled thereto may direct in writing. Every such check or warrant shall be made payable to the order of the person to whom it is sent, or to such person as the person entitled thereto as aforesaid may direct, and payment of the check or warrant by the banker upon whom it is drawn shall be a good discharge to the Company. Every such check or warrant shall be sent at the risk of the person entitled to the money represented thereby.

73. Receipt from a Joint Holder

If two or more persons are registered as joint holders of any share, or are entitled jointly thereto in consequence of the death or bankruptcy of the holder or otherwise, any one of them may give an effective receipt for any dividend or other monies payable or property distributable in respect of such share.

**ACCOUNTS AND AUDIT**

74. Books of Account

The Board shall cause accurate books of account to be kept in accordance with the provisions of the Law, and of any other applicable law or regulation including the rules of any stock exchange upon which the Ordinary Shares are listed or included for quotation. Such books of account shall be kept at the Office, or at such other place or places as the Board may think fit, and they shall always be open to inspection by all directors. Shareholders who do not serve as directors, shall only have such rights to inspect any account or book or other similar document of the Company as conferred by Law or authorized by the Board.

75. Audit

At least once in every fiscal year the accounts of the Company shall be audited and the correctness of the profit and loss account and balance sheet certified by one or more duly qualified auditors.

76. Auditors

The appointment, authorities, rights and duties of the auditor(s) of the Company, shall be regulated by applicable law; *provided, however*, that in exercising authority to fix the remuneration of the auditor(s), the Shareholders in a general meeting may act (and in the absence of any action in connection therewith shall be deemed to have so acted) to authorize the Board and/or a Committee of the Board to fix such remuneration subject to such criteria or standards, if any, as may be provided in such resolution, and if no such criteria or standards are so provided, such remuneration shall be fixed in an amount commensurate with the volume and nature of the services rendered by such auditor(s).

**RIGHTS OF SIGNATURES**

77. Rights of Signature

The Board shall be entitled to authorize any person or persons (who need not be directors) to act and sign on behalf of the Company, and the acts and signature of such person(s) on behalf of the Company shall bind the Company insofar as such person(s) acted and signed within the scope of his or their authority.

**NOTICES**

78. Notices

78.1. Any written notice or other document may be served by the Company upon any Shareholder either personally, electronically, or by sending it by prepaid mail (airmail if sent internationally) addressed to such Shareholder at his address as described in the Shareholders Register or such other address as he may have designated in writing for the receipt of notices and other documents. Any written notice or other document may be served by any Shareholder upon the Company by tendering the same in person to the secretary or the Chief Executive Officer of the Company at the Office or by sending it by prepaid registered mail (airmail if posted outside Israel) to the Company at its Office. Any such notice or other document shall be deemed to have been served 48 hours after it has been posted (seven business days if sent internationally), or when actually received by the addressee if sooner than 48 hours or seven business days, as the case may be, after it has been posted, or when actually tendered in person, to such shareholder (or to the secretary or the Chief Executive Officer). Notice sent by telegram, facsimile or electronic mail shall be deemed to have been served when actually received by the addressee, including in the event that it was defectively addressed or failed, in some other respect, to comply with the provisions of this Article 78.1.

78.2. All notices to be given to the Shareholders shall, with respect to any share to which persons are jointly entitled, be given to whichever of such persons is named first in the Shareholders Register or in the records of the Company's transfer agent, and any notice so given shall be sufficient notice to the holders of such share.

- 78.3. Any Shareholder whose address is not described in the Shareholders Register, and who shall not have designated in writing an address for the receipt of notices, shall not be entitled to receive any notice from the Company.
- 78.4. Notwithstanding anything to the contrary contained herein and subject to the provisions of the Law, notice to a Shareholder may be served, as general notice to all Shareholders, in accordance with applicable rules and regulations of any stock exchange upon which the Company's shares are listed or included for quotation.
- 78.5. Subject to applicable law, any Shareholder, director or any other person entitled to receive notice in accordance with these Articles or Law, may waive notice, in advance or retroactively, in a particular case or type of cases or generally, and if so, notice will be deemed as having been duly served, and all proceedings or actions for which the notice was required will be deemed valid.
- 78.6. The accidental omission to give notice of a meeting to any Shareholder or the non-receipt of notice by any Shareholder entitled to receive notice shall not invalidate the proceedings at any meeting or any resolution(s) adopted by such a meeting.

**INSURANCE, EXEMPTION AND INDEMNITY OF OFFICERS**

- 79. Subject to the provisions of the Law, the Company may:
  - 79.1. enter into a contract for the insurance of the liability, in whole or in part, of any of its Office Holders with respect to an obligation imposed on such Office Holder due to an act performed by the Office Holder in the Office Holder's capacity as an Office Holder of the Company arising from any of the following:
    - 79.1.1. a breach of duty of care to the Company or to any other person;
    - 79.1.2. a breach of the duty of loyalty to the Company provided that the Office Holder acted in good faith and had reasonable grounds to assume that the act would not harm the interests of the Company;
    - 79.1.3. a financial liability imposed on such Office Holder in favor of any other person;

- 79.2. undertake, in advance to indemnify, or may indemnify retroactively, an Office Holder of the Company with respect to any of the following liabilities or expenses that arise from an act performed by the Office Holder by virtue of being an Office Holder of the Company:
- 79.2.1. a financial liability imposed on an Office Holder in favor of another person by any judgment, including a judgment given as a result of a settlement or an arbitrator's award which has been confirmed by a court,
  - 79.2.2. reasonable litigation expenses including attorney's fees, incurred by him as a result of an investigation or proceedings instituted against him by an authority empowered to conduct an investigation or proceedings, which are concluded without the filing of an indictment against the Office Holder and without the levying of a monetary obligation in lieu of criminal proceedings upon the Office Holder, or which are concluded without the filing of an indictment against the Office Holder but with levying a monetary obligation in substitute of such criminal proceedings upon the Office Holder for a crime that does not require proof of criminal intent; and
  - 79.2.3. reasonable litigation expenses, including attorney's fees, expended by an Office Holder or which were imposed on an Office Holder by a court in proceedings filed against the Office Holder by the Company or in its name or by any other person or in a criminal charge on which the Office Holder was acquitted or in a criminal charge on which the Office Holder was convicted for an offense which did not require proof of criminal intent;

provided however, that in the event the Company wishes to indemnify an Office Holder in advance for financial liabilities under Article 79.2.1 it may only do so if the undertaking to indemnify the Office Holder for such liabilities was restricted to those events that the Board may deem foreseeable in light of the Company's actual activities, at the time of giving of such undertaking, and to a specific sum or a reasonable criterion under such circumstances as determined by the Board.

80. Subject to the provisions of the Law, the Company hereby releases, in advance, its Office Holders from liability to the Company for damage that arises from the breach of the Office Holder's duty of care to the Company.
81. The provisions of Articles 79 and 80 are not intended, and shall not be interpreted, to restrict the Company in any manner in respect of the procurement of insurance or in respect of indemnification (i) in connection with any person who is not an Office Holder, including, without limitation, any employee, agent, consultant or contractor of the Company who is not an Office Holder, or (ii) in connection with any Office Holder to the extent that such insurance and/or indemnification is not specifically prohibited under law; *provided* that the procurement of any such insurance or the provision of any such indemnification shall be approved by the Board . Any modification of Articles 79 through 81 shall be prospective in effect and shall not affect the Company's obligation or ability to indemnify an Office Holder for any act or omission occurring prior to such modification.



TRANSLATION FOR CONVENIENCE ONLY  
BINDING VERSION IS THE HEBREW ORIGINAL

Date: December 3, 2013

To  
The First International Bank of Israel Ltd.  
Ramat Hachayal Branch (the "**Bank**")  
Dear Sirs,

Re: Amendment to Financial Covenants

**Whereas**, Perion Network Ltd. (hereinafter the "**Company**"), is and/or will be indebted to the Bank for various amounts of money on account of credit, documentary credit, various loans, overdraft on the Company's checking account, debit or other account, various letter of indemnification and guaranty, discounts of bills and other banking services made available and that will be made available to the Company and/or other persons guaranteed by the Company (hereinafter the "**Banking Services**"); and

**Whereas**, In order to secure the Banking Services, on September 6, 2011, the Company has *inter alia*, executed an undertaking for the compliance with financial covenants as amended on April 15, 2012 (as amended, the "**Undertaking**"); and

**Whereas**, the Bank and the Company have agreed to amend the Undertaking in the manner described below;

**THEREFORE**, it is hereby agreed by the Company as follows:

1. Section 1.5 shall be deleted in its entirety.
2. The remaining sections of the Undertaking shall not be amended and shall remain in full force and effect.
3. Without derogating from the foregoing, the Company acknowledges that this consent does not derogate from other undertakings of the Company towards the Bank, including any other covenant specified in the Undertaking.

Sincerely,  
[s] Perion Network Ltd.

[s] The First International Bank of Israel Ltd.  
Ramat Hachayal branch

Search Services Agreement by and between Conduit Ltd. and Microsoft Online, Inc., dated  
November 19, 2010, as amended on May 11, 2011.

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**PORTIONS OF THIS AGREEMENT WERE OMITTED AND HAVE BEEN FILED SEPARATELY  
WITH THE SECRETARY OF THE COMMISSION PURSUANT TO AN APPLICATION FOR  
CONFIDENTIAL TREATMENT UNDER RULE 24b-2 OF THE SECURITIES EXCHANGE ACT  
OF 1934; [\*\*\*] DENOTES OMISSIONS.**

**EXECUTION VERSION**

**SEARCH SERVICES AGREEMENT**

This Search Services Agreement (this "Agreement") is made and entered into as of November 19, 2010 (the "Effective Date"), by and between Conduit Ltd., a company formed under the laws of Israel ("Conduit") and Microsoft Online, Inc., a Nevada corporation ("Microsoft"), a wholly-owned subsidiary of Microsoft Corporation, a Washington corporation. Conduit and Microsoft are each a "Party" and are together referred to as the "Parties."

**RECITALS**

WHEREAS, Microsoft operates search services and provides certain monetization services on behalf of itself and to companies that publish and provide Web sites and other interactive applications and services;

WHEREAS, Conduit develops, publishes and distributes Web sites, applications, software and other digital properties on behalf of itself and third-party publishers on a variety of platforms throughout the world;

WHEREAS, Conduit desires to provide Microsoft with distribution services to enable Conduit and its third-party publishers to access Microsoft's search services and search monetization services as described herein; and

WHEREAS, Microsoft desires to provide such search services and search monetization services;

NOW, THEREFORE, in consideration of the promises, the mutual covenants and agreements herein contained and other good and valuable consideration, the receipt and sufficiency of which are expressly acknowledged, the Parties hereto, intending to be legally bound, agree as follows:

**AGREEMENT**

**1. DEFINITIONS**

- 1.1 "Affiliate" means, with respect to a Party, any entity that, at a given time during the Term, directly or indirectly Controls, is Controlled by or is under common Control with, such Party.
- 1.2 "Algorithmic Listings" means the results generated by Microsoft's Algorithmic Search Services for a given Query.
- 1.3 "Algorithmic Search Services" means Internet Search services that utilize general indices of content available on the World Wide Web including vertical search functionality such as search for images, video, news, shopping and travel.
- 1.4 "API WL Solution" has the meaning given in Section 2.1.3(b).
- 1.5 "Bing" means the proprietary search engine owned and operated by Microsoft utilized on the Bing Site and any successor thereto.
- 1.6 "Bing Site" means [www.bing.com](http://www.bing.com) or the localized equivalent (e.g., [bing.co.uk](http://bing.co.uk) or [bing.fr](http://bing.fr)) and all subdomains and any successor sites that replace such sites and subdomains.

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- 1.7 “Brand Features” means trade names, trademarks, service marks, logos, domain names, trade dress and other distinctive brand features, including any goodwill represented thereby.
- 1.8 “Business Day” means any day other than a Saturday or Sunday or any day on which the Federal Reserve Bank of New York is closed.
- 1.9 “Change of Control Transaction” means, with respect to a Party, (i) a sale of all or substantially all of such Party’s assets, other than to a Financial Investor, (ii) a transfer of Control of such Party to a third party that is not an Affiliate of any shareholder of such Party, other than to a Financial Investor, or (iii) a merger, consolidation, share exchange, recapitalization, restructuring or business combination involving such Party, as a result of which Control of the surviving entity is held by a third party that is not an Affiliate of any shareholder of such Party, other than by a Financial Investor.
- 1.10 “Commencement Date” means the earlier of (a) January 1, 2011 and (b) the date that Microsoft begins providing the Services to Conduit.
- 1.11 “Conduit” has the meaning given in the preamble of this Agreement.
- 1.12 “Conduit Brand Features” means the Brand Features of Conduit, its Affiliates and the Conduit Publishers.
- 1.13 “Conduit Engine” means Conduit software that powers Conduit applications, such as Conduit’s toolbar.
- 1.14 “Conduit Indemnified Party” means Conduit, any Affiliate of Conduit, any successor to all of Conduit’s rights and obligations under this Agreement permitted under Section 16.4, and any employee, officer, director, representative or agent of any of the foregoing in his, her or its capacity as such.
- 1.15 “Conduit Publisher” means a third party with whom Conduit has contracted to provide Algorithmic Search Services or Paid Search Services on or in connection with Conduit’s or such third party’s Web sites, applications, software and other digital properties.
- 1.16 “Confidential Information” has the meaning given in Section 6.1.
- 1.17 “Control” means, with respect to an entity, the beneficial ownership, directly or indirectly through or with one or more intermediaries, of equity securities or other ownership interests representing more than 50% of the voting power of such entity and the right to appoint more than 50% of the directors of such entity.
- 1.18 “Covered Amounts” means any damages, penalties, fines, fees, costs and expenses (including reasonable attorneys’ fees and costs) incurred directly and reasonably necessarily in connection with any Third Party Claim or agreed to by the Indemnifying Party in settlement of any Third Party Claim, but excluding internally allocated costs incurred by an Indemnified Party in providing cooperation to an Indemnifying Party or in participating in the defense of a Third Party Claim (provided that the Indemnifying Party has assumed the defense of such Third Party Claim).
- 1.19 “Destination Page” means the Web page that is displayed when an End User clicks on a Result.
- 1.20 “Disclosing Party” has the meaning given in Section 6.1.

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- 1.21 “Effective Date” has the meaning given in the preamble of this Agreement.
- 1.22 “End User” means an individual, human end user who visits or uses a Property or a Source (i.e., not bots, macro programs, Internet agents, crawlers or any other automated means).
- 1.23 “Event” means, with respect to an End User, any of the following (a) the End User submits a Query from any Source and (b) the End User visits or otherwise interacts with the Microsoft Network.
- 1.24 “Excess Revenue Share Payment” has the meaning given in Section 4.1.2.
- 1.25 “Financial Investor” is a financial institution, a fund or a pooled investment vehicle (e.g., a private equity fund or a hedge fund), or a person or entity whose main business is making investments in other entities engaged in multiple businesses.
- 1.26 “Governmental Authority” means any United States or non-United States federal, national, provincial, state or local government or other political subdivision thereof, any entity, authority, agency or body exercising executive, legislative, judicial, regulatory or administrative functions of any such government or political subdivision, and any super-national organization of sovereign state exercising such functions for such sovereign states.
- 1.27 “Gross Revenue” [\*\*\*]
- 1.28 “Indemnified Party” means a Microsoft Indemnified Party or a Conduit Indemnified Party entitled to defense and indemnification under Section 10.1 or 10.2, as the case may be.
- 1.29 “Indemnifying Party” means Microsoft or Conduit, whichever is obligated to provide defense and indemnification under Section 10.1 or 10.2, as the case may be.
- 1.30 “Intellectual Property Rights” means any and all rights existing from time to time under patent law, copyright law, moral rights law, trade secret law, trademark law, whether registered or unregistered, and any and all other similar proprietary rights, as well as any and all applications, renewals, extensions, divisionals, continuations, restorations and re-instatements thereof, now or hereafter in force and effect worldwide.
- 1.31 “Internet Search” means search via a search engine that utilizes a general index of content located on the World Wide Web.
- 1.32 “Laws” means any Federal, state, provincial, county, municipal or other local laws, rules, regulations, ordinances or judicial decisions enacted or issued by a court or other Governmental Authority of any country, state, province, county, city or other municipality.
- 1.33 “Microsoft” has the meaning given in the preamble of this Agreement.
- 1.34 “Microsoft Indemnified Party” means Microsoft, any Affiliate of Microsoft, any successor to all of Microsoft’s rights and obligations under this Agreement permitted under Section 16.4, and any employee, officer, director, representative or agent of any of the foregoing in his, her or its capacity as such.

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- 1.35 “Microsoft Network” means Microsoft O&O Properties and Microsoft Partner properties.
- 1.36 “Microsoft O&O Properties” means all Web sites, applications, software and other digital properties receiving or using the Services that are owned or operated by or for Microsoft or its Affiliates during the Term.
- 1.37 “Microsoft Partner” means a third party that has entered into an arrangement or agreement with Microsoft to receive Microsoft’s Paid Search Services and/or Algorithmic Search Services.
- 1.38 “Mobile Device” means (a) a mobile telephony device used for any computing, communications or other services, and (b) any other device that Microsoft and Conduit either agree in writing are Mobile Devices or both treat as mobile for purposes of rendering the user experience. Examples include, as of the Effective Date, devices such as the Samsung Focus, Apple iPhone, RIM Blackberry, Motorola Droid, the Palm Pre, and any other similar devices manufactured by other companies and, in the future, any devices that are captured by this definition.
- 1.39 [\*\*\*]
- 1.40 “Non-Infringing Alternative” has the meaning given in Section 10.4.
- 1.41 [\*\*\*]
- 1.42 “Other Platforms” means platforms and devices other than Personal Computers, including, but not limited to Mobile Devices and Internet Protocol Television (“IPTV”).
- 1.43 “Other Platform Payments” has the meaning given in Section 4.1.3.
- 1.44 “Other Platform Services” has the meaning given in Section 2.10.
- 1.45 “Page Click Through Rate” means the percentage of Results Pages for which the user clicks on any content on a Results Page.
- 1.46 “Paid Listing” means any advertisement for which the review, cataloguing, collection, maintenance, indexing, ranking, or display is paid, regardless of the method by which that payment is counted (whether cost for review, cost per click, cost per action, cost per impression, pay-for-placement, or otherwise).
- 1.47 “Paid Search Services” means services that deliver Paid Listings in response to Queries.
- 1.48 “Patents” means any and all existing and future patents and patent applications owned or licensable by the relevant Party, and filed or issued anywhere in the world.
- 1.49 “Personal Computer” means a general purpose computer, such as a desktop, laptop, tablet or netbook, that (a) is not a Mobile Device, and (b) is primarily designed to be used by a single individual or small group of individuals at one time and to perform a multiplicity of general purpose computing functions at the direction of the user through applications. Examples include, as of the Effective Date, devices such as a Dell Inspiron, the Lenovo Thinkpad, the Apple iPad and the Toshiba Mini.

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- 1.50 [\*\*\*]
- 1.51 “Privacy Laws” means those Laws relating to data privacy, data protection or data retention.
- 1.52 “Property” or “Properties” means Conduit’s and Conduit Publishers’ current and future Web sites, applications, software and other digital properties (including Bing applications).
- 1.53 “Query” means a single Internet Search request that is submitted by an individual End User. As used in the prior sentence, “submission” by an End User includes manual typing in a search box (followed by a click or pressing of the enter key to submit the Internet Search request) or other affirmative act by the End User that, in relevant context, manifests a bona fide intent to submit a particular Internet Search request for information (e.g., by clicking on a search link or a related terms link). The term “submission” does not include the automatic, real-time transmission by Microsoft or Conduit of suggested search terms during manual typing in a search box occurring prior to a click or prior to any other affirmative act to submit the Internet Search request.
- 1.54 “Receiving Party” has the meaning given in Section 6.1.
- 1.55 “Results” means Paid Listings and Algorithmic Listings.
- 1.56 “Results Page” means Web pages on which Results are displayed in response to a Query submitted through a Source.
- 1.57 “Self-Serve Platform” means the platform operated by Conduit through which publishers can create customized applications for distribution on a self-serve basis.
- 1.58 “Services” means Microsoft’s Algorithmic Search Services and Paid Search Services.
- 1.59 [\*\*\*]
- 1.60 “Source” means a search entry point as specified in Exhibit B that is enabled on or as a direct result of an End User’s interaction with a Property and that allows an End User to conduct an Internet Search.
- 1.61 “Tax” means any federal, state, local, or foreign income, profits, capital gains, gross receipts, franchise, net worth, sales, use, value added, goods and services, property, ad valorem, intangible, unitary, transfer, stamp, documentary, payroll, employment, estimated, excise, license, withholding, social security, alternative or add-on minimum, recapture or other taxes of any kind imposed by any Governmental Authority.
- 1.62 “Term” has the meaning given in Section 15.1.
- 1.63 “Termination Override Notice” has the meaning given in Section 15.3.1.

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- 1.64 “Territory” means worldwide, to the extent permitted by U.S. law.
- 1.65 “Third Party Claim” means any claim, demand, suit, action, or administrative, regulatory or other proceeding by anyone other than an Indemnified Party in connection with such matter.
- 1.66 “Tier” has the meaning given in Section 4.1.1.
- 1.67 “Transaction Tax” means any sales, use, value added, goods and services, or similar Tax.
- 1.68 [\*\*\*]
- 1.69 “Withholding Taxes” has the meaning given in Section 4.5.2.

## 2. SERVICES

### 2.1 Scope of Services.

2.1.1 Provision of Services. During the Term and in accordance with the provisions of this Agreement, Microsoft will provide the Services in response to all Queries delivered by Conduit from all Sources in the Territory. Conduit, [\*\*\*], shall be entitled to access the Services through all Sources in the Territory and as otherwise agreed by the Parties, other than Sources on Properties excluded under Section 2.1.3. [\*\*\*],

2.1.2 Initial Migration of Existing Properties. During the portion of the Term between the Commencement Date and December 31, 2010 (if the Commencement Date is earlier than January 1, 2011), Microsoft will make the Services available to the Properties and Conduit Publishers that the Parties agree to migrate to the Services. Beginning on January 1, 2011 and continuing throughout the Term, Microsoft will make the Services available to all of the Properties and Conduit Publishers supported by Conduit as of the Commencement Date.

### 2.1.3 New Properties; Exclusion of Properties.

(a) New and Changed Properties. After the Commencement Date, Conduit may add new Properties (“New Properties”), new Sources as allowed under Exhibit B, and new Conduit Publishers, including those that become Conduit Publishers via the Self-Serve Platform, without prior approval from Microsoft. Conduit will use commercially reasonable efforts to prevent the use of the Services or the enablement of Sources on or in connection with New Properties (and Properties supported by Conduit as of the Commencement Date that materially change after the Commencement Date (a “Changed Property”)) that violate (for so long as they violate) Microsoft’s standard advertising editorial guidelines as applicable in the local geographic market of the applicable Conduit Publisher (the “Guidelines,” a current copy of such guidelines, as applicable in the United States, is available at <http://advertising.microsoft.com/support-center/search-advertising/editorial-guidelines>) with respect to (i) adult content; (ii) gambling activity; (iii) the promotion of illegal drugs or other illegal activity; (iv) the distribution of spyware, computer viruses, SPAM or similar harmful software or code; and (v) the distribution of products or services whose primary intent is to provide software or platforms that enable file sharing of copyrighted content or that enable the bypassing of copyright protection. “Commercially reasonable efforts” as used in the preceding sentence means that Conduit (x) provides clear notice to prospective Conduit Publishers of the foregoing Guidelines; (y) posts such policies in an easily accessible location on the Conduit.com Web site (either by incorporating the relevant Guidelines into Conduit’s publisher terms and conditions or linking directly to the Guidelines); and (z) investigates and takes reasonable action in response to violations within a reasonable time following a reported violation. Microsoft will provide reasonable cooperation to Conduit at Conduit’s request in connection with any such violations.

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(b) Notice of Suspension; White-Label Solution. Microsoft may require Conduit to suspend or cease providing Services to Sources within a Property by providing at [\*\*\*] Conduit, if (i) in Microsoft's reasonable judgment, such Property violates Microsoft's guidelines with respect to subsections (i)-(v) of subsection (a) above, (ii) Microsoft would not enter into a direct relationship with such Conduit Publisher to provide Services with respect to such Property and (iii) Microsoft has not accepted advertising with respect to such Property or Conduit Publisher on the Microsoft O&O Properties. Such notice will include a detailed description of the reasons for the requested action and, upon Conduit's request, the Parties shall work together promptly and in good faith to address and attempt to resolve such issues in order to resume providing Services to the affected Property. If the Parties are unable to resolve such issues after using such good faith efforts, [\*\*\*]

Microsoft will consider such request promptly and in good faith. Such [\*\*\*] as may be agreed by the Parties. Any [\*\*\*] will be subject to all of the terms of this Agreement except with respect to Microsoft branding. Any API WL Solution will be subject to the terms of Microsoft's standard API license terms as generally applied and such other terms as may be agreed by the Parties, including reasonable adjustments to the service levels and other obligations of Microsoft with respect to the implementation and technical delivery of the Services set forth in this Agreement. For clarity, the payment provisions of this Agreement will continue to apply with respect to any [\*\*\*].

(c) Suspension. Conduit will promptly suspend or terminate the provision of Services to each Property as required by Microsoft under this Section 2.1.3; provided that the process described in this Section 2.1.3 shall be undertaken by both Parties with consideration to minimizing any potential interference with the business of any Conduit Publisher. For clarity, (i) the fact that a Property may violate any of subsections (i)-(v) of subsection (a) above shall not be deemed a breach of this Agreement and (ii) the submission of a Query by an End User from a Source or the contents of any Results does not mean that the Property is in violation of subsections (i)-(v) of subsection (a) above.

## 2.2 Implementation.

2.2.1 Hosting of Results Page. Unless otherwise agreed upon in writing by the Parties, Microsoft will host the Results Pages. The Parties will mutually agree on the mechanisms to deliver and correctly display the Conduit and Conduit Publisher content described in Sections 2.2.2(b) -2.2.2(d). For the avoidance of doubt, nothing in this Section 2.2 or otherwise will affect Conduit's right to engage in homepage replacement (as described in 2.7.3(a)) and to host homepages in connection therewith. If such homepage replacement includes the replacement of an End User's browser's homepage with the Bing Site homepage, Microsoft will, subject to Conduit's proper implementation of the [\*\*\*]

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2.2.2 Display of Results.

(a) [\*\*\*]

(b) The Results Page will include a link or other visual element (as shown in Exhibit C-1), which when clicked on, directs the user to Conduit's applications marketplace (the "Apps Link"). The Apps Link will be implemented in substantially the location shown in Exhibit C-1 unless otherwise mutually agreed by the Parties in writing.

(c) Notwithstanding Section 2.2.2(a), Conduit may include content and links to applications on the Results Page in a "[\*\*\*]" as shown in Mockup 1 of Exhibit C-2 or as otherwise agreed by the Parties. The content and applications that are included in the "[\*\*\*]" will be determined by Conduit in its sole discretion; provided, however that Microsoft may object in good faith to the association of content or applications with a particular Results Page on relevance grounds or subject to Microsoft's standard advertising acceptance policies as applied generally to the display of content on the Bing Site, in which case Microsoft may elect not to display such content or applications in the "[\*\*\*]" (unless Microsoft accepts advertising in connection with such content or applications, in which event, Microsoft will display such content in the "[\*\*\*]"). The "[\*\*\*]" will be located on the Results Page so as to optimize user experience (e.g., "[\*\*\*]"), as mutually agreed upon by the Parties. The Parties will work together to implement the Conduit Layer beginning March 1, 2011 in accordance with Mockup 1 of Exhibit C-2. If the Parties cannot agree on how to implement the Conduit Layer in accordance with Mockup 1 of Exhibit C-2 or if Microsoft is not able to implement the "[\*\*\*]" by March 1, 2011, then, beginning on "[\*\*\*]", the Conduit Layer will be implemented on the "[\*\*\*]" "[\*\*\*]", if any, as shown in Mockup 2 of Exhibit C-2.

(d) The Parties will use reasonable efforts to implement buttons or links to appear on the Results Page (e.g., next to relevant Results) from which users can download or be directed to applications and other Conduit or Conduit Publisher content, an example of which is shown in Exhibit C-3. The Parties will work together to develop the appropriate mechanism for implementing such buttons or links and shall test such implementation according to a mutually-agreed test plan on a Source-by-Source basis for the purposes of measuring the impact of such links on the overall "[\*\*\*]". If the test demonstrates a positive or neutral impact on overall "[\*\*\*]" with respect to a Source, then Microsoft will implement such buttons or links for all Results Pages from that Source. If the test demonstrates a negative impact on overall "[\*\*\*]" with respect to a Source, then the Parties will work together to implement changes designed to remedy such negative impact and will conduct one or more retests. If, after using commercially reasonable efforts, the Parties agree that the negative impact cannot reasonably be corrected, then Microsoft will not have an obligation to implement such buttons or links on Results Pages in connection with such Source. Nothing in this paragraph shall affect Microsoft's right to control the order and location of Results on Results Pages.

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(e) For clarity, Conduit may instruct Microsoft not to display any or all of the content described in Sections 2.2.2(b) - 2.2.2(d) with respect to one or more Conduit Publishers. [\*\*\*]

(f) Commencing [\*\*\*], when desired by Conduit, Microsoft will display the content described in Sections 2.2.2(b) - 2.2.2(d) in connection with any search conducted from any Microsoft search entry point (e.g., from the Bing Site) by an End User with an installed active [\*\*\*].

2.3 General.

2.3.1 Improvements and Successive or Substitute Services. For avoidance of doubt, the Services provided by Microsoft under this Agreement will include each such service as it exists as of the Effective Date, all improvements thereto and any successor or substitute [\*\*\*] or [\*\*\*] that is used on the Bing Site.

2.3.2 Parity. [\*\*\*]

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2.3.3 Microsoft Reward Programs. Microsoft will use good faith efforts to enable End Users to obtain [\*\*\*] and the benefit of other similar Microsoft programs (to the extent Microsoft makes them available other than on a test basis) from Internet Searches conducted through the Sources, subject to the generally applicable terms, technical requirements and technical feasibility of such programs.

2.4 Non-Discrimination. [\*\*\*]

2.5 Branding. At Conduit's option and on a Source-by-Source basis, the footer of the Results Page may be co-branded with Conduit's and/or a Conduit Publisher's logo, examples of which are shown in Exhibit C-4. Such logos may be clickable live links to Conduit or Conduit Publisher sites. Conduit shall use reasonable efforts to ensure that the Conduit Brand Features that are displayed in the footer and the footer itself conform to the technical requirements set forth on Exhibit I, as such requirements may be modified by the mutual agreement of the Parties. For the avoidance of doubt, except as expressly provided in this Agreement, [\*\*\*] except with respect to the Results and other content provided by Microsoft. After January 1, 2011, the Parties will explore in good faith co-branding the Results Page header with Conduit's and/or a Conduit Publisher's logo as shown in Exhibit C-5 or as otherwise agreed by the Parties.

2.6 Reporting. The Parties will work together in good faith to implement an appropriate reporting solution that provides reporting metrics, functionality and performance at a level that meets the needs of Conduit and all Conduit Publishers. [\*\*\*] Microsoft will provide Conduit with the ability to generate up to [\*\*\*], or such higher number as the Parties may agree, so that [\*\*\*] Microsoft will report on [\*\*\*] at least the following information in [\*\*\*] Microsoft will report on a monthly basis at least the following information [\*\*\*] by [\*\*\*] Notwithstanding the foregoing, for the months of December 2010, Microsoft shall provide [\*\*\*] following information [\*\*\*]

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2.7 Prohibited Actions.

2.7.1 Restrictions. Unless otherwise agreed to by Microsoft, Conduit shall not, and shall not authorize, allow or permit any third-party to:

- (a) edit, modify, truncate, filter or change the order of the information contained in any Results (either individually or collectively);
- (b) frame any Destination Page;
- (c) redirect an End User away from the Destination Page, provide a version of the Destination Page different from the page an End User would access by going directly to the Destination Page, intersperse any content between a Result and the corresponding Destination Page;
- (d) display any Results in pop-up, pop-under, exit windows, expanding buttons, or animation;
- (e) except to the extent expressly permitted herein, transfer, sell, lease, syndicate, sub-syndicate, lend, or use for co-branding, timesharing, service bureau or other unauthorized purposes any Services or access thereto (including, but not limited to the Results, or any part, copy or derivative thereof);
- (f) directly or indirectly generate Queries, or impressions of or clicks on Results, through any incited, automated, deceptive, fraudulent or other invalid means for the purpose of artificially increasing the number of Unique Searchers or Gross Revenue (including, but not limited to, (A) click spam, robots, macro programs, Internet agents; (B) blind links (where End Users do not know that they will be performing a Query or clicking on a Result; (C) requiring an End User to click to receive some other benefit, obtain some other result or perform another function (such as leaving a Web page or closing a window); (D) pre-populating a Source, except that spell check, auto completion, and suggested query functionalities will not be considered a violation of this subsection; or (E) Conduit, its employees, contractors or agents submitting Queries except in the course of normal individual use);
- (g) encourage or require End Users or any other persons, either with or without their knowledge, by offering incentives or payments to enter Queries or click on Results using methods that are manipulative, deceptive, malicious or fraudulent for the purpose of artificially increasing the number of Unique Searchers or Gross Revenue (provided that neither this subsection (g) nor subsection (f) above shall be deemed to prohibit valid means of incentivizing searches such as through toolbars that provide benefits to End Users, such as toolbars that give a portion of revenue to the charity of an End User's choice);
- (h) provide End Users with the ability to submit Queries or access any Results through any client software application that is known to be harmful or malicious or that is installed without an End User's consent (such as malware, spyware, and "drive-by" downloads) or that otherwise fails to comply with applicable Laws relating to client software applications that include dynamically served third party advertisements;
- (i) install any program on an End User's computer or replace an End User's home page, without the End User's prior consent;

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(j) modify, adapt, translate, prepare derivative works from or decompile, reverse engineer, disassemble or otherwise attempt to derive source code from (except to the extent permitted under this Agreement or allowed by Law) the technology used to provide the Services (excluding any technology provided by Conduit); or

(k) remove, deface, obscure, or alter Microsoft’s copyright notice, trademarks or other proprietary rights notices affixed to or provided or displayed as part of any Services, or any other Microsoft technology, software, materials and/or documentation.

2.7.2 Exceptions. The restrictions in Section 2.7.1 will not apply to prohibit any action or practice with respect to the Services that is engaged in by Microsoft or a Microsoft Partner.

2.7.3 User Consent.

(a) Conduit will provide a user notice and obtain user consent, [\*\*\*], in compliance with applicable Laws and acceptable industry practices, before changing any user settings with respect to any of the Sources. For purposes of the foregoing sentence, certification by TRUSTe or a comparable entity (“Certification”) shall constitute compliance with acceptable industry practices. If Conduit no longer maintains Certification and Microsoft believes that a given Conduit practice violates acceptable industry practices, then Microsoft may raise the issue to Conduit and the Parties work together in good faith to resolve the issue. For the avoidance of doubt, to the best of Microsoft’s knowledge (including the mock-ups and policies disclosed by Conduit prior to the Effective Date), Microsoft acknowledges and agrees that Conduit’s notice and consent practices in effect as of the Effective Date comply with acceptable industry practices and are acceptable means of providing such user notices and obtaining such user consent as of the Effective Date. In addition, Microsoft acknowledges and agrees that Conduit may, on either [\*\*\*] basis, [\*\*\*] that may include [\*\*\*] which may be the [\*\*\*] (in which event, [\*\*\*])

(b) Microsoft will provide a user notice and obtain user consent, either on [\*\*\*], in compliance with applicable Laws and acceptable industry practices, before changing any user settings of End Users. For purposes of the foregoing sentence, Certification shall constitute compliance with acceptable industry practices. If Microsoft does not maintain Certification and Conduit believes that a given Microsoft practice violates acceptable industry practices, then Conduit may raise the issue to Microsoft and the Parties work together in good faith to resolve the issue. Microsoft may or may not implement functionality on Results Pages that enables End Users to change their default search provider settings for the Sources. If Microsoft enables such functionality, Microsoft will continue to recognize such End Users as [\*\*\*]

(c) Click-Fraud Cooperation. If Microsoft detects or reasonably suspects fraudulent clicks or Queries, Conduit will cooperate with Microsoft to detect and prevent such fraudulent clicks or Queries in a manner that is consistent with the Parties’ privacy policies and all applicable Laws.

2.8 Traffic Assignment. Each Party will take all reasonable actions and provide all reasonable assistance to the other Party (including the execution, acknowledgment, delivery and assistance in preparation of documents) as may be requested by the other Party to ensure that (a) Microsoft obtains [\*\*\*] and (b) Conduit receives [\*\*\*]. Such reasonable actions may include, by way of example and without limitation, (x) Microsoft hosting the [\*\*\*]; (y) [\*\*\*] and (z) [\*\*\*]

2.9 Service Levels. [\*\*\*]

2.10 Other Platforms. Conduit shall have the right to implement all then-available versions of the Services designed for Other Platforms (“Other Platform Services”). If Microsoft does not have a version of the Services designed for an Other Platform with respect to which Conduit desires to receive Services, but a then-available version of a Service may be readily adapted to such Other Platform (e.g., by making reasonable format changes to Results from such available Services), then the Parties will work together to make such adaptations and Conduit may implement the Services on such Other Platform. If then-available Services may not be readily adapted to such Other Platform, the Parties will study the feasibility, effort and timing of providing Services for such Other Platform for a period of 60 days from Conduit’s request to receive such Services. If the Parties do not mutually agree to include the Services for such Other Platform, Microsoft will have no further obligation with respect to such requested Other Platform Services. If the Parties agree to include the Services for such Other Platform, Microsoft will work with Conduit to provide the requested Other Platform Services in the agreed manner and timeframe, and, when made available, Conduit will use the Other Platform Services consistent with the terms and conditions of this Agreement as such terms and conditions may need to be modified in light of the nature of the particular platform or differing business models; provided that (a) the Parties will act reasonably and work together in good faith to agree on any such modifications (for example, the provision of the [\*\*\*] may not apply to implementations on Other Platforms) and (b) any such modifications will be consistent with the spirit and intent of this Agreement and preserve the Parties’ relative shares of the ongoing economic benefits of this Agreement. Unless the Parties otherwise agree in writing, this Section shall not be construed to require Microsoft to provide Conduit with any software code (for example, apps) other than software (such as APIs or other code to enable the Services) that Microsoft makes generally available to other Microsoft Partners in connection with the Services.

3. [\*\*\*]

3.1 Search Services Exclusivity. Except as otherwise provided for in this Agreement, commencing on [\*\*\*] and continuing throughout the Term, Microsoft will be [\*\*\*] and [\*\*\*]. Conduit will not do anything to circumvent [\*\*\*]. For clarity, the foregoing [\*\*\*]. In addition, [\*\*\*] in this Section 3.1 does not apply to: [\*\*\*]

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4. COMPENSATION AND PAYMENT

4.1 Payments  
[\*\*\*]

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4.2 Method and Timing of Payment.

4.2.1 Monthly Reports. Microsoft will provide Conduit in a timely manner (no later than [\*\*\*] following the end of each calendar month) with a monthly report containing such information as is reasonably necessary for Conduit to prepare invoices for amounts payable to Conduit pursuant to Section 4.1, including at a minimum, [\*\*\*] information described in Exhibit I for activity in the immediately preceding month and reasonable detail regarding any allowed adjustments made to revenues received from the Services to arrive at [\*\*\*] All information contained in Microsoft's reports under this Section 4.2.1 shall be deemed Confidential Information (as defined in the NDA) of each Party and will be used and disclosed by the Parties only as expressly provided in this Agreement.

4.2.2 Invoices and Payments. [\*\*\*] Microsoft will make all payments to Conduit in U.S. Dollars by wire transfer in accordance with the instructions set forth in Exhibit H or otherwise as instructed by Conduit in writing. All currency conversions made under this Agreement will be made using the applicable average daily exchange rate for the applicable period as published by OANDA or such other internationally recognized source as may be agreed by the Parties in writing.

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4.3 Disputed Amounts. Delivery or payment of an invoice without asserting a dispute is not a waiver of any claim or right by either Party to dispute such amount.

4.4 Late Payments. Late payments shall incur interest at the lesser of the one year London Interbank Offered Rate (LIBOR) plus one percent per annum and the highest interest rate permitted by Law.

4.5 Taxes.

4.5.1 Payment. All payments under this Agreement are exclusive of Taxes imposed by any Governmental Authority and the Parties shall not be liable for any of the Taxes of the other party that the other Party is legally obligated to pay and which are incurred or arise in connection with or related to the payments made under this Agreement, and all such Taxes shall be the financial responsibility of the Party who is obligated by operation of law to pay such tax. More specifically, Microsoft shall be responsible for the payment of all Taxes arising in connection with the Services, including all Transaction Taxes and Withholding Taxes. Additionally, Microsoft shall pay to Conduit any Transaction Taxes that are required to be collected from Microsoft by Conduit under applicable law. Conduit shall be responsible for the payment of all Taxes arising in connection with any payment received from Microsoft pursuant to this Agreement as well as any Taxes on any payments made by Conduit to any Conduit Publisher.

4.5.2 Withholding Taxes. If taxes are required by Law to be withheld on any amounts to be paid by Microsoft to Conduit ("Withholding Taxes"), Microsoft will deduct them from the amount otherwise owed and pay them to the appropriate taxing authority. Microsoft shall secure and deliver to Conduit an official receipt for any Withholding Taxes withheld. Microsoft shall use reasonable efforts to minimize Withholding Taxes to the extent permissible under applicable Law.

4.5.3 Cooperation on Tax Matters. Microsoft and Conduit will reasonably cooperate with each other to mitigate, reduce or eliminate any Withholding Taxes arising in connection with this Agreement, including by using commercially reasonable efforts to obtain any certificate or other document from any Governmental Authority or any other person as may be necessary to mitigate, reduce or eliminate any such Taxes. If Microsoft intends to withhold any Withholding Taxes, Microsoft will provide prior written notice to Conduit describing the rationale for such determination. Such notice shall be provided to Conduit promptly following Microsoft's determination to withhold and sufficiently in advance of any actual withholding (no less than 14 days) to provide Conduit a reasonable time to contest such determination. Conduit shall have the right, upon notice to Microsoft, to direct payment under this Agreement to one or more Conduit Affiliates in order to minimize any Taxes, including Withholding Taxes.

4.6 Audit. During the Term and for a period of [\*\*\*]

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4.7 Expenses. Except for the payments specified in this Section 4 and unless otherwise agreed by the Parties in writing, each Party shall be responsible for its own costs and expenses in connection with the delivery and receipt of Services under this Agreement and neither Party shall be responsible for any other charges or fees in connection therewith.

## 5. LICENSES; INTELLECTUAL PROPERTY

### 5.1 Ownership.

5.1.1 Microsoft Rights. Microsoft grants to Conduit and the [\*\*\*] limited, nonexclusive and [\*\*\*] license during the Term, under all of its Intellectual Property Rights, to access, use and display the Services in the Territory solely to the extent permitted hereunder. The foregoing license is intended to permit Conduit to implement any code necessary to enable the Sources or Results Pages (e.g., [\*\*\*]). Except to the limited extent expressly provided in this Agreement, Microsoft does not grant, and Conduit and the Conduit Publishers shall not acquire, any right, title or interest (including, without limitation, any implied license) in or to any Microsoft Intellectual Property Rights; and all rights not expressly granted herein are reserved to Microsoft. Except as expressly set forth in Section 5.2.2 of this Agreement, Microsoft reserves all right, title and interest in and to all of Microsoft's Intellectual Property Rights.

5.1.2 Conduit Rights. Except as expressly set forth in Sections 5.2.3 and 5.3 of this Agreement, Conduit, the [\*\*\*], and each of their respective licensors and other applicable third-party providers reserve all of their Intellectual Property Rights in and to the Properties and the content therein. Microsoft shall not acquire, any right, title or interest (including, without limitation, any implied license) in or to any Conduit Intellectual Property Rights. Conduit reserves all right, title and interest in and to all of Conduit's Intellectual Property Rights.

### 5.2 Brand Features.

5.2.1 Brand Features. Each Party shall own all right, title and interest, including without limitation all Intellectual Property Rights, in and to its own Brand Features. Except to the limited extent expressly provided in this Agreement, neither Party grants, and the other Party shall not acquire, any right, title or interest (including, without limitation, any implied license) in or to any Brand Features of the first Party; and all rights not expressly granted herein are deemed withheld. All use by Conduit of Microsoft Brand Features under this Agreement (including any goodwill associated therewith) shall inure to the benefit of Microsoft. All use by Microsoft of Conduit Brand Features under this Agreement (including any goodwill associated therewith) shall inure to the benefit of their respective owners.

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5.2.2 License to Microsoft Brand Features. Subject to the terms and conditions of this Agreement, Microsoft grants to Conduit a limited, nonexclusive and non-sublicensable (except as provided herein) license during the Term to display those Microsoft Brand Features expressly authorized by Microsoft, which will include the “Microsoft” and “bing” word marks and logos, examples of which are set forth in Exhibit E, and such other Brand Features as Microsoft may authorize during the Term, solely to promote the availability of the Services on all Properties (e.g., using “powered by Microsoft” on Conduit’s Web site or toolbar) and Sources (e.g., including the bing logo in a search box), other than Sources on Properties excluded under Section 2.1.3. In its use of any Microsoft Brand Feature, Conduit agrees to adhere to Microsoft’s standard, generally applicable brand treatment guidelines for use of Microsoft’s Brand Features as such guidelines may be updated in writing by Microsoft from time to time (in which event, Conduit shall have a reasonable time to comply with such updated guidelines following notice thereof). The current version of such guidelines as of the Effective Date are attached hereto as Exhibit F.

5.2.3 License to Conduit Brand Features. Subject to the terms and conditions of this Agreement, Conduit grants to Microsoft a limited, nonexclusive and non-sublicensable license during the Term to display those Conduit Brand Features expressly authorized by Conduit on the Results Pages and in connection with the promotion of the availability of the Services. In its use of any Conduit Brand Feature, Microsoft agrees to adhere to Conduit’s brand treatment guidelines for use of Conduit’s Brand Features, as such guidelines may be provided by Conduit to Microsoft from time to time.

5.3 License to [\*\*\*] Conduit grants to Microsoft a limited, nonexclusive and non-sublicensable license in the Territory to display the content and applications included by Conduit in the Conduit Layer to End Users during the Term.

5.4 No Implied Licenses. Nothing in this Agreement or the performance thereof, or that might otherwise be implied by Law, will operate to grant a Party any right, title or interest, implied or otherwise, in or to the Intellectual Property Rights of the other Party hereto, other than the rights and licenses expressly granted in this Agreement. Nothing in this Agreement will operate to prohibit either Party from licensing its Intellectual Property Rights or technology to any third party. Each Party expressly reserves all Intellectual Property Rights not expressly granted hereunder.

5.5 No Joint Ownership. Neither Party acquires nor will acquire any right to joint ownership of any Intellectual Property Rights by virtue of this Agreement.

## 6. CONFIDENTIALITY

6.1 Confidentiality. Each Party (together with each Affiliate receiving Confidential Information, a “Receiving Party”) understands that the other Party (together with each Affiliate disclosing Confidential Information, a “Disclosing Party”) may disclose to the Receiving Party, or the Receiving Party may otherwise acquire or have access to in the course of its performance under this Agreement, information and materials of a confidential nature including, without limitation, product information, data, pricing, business plans and strategies, employee lists, sales prospect lists, advertiser and partner information, contractual agreements, financial information, End User information, software, specifications, research and development and proprietary algorithms or other information and materials that are (a) clearly and conspicuously marked as “confidential” or with a similar designation; (b) identified by the Disclosing Party as confidential and/or proprietary before, during, or promptly after presentation or communication; or (c) disclosed to (or otherwise acquired by) Receiving Party in a manner in which the Disclosing Party reasonably communicated, or the Receiving Party should reasonably have understood under the circumstances or from the nature of the information or data disclosed, that the information or materials should be treated as confidential, whether or not the specific designation “confidential” or any similar designation is used (“Confidential Information”).

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6.2 **Disclosure and Use.** Except as provided in Section 6.3 or with the prior written consent of the Disclosing Party, the Receiving Party will not (a) disclose any Confidential Information of the Disclosing Party other than on a need-to-know basis to its and its Affiliates' officers, directors, employees, consultants, contractors, attorneys, accountants, investors, lenders, financial advisors, and potential acquirers (collectively, "Individual Recipients"), who have signed a non-disclosure agreement or are otherwise subject to confidentiality obligations that are no less stringent with respect to the Disclosing Party's Confidential Information than the terms set forth in this Section 6.2; (b) use Confidential Information, except as permitted under this Agreement or for fulfilling the obligations or exercising the rights of the Receiving Party under this Agreement; (c) make internal business copies or allow others to make copies of such Confidential Information, except as permitted under this Agreement or for fulfilling the obligations or exercising the rights of the Receiving Party under this Agreement; or (d) remove or export any such Confidential Information from the country of the Receiving Party in violation of Laws. Nothing in this Section 6.2 or the rest of the Agreement shall prevent a Party from using Confidential Information as is necessary to support or defend a Dispute within the meaning of Section 11 (Dispute Resolution; Arbitration). The Receiving Party shall treat the Confidential Information of the Disclosing Party, and will cause its Individual Recipients to treat such Confidential Information in accordance with this Section 6 and with at least the same degree of care and protection as it would use with respect to its own Confidential Information of a similar nature, but in no event less than a reasonable standard of care. The foregoing obligations shall survive for a period of three years following the termination or expiration of this Agreement.

6.3 **Exceptions; Required Disclosures.** Except as provided in Section 12, nothing in this Section 6 prohibits or limits either Party's use or disclosure of information (a) previously known to it without obligation of confidence, (b) independently developed by or for it without use of or access to the other Party's Confidential Information, (c) acquired by it from a third-party which is not under an obligation of confidence to the other Party or its Affiliates with respect to such information, or (d) which is or becomes publicly known and generally available to the public through no breach of this Agreement. A Receiving Party may make a disclosure of Confidential Information (i) if required either by Law or legal process (as a result of legal compulsion or in order to advance a defense to a claim), (ii) in response to a request by a governmental or regulatory agency, including but not limited to, a national stock market or exchange, or the Securities and Exchange Commission or other regulatory agency, or (iii) in connection with a proceeding before a court, adversary proceeding, administrative proceeding, governmental or regulatory proceeding, including but not limited to, the rules and regulations of a national stock market or exchange, or the Securities and Exchange Commission or other regulatory agency (e.g., in the event of an initial public offering involving Conduit) if, in each case, the Receiving Party only discloses that portion of the Confidential Information reasonably required to be disclosed (on advice of Receiving Party's counsel); and unless prohibited by Law, the Receiving Party provides reasonable written notice to the Disclosing Party in advance of the disclosure so that the Disclosing Party may (x) seek confidential treatment for the Confidential Information, a protective order or other appropriate remedy, relief or reliable assurances that confidential treatment will be afforded the information so disclosed (in which event, the Receiving Party will cooperate with the Disclosing Party to obtain such confidential treatment, orders or other remedy, relief or assurances); or (y) consent in writing to having the Confidential Information so produced or so disclosed (which consent will extend solely to the disclosure and production in question). Disclosure under this Section 6, including any authorized disclosure by the Disclosing Party, does not relieve the Receiving Party of its obligations of confidentiality generally under this Agreement. In no event will the Receiving Party or its Individual Recipients oppose an action by the Disclosing Party to obtain a protective order or other relief requiring that Confidential Information to be disclosed shall be treated confidentially in connection with a third-party claim, action or proceeding. If the Receiving Party or its Individual Recipients, as the case may be, has complied fully with the provisions of this Section 6.3, such disclosure may be made by the Receiving Party or its Individual Recipients, as the case may be, without any liability to the Disclosing Party hereunder.

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6.4 **Confidentiality of Agreement.** Each Party agrees that the terms and conditions of this Agreement shall be deemed Confidential Information of the other Party and will be disclosed only as set forth in this Section 6 or as otherwise provided in Section 14 (Public Relations and Communications).

6.5 **Feedback.** Any Feedback is given entirely voluntarily, and the recipient of Feedback is free to use, disclose, reproduce, license or otherwise distribute, and exploit Feedback provided to it as it sees fit, without obligation or restriction of any kind to the other Party. As used in this Agreement, "Feedback" means a Party's suggestions, comments, or other input specifically about the products and services of the Party receiving the feedback.

## 7. REPRESENTATIONS, WARRANTIES AND COVENANTS

7.1 **Mutual.** Each of the Parties hereto represents, warrants and covenants to the other as of the Effective Date that (a) it is a corporation duly organized, validly existing and in good standing under the laws of its jurisdiction of incorporation; (b) it has the corporate power and authority to enter into this Agreement and the transactions contemplated hereby, the execution, delivery and performance of this Agreement and the transactions contemplated hereby, have been duly authorized by all necessary corporate action by such Party; and (c) the execution, delivery and performance of this Agreement by such Party or its Affiliates does not (i) violate any provision of its articles of incorporation, bylaws or other organizational documents or (ii) induce, cause, constitute or result in any violation, breach or impairment of, any default under or any conflict or interference with any agreement, contract, license, promise, commitment, arrangement, option or undertaking, whether written or oral, of a Party or any of its Affiliates. Each of the Parties hereto further covenants to the other that in providing and implementing the Services or performing its obligations hereunder, it will comply with all applicable Laws, including, but not limited to all applicable Privacy Laws and the Laws of the United States regulating the export of software, technology, services, information and hardware covered under this Agreement.

7.2 **By Microsoft.** Microsoft represents and warrants that (a) it is a wholly-owned subsidiary of Microsoft Corporation and (b) that it has sufficient assets and financial resources to perform its obligations under this Agreement, including providing the Services in the Territory and payment obligations, during the Term.

## 8. DISCLAIMER

EXCEPT FOR THE EXPRESS REPRESENTATIONS AND WARRANTIES MADE BY THE PARTIES IN THIS AGREEMENT AND TO THE MAXIMUM EXTENT PERMITTED BY LAW, NO PARTY HERETO MAKES ANY OTHER REPRESENTATIONS OR WARRANTIES. EXCEPT AS EXPRESSLY SET FORTH IN THIS AGREEMENT AND TO THE MAXIMUM EXTENT PERMITTED BY LAW, EACH PARTY EXPRESSLY DISCLAIMS ANY AND ALL OTHER REPRESENTATIONS AND WARRANTIES, EXPRESS OR IMPLIED, INCLUDING ANY IMPLIED WARRANTIES OF FITNESS FOR A PARTICULAR PURPOSE, MERCHANTABILITY, OR NONINFRINGEMENT OR ARISING FROM COURSE OF PERFORMANCE, COURSE OF DEALING OR USAGE OF TRADE.

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**9. LIMITATION OF LIABILITY**

9.1 NO CONSEQUENTIAL DAMAGES. SUBJECT TO SECTION 9.3 (EXCEPTIONS FROM EXCLUSIONS AND LIMITATIONS), TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER PARTY WILL BE LIABLE TO THE OTHER PARTY FOR ANY INDIRECT, SPECIAL, INCIDENTAL, PUNITIVE OR CONSEQUENTIAL DAMAGES (INCLUDING FOR THE INDIRECT LOSS OF PROFIT OR REVENUE) ARISING OUT OF OR IN CONNECTION WITH THIS AGREEMENT, HOWEVER CAUSED, AND UNDER WHATEVER CAUSE OF ACTION OR THEORY OF LIABILITY BROUGHT (INCLUDING UNDER ANY CONTRACT, NEGLIGENCE OR OTHER TORT THEORY OF LIABILITY), EVEN IF SUCH PARTY HAS BEEN ADVISED OF THE POSSIBILITY OF SUCH DAMAGES.

9.2 LIABILITY CAP. SUBJECT TO SECTION 9.3 (EXCEPTIONS FROM EXCLUSIONS AND LIMITATIONS), IN NO EVENT SHALL EITHER PARTY'S LIABILITY FOR ANY CLAIM ARISING OUT OF OR IN CONNECTION WITH THIS AGREEMENT (WHEN AGGREGATED WITH SUCH PARTY'S LIABILITY FOR ALL OTHER CLAIMS ARISING OUT OF OR IN CONNECTION WITH THIS AGREEMENT BUT EXCLUDING AMOUNTS PAID IN CONNECTION WITH ITEMS SPECIFIED IN SECTION 9.3 (EXCEPTIONS FROM EXCLUSIONS AND LIMITATIONS)) EXCEED THE GREATER OF (A) [\*\*\*] MONTH PERIOD IMMEDIATELY PRIOR TO THE INCIDENT FIRST GIVING RISE TO THE LIABILITY.

9.3 Exceptions from Exclusions and Limitations. Nothing in this Agreement shall exclude or limit either Party's liability for: (a) breaches of Section 6 (Confidentiality); (b) amounts owed under Section 4 (Compensation and Payment); [\*\*\*] (e) breach of the exclusivity provisions set forth in Section 3.1; or (f) gross negligence, intentional misconduct or abandonment of this Agreement.

9.4 Allocation of Risk. The Parties agree that (a) the mutual agreements made in this Section 9 (Limitation of Liability) reflect a reasonable allocation of risk, and (b) that each Party would not enter into the Agreement without these exclusions and limitations on liability and the exceptions set forth above.

**10. INDEMNIFICATION**

10.1 Microsoft Indemnity of Conduit. Microsoft will defend at Microsoft's cost (with legal counsel selected by Microsoft and approved by Conduit, which approval will not be unreasonably withheld) the Conduit Indemnified Parties from and against any Third Party Claim and indemnify the Conduit Indemnified Parties from any Covered Amounts resulting from such Third Party Claim, to the extent that the Third Party Claim is based upon:

10.1.1 an allegation that any Service, Other Platform Service or any portion or element of any of the foregoing or the underlying technology or business methods used by Microsoft in providing any of the foregoing (a) infringes, misappropriates or otherwise violates any third-party Intellectual Property Rights or violates any Law; (b) breaches any third-party rights of publicity or privacy, or (c) is false, deceptive, misleading, defamatory or libelous;

10.1.2 an allegation that any Result provided by Microsoft in the performance of Services or Other Platform Services under this Agreement (a) infringes, misappropriates or otherwise violates any third-party Intellectual Property Rights or violates any Law, (b) breaches any third-party rights of publicity or privacy, or (c) is false, deceptive, misleading, defamatory or libelous;

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10.1.3 any breach (or any allegation that, if true, would constitute a breach) by Microsoft of any of its representations, warranties or covenants under Section 7;

10.1.4 any breach (or any allegation that, if true, would constitute a breach) by Microsoft of any agreement between Microsoft and any third-party, including any advertiser or any third-party publisher in the Microsoft Network, except to the extent such breach was caused by a breach of this Agreement by Conduit or any of its Affiliates or Conduit Publishers; or

10.1.5 any allegation that a Microsoft Brand Feature infringes any third-party trademark, service mark, domain name or trade dress rights or any copyrights.

10.2 Conduit Indemnity of Microsoft. Conduit will defend at Conduit's cost (with legal counsel selected by Conduit and approved by Microsoft, which approval will not be unreasonably withheld) the Microsoft Indemnified Parties from and against any Third Party Claim and indemnify each of the Microsoft Indemnified Parties from any Covered Amounts resulting from such Third Party Claim, to the extent that the Third Party Claim is based upon:

10.2.1 an allegation that the Conduit Engine, Conduit's applications marketplace, [\*\*\*] (including any content, links or other materials therein) or any content (other than Results or other content provided by or for Microsoft) displayed on Web pages within the Properties on which Results are also displayed (a) infringes, misappropriates or otherwise violates any third-party Intellectual Property Rights or violates any Law, (b) breaches any third-party rights of publicity or privacy, or (c) is false, deceptive, misleading, defamatory or libelous;

10.2.2 [\*\*\*]

10.2.3 any breach (or any allegation which, if true, would constitute a breach) by Conduit of any agreement between Conduit and any third party, including any advertiser, End User or any Conduit Publisher, except to the extent such breach was caused by any breach of this Agreement by Microsoft or its Affiliates;

10.2.4 any action or inaction that would constitute a breach of Section 2.7.1(f), 2.7.1(g), 2.7.1(h), or 2.7.1(i); or

10.2.5 any allegation that a Conduit Brand Feature infringes any third-party trademark, service mark, domain name or trade dress rights or any copyrights.

10.3 Procedure. The Indemnified Party will promptly notify the Indemnifying Party in writing, of any Third Party Claim for which defense and indemnification is sought, provided that the failure to promptly notify the Indemnifying Party will relieve the Indemnifying Party of its obligations hereunder only to the extent that the Indemnifying Party is prejudiced by such failure. The Indemnified Party will allow the Indemnifying Party or its authorized representative, at the Indemnifying Party's cost and expense to control the defense and settlement of the claim. The Indemnified Party will be entitled to participate reasonably in the defense and settlement of the claim with counsel of its choice at its own expense, and will reasonably cooperate with the Indemnifying Party with respect to such defense and settlement. The Indemnifying Party will not settle any claim without the written consent of the Indemnified Party (which consent will not be unreasonably withheld or delayed).

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10.4 **Right to Ameliorate Damages.** If an Indemnified Party seeks indemnity under this Agreement for a claim for infringement of Intellectual Property Rights, the Indemnifying Party may, in its sole discretion and at its sole expense and without limiting any of its obligations under Section 10.1 or 10.2, as the case may be: (a) obtain the right for the Indemnified Party to continue to use the allegedly infringing service, technology, content or material; or (b) provide a non-infringing substitute with at least the same features, functions and performance as the allegedly infringing service, technology, content or material (a "Non-Infringing Alternative"), in which case the Indemnified Party will use commercially reasonable efforts to implement promptly such Non-Infringing Alternative, provided that the Indemnifying Party agrees to reimburse the Indemnified Party for any out-of-pocket expenses reasonably incurred to implement the Non-Infringing Alternative.

10.5 **Limitations on Indemnity Obligations.** Notwithstanding anything to the contrary, neither Party will have any obligation to provide any defense or indemnification under this Agreement with respect to any Third Party Claim to the extent arising from any use of the Indemnifying Party's services, technology, content or material in a manner that is prohibited by this Agreement. In addition, notwithstanding anything to the contrary, neither Party will have any obligation to provide any defense or indemnification under this Agreement with respect to any claim of infringement, misappropriation or other violation of third-party Intellectual Property Rights to the extent arising from (a) the combination or use of the Indemnifying Party's services, technology, content or material with any other services, technology, content or material that were neither (i) provided or specified by the Indemnifying Party or its Affiliates; nor (ii) specifically designed or reasonably required for use as contemplated by this Agreement, if, in the absence of such combination, the infringement, misappropriation or violation would not have occurred; (b) modification of the Indemnifying Party's services, technology, content or material by the other Party, any of its Indemnified Parties or any customer of any of the foregoing, where, in the absence of such modification, the infringement, misappropriation or violation would not have occurred; or (c) use of any services, technology, content or material after the date by which the Indemnified Party reasonably could have implemented a Non-Infringing Alternative pursuant to Section 10.4.

## 11. INSURANCE

Throughout the Term and for two (2) years thereafter, Conduit will maintain from an internationally reputable insurance carrier (e.g., Lloyds of London) (a) Errors and Omissions insurance coverage with an aggregate limit of [\*\*\*] and Directors and Officers insurance coverage with an aggregate limit of [\*\*\*]

## 12. DISPUTE RESOLUTION; ARBITRATION

12.1 **Dispute Resolution.** Except with respect to a Party's request for equitable or provisional relief or to otherwise protect its Intellectual Property Rights or Confidential Information provided under this Agreement, no civil action, proceeding as set forth below with respect to any dispute, controversy or claim arising out of, or relating to, or in connection with, this Agreement, or the breach, termination, or validity hereof, including the validity of this dispute resolution provision (each of which dispute, controversy, or claim will be termed a "Dispute") between the Parties may be commenced, nor may a Party terminate any portion of this Agreement for a material breach of a material warranty, representation, covenant or obligation of this Agreement, until the Parties have first attempted in good faith to resolve the Dispute amicably in accordance with this Section 12.1.

12.1.1 **Notice of Dispute.** In the event of a Dispute, the Party raising the Dispute shall give written notice to the other Party setting forth the details of the Dispute and any proposed solution or compromise. The Parties shall cooperate in good faith to resolve the Dispute within 30 days of receipt of the notice of Dispute.

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12.1.2 Escalation. In the event that the Parties are unable to resolve the Dispute within 30 days, the Parties shall escalate the Dispute by referring the details of the Dispute, the status of the negotiations and any proposed compromise in writing to the Parties' respective designated executive with decision-making authority. The Parties' designated executives shall have 30 days from receipt of notice of the Dispute or such longer period as the Parties may mutually agree to in writing, to resolve the Dispute in good faith. If the Parties' designated executives are unable to resolve the Dispute, the Dispute will be escalated to an officer of each Party, who shall have ten days, or such longer period as the Parties may mutually agree to in writing, to attempt to resolve the Dispute in good faith.

12.2 Arbitration. If the Parties cannot resolve a Dispute pursuant to Section 12.1 above, any and all Disputes (including, but not limited to, the validity of this agreement to arbitrate) will be settled exclusively by final and binding arbitration joining all of the claims asserted by or against the Parties in connection with such Dispute or claim. The arbitration will be conducted in San Francisco, California and shall be administered by JAMS in accordance with its Comprehensive Arbitration Rules and Procedures then in effect except as limited or expanded by this Agreement. This clause shall not preclude Parties from seeking provisional remedies in aid of arbitration (e.g., to compel arbitration) or from seeking equitable or provisional relief from a court of competent jurisdiction.

12.2.1 Smaller Claims. If the Dispute involves a claim for monetary damages only and in an amount equal to or less than \$1 million, exclusive of legal fees and costs of the arbitration, then the Parties will jointly select one independent arbitrator who is experienced and knowledgeable about the Internet industry and about the particular products or services at issue and who is not an employee, consultant or former employee or consultant of either Party. If the Parties do not agree on the identity of the arbitrator within five Business Days of the commencement of the arbitration, either Party may apply to JAMS for the appointment of an arbitrator who will have, to the greatest extent possible, experience and knowledge about the Internet industry and about the particular products or services at issue. If required to act in accordance with this Section to appoint a single arbitrator in lieu of a Party, JAMS will appoint an arbitrator within 15 days of such application.

12.2.2 Larger Claims.

(a) For all other Disputes governed by this Section 12.2, the Dispute will be determined by a panel of three arbitrators. The Party initiating the arbitration (the "Claimant") will appoint an arbitrator experienced and knowledgeable about the Internet industry and about the particular products or services at issue and who is not an employee, consultant or former employee or consultant of either Party in its request for arbitration, demand for arbitration or notice of claim (the "Demand"). The Party responding to the Demand (the "Respondent") will within 15 days appoint one arbitrator experienced and knowledgeable about the Internet industry and about the particular products or services at issue and who is not an employee, consultant or former employee or consultant of either Party and will notify the Claimant in writing of the appointment. If within 30 days after receipt of the Demand by the Respondent, either Party has not appointed an arbitrator, then that Arbitrator will be appointed by JAMS from its then-current roster of arbitrators for Large, Complex Commercial Disputes, and in making this appointment, JAMS will nominate an arbitrator who is (i) experienced and knowledgeable about the Internet industry and about the particular products or services at issue and (ii) not an employee, consultant or former employee or consultant of either Party. If required to act in accordance with this Section to appoint an arbitrator in lieu of a Party, JAMS will appoint an arbitrator within 15 days of such application.

(b) Within 30 days of the appointment of the second arbitrator, JAMS shall appoint the third arbitrator in accordance with Rule 15 of the JAMS Comprehensive Arbitration Rules and Procedures. The third arbitrator must be (i) experienced and knowledgeable about the Internet industry and about the particular products or services at issue and (ii) not an employee, consultant or former employee or consultant of either Party. The third arbitrator will act as the chair of the arbitration panel.

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(c) Prior to the commencement of an arbitration proceeding, either Party may disqualify the appointment of an arbitrator for conflict of interest as established in good faith by the Party. Additionally, each Party may in its sole discretion exercise one preemptory disqualification of the third arbitrator.

12.2.3 Choice of Law. This arbitration provision (including the validity and applicability of the agreement to arbitrate, the conduct of any arbitration of a Dispute, the enforcement of any arbitral award made hereunder and any other questions of arbitration law or procedure arising hereunder) and its interpretation, any and all disputes between the Parties arising out of or relating to this Agreement in any manner, shall be governed by and construed in accordance with the internal laws of the State of New York, without giving effect to any choice or conflict of law provision or rule (whether of the State of New York or any other jurisdiction) that would cause the application of laws of any jurisdictions other than those of the State of New York or the United States. The Parties specifically exclude from application to the Agreement the United Nations Convention on Contracts for the International Sale of Goods and the Uniform Computer Information Transactions Act. The parties further agree that any claim, cause of action or proceeding relating to any arbitration sought, compelled or performed hereunder will be brought and pursued only in the U.S. District Court for the Southern District of New York or, solely in the case that such federal court does not have jurisdiction, in any New York State court sitting in New York City (collectively, the "New York Courts"). Microsoft and Conduit each submit to the exclusive jurisdiction and venue of the New York Courts for such purposes, except that any confirmed arbitration award may be enforced in any court having jurisdiction over a party or, to the extent of any in rem action, any of its assets. The parties further irrevocably waive any objection to the laying of the venue of any such proceeding in the New York Courts, any claim that any such proceeding has been brought in an inconvenient or inappropriate forum and any right to a jury trial with regard to any such proceeding.

12.2.4 Conduct of Arbitration.

(a) Decision. The arbitration award will be a reasoned decision, will be in writing and will state with particularity the legal and factual bases for the decision and will be final and binding upon the Parties.

(b) Fees and Awards. The arbitrators' fees and costs of the arbitration will be borne by the Claimant and Respondent equally, unless the arbitration panel in its discretion makes a different provision in the final award. The arbitration panel is empowered in its discretion to include an award of costs, including reasonable attorneys' fees and disbursements to the prevailing Party. In addition to monetary damages, the arbitration panel will be empowered to award equitable relief, including, but not limited to, an injunction and specific performance of any obligation under this Agreement. The arbitrators' award of damages shall be limited by Section 9 (Limitation of Liability) and any other relief, including suspension or termination, will be consistent with the terms and conditions of this Agreement. The arbitrators will have no jurisdiction to, and are not empowered to, modify or amend the exclusions and limitations of liability or the termination rights set forth in this Agreement. The arbitration panel will be authorized in its discretion to grant pre- and post-award interest at commercial rates. Any costs, fees or taxes incident to enforcing the award will, to the maximum extent permitted by law, be charged against the Party resisting such enforcement. Judgment upon the award may be entered by any court in the United States having jurisdiction over the relevant Party or any of its assets.

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12.2.5 **Confidentiality of Proceedings.** The Parties agree that any arbitration proceedings hereunder will be treated as the Confidential Information of both Parties and that the existence of the proceeding and any element of it (including, but not limited to, any pleadings, briefs or other documents submitted or exchanged and any testimony or other oral submissions and awards) will not be disclosed beyond the arbitration panel, except as may lawfully be required in judicial proceedings relating to the arbitration or in accordance with the disclosure provisions of Section 6.3 (Required Disclosures). In addition, if a Party's Confidential Information is required to be disclosed pursuant to an arbitration proceeding or other judicial proceeding, the Receiving Party shall treat the Disclosing Party's Confidential Information pursuant to the terms of Section 6 (Confidentiality).

### 13. ACCOUNT MANAGEMENT

13.1 **Appointment.** Each Party shall designate an individual to oversee and manage this Agreement and the relationship of the Parties during the Term (each, an "Account Manager"), and each Account Manager shall be the first point of escalation for the resolution of Disputes. Each Account Manager shall be the individual to whom all communications regarding the Parties' relationship under this Agreement may be addressed, and who has the authority to act for the appointing Party in connection with all day to day aspects of this Agreement. Microsoft's Account Manager shall be available to Conduit as reasonably required and will assist Conduit, as reasonably requested by Conduit, in all aspects of implementing the Services. The parties will discuss such things as optimizing the End User experience, the number of Unique Searchers, Gross Revenue and the placement and content of Conduit content and applications on Results Pages. Without limiting the foregoing, each Account Manager, together with other personnel as determined by the Account Managers, will meet telephonically or in person (a) from time to time (at a minimum on a weekly basis) to discuss the various elements of this Agreement or (b) as needed to resolve any business or technical issues that may arise with respect to this Agreement or the relationship of the Parties. Each Party shall similarly appoint a technical leader (each, a "Tech Lead"), who shall be the primary point of contact for addressing technical issues with the implementation of the Services on the Properties. Each Party will be responsible for all travel and other costs and expenses for its representatives to attend meetings of, or otherwise participate in, such meetings. The appointment or removal of Microsoft's Account Manager or Tech Lead and any replacement will be with the prior consent of Conduit, which consent shall not be unreasonably withheld. Conduit shall have the right to request, by delivery of written notice to Microsoft, the removal from the engagement of Microsoft's Account Manager or Tech Lead, and within ten days of the delivery of such notice to Microsoft, Microsoft shall comply with Conduit's request, unless Microsoft has a good faith belief that removal is not justified, in which event Conduit will consider in good faith the reasons for Microsoft's belief and may withdraw its request.

13.2 **Escalation.** Any issue requiring resolution by the Account Executives that remains unresolved will be resolved in accordance with the dispute resolution procedures of Section 12.1.

### 14. PUBLIC RELATIONS AND COMMUNICATIONS

14.1 **Publicity.** Promptly following the execution of this Agreement, the Parties agree to make a mutually-agreed public statement regarding the Agreement and relationship contemplated hereby. Except with respect to such public statement, no Party (or their Affiliates) may issue any press release or make any similar public announcement or public statement, regarding this Agreement without the other Party's prior written approval and consent, except as may be required by Law (including securities laws and regulations including in the context of an initial public offering) or legal process or by any listing agreement with a national securities exchange, in which case the Party proposing to issue such press release or make such public announcement will use its commercially reasonable efforts to consult in good faith with the other Party before making any such public announcement. Except as otherwise provided in this Section 14.1, any and all press releases or similar public announcements or public statements relating to this Agreement will be approved in advance of the release, in writing, by both Conduit and Microsoft and once released, either Party may repeat information so released and any other public statement that has been publicly disclosed in accordance with Section 6.2 or Section 6.3 without further consent of the other Party.

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**15. TERM AND TERMINATION**

15.1 Term. The term of this Agreement will commence on the Effective Date and will continue until[\*\*\*] , unless earlier terminated as provided in this Section 15 (the "Term").

15.2 Termination for Repeated Material Breach. A non-breaching Party may terminate this Agreement if the breaching Party has repeatedly materially breached material provisions of this Agreement to such a degree that it is unlikely that the breaching Party is willing or able to continue to perform its obligations under this Agreement without continuing to materially breach this Agreement.

15.3 Termination for Convenience.

15.3.1 By Microsoft. Microsoft shall have the option of terminating the Agreement for convenience by providing at least [\*\*\*] prior written notice with the termination being effective no sooner than [\*\*\*] . If Microsoft elects to terminate, then Conduit may override Microsoft's election by providing notice to Microsoft of its intent to continue the Agreement ("Termination Override Notice") in which event, the Agreement will continue unless otherwise terminated pursuant to this Section 15 (provided that Microsoft may not thereafter provide notice under this Section 15.3.1).

15.3.2 Conduit shall have the option of terminating the Agreement for convenience (including in the event that Termination Override Notice is given) by providing at least 90 days prior written notice with the termination being effective no sooner than [\*\*\*] .

15.4 Termination for Change of Control Transaction. As promptly as practicable following the earlier to occur of (a) the execution of a definitive agreement by a Party providing for a Change of Control Transaction of such Party and (b) the consummation of a Change of Control Transaction of such Party, such Party shall provide the other Party written notice thereof and, no later than the 60th day following such notice, either Party shall have the option to terminate this Agreement upon written notice to the other Party. Such termination will be effective (x) upon the consummation of the Change of Control Transaction, if such notice of termination is given prior to the consummation of the Change in Control or (y) upon the delivery of such termination notice, if the consummation of the Change in Control Transaction has already occurred; provided that in either case, if Microsoft is the terminating Party, Conduit (or its successor) shall have the option to extend this Agreement for up to an additional 90 days upon notice to Microsoft.

15.5 Effect of Early Termination. If this Agreement is terminated by either party pursuant to Section 15.2 or 15.4 (but not Section 15.3) prior to the expiration of the four-year period defined under Section 15.1, then

15.5.1 At Conduit's election prior to the end of the Term, Microsoft will continue to provide Services to Conduit and the Conduit Publishers under the applicable terms and conditions of this Agreement for a period of time not to exceed 90 days from the date of Conduit's election so that Conduit may transition from the Services provided by Microsoft to another solution (the "Tail Transition Period");

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15.5.2 During the Tail Transition Period, except as otherwise provided in this Section 15.5, all provisions of this Agreement will apply and the Parties will still share revenues according to Section 4; and

15.5.3 This Agreement will terminate upon the conclusion of the Tail Transition Period.

15.6 Exclusive Rights to Terminate. The express rights to terminate this Agreement set forth in this Section 15 are exclusive and, without limitation of a Party's other remedies available hereunder, neither Party will have any additional right (whether at Law, in equity, under Section 16.7 or otherwise) to terminate this Agreement, in whole or in part.

15.7 Survival. Sections 1.4, 5.1 (with respect to the Parties' respective ownership of their Intellectual Property Rights), 5.2.1, 5.4, 5.5, 6, 7, 8, 9, 10, 12, 15 (provisions of Section 15 generally, as they concern the conditions under which termination is permitted and which must be satisfied after exercise of a termination right) and 16 will survive expiration or termination of the Term. In addition, all payment obligations arising under any other Sections of this Agreement or its Exhibits survive with respect to the amounts owed under such obligations as of the effective date of termination or expiration.

## 16. MISCELLANEOUS

16.1 Rules of Construction. The words "hereof," "herein" and "hereunder" and other words of similar import refer to this Agreement in its entirety and not to any part hereof unless the context shall otherwise require. All references herein to Sections and Exhibits shall be deemed references to and Sections of, and Exhibits to, this Agreement unless the context shall otherwise require. The word "including," when used herein is not intended to be exclusive and means "including, but not limited to." The headings used in this Agreement are inserted for convenience of reference only and do not constitute a part of and will not be utilized in interpreting this Agreement. Except where the context so requires, any reference to a singular noun shall include its plural, the use of the word "all" shall be construed as "any and all," the word "any" shall be construed as "any and all," and the word "each" shall be construed as "all and each." This Agreement has been negotiated by the Parties and their respective counsel and will be fairly interpreted in accordance with its terms and conditions pursuant to the governing Law selected by the Parties pursuant to Section 12.2.3 without application of any rules of construction relating to which Party drafted this Agreement in favor of, or against, either Party. Unless otherwise expressly provided herein or unless the context shall otherwise require, any references as of any time to any agreement (including this Agreement) or other contract, instrument or document or to any statute or regulation or any specific section or other provision thereof are to it as amended and supplemented through such time (and, in the case of a statute or regulation or specific section or other provision thereof, to any successor of such statute, regulation, section or other provision). Any reference in this Agreement to a "day" or number of "days" (without the explicit qualification of "Business Day") shall be interpreted as a reference to a calendar day or number of calendar days. If any action or notice is to be taken or given on or by a particular calendar day, and such calendar day is not a Business Day, then such action or notice shall be deferred until, or may be taken or given on, the next Business Day. Unless otherwise expressly provided herein or unless the context shall otherwise require, any provision of this Agreement using a defined term (by way of example and without limitation, such as "Affiliate") which is based on a specified characteristic, qualification, feature or status shall, as of any time, refer only to such persons or entities who have the specified characteristic, qualification, feature or status as of that particular time. This contract is written in English and, if it is translated into any other language, the English-language version controls.

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16.2 Force Majeure. Neither Party or its Affiliates will be in violation of any of the requirements of this Agreement to the extent that its performance is impaired as a result of any delay, failure in performance, or interruption of service, resulting directly or indirectly from acts of God, acts of civil or military authorities, civil disturbances, wars, acts of terrorism, strikes or other labor disputes, fires, transportation contingencies, outages of third party telecommunications networks with whom the non-performing Party does not have a direct contractual relationship, failure of suppliers with whom the non-performing Party does not have a direct contractual relationship, or other similar occurrences which are beyond such Party's reasonable control; provided, however, that any such delay or failure will be remedied by such Party as soon as reasonably possible. Upon the occurrence of a force majeure event, the Party unable to perform will, if and as soon as possible, provide written notice to the other Party indicating that a force majeure event occurred and detailing how such force majeure event impacts the performance of its obligations. Microsoft will maintain during the Term, appropriate business continuity and disaster recovery plans, procedures, facilities and equipment to restore operation of the Services within a reasonable period of time under the circumstances.

16.3 Amendment or Modification. This Agreement may be amended or modified only by a written agreement that (a) refers to this Agreement; and (b) is executed by an authorized representative of each Party.

16.4 Assignment; Delegation. This Agreement and the performance of any duties hereunder may not be assigned, transferred, delegated (except as set forth below), sold or otherwise disposed of by a Party other than (a) with the prior written consent of the other Party, or (b) in the event of a sale of all or substantially all of such Party's assets or in the event of a merger, consolidation, share exchange, recapitalization, restructuring or business combination involving such Party. This Agreement will be binding upon and shall inure to the benefit of a Party's permitted successors and assigns. Any purported assignment, transfer, delegation, sale or other disposition in contravention of this Section 16.4 is null and void. Notwithstanding the foregoing, either Party may delegate its performance to, or exercise its rights through, one or more Affiliates in the Territory; provided that in the event of any such delegation or exercise, each Party will remain liable and fully responsible for its Affiliates' performance of and compliance with such Party's obligations and duties under this Agreement.

16.5 Notices. All notices hereunder shall be deemed given (a) upon receipt when delivered personally, (b) upon written verification of receipt from overnight courier, (c) upon verification of receipt of registered or certified mail or (d) upon verification of receipt via facsimile, provided that such notice is also sent via first class mail by no later than the next Business Day after sending via facsimile. All notices shall be in English and in writing and sent to:

If to Microsoft, to:

Microsoft Corporation  
One Microsoft Way  
Redmond, WA 98052  
USA  
Attention: General Manager for Strategic Partnerships,  
Online Services Division  
Telephone: (425) 882-8080  
Telecopy: (425)936-7329

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with a copy to:

Microsoft Corporation  
One Microsoft Way  
Redmond, WA 98052  
USA  
Attention: Deputy General Counsel, Online Services Division  
Telephone: (425) 882-8080  
Telecopy: (425) 936-7329

If to Conduit, to:

Conduit Ltd.  
5 Golda Meir Street  
Park Ta'asiyot Hamada  
Ness-Ziona, 74140  
Israel  
Attention: Legal Counsel  
Telephone: 972-8-9461713  
Telecopy: 972-73-7017378

A Party may change its address for notices by written notice given pursuant to this Section 16.5.

16.6 Waiver. Any of the provisions of this Agreement may be waived by the Party entitled to the benefit thereof. No Party will be deemed, by any act or omission, to have waived any of its rights or remedies hereunder unless such waiver is in writing and signed by the waiving Party, and then only to the extent specifically set forth in such writing. A waiver with reference to one event will not be construed as continuing or as a bar to, or waiver of, any right or remedy as to a subsequent event.

16.7 Remedies Cumulative. Except as expressly set forth herein, no remedy conferred upon any of the Parties by this Agreement is intended to be exclusive of any other remedy, and each and every such remedy will be cumulative and will be in addition to any other remedy given hereunder or now or hereafter existing at Law or in equity. For clarity, this Section does not expand either Party's ability to terminate this Agreement beyond the provisions of Section 15.

16.8 Severability. If the application of any provision or provisions of this Agreement to any particular facts or circumstances is held to be illegal, invalid or unenforceable by any arbitrator, arbitration panel or court of competent jurisdiction, the validity and enforceability of such provision or provisions as applied to any other particular facts or circumstances and the validity of other provisions of this Agreement will not in any way be affected or impaired thereby, and the Parties agree that the arbitrator, arbitration panel or court of competent jurisdiction making such determination will have the power to modify the provision in a manner consistent with its objectives such that it is enforceable.

16.9 Independent Contractors. The Parties acknowledge and agree that they are dealing with each other as independent contractors. Neither this Agreement nor any terms and conditions contained in this Agreement may be construed to: (a) give any Party the power to direct and control the day-to-day activities of any of the other; (b) create or constitute a partnership, joint venture, franchise, employment or agency relationship between or among the Parties; or (c) allow any Party to create or assume any obligation on behalf of the other Party for any purpose whatsoever.

16.10 No Third Party Beneficiaries. Nothing in this Agreement, express or implied, is intended to or will confer upon any person (other than the Parties, their Affiliates and the Indemnified Parties) any right, benefit or remedy of any nature whatsoever under or by reason of this Agreement.

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16.11 Entire Agreement. This Agreement supersedes any other prior or collateral agreements, whether oral or written, with respect to the subject matter hereof. This Agreement (including any exhibits thereto) constitutes the entire agreement with respect to the subject matter hereof.

16.12 Counterparts; Facsimiles. This Agreement may be executed in any number of textually identical counterparts, each of which when so executed and delivered will be deemed an original, and such textually identical counterparts together will constitute one and the same instrument. Each Party will receive a duplicate original of the counterpart copy or copies executed by it. For purposes hereof, a facsimile or scanned copy of this Agreement, including the signature pages hereto, will be deemed to be an original. Notwithstanding the foregoing, the Parties will each deliver original execution copies of this Agreement to one another as soon as practicable following execution thereof.

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IN WITNESS WHEREOF, the Parties to this Agreement by their duly authorized representatives have executed this Agreement as of the Effective Date.

CONDUIT LTD.

MICROSOFT ONLINE, INC.

*Donna Shilg CEO*

*J. McClamroch, Jr.*

By: \_\_\_\_\_

By: \_\_\_\_\_

Name:  
Title:

Name: J. McCLAMROCH, JR.  
Title: GM, OSD, MICROSOFT

[Signature Page to Search Services Agreement]

---

THIS EXHIBIT WAS OMITTED AND FILED SEPARATELY  
WITH THE SECRETARY OF THE COMMISSION PURSUANT TO AN APPLICATION FOR  
CONFIDENTIAL TREATMENT UNDER RULE 24b-2 OF THE SECURITIES EXCHANGE ACT  
OF 1934; [\*\*\*] DENOTES OMISSIONS.

Exhibit A  
[\*\*\*]

---

PORTIONS OF THIS EXHIBIT WERE OMITTED AND HAVE BEEN FILED SEPARATELY  
WITH THE SECRETARY OF THE COMMISSION PURSUANT TO AN APPLICATION FOR  
CONFIDENTIAL TREATMENT UNDER RULE 24b-2 OF THE SECURITIES EXCHANGE ACT  
OF 1934; [\*\*\*] DENOTES OMISSIONS.

**EXHIBIT B**

**SOURCES**

Conduit enables search opportunities through a variety of Sources. Sources may be implemented by End Users, either on an [\*\*\*], as permitted under Section 2.7.3(a) of the Agreement. For purposes of the Agreement and unless otherwise agreed by the Parties in writing, the term "Sources" includes only the following:

[\*\*\*]

From time to time, the Parties upon mutual agreement may deem additional sources to be "Sources" or remove any sources from the scope of the Agreement by executing a written amendment to this Exhibit B.

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THIS EXHIBIT WAS OMITTED AND FILED SEPARATELY  
WITH THE SECRETARY OF THE COMMISSION PURSUANT TO AN APPLICATION FOR  
CONFIDENTIAL TREATMENT UNDER RULE 24b-2 OF THE SECURITIES EXCHANGE ACT  
OF 1934; [\*\*\*] DENOTES OMISSIONS.

Exhibit C-1  
[\*\*\*]

---

THIS EXHIBIT WAS OMITTED AND FILED SEPARATELY  
WITH THE SECRETARY OF THE COMMISSION PURSUANT TO AN APPLICATION FOR  
CONFIDENTIAL TREATMENT UNDER RULE 24b-2 OF THE SECURITIES EXCHANGE ACT  
OF 1934; [\*\*\*] DENOTES OMISSIONS.

Exhibit C-2  
[\*\*\*]

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THIS EXHIBIT WAS OMITTED AND FILED SEPARATELY  
WITH THE SECRETARY OF THE COMMISSION PURSUANT TO AN APPLICATION FOR  
CONFIDENTIAL TREATMENT UNDER RULE 24b-2 OF THE SECURITIES EXCHANGE ACT  
OF 1934; [\*\*\*] DENOTES OMISSIONS.

Exhibit C-3  
[\*\*\*]

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THIS EXHIBIT WAS OMITTED AND FILED SEPARATELY  
WITH THE SECRETARY OF THE COMMISSION PURSUANT TO AN APPLICATION FOR  
CONFIDENTIAL TREATMENT UNDER RULE 24b-2 OF THE SECURITIES EXCHANGE ACT  
OF 1934; [\*\*\*] DENOTES OMISSIONS.

Exhibit C-4  
[\*\*\*]

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THIS EXHIBIT WAS OMITTED AND FILED SEPARATELY  
WITH THE SECRETARY OF THE COMMISSION PURSUANT TO AN APPLICATION FOR  
CONFIDENTIAL TREATMENT UNDER RULE 24b-2 OF THE SECURITIES EXCHANGE ACT  
OF 1934; [\*\*\*] DENOTES OMISSIONS.

Exhibit C-5  
[\*\*\*]

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THIS EXHIBIT WAS OMITTED AND FILED SEPARATELY  
WITH THE SECRETARY OF THE COMMISSION PURSUANT TO AN APPLICATION FOR  
CONFIDENTIAL TREATMENT UNDER RULE 24b-2 OF THE SECURITIES EXCHANGE ACT  
OF 1934; [\*\*\*] DENOTES OMISSIONS.

Exhibit D  
[\*\*\*]

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EXHIBIT E  
MICROSOFT BRAND FEATURES



**The reversed full-color logos are preferred for all marketing communications on dark-color photographs or backgrounds.**



**The gray full-color logos can be used on light-color photographs or backgrounds.**



**The full-color blue logo is for use in the UI only.**

Logos in different sizes can be found at <https://brandtools.partners.extranet.microsoft.com/>

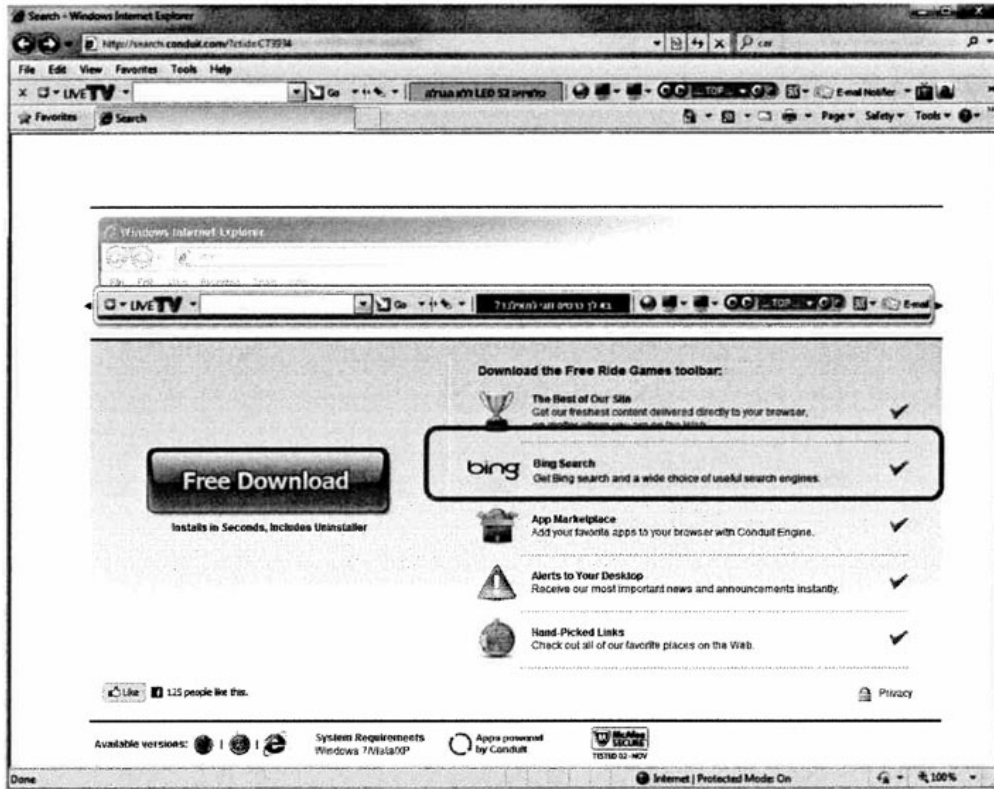
CONFIDENTIAL

EXAMPLE OF USE OF BING BRAND ON CONDUIT.COM WEBSITE:



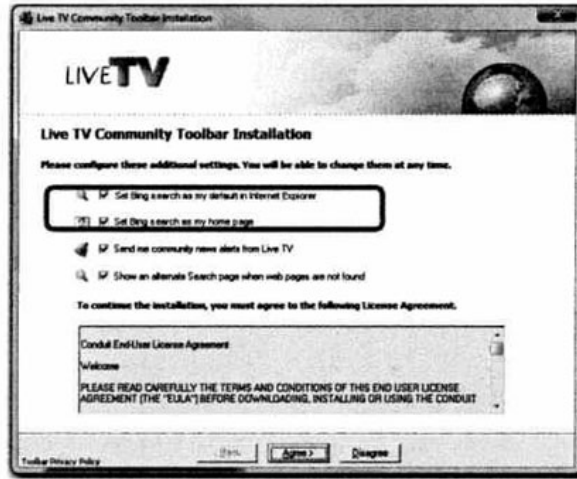
CONFIDENTIAL

EXAMPLE OF USE OF BING BRAND ON PUBLISHER INSTALL PAGES:



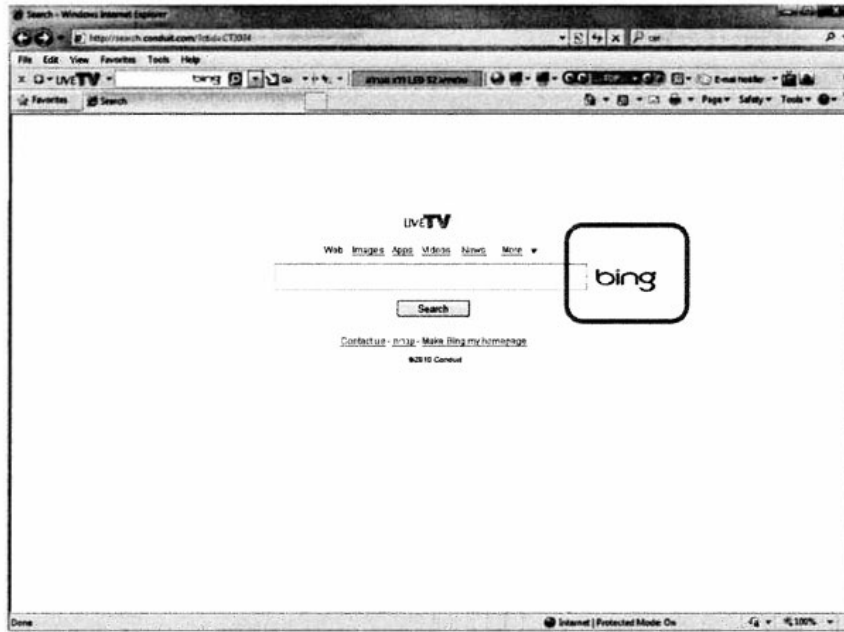
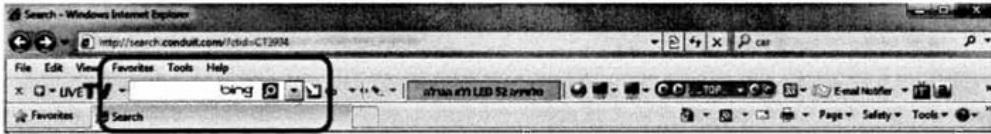
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EXAMPLE OF USE OF BING BRAND IN TOOLBAR INSTALLATION PROCESS:



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EXAMPLES OF USE OF BING BRAND ON SEARCH BOX (TOOLBAR AND CUSTOM HOMEPAGE:



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**EXHIBIT F**  
**MICROSOFT BRAND GUIDELINES**

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Exhibit F- Page 1

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## Bing Product Guidelines

This document provides visual guidelines and recommendations to implement the branding for Bing for third parties. These guidelines can help echo the Bing product brand experience into your environment.

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## Document Overview

The purpose of this guideline document is to provide guideline and usage specifications for using and syndicating Bing Search on Bing partner sites. These guidelines contain the information you need to include the Bing branded searchbox, assets and behaviors of the searchbox on your site.

## Bing Brand Overview

This section will provide an overview of the brand, brand elements and guidelines for partners incorporating Bing search functionality on their sites.

Product branding is achieved through a combination of factors. This includes the product name and logo, use of color, text, graphics and sound, the style of various other design elements, marketing and most important, the attributes of the product experience itself.

## Brand Signature Overview

A brand signature is a branding element that communicates brand identity and consists of elements such as the brand trademarked symbol, the brand name, or the brand logotype or other iconography.

The Bing brand signatures include:

- Bing text with trademark
- Bing logo - full color or reverse
- Bing Spyglass icon when used in conjunction with a searchbox form field
- Bing Favicon

Bing brand signatures can be used in the user interface and certain elements must be used when showing the Bing searchbox. The specific guidelines about when and where to use the various Bing brand signatures are included in this document.

### Bing Text with Trademark

Bing™

Bing logo

The image shows the word "bing" in a lowercase, sans-serif font. The letters are black, and there is a small trademark symbol (™) at the top right of the letter "g".

Bing logo – full color



Bing logo - reverse

### Bing Spyglass Icon



### Bing Favicon



## Bing Brand Usage Guidelines

This section provides guidelines for using the Bing brand elements for Bing searchboxes on your sites. The guidelines are applicable regardless of method of search, either via the API or through direct queries to <http://www.bing.com>.

### Bing Text Brand Signature Guidelines

The Bing text brand signature includes the brand text that reads **Bing**<sup>™</sup> (with trademark). In instances where Bing or a Bing service is referenced in text in a sentence, on the first mention of a trademarked name in body copy, the trademark symbol (<sup>™</sup>) should be used, e.g., **Bing**<sup>™</sup>.

- References to the Bing name in text must always have an uppercase B.
- Never abbreviate Bing. For example, do not use BG, B Search, and so on.
- Never use Microsoft or Bing in the possessive form, such as "Microsoft's Bing features are excellent." Instead, use the company name as an adjective. For example, you can say "Microsoft Bing features are excellent."

In-depth information regarding use of Microsoft trademarks may be found at the General Microsoft Trade mark site. Reference the guidelines at <http://www.microsoft.com/about/legal/trademarks/usage/general.aspx>.

### Logo Usage Guidelines

Full Color and Reverse Color versions of the logo are the only two versions that should be used in user interfaces that include the Bing searchbox.



### Full Color Logo



### Reverse Color Logo

### Logo Orientation

The Bing brand signature should never vary in orientation from how it appears in the artwork provided in the product. Always position the Bing logo at a 0 degrees horizontal angle. Never tilt it or position it at an angle that is not perpendicular.

### Logo Minimum Size

The graphic below shows the Bing logo at its smallest acceptable size. The logo (excluding the trademark symbol) should never be less than .625" in print or 45 pixels online.  
.625" or 45 px wide

---

### Clear space

A minimum clearance must be maintained around the logo and other graphics and visual elements. The clear space (x) around the logo is equal to the height of the lowercase letter “n” in the word “Bing.”

### Logos for dark backgrounds

Use the reverse full-color versions of the Bing logo (with the “Bing” letterforms in white and the dot over the letter “i” in Bing orange) on dark backgrounds.

Because it would lack sufficient contrast with the dot over the letter “i”, the full-color version of the Bing logo should never be placed against an orange background. Never use the single color black Bing logo over the orange. If the Bing logo must appear on an orange background, use the single color reverse white version only

### Bing Logo Usage

- The logo should never appear connected to, or as part of, any other symbol or icon.
- The logo should never be contained in a box, circle, or other shape.
- The logo should never be modified in any way. Do not recombine the artwork elements together with other logos or graphics to create new artwork. Use the artwork as it is provided from the Bing branding team.

The Bing logo brand signature should also not be used by third parties without obtaining written permission from Microsoft, and obtaining approval from the Legal and Corporate Affairs (LCA) department.

---

## Brand the User Interface with the Bing Searchbox

As the gateway to the Bing search experience, the searchbox forms an integral part of the Bing brand. The following Bing brand signature elements should be used in conjunction with a Bing powered searchbox. All searchboxes should include:

- Logo – Bing Logo, either full color or reverse
- Spyglass – Bing orange spyglass placed per examples below
- In order to avoid confusion, the Bing search box should never be used as a supporting graphic (non working search box) on a Web site.
- The Bing brand should be easy to see and easy to read.
- Only full color versions are allowed
- The Bing brand signature must appear on the same UI screen that is used for submitting category queries.

### Bing Searchbox Details

#### Size

The research done in search on box size indicates that the best relevant results are obtained when a user enters 2-3 words. The optimal box size for 2-3 words is 35 w's.

- Text box should be wide enough to accommodate 35 w's
- Border around box is 1px solid #ACBABD for primary box. (alternate color #CCCCCC)

#### Proportions

The entry field box may be expanded horizontally, but its width should never be less than ten times its height.

#### Clear Space

Always allow for clear space around the search box that is the equivalent to the height of the box. The only exception is if you have site scoping above the search box. See examples below.

#### Searchbox Design Options

There are two types of searchboxes for a Bing Powered search experience in the user interface.

- The Simple Searchbox
  - The Site Search Searchbox
-

## Simple Searchbox

The simple searchbox can be used for sites that want to do direct transfers to [bing.com](http://bing.com) when a user implements a search.

- When used with the searchbox the Bing Logo should be on either the left or right of the searchbox.
- The logo should be within a 10 px proximity of the box when incorporating the brand.
- Logo - Bing Logo, either full color or reverse
- Spyglass - Bing orange spyglass placed per examples below

### Simple Searchbox - Logo on the Left



Searchbox on Light Background with Logo on Left



Redline - Searchbox with Logo on Left

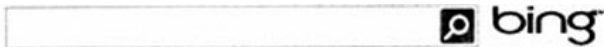


Searchbox on Dark Background with Logo on Left



Redlines - Searchbox with Logo on Left

### Simple Searchbox - Logo on the Right



Searchbox on Light Background with Logo on Right

---



Redlines - Searchbox on Light Background with Logo on Left



Searchbox on Dark Background with Logo on Right



Redlines - Searchbox with Logo on Right

### Simple Searchbox Behaviors

- The Logo should be clickable and should transfer a user to <http://www.bing.com>.
- If there is a query term in the searchbox, clicking the logo or the spyglass would execute a search.
- Tool Tip - The Alt Text for the graphic should be "search by Bing" or "powered by Bing".
- Tool Tip - Hover over the searchbox shows the tip "Search for"
- Tool Tip - Hover over the magnifying glass shows the tip "Search"
- Tool Tip - Hover over the logo shows the tip "bing.com"

### Site Search Searchbox

The Site Search searchbox designs can be used for sites that want to include site search and site scoping options as well as transfers to Bing.

In tests, the search boxes with scoping above the box performed better than those in a drop down. Therefore we make the following recommendations:

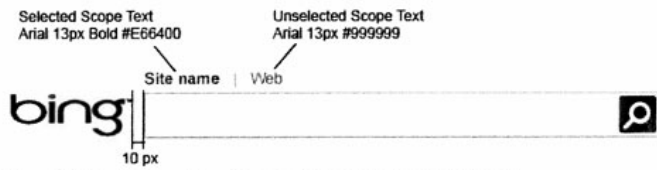
- Highlight the scope state as illustrated below.
  - Use optional helper text in the search box that reflects the state of the scope
    - Search <site name>
    - Search with Bing or Search the Web
  - If a user resets the scope, don't take them off their current page until they execute a search.
  - If you use the drop down option, allow 10 px of space around the drop down arrow for visual prominence.
-



Site Search Above the Box - Logo on the Left



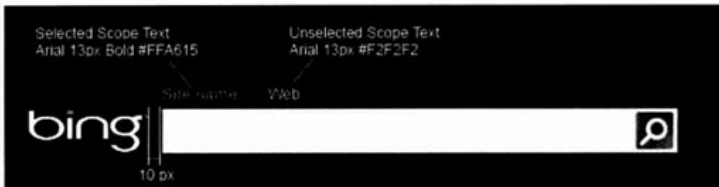
Site Search Scopes Above the Searchbox with Full Color, Logo Left



Redlines - Site Search Scopes Above the Searchbox with Full Color, Logo Left



Site Search Scopes Above the Searchbox with Reverse Color, Logo Left



Redlines - Site Search Scopes Above the Searchbox with Reverse Color, Logo Left

Site Search Above the Box - Logo on the Right



Site Search Scopes Above the Searchbox - Full Color, Logo Right





Redlines - Site Search Scopes Above the Searchbox - Full Color, Logo Right



Site Search Scopes Above the Searchbox with Reverse Color, Logo Right

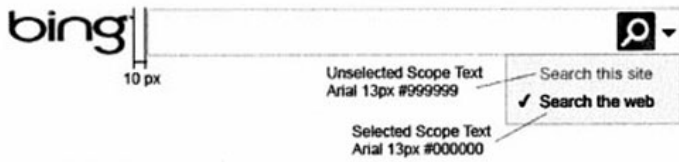


Redlines - Site Search Scopes Above the Searchbox with Reverse Color, Logo Right

Site Search in a Dropdown - Logo on the Left



Site Search Scopes in Dropdown with Full Color, Logo Left



Redlines - Site Search Scopes in Dropdown with Full Color, Logo Left

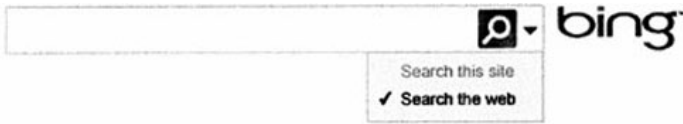


Site Search Scopes in Dropdown with Reverse Color, Logo Left

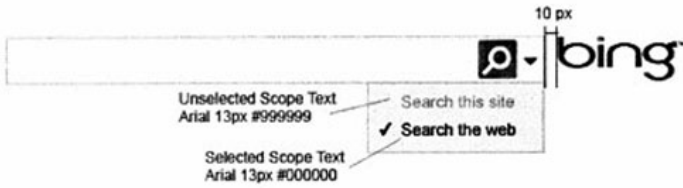


Redlines - Site Search Scopes in Dropdown with Reverse Color, Logo Left

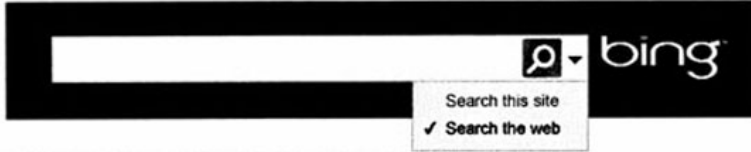
Site Search in a Dropdown - Logo on the Right



Site Search Scopes in Dropdown with Full Color, Logo Right



Redlines - Site Search Scopes in Dropdown with Full Color, Logo Right



Site Search Scopes in Dropdown with Reverse Color, Logo Right

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Redlines - Site Search Scopes in Dropdown with Reverse Color, Logo Right

### Behaviors for Site Scoping Searchboxes

The following are the guidelines associated with the behavior of the site search functionality for the search box:

- The Logo should be clickable and should transfer a user to <http://www.bing.com>.
- If there is a query term in the searchbox, clicking the logo would execute a search on bing.com.
- If the scope is set to 'web' and a user clicks the spyglass the box would execute a search and transfer the user to bing.com.
- Tool Tip - The Alt Text for the graphic should be "search by Bing" or "powered by Bing".
- Tool Tip - Hover over the searchbox shows the tip "Search for"
- Tool Tip - Hover over the magnifying glass shows the tip "Search"
- Tool Tip - Hover over the logo shows the tip "bing.com"

### Third Party Searchbox Options

These guidelines are specific to our syndicated search box and are intended for third party external Microsoft use **only** as an option when the preferred Bing searchbox above is not available.

The simple searchbox can be used for sites that want to do direct transfers to Bing when a user executes a search.

- Spyglass - Bing orange spyglass placed per examples below
- The text in the Searchbox should be "Search with Bing"
- Font in the Bing searchbox is small/normal or 14pt Arial, Verdana, Helvetica, Sans-Serif
- Color of text is #525051



Searchbox on Dark Background



Searchbox on Light Background



### Third Party Searchbox Behaviors

- If there is a query term in the searchbox, clicking the spyglass would execute a search on [bing.com](http://www.bing.com).
- If there is no query term in the searchbox, clicking the spyglass would take a user to <http://www.bing.com>.

### Attribution on the Search Results Page

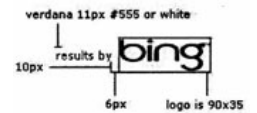
The logos here are only to be used for display on Search Engine Results Pages (SERP) when attribution is needed.

- The phrase preceding the brand is “results by” and it is localized as well as localizable.
- When the text + logo version is used in a market that requires “results by” text to be localized, system text can be used.
- Partners can localize the text our use the localized strings provided in the appendix below.
- The font for ‘results by’ is Verdana, 11px
- The color is #555 or white, depending on site background
- There are 6 px of space between the text and the logo.
- In limited cases, “powered by” is the appropriate phrase to precede the Bing logo on the SERP. This is reserved for use by third parties that license our technology, build an application or service on top of it, and then market their application or service.

results by **bing**



example background colors



## Font guidelines for UI

This topic provides user-interface (UI) guidelines for using Bing brand fonts.

The Segoe UI and Arial font family in Light, or Bold in Black is the preferred font to use in online communications. Verdana or Helvetica in Regular, Regular, or Bold in the color Black is the second choice.

- When possible, avoid using italic fonts to ensure clarity and readability in the UI.

### Tag Lines

#### Short Name

Bing. Search by Microsoft.

#### Long Name

Bing

For Decisions that Matter. Bing and Decide.

#### For Search Provider

Bing

Bing. Search by Microsoft.

#### Space Constrained

Bing. Search by Microsoft.

#### Outside the US

Bing

Stop Searching. Start Finding.

#### For the US:

Bing

For Decisions that Matter. Bing and Decide.

For teams unable to localize/manage against two different strings for Int'l/US

Bing

For Decisions that Matter. Bing and Decide.

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## Bing Favicon

The Bing favicon (Favorite icon) graphic is the 16x16 pixel icon that is associated with the Bing web page. Its primary use is as a smaller visual representation of the brand for the browser address window or the Bing for mobile interface.

This image with the white Bing “b” over the orange background is intended to communicate the moment of decision when space doesn’t allow the full word mark.

Any use of the favicon should adhere to the following guidelines:

- **Don’t** use the favicon instead of the logo in or near the searchbox.
- **Do** use the Bing brand logo as the primary visual representation for the Bing brand. The favicon is not the brand logo and should never replace the approved TM logo
- **Don’t** change the favicon colors
- **Do** place the favicon immediately in front of the word Bing™ in copy text to reinforce the favicon association with the trademarked brand
- **Don’t** use or combine the favicon with your own logos or logotypes
- **Don’t** combine or “lock up” the favicon with the logo
- **Don’t** modify the favicon in any way. Do use the artwork as it is provided
- **Don’t** change the favicon colors. Don’t modify the favicon in any way. Do use the artwork as provided
- **Don’t** “lock up” or combine the favicon with the logo
- **Don’t** provide this asset or allow partners to use the favicon in any marketing material
- If space is limited and you wish to use the favicon alone or the favicon requires a different design treatment, contact [bingbrnd@microsoft.com](mailto:bingbrnd@microsoft.com) and LCA for approval
- The favicon is available in two sizes.
  - o 16x16
  - o 32x32



**Bing Favicon**



**Redline - Bing Favicon 16x16 version**

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## Tools

There are two ways to get assets to incorporate the brand into your sites.

### The Brand Asset Interface

The assets described in this document are available from the Brand distribution interfaces that were created to define brand locations. The intent of these interfaces is to make it easy for partners to be able to implement the brand. It was designed as an interface to support the rebrand change automatically and post rebrand all the partners should use this as text file and hardcode the path instead of dynamically reading it from the file.

- The location to the assets will be contained in XML and JSON static files on the API server that will contain the branding logos and URLs .
- The static files will be named BrandAssets.xml and BrandAssets.js and will be available on api.bing.com.
- <http://api.bing.com/Brandassets.xml>
- <http://api.bing.com/Brandassets.js>

### Hosting the Assets on Your Site

If you wish to host the assets on your site yourself, the approved images can be obtained from your Microsoft contact who can access them from either Microsoft Brand Tools or Microsoft Mediabank.

- Logo
- Spyglass
- Favicon

### Using the Asset Interface

Each element in the asset file contains pointers to published brand assets. To use the asset, simply target your UX to use the element provided in the XML or JSON file. For example, if your UX requires a 40x16 image with white lettering, you would use the value of the element:

```
<LogoBigWhite>  
http://www.bing.com/siteowner/s/siteowner/Logo_63x23_White.png  
< Width >63 </Width >  
<Height>23</Height>  
</LogoBigWhite>
```

You should not hardcode the path itself, but rather use the value of the element as the value will change when the asset is updated at Bing launch. By doing this you can work with the asset files before launch, and the assets will automatically change when the new files are published at Bing launch.

We recommend that you poll our XML file and then cache/host assets locally. This will ensure optimal performance for your sites; while enabling you to use the XML file to update your sites.

---





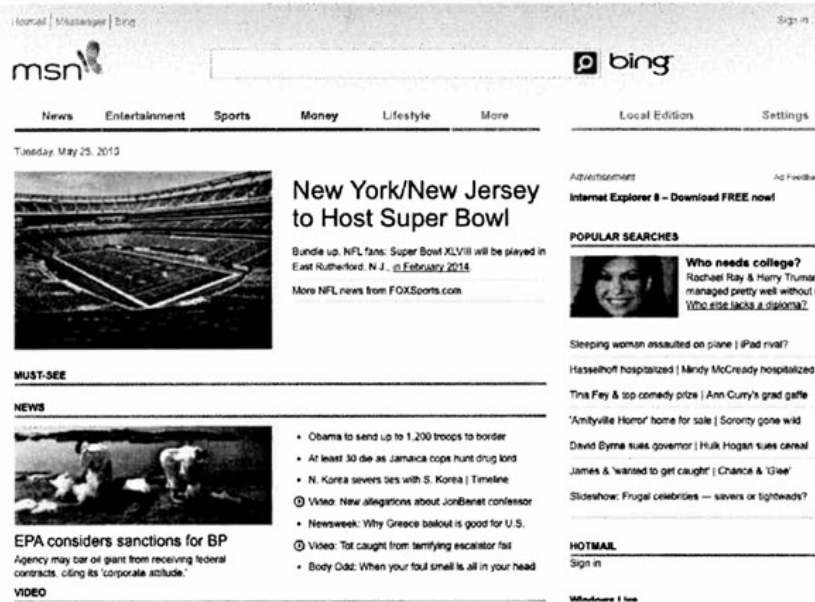
Windows Live



Microsoft.com with site scoping in a drop down



Microsoft.com with site scoping above the box



MSN US Home Page

News Entertainment Sports Money Lifestyle Movies Bing

msn  bing

Make msn.com your home page

Home Showtimes & Tickets Top Box Office Trailers & More In Theaters Coming Soon New on DVD Critics' Reviews Photos News Blog Superfans

Exclusive Clip: The A-Team  
Watch an explosive scene from the reborn of the 80s action show

2010 SUMMER MOVIE GUIDE  
The Rundown

COMING SOON  
In Theaters  
New on DVD

Get Him to the Greek  
A record company seeks tries to transport a British rock star to a show in L.A.

Marmaduke  
The comic strip canine comes to the big screen

Solice  
Genetic engineers create an animal-human hybrid

showtimes & tickets  
Theaters near 95004  
(change location)  
Lincoln Square Cinema  
SBC Loews Theatre @ Kirkland Parkplace Cinema

More Theaters  
Or By Movie Title

Customize Local Theaters

MSN Entertainment Channel with Scoping above the box

msn Entertainment Money Lifestyle Movies Bing

FOX SPORTS

SCOUT WHAT IF FOX SPORTS RADIO SHOP

Guest SIGN IN

Search this site Search the web

Headlines

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STARTING LINEUP

Support Red Cross efforts in Haiti  
TEXT "HAITI" TO 80888

Tell us what you think  
by participating in a short survey

MSN Fox Sports Channel with Scoping in the Drop down

THIS EXHIBIT WAS OMITTED AND FILED SEPARATELY  
WITH THE SECRETARY OF THE COMMISSION PURSUANT TO AN APPLICATION FOR  
CONFIDENTIAL TREATMENT UNDER RULE 24b-2 OF THE SECURITIES EXCHANGE ACT  
OF 1934; [\*\*\*] DENOTES OMISSIONS.

Exhibit G  
[\*\*\*]

---

THIS EXHIBIT WAS OMITTED AND FILED SEPARATELY  
WITH THE SECRETARY OF THE COMMISSION PURSUANT TO AN APPLICATION FOR  
CONFIDENTIAL TREATMENT UNDER RULE 24b-2 OF THE SECURITIES EXCHANGE ACT  
OF 1934; [\*\*\*] DENOTES OMISSIONS.

Exhibit H  
[\*\*\*]

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**EXHIBIT I**

**TECHNICAL REQUIREMENTS FOR BRANDED FOOTER**

Size Dimensions

Iframe width – 350px  
Text color = #737373  
Font = 8pt unbolded  
Logo = max height 15px (increasing to 20px within a reasonable period of time as determined by mutual agreement)

CONFIDENTIAL

PORTIONS OF THIS AGREEMENT WERE OMITTED AND HAVE BEEN FILED SEPARATELY  
WITH THE SECRETARY OF THE COMMISSION PURSUANT TO AN APPLICATION FOR  
CONFIDENTIAL TREATMENT UNDER RULE 24b-2 OF THE SECURITIES EXCHANGE ACT  
OF 1934; [\*\*\*] DENOTES OMISSIONS.

EXECUTION VERSION

AMENDMENT TO SEARCH SERVICES AGREEMENT

This Amendment to Search Services Agreement (this "Amendment") is entered into as of May 11, 2011 ("Amendment Effective Date") by and between Conduit Ltd., a company formed under the laws of Israel ("Conduit") and Microsoft Online, Inc., a Nevada corporation ("Microsoft"), a wholly-owned subsidiary of Microsoft Corporation, a Washington corporation.

WHEREAS, Conduit and Microsoft are parties to that certain Search Services Agreement, entered into as of November 19, 2010 (the "Agreement"); and

WHEREAS, the Parties wish to amend the Agreement as more fully described herein.

NOW, THEREFORE, in consideration of the mutual promises contained herein, the Parties agree as follows:

1. Definitions.

1.1 Sections 1.23 (Event), 1.41 ([\*\*\*]), 1.50 ([\*\*\*]), 1.59 ([\*\*\*]), and 1.63 (Termination Override Notice) of the Agreement are deleted in their entirety and all references to such defined terms in the Agreement are stricken.

1.2 Section 1.24 of the Agreement is amended and restated in its entirety as follows:

"1.24 "Excess Revenue Share Payment" has the meaning given in Section 4.1.1(d)."

1.3 Section 1.39 of the Agreement is amended and restated in its entirety as follows:

[\*\*\*]

1.4 Section 1.66 of the Agreement is amended and restated in its entirety as follows:

"1.66 [\*\*\*]

1.5 Section 1.68 of the Agreement is amended and restated in its entirety as follows:

[\*\*\*]

1.6 The Agreement is amended to include new Section 1.70 as follows:

[\*\*\*]

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1.7 The Agreement is amended to include new Section 1.71 as follows:

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2. [\*\*]

2.1 Section 3.1 of the Agreement is hereby amended and restated in its entirety as follows:

“3.1 Search Services. Conduit will, subject only to the exceptions set forth in Section 3.1.2 below, ensure that the following requirement is achieved:

[\*\*]

3.1.2 Exceptions.

[\*\*]

3.1.3 Notification Process and Data Obligations. [\*\*]

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3.1.4 Reporting Related to [\*\*\*] Exception. [\*\*\*]

3.1.5 Violation of [\*\*\*] Exception. [\*\*\*]

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3.1.6 Application of [\*\*\*] Exception-Based Adjustments. [\*\*\*]

3.1.7 End User Location. Conduit will use good faith, commercially reasonable efforts to determine where each End User is located.

3.1.8 Use of Other Services. For clarity, subject to Sections 3.1.1, 3.1.2, 3.1.3 and 3.1.4 (each of which applies to Conduit in accordance with its terms), no obligation, restriction or requirement in this Agreement will apply to Conduit with respect to any third-party provider of [\*\*\*] or [\*\*\*] or to [\*\*\*] of third party [\*\*\*] or [\*\*\*] (including any obligation, restriction or requirement in the Agreement regarding any Source, Query or Results Page).”

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2.2 Section 3.2 of the Agreement is hereby amended and restated in its entirety as follows:

[\*\*\*]

3. Compensation and Payment.

[\*\*\*] Following 2 pages reduced in full

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3.4 Exhibit J. Exhibit J attached hereto is added to the Agreement.

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3.5 Section 4.1.4. Section 4.1.4 of the Agreement ( [\*\*\*] ) is deleted in its entirety.

3.6 Section 4.2.1. The words “Exhibit I” in Section 4.2.1 are deleted and replaced with “Section 2.6.”

3.7 Disputed Amounts. Section 4.3 of the Agreement is amended and restated in its entirety as follows:

“4.3 Disputed Amounts: Breach of Payment and Reporting Obligations.

4.3.1 Disputed Amounts. Delivery or payment of an invoice without asserting a dispute is not a waiver of any claim or right by either Party to dispute such amount. In the event of a Dispute (as defined in Section 12.1), Microsoft may not under any circumstances, and regardless of the existence or outcome of any [\*\*\*] (as defined in Section 4.3.3), withhold more than an absolute maximum of [\*\*\*] of any invoiced amounts pending the resolution of such Dispute, provided that such invoiced amounts are submitted in material compliance with and contain all material information required by this Agreement.

4.3.2 Failures to Report. In the event that Microsoft fails to provide a timely and materially complete and accurate [\*\*\*] report in accordance with Section 4.2.1, then without limiting Conduit’s other rights and remedies and on a provisional basis until such report is provided, Conduit may invoice Microsoft and Microsoft shall pay the average of the invoiced amounts for the immediately preceding three calendar months. When such report is provided it shall be reconciled against such provisional payment and Microsoft shall promptly pay Conduit the amount of any underpayment or deduct the amount of any overpayment against subsequent payments under the Agreement.

4.3.3 Disputes Regarding Payment Obligations. All Disputes involving nonpayment of invoices under this Agreement (“Nonpayment Disputes,” which term, for the avoidance of doubt, includes any nonpayment of an invoice in connection with a “ [\*\*\*] ” as defined in Section 4.3.4 and any nonpayment of an invoice issued under Section 4.3.2) will, following written notice by the Party raising the Dispute to the other Party setting forth the details of the Dispute and any proposed solution or compromise, be resolved exclusively through the good faith negotiation of the Parties or in binding arbitration. The governing arbitration procedures shall be those described in this Section 4.3.3 and the Commercial Arbitration Rules of the American Arbitration Association (AAA), including, if invoked as described below, those provisions for interim relief provided in Rule 34 and Optional Rules O thereof (the “Expedited Relief Process”) in San Francisco, California. To the extent not inconsistent with the previous sentence or with effectuation of the Expedited Relief Process contemplated therein, the parties, AAA and arbitrator(s) will apply the provisions of Section 12.2, using the AAA equivalent rules in lieu of JAMS rules. Notwithstanding Section 12.1 and 12.2, neither Party will have any remedy in court with respect to Nonpayment Disputes except those sought in aid of arbitration (e.g., an order compelling arbitration). In the event of a Nonpayment Dispute, regardless of whether the Expedited Relief Process is invoked at the commencement thereof:

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- (a) the provisions of Sections 12.1.1 and 12.1.2 will not apply;
- (b) the Nonpayment Dispute will immediately after written notice thereof be escalated to an officer of each Party and they will have 15 days from the date of escalation to attempt to resolve the dispute, acting in good faith;
- (c) if the Nonpayment Dispute is not resolved within such time period, either Party thereafter may invoke arbitration remedies and either Party (as the "Initiating Party") may elect for such Dispute to be reviewed under the Expedited Relief Process (and the other Party may not contest such an election), in which case the Initiating Party may commence a proceeding for emergency relief, the other Party will be required to respond to the initial motion for relief within seven (7) days, the Initiating Party will be required to reply to the response within seven (7) days, the arbitration hearing will occur within seven (7) days after the reply is submitted, and the arbitrator will issue a decision within seven (7) days after the hearing. The arbitrator in such an Expedited Relief Process shall automatically award interim monetary and injunctive relief (without requiring a bond) compelling payment to Conduit of a minimum of [\*\*\*] of all unpaid invoices submitted in material compliance with and containing all material information required by this Agreement. In addition, arbitrator in such an Expedited Relief Process shall award such further amounts as to which either Party establishes a substantial likelihood of prevailing on the merits. In the Expedited Relief Process, the arbitrator will not require either Party to establish proof that it would be immediately or irreparably harmed or damaged absent such interim relief nor consider the asserted adequacy of any alternative remedy. The Parties intend for this subsection (c) to contractually permit either Party to pursue a remedy providing immediate payment, rather than having such recourse available only after completion of an arbitration proceeding. Payments made pursuant to any arbitral award of interim relief may be subsequently adjusted in accordance with further arbitral proceedings regarding the applicable Dispute or as the Parties may otherwise agree in connection with settling the applicable Dispute;
- (d) the arbitrator(s) will award (in place of, and not in addition to, the interest at commercial rates referenced in Section 12.2.4(b)) pre- and post-award interest at the rate of [\*\*\*] per month with respect to any amounts determined by such arbitration to be overdue in payment by Microsoft to Conduit;
- (e) notwithstanding any other provision of this Agreement, in the event that an arbitration of any Nonpayment Dispute is initiated at the AAA, any other arbitration relating to this Agreement shall be consolidated to proceed at the AAA in conjunction therewith, provided, however, that if the members of an arbitral tribunal have been fully and finally constituted in a JAMS arbitration relating to this Agreement, any arbitration of a Nonpayment Dispute commenced thereafter will proceed before such previously constituted panel, which shall adhere to the procedures and timelines for the Expedited Relief Process set forth in Section 4.3.3;
- (f) the parties and arbitrator shall make best efforts to finally complete a final award in any arbitration of a Nonpayment Disputes as expeditiously as possible, but in all events within nine (9) months after initiation of such arbitration; and

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(g) the arbitrator(s) shall also require that that all costs of arbitration and all reasonable attorneys' fees and costs incurred in connection with any arbitration of any Nonpayment Dispute by the substantially prevailing Party be paid by the other Party, notwithstanding anything to the contrary in Section 12.2.4.(b) or any other provision of this Agreement.

4.3.4 **Exception-Related Disputes.** All Disputes regarding or related to the application or calculation of a [\*\*\*] Exception-Based Adjustment (a "[\*\*\*] Exception-Related Dispute") will be resolved exclusively through the good faith negotiation of the Parties or in the binding arbitration procedures described in Section 12.2; provided that either Party may elect (which election the other Party may not contest) that the timelines, but not the discovery-related procedures, set forth in the Expedited Procedures as defined in the JAMS Comprehensive Arbitration Rules and Procedures then in effect (as referenced in Section 12.2) shall apply. Notwithstanding Section 12.1 and 12.2, neither Party will have any remedy in court with respect to a [\*\*\*] Exception-Related Dispute except those sought in aid of arbitration (e.g., an order compelling arbitration) In the event of a [\*\*\*] Exception-Related Dispute (a) the provisions of Sections 12.1.1 and 12.1.2 will not apply; (b) the [\*\*\*] Exception-Related Dispute will immediately be escalated to an officer of each Party and they will have 15 days from the date of escalation to attempt to resolve the dispute, acting in good faith; and (c) if the [\*\*\*] Exception-Related Dispute is not resolved within such time period, either Party thereafter may invoke the arbitration remedies permitted under Section 12. If such an arbitration finds that either Party owes any amount to the other Party with respect to a [\*\*\*] Exception-Related Dispute, the arbitrator(s) will award (in place of, and not in addition to, the interest at commercial rates referenced in Section 12.2.4(b)) pre- and post-award interest at the then-current U.S. prime rate (as published by the Wall Street Journal) plus [\*\*\*] per year with respect to any amounts determined by such arbitration to be overdue in payment by one Party to the other Party.

4.3.5 If either Party does not pay all amounts due to the other Party under an interim or final arbitral award within ten (10) days of such award being issued in writing in connection with a Dispute, then notwithstanding anything to the contrary in Section 12 of the Agreement or this Section 4.3, the Party to whom such amounts are owed may pursue enforcement of such award in any court of competent jurisdiction."

4. **Termination.** Section 15.3 of the Agreement is deleted in its entirety and all references thereto in the Agreement are stricken.

5. **Exhibit G and Exhibit D.** Exhibit G is deleted in its entirety. The title of Exhibit D is deleted in its entirety and replaced with the following: " [\*\*\*] In addition, the title of the first table in Exhibit D is deleted and replaced with the following: [\*\*\*]"

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6. Mutual Release.

6.1 By Conduit. Conduit, on behalf of itself and each of its officers, directors, employees, and Affiliates (the "Conduit Releasing Parties"), hereby irrevocably and unconditionally releases and forever discharges Microsoft and each and all of its former or present directors, officers, agents, consultants, shareholders, investors, supervisors, employees, representatives, attorneys, and their successors and assigns and all persons acting by, through, under, or in concert with any of them (the "Microsoft Released Parties") from any and all charges, demands, complaints, claims, proceedings, causes of action, orders, obligations, contracts, agreements, promises, debts, liabilities, controversies, losses, damages, costs and expenses (including attorneys' fees and costs actually incurred) of any kind or nature, whatsoever, fixed or contingent, whether known or unknown, suspected or unsuspected, both at law and in equity, which Conduit or its Affiliates now has, has ever had, or may hereafter have against the Microsoft Released Parties or any of them relating to or arising from or in connection with the Agreement (including the negotiation and formation of the Agreement) prior to the Amendment Effective Date (the "Conduit Claims"). Conduit, on behalf of itself and each of the Conduit Releasing Parties, covenants and agrees never to commence, prosecute, or cause, permit, or advise to be commenced or prosecuted on behalf of Conduit or any of the Conduit Releasing Parties, any action, suit or proceeding based upon any Conduit Claim, and Conduit shall procure that the other Conduit Releasing Parties shall comply with the terms of this Section 6.1 as if they were a party to it.

6.2 By Microsoft. Microsoft, on behalf of itself and each of its officers, directors, employees, and Affiliates (the "Microsoft Releasing Parties"), hereby irrevocably and unconditionally releases and forever discharges Conduit and each and all of its former or present directors, officers, agents, consultants, shareholders, investors, supervisors, employees, representatives, attorneys, and their successors and assigns and all persons acting by, through, under, or in concert with any of them (the "Conduit Released Parties") from any and all charges, demands, complaints, claims, proceedings, causes of action, orders, obligations, contracts, agreements, promises, debts, liabilities, controversies, losses, damages, costs and expenses (including attorneys' fees and costs actually incurred) of any kind or nature, whatsoever, fixed or contingent, whether known or unknown, suspected or unsuspected, both at law and in equity, which Microsoft or its Affiliates now has, has ever had, or may hereafter have against the Conduit Released Parties or any of them relating to or arising from or in connection with the Agreement (including the negotiation and formation of the Agreement) prior to the Amendment Effective Date (the "Microsoft Claims"). Microsoft, on behalf of itself and each of the Microsoft Releasing Parties, covenants and agrees never to commence, prosecute, or cause, permit, or advise to be commenced or prosecuted on behalf of Microsoft or any of the Microsoft Releasing Parties, any action, suit or proceeding based upon any Microsoft Claim, and Microsoft shall procure that the other Microsoft Releasing Parties shall comply with the terms of this Section 6.2 as if they were a party to it.

6.3 Waiver. Each Party has been advised of the existence of Section 1542 of the California Civil Code which provides as follows:

**A general release does not extend to claims which the creditor does not know or suspect to exist in his or her favor at the time of executing the release, which if known to him or her must have materially affected his or her settlement with the debtor.**

Each Party hereby irrevocably waives and relinquishes all rights and benefits which it has or may have under California Civil Code, Section 1542, as well as any other Law, as it pertains to the general releases above, and acknowledges and agrees that this waiver is an essential and material term of this Amendment, and that without such waiver this Amendment would not have been entered into. Each Party represents to the other Party that it has received the advice of its legal counsel and understands and acknowledges the significance and consequence of this waiver of Section 1542.

6.4 Intended Beneficiaries. Each of the Microsoft Released Parties and the Conduit Released Parties are intended third-party beneficiaries of this Section 6 and shall be entitled to enforce the releases directly against the releasing Party and each of its Affiliates.

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7. Representations and Warranties. Each of the Parties hereto represents, warrants and covenants to the other as of the Amendment Effective Date that (a) it is a corporation duly organized, validly existing and in good standing under the laws of its jurisdiction of incorporation; (b) it has the corporate power and authority to enter into this Amendment and the transactions contemplated hereby, the execution, delivery and performance of this Amendment and the transactions contemplated hereby, have been duly authorized by all necessary corporate action by such Party; (c) it has thoroughly analyzed the provisions of this Amendment and their implications, has received and relied solely upon the advice of its legal counsel and experts (and not upon any information provided by the other Party) and understands and acknowledges the significance and consequences of this Amendment; and (d) it has not transferred any of the claims identified in Section 6.1 and Section 6.2, as applicable, to any other party.

8. Miscellaneous. This Amendment will be governed and construed, to the extent applicable, in accordance with the laws of the State of New York, without regard to its conflict of law principles. Sections 3.1 and 3.3 of this Amendment (with respect to any unpaid amounts), and Sections 6, 7 and 8 of this Amendment shall survive the expiration or termination of the Agreement. This Amendment may be executed in multiple counterparts, each of which shall be deemed an original and all of which shall constitute one and the same instrument. This Amendment may be amended or modified only by a written agreement that (a) refers to this Amendment; and (b) is executed by an authorized representative of each Party. This Amendment shall be binding on the parties hereto and their respective personal and legal representatives, successors, and permitted assigns. Except as expressly set forth herein, the Agreement remains in full force and effect and this Amendment shall not be construed to alter, amend or change any of the other terms or conditions set forth in the Agreement. To the extent of any conflict between this Amendment and any provisions of the Agreement, this Amendment shall control with respect to the subject matter hereof.

[Signature page to follow]

DE RS

THIS EXHIBIT WAS OMITTED AND FILED SEPARATELY  
WITH THE SECRETARY OF THE COMMISSION PURSUANT TO AN APPLICATION FOR  
CONFIDENTIAL TREATMENT UNDER RULE 24b-2 OF THE SECURITIES EXCHANGE ACT  
OF 1934; [\*\*\*] DENOTES OMISSIONS.

Exhibit J  
[\*\*\*]

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IN WITNESS WHEREOF, the Parties by their duly authorized representatives have executed this Amendment as of the Amendment Effective Date.

CONDUIT LTD.

MICROSOFT ONLINE, INC.

By: DROR EREZ  
Name: DROR EREZ  
Title: LTO

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

קונדויט בע"מ  
CONDUIT LTD  
ח.פ. 513669671



By: \_\_\_\_\_  
Name: Ronen Shilo  
Title: CEO

[Signature Page to  
Amendment]

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**List of all subsidiaries**

1. IncrediMail Inc., a Delaware corporation
  2. Perion Interactive Ltd., an Israeli corporation (under voluntary liquidation)
  3. Smilebox Inc., a Washington corporation
  4. SweetIM Ltd., a Belize company
  5. SweetIM Technologies Ltd., an Israeli company
  6. ClientConnect Ltd., an Israeli company
  7. ClientConnect B.V., a Netherlands company
  8. ClientConnect, Inc., a Delaware corporation
- 
-

CERTIFICATIONS

I, Josef Mandelbaum, certify that:

1. I have reviewed this annual report on Form 20-F of Perion Network Ltd.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this report;
4. The Company's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Company and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the Company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the Company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting; and
5. The Company's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company's auditors and the audit committee of the Company's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal control over financial reporting.

Date: April 10, 2014

/s/ Josef Mandelbaum  
Josef Mandelbaum,  
Chief Executive Officer

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CERTIFICATIONS

I, Yacov Kaufman, certify that:

1. I have reviewed this annual report on Form 20-F of Perion Network Ltd.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this report;
4. The Company's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Company and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the Company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the Company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting; and
5. The Company's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company's auditors and the audit committee of the Company's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal control over financial reporting.

Date: April 10, 2014

/s/ Yacov Kaufman  
Yacov Kaufman,  
Chief Financial Officer

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CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report on Form 20-F of Perion Network Ltd., (the "Issuer"), for the period ended December 31, 2013, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Josef Mandelbaum, Chief Executive Officer of the Issuer, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

1. The Report containing the financial statements fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. Information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Issuer.

/s/ Josef Mandelbaum  
Josef Mandelbaum  
Chief Executive Officer

Date: April 10, 2014

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CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report on Form 20-F of Perion Network Ltd., (the "Issuer"), for the period ended December 31, 2013, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Yacov Kaufman, Chief Financial Officer of the Issuer, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

1. The Report containing the financial statements fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. Information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Issuer.

/s/ Yacov Kaufman  
Yacov Kaufman  
Chief Financial Officer

Date: April 10, 2014

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CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statements on Form S-8 (File Nos. 333-193145, 333-192376, 333-188714, 333-171781, 333-152010 and 333-133968), of our reports dated April 10, 2014, with respect to (i) the consolidated financial statements of Perion Networks Ltd. and its subsidiaries and (ii) the effectiveness of internal control over financial reporting of Perion Network Ltd., which appears in this Annual Report on Form 20-F for the year ended December 31, 2013.

Tel Aviv, Israel  
April 10, 2014

/s/ KOST FORER GABBAY & KASIERER  
KOST FORER GABBAY & KASIERER  
A member of Ernst & Young Global

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