MER TELEMANAGEMENT SOLUTIONS LTD
Form 20-F
March 30, 2007

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON D.C. 20549

FORM 20-F

[_] REGISTRATION STATEMENT PURSUANT TO SECTION 12(B) OR (G) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

OR

[_] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM _____ TO _____

[_] 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.....

COMMISSION FILE NUMBER: 0-28950

MER TELEMANAGEMENT SOLUTIONS LTD.
(Exact Name of Registrant as specified in its charter
and translation of Registrant's name into English)

ISRAEL
(Jurisdiction of incorporation or organization)

22 ZARHIN STREET, RA'ANANA 43662, ISRAEL
(Address of principal executive offices)

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

Title of each class	Name of each exchange on which registered
ORDINARY SHARES, NIS 0.1 PAR VALUE	NASDAQ CAPITAL MARKET

Securities registered or to be registered pursuant to Section 12(g) of the Act:
NONE

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: NONE

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:

ORDINARY SHARES, PAR VALUE NIS 0.01 PER SHARE..... 5,773,845
(as of December 31, 2006)

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

Yes [_] No [X]

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 [X]

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 [X] 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 [X]

Indicate by check mark which financial statement item the registrant has elected to follow:

Item 17 [_] Item 18 [X]

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 [X]

This Report on Form 20-F is incorporated by reference into our Form F-3 Registration Statement File No. 333-128225 and into our Form S-8 Registration Statements File No. 333-12014 and 333-123321.

INTRODUCTION

Mer Telemanagement Solutions Ltd. is a worldwide provider of solutions for telecommunications expense management, or TEM, used by enterprises, and business support systems, or BSS, used by information and telecommunication service providers, or ITSPs. Our TEM solutions assist enterprises and organizations to make smarter choices with their telecommunications spending at each stage of the service lifecycle, including allocation of cost, proactive budget control, fraud detection, processing of payments and spending forecasting. Our TEM solutions support our clients on an ongoing basis with both sophisticated software applications and a variety of managed services relationship models. Our converged BSS solutions for ITSPs have been successfully implemented worldwide by wireless providers, Voice over Internet Protocol, Internet Protocol Television, and content service providers. Our converged BSS solutions include charging and invoicing customers, interconnect billing and partner revenue management using pre-pay and post-pay schemes. Our pre-configured BSS solutions

have been designed to be implemented quickly and are competitively priced.

Since our public offering in May 1997, our ordinary shares have been listed on the NASDAQ Stock Market (symbol: MTSL). As used in this annual report, the terms "we," "us" and "our" mean Mer Telemanagement Solutions Ltd. and its subsidiaries, unless otherwise indicated.

We have obtained a U.S. trademark registration for TABS by MER(R) and have common law rights in the trademarks TABS.IT, FACILITRAK, and PMSI, based on use of the marks in the United States. We have also acquired rights in the TOTAL-e(TM) trademark in connection with the products we acquired from Teleknowledge Group Ltd. in December 2004. Additionally, in connection with the assets we acquired from TelSoft Solutions, Inc. in July 2006, we have acquired the rights in the CALLTRAC(R) registered trademark and the common law trademarks and service marks TELSOFT SOLUTIONS, TELSOFT, MEGACALL, CALLTRAC LITE, MEGAPOLL, MEGABILL, MEGABILL-BACK and MEGASYNC. All other trademarks and trade names appearing in this annual report owned by their respective holders.

Our consolidated financial statements appearing in this annual report are prepared in U.S. dollars and in accordance with generally accepted accounting principles in the United States, or U.S. GAAP. All references in this annual report to "dollars" or "$" are to U.S. dollars and all references in this annual report to "NIS" are to New Israeli Shekels.

Statements made in this annual report concerning the contents of any contract, agreement or other document are summaries of such contracts, agreements or documents and are not complete descriptions of all of their terms. If we filed any of these documents as an exhibit to this annual report or to any registration statement or annual report that we previously filed, you may read the document itself for a complete description of its terms.

Except for the historical information contained in this annual report, the statements contained in this annual report are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995, as amended, with respect to our business, financial condition and results of operations. Such forward-looking statements reflect our current view with respect to future events and financial results. We urge you to consider that statements which use the terms "anticipate," "believe," "do not believe," "expect," "plan," "intend," "estimate," "anticipate" and similar expressions are intended to identify forward-looking statements. We remind readers that forward-looking statements are merely predictions and therefore inherently subject to uncertainties and other factors and involve known and unknown risks that could cause the actual results, performance, levels of activity, or our achievements, or industry results, to be materially different from any future results, performance, levels of activity, or our achievements expressed or implied by such forward-looking statements. Such forward-looking statements are also included in Item 4 - "Information on the Company" and Item 5 - "Operating and Financial Review and Prospects." Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. Except as required by applicable law, including the securities laws of the United States, we undertake no obligation to publicly release any update or revision to any forward-looking statements to reflect new information, future events or circumstances, or otherwise after the date hereof. We have attempted to identify significant uncertainties and other factors affecting forward-looking statements in the Risk Factors section that appears in Item 3D. "Key Information - Risk Factors."

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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 selected consolidated financial data for and as of the five years ended December 31, 2006 are derived from our audited consolidated financial statements, which have been prepared in accordance with U.S. GAAP. Our audited consolidated financial statements with respect to the three years ended December 31, 2006 and as of December 31, 2005 and 2006 appear elsewhere in this Annual Report. Our selected consolidated financial data as of December 31, 2004, 2003 and 2002 and for the years ended December 31, 2003 and 2002 have been derived from audited consolidated financial statements not included in this Annual Report. The selected consolidated financial data set forth below should be read in conjunction with Item 5. "Operating and Financial Review and Prospects," and our consolidated financial statements and notes thereto included elsewhere in this annual report.

STATEMENT OF OPERATIONS DATA:

	Year Ended December 31,			
	2002	2003	2004	20
	(in thousands, except share and per shar			
Revenues	$ 9,787	$ 9,230	$ 9,413	$ 1
Cost of revenues	1,896	1,849	2,814	
Gross profit	7,891	7,381	6,599	
Selling and marketing	3,954	3,916	6,300	
Research and development, net	2,127	1,825	2,362	
General and administrative	1,858	1,830	2,101	
Operating loss	(48)	(190)	(4,164)	(
Financial income (expenses), net	(6)	130	78	
Loss before taxes on income	(54)	(60)	(4,086)	(
Taxes on income	52	198	266	
Net loss before equity in earnings of affiliate	(106)	(258)	(4,352)	(
Equity in earnings of affiliate	236	345	225	
Net loss	$ 130	$ 87	$ (4,127)	$ (
Basic and diluted net loss per share	$ 0.03	$ 0.02	$ (0.89)	$
Weighted average number of ordinary shares used in computing basic net loss per share	4,709,796	4,617,099	4,634,413	5,09
Weighted average number of ordinary shares used in computing diluted net loss per share	4,709,796	4,628,249	4,634,413	5,09

BALANCE SHEET DATA:

	As of December 31,				
	2002	2003	2004	2005	2006
	(in thousands)				
Working capital	$ 9,244	$ 9,437	$ 2,773	$ 2,065	$ 186
Total assets	17,707	18,182	15,323	13,816	14,054
Long-term loans	8	--	--	--	583
Shareholders' equity	14,013	14,464	10,657	9,174	7,542

B. CAPITALIZATION AND INDEBTEDNESS

Not applicable.

C. REASONS FOR THE OFFER AND USE OF PROCEEDS

Not applicable.

D. RISK FACTORS

INVESTING IN OUR ORDINARY SHARES INVOLVES A HIGH DEGREE OF RISK AND UNCERTAINTY. YOU SHOULD CAREFULLY CONSIDER THE RISKS AND UNCERTAINTIES DESCRIBED BELOW BEFORE INVESTING IN OUR ORDINARY SHARES. IF ANY OF THE FOLLOWING RISKS ACTUALLY OCCURS, OUR BUSINESS, PROSPECTS, FINANCIAL CONDITION AND RESULTS OF OPERATIONS COULD BE HARMED. IN THAT CASE, THE VALUE OF OUR ORDINARY SHARES COULD DECLINE, AND YOU COULD LOSE ALL OR PART OF YOUR INVESTMENT.

RISKS RELATING TO OUR BUSINESS AND MARKET

WE HAVE HAD A RECENT HISTORY OF OPERATING LOSSES AND MAY NOT ACHIEVE OR SUSTAIN PROFITABILITY IN THE FUTURE.

We have incurred operating losses in each of the last five fiscal years and we may not be able to achieve or sustain profitable operations in the future. To the extent that we continue to incur operating losses, we may not have sufficient working capital to fund our operations in the future. If we do not generate sufficient cash from operations, we will be required to obtain additional financing or reduce level of expenditure. Such financing may not be available in the future, or, if available, may not be on terms satisfactory to us.

OUR OPERATING RESULTS FLUCTUATE SIGNIFICANTLY.

Our quarterly results have fluctuated significantly in the past and are likely to fluctuate significantly in the future. Our future operating results will depend on many factors, including, but not limited to the following:

- demand for our products;
- changes in our pricing policies or those of our competitors;
- new product announcements by us and our competitors;
- the number, timing and significance of product enhancements;
- product life cycles;
- our ability to develop, introduce and market new and enhanced products on a timely basis;
- changes in the level of our operating expenses;

- budgeting cycles of our customers;
- customer order deferrals in anticipation of enhancements or new products that we or our competitors offer;
- changes in our strategy;
- seasonal trends and general domestic and international economic and political conditions, among others; and
- currency exchange rate fluctuations and economic conditions in the

geographic areas where we operate.

Due to the foregoing factors, quarterly revenues and operating results are difficult to forecast, and it is likely that our future operating results will be adversely affected by these or other factors.

Revenues are also difficult to forecast because the market for telecommunication management and billing solutions is rapidly evolving and our sales cycle for our solutions, from initial evaluation to purchase, is lengthy and varies substantially from customer to customer.

We typically ship orders for our TABS product line shortly after receipt of a purchase order and, consequently, order backlog at the beginning of any quarter has in the past represented only a small portion of that quarter's revenues. As a result, license revenues from our TABS product line in any quarter depend substantially on orders for TABS products that have been booked and shipped in that quarter. Also, we can not predict whether revenues from our Application Suite will be recognized in any quarter because the delivery and, in some cases, the implementation of all the components of the Application Suite (including among, other things, customer training) are dependent on the customers individual timing requirements, which can delay the completion of these orders. In addition, revenues from our billing solutions are generated by using contract accounting on a percentage of completion method and because the completion pace varies from quarter to quarter and is dependent on different variables that are out of our control, billing solutions revenues in any quarter depend on our customers' operational plans, which can delay our ability to progress and complete the projects.

Due to all of the foregoing, we cannot predict revenues for any future quarter with any significant degree of accuracy. Accordingly, we believe that period-to-period comparisons of our operating results are not necessarily meaningful and you should not rely upon them as indications of future performance. Our revenues declined in 2006 and we may not be able to achieve or sustain revenue growth in the future.

OUR QUARTERLY FINANCIAL PERFORMANCE VARIES SIGNIFICANTLY.

We have often recognized a substantial portion of our revenues in the last quarter of the year and in the last month, or even weeks or days, of a quarter. Our expense levels are substantially based on our expectations for future revenues and are therefore relatively fixed in the short term. If revenue levels fall below expectations, our quarterly results are likely to be disproportionately adversely affected because a proportionately smaller amount of our expenses varies with our revenues. Our operating results are generally not characterized by a seasonal pattern, except that our sales in Europe are generally lower in the summer months.

Due to the foregoing, our quarterly financial performance has in the past and may in the future vary significantly. Our revenues and operating results in any quarter may not be indicative of our future performance and it may be difficult for investors to evaluate our prospects. In some future quarter, our operating results may be below the expectations of public market analysts and investors. In such event, it is likely that the price of our ordinary shares would be materially and adversely affected.

WE DERIVE THE MAJORITY OF OUR REVENUES FROM TELECOMMUNICATIONS EXPENSE MANAGEMENT SOLUTIONS, THE MARKET FOR WHICH HAS DECLINED IN RECENT YEARS.

Until 2005, we derived substantially all of our revenues from our TABS.IT call accounting and billing products. In late 2004, we implemented a new strategy that has led to the development and introduction of our Application Suite. The Application Suite is built on the Microsoft.Net platform and establishes a framework for us to provide customized solutions that include customer care and billing in addition to our traditional telecommunications expense management , or TEM, solutions. The main functions of our TABS.IT and prior WinTrak families of products were incorporated into the Application Suite. In 2005, we expanded and enhanced the functionality of the Application Suite to include invoice management, which facilitates bill reconciliation and dispute management. In July 2006, we completed the acquisition of certain assets and liabilities of TelSoft Solutions, Inc., or TelSoft, a California-based provider of call accounting and TEM solutions. Despite all of the foregoing, our revenues from our TEM solutions declined each year from 1999 until 2003 and again in 2006 and revenues for these products may not grow in the future. If the market for our TEM solutions fails to grow in the future, our business, operating results and financial condition would be materially adversely affected. Our future financial performance will be dependent to a substantial degree on the successful introduction, marketing and customer acceptance of our invoice management products.

WE DEPEND ON BUSINESS TELEPHONE SYSTEM MANUFACTURERS, VENDORS AND DISTRIBUTORS FOR OUR SALES.

One of the primary distribution channels for our call accounting management products are private branch exchange, or PBX, original equipment manufacturers, or OEMs, and vendors who market our products to end-users in conjunction with their own products. We are highly dependent upon the active marketing and distribution efforts of our PBX OEMs. In 2004, 2005 and 2006, our three major OEMs, Siemens Gmbh, Philips Communications Systems B.V. and Ericsson, generated together 47.0%, 42.0% and 34.0%, respectively, of our consolidated revenues. The following percentage of sales were attributable to each of these OEMs in each of the 12 months ended December 31:

	2004	2005	2006
Siemens	38.0%	36.0%	29.0%
Philips	5.0%	4.0%	4.0%
Ericsson	4.0%	2.0%	1.0%

As these and other PBX vendors expand their product offerings to offer a wider range of newer technologies such as the Internet, Wireless Fidelity, or WiFi, and voice over Internet protocol, or VoIP, we have enhanced our Application Suite to accommodate these new services. In late 2004 and early 2005, we entered into partnership agreements with each of NEC Unified Solutions, Inc. and Avaya Inc. for the integration of our products with their own products and the marketing of our integrated product. Sales of call accounting solutions by PBX manufacturers and vendors have declined markedly in the recent past, and sales through this channel may not recover. Our success will be dependent to a substantial degree on the marketing and sales efforts of such third parties in marketing and integrating our products. These third parties may not give priority to the sale of our products as an enhancement to their products. Although most of the major business telephone switching systems manufacturers and vendors currently rely on third-party suppliers to provide call accounting and other telemanagement products, these manufacturers and vendors, including our current customers, may develop their own competing products or purchase competing products from others.

Because we sell our products through local master distributors in countries where we do not have a marketing subsidiary, we are highly dependent upon the

active marketing and distribution efforts of our distributors. We also depend in large part upon our distributors for product maintenance and support. Our distributors may not continue to provide adequate maintenance and support to end-users or provide maintenance and support for new products, which might cause us to seek new or additional distributors or incur additional service and support costs. The distributors to whom we sell our products are generally not contractually required to make future purchases of our products and could, therefore, discontinue carrying our products at any time. None of our distributors or resellers is subject to any minimum purchase requirements under their agreements with us. We may not be able to continue our relationships with our OEM customers or, if such relationships are not maintained, we may not be able to attract and retain comparable PBX original equipment manufacturers. The loss of any of our major reseller or OEM relationships, either to competitive products offered by other companies or products developed by such resellers, would have a material adverse effect on our business, financial condition and results of operations. Our future performance will depend, in part, on our ability to attract additional PBX manufacturers and vendors that will be able to market and support our products effectively, especially in markets in which we have not previously distributed our products.

IN DECEMBER 2004, WE ACQUIRED CERTAIN ASSETS AND LIABILITIES OF TELEKNOWLEDGE GROUP LTD. AND ON JULY 31, 2006, WE ACQUIRED CERTAIN ASSETS AND LIABILITIES OF TELSOFT SOLUTIONS, INC. AND WE MAY NOT BE ABLE TO SUCCESSFULLY EXPLOIT THE ACQUIRED PRODUCTS.

In December 2004, we completed the acquisition of certain assets and liabilities of Teleknowledge Group Ltd., or Teleknowledge, a provider of carrier class billing and related solutions, and on July 31, 2006, we completed the acquisition of certain assets and liabilities of TelSoft, a California corporation, a provider of call accounting and TEM solutions. The acquisition of the Teleknowledge billing solution enables us to offer an end-to-end customer care and billing solution, including pre/post paid billing, web self-care, assets management, partner management, help desk and order management modules. These products offer a complementary solution to our own products. We believe that the acquisition of TelSoft's TEM and call accounting software will enable us to expand our TEM solutions and will assist us to strengthen our growing business in the United States. We may not be able to successfully integrate the operations of Teleknowledge and TelSoft into our business or successfully exploit the solutions that we acquired from them.

WE FACE RISKS ASSOCIATED WITH EXPANDING AND MAINTAINING OUR DISTRIBUTION NETWORK.

We sell our products through distributors, business telephone switching systems manufacturers and vendors, post, telephone and telegraph authorities, or PTTs and our direct sales force. Our ability to achieve revenue growth in the future will depend in large part on our success in establishing and maintaining relationships with business telephone switching systems manufacturers and vendors and PTTs, and establishing and maintaining relationships with distributors. Historically, we have at times experienced difficulty in establishing effective distribution relationships. We may not be able to successfully expand our distribution channels or any such expansion may not result in an increase in revenues. The failure to expand or maintain our distribution channels could have a material adverse effect on our business, operating results and financial condition.

WE ARE SUBJECT TO RISKS ASSOCIATED WITH INTERNATIONAL OPERATIONS.

We are based in Israel and generate a large percentage of our sales outside the United States. Our sales in the United States accounted for 53.0%, 52.0% and 51.1% of our total revenues for the years ended December 31, 2004, 2005 and 2006, respectively. We may not be able to maintain or increase international market demand for our products. To the extent that we cannot do so in a timely manner, our business, operating results and financial condition will be materially and adversely affected.

International operations are subject to inherent risks, including the following:

- the impact of possible recessionary environments in multiple foreign markets;
- costs of localizing products for foreign markets;
- longer receivables collection periods and greater difficulty in accounts receivable collection;
- unexpected changes in regulatory requirements;
- difficulties and costs of staffing and managing foreign operations;

- reduced protection for intellectual property rights in some countries;
- potentially adverse tax consequences; and
- political and economic instability.

Our distributors or resellers may not be able to sustain or increase revenues from international operations or the foregoing factors may have a material adverse effect on our future revenues and, as a result, on our business, operating results and financial condition.

We may be adversely affected by fluctuations in currency exchange rates. While our revenues are generally denominated in U.S. dollars and Euro, a significant portion of our expenses are incurred in NIS. We do not currently engage in any currency hedging transactions intended to reduce the effect of fluctuations in foreign currency exchange rates on our results of operations. If we were to determine that it was in our best interests to enter into any hedging transactions in the future, we may not be able to do so or such transactions, if entered into, may not materially reduce the effect of fluctuations in foreign currency exchange rates on our results of operations. In addition, if, for any reason, exchange or price controls or other restrictions on the conversion of foreign currencies into NIS were imposed, our business could be adversely affected. Currency fluctuations in the future may have a material adverse effect on revenues from international sales and, consequently, on our business, operating results and financial condition.

WE ARE SUBJECT TO RISKS RELATING TO PROPRIETARY RIGHTS AND RISKS OF INFRINGEMENT.

We are dependent upon our proprietary software technology and we rely primarily on a combination of copyright and trademark laws, trade secrets, confidentiality procedures and contractual provisions to protect our proprietary rights. We try to protect our software, documentation and other written materials under trade secret and copyright laws, which afford only limited

protection. It is possible that others will develop technologies that are similar or superior to our technology. Unauthorized parties may attempt to copy aspects of our products or to obtain and use information that we regard as proprietary. It is difficult to police the unauthorized use of our products, and we expect software piracy to be a persistent problem, although we are unable to determine the extent to which piracy of our software products exists. In addition, the laws of some foreign countries do not protect our proprietary rights as fully as do the laws of the United States. Our means of protecting our proprietary rights in the United States or abroad may not be adequate or our competition may independently develop similar technology.

We are not aware that we are infringing upon any proprietary rights of third parties. However, it is possible, that third parties will claim infringement by us of their intellectual property rights. We believe that software product developers will increasingly be subject to infringement claims as the number of products and competitors in our industry segment grows and the functionality of products in different industry segments overlaps. It would be time consuming for us to defend any such claims, with or without merit, and any such claims could:

- result in costly litigation;
- divert management's attention and resources;
- cause product shipment delays; or
- require us to enter into royalty or licensing agreements. Such royalty or licensing agreements, if required, may not be available on terms acceptable to us, if at all.

If there is a successful claim of product infringement against us and we are not able to license the infringed or similar technology, our business, operating results and financial condition would be materially and adversely affected.

We rely upon certain software that we license from third parties, including software that we integrate with our internally developed software. These third-party software licenses may not continue to be available to us on commercially reasonable terms. If we lose or are unable to maintain any such software licenses, we could suffer shipment delays or reductions until equivalent software could be developed, identified, licensed and integrated, which would materially and adversely affect our business, operating results and financial condition.

WE MAY BE UNSUCCESSFUL IN OUR DEFENSE OF PENDING LITIGATION.

In April 2000, the tax authorities in Israel issued a demand for a tax payment for the 1997-1999 period in the amount of approximately NIS 6.0 million ($1.4 million). We have appealed to the Israeli District Court in respect of such tax demand and believe that certain defenses can be raised against the demand of the tax authorities. We have made a provision in our financial statements for this tax demand for the amount deemed probable.

If we are unsuccessful in these matters or if actual results are not consistent with our assumptions and judgments, we may be exposed to losses that could be material to our company.

OUR RESULTS MAY BE ADVERSELY AFFECTED BY COMPETITION.

The market for telemanagement products and invoice management solutions is fragmented and is intensely competitive. Competition in the industry is generally based on product performance, depth of product line, technical support and price. We compete both with international and local competitors (including providers of telecommunications services), many of whom have significantly greater financial, technical and marketing resources than us. We anticipate continuing competition in the telemanagement products and invoice management solution market and the entrance of new competitors into the market. Our existing and potential customers, including business telephone switching system manufacturers and vendors, may be able to develop telemanagement products and services that are as effective as, or more effective or easier to use than, those offered by us. Such existing and potential competitors may also enjoy substantial advantages over us in terms of research and development expertise, manufacturing efficiency, name recognition, sales and marketing expertise and distribution channels. We may not be able to compete successfully against current or future competitors and that competition may have a material adverse effect on our future revenues and, consequently, on our business, operating results and financial condition.

WE ARE SUBJECT TO RISKS ASSOCIATED WITH RAPID TECHNOLOGICAL CHANGE AND RISKS ASSOCIATED WITH NEW VERSIONS AND NEW PRODUCTS.

The information and telecommunication service providers market in which we compete is characterized by rapid technological change, introductions of new products, changes in customer demands and evolving industry standards. Our future success will depend upon our ability to keep pace with the technological developments and to timely address the increasingly sophisticated needs of our customers by supporting existing and new telecommunication technologies and services and by developing and introducing enhancements to our current and new products. We may not be successful in developing and marketing enhancements to our products that will respond to technological change, evolving industry standards or customer requirements, we may experience difficulties that could delay or prevent the successful development, introduction and sale of such enhancements or such enhancements may not adequately meet the requirements of the marketplace and achieve any significant degrees of market acceptance. If release dates of any new products or enhancements are delayed or, if when released, they fail to achieve market acceptance, our business, operating results and financial condition would be materially and adversely affected. In addition, the introduction or announcement of new product offerings or enhancements by us or our competitors may cause customers to defer or forgo purchases of current versions of our product, which could have a material adverse effect on our business, operating results and financial condition.

WE MAY NOT BE ABLE TO RETAIN OR ATTRACT KEY MANAGERIAL, TECHNICAL AND RESEARCH AND DEVELOPMENT PERSONNEL WE NEED TO SUCCEED.

Our success has largely depended and will depend in the future on our skilled professional and technical employees. The competition for these employees is intense. We may not be able to retain our present employees, or recruit additional qualified employees as we require them. The loss of any key member of our management team might significantly delay or prevent the achievement of our business or development objectives. Our ability to replace key members of our management team and hire additional skilled personnel in the future might be negatively impacted by the use of restrictive covenants in our industry and market. Any failure to attract and retain key managerial, technical

and research and development personnel could have a material adverse affect on our ability to generate sales, deploy our products or successfully develop new products and enhancements.

THREE OF OUR SHAREHOLDERS ARE IN A POSITION TO CONTROL MATTERS REQUIRING A SHAREHOLDER VOTE.

Mr. Chaim Mer, our Chairman, and his wife, Dora Mer, our Israeli counsel, currently control the vote of approximately 35.05% of our outstanding ordinary shares, and Isaac Ben-Bassat, one of our directors, is the owner of 11.94% of our outstanding ordinary shares. As a result, such persons control and will continue to control the election of our entire Board of Directors other than our two outside directors and generally have the ability to direct our business and affairs.

WE ARE SUBJECT TO RISKS ARISING FROM PRODUCT DEFECTS AND POTENTIAL PRODUCT LIABILITY.

We provide free warranty and support for up to one year for end-users and up to 15 months for our OEM distributors. Our sales agreements typically contain provisions designed to limit our exposure to potential product liability or related claims. The limitation of liability provisions contained in our agreements may not be effective. Our products are used by businesses to reduce communication costs, recover charges payable by third parties, prevent abuse and misuse of telephone networks and converged BSS solutions for ITSPs, and as a result, the sale of products by us may entail the risk of product liability and related claims. A product liability claim brought against us could have a material adverse effect upon our business, operating results and financial condition. Products such as those offered by us may contain undetected errors or failures when first introduced or when new versions are released. Despite our testing and testing by current and potential customers, errors may be found in new products or releases after commencement of commercial shipments. The occurrence of these errors could result in adverse publicity, loss of or delay in market acceptance or claims by customers against us, any of which could have a material adverse effect upon our business, operating results and financial condition.

RISK FACTORS RELATED TO OUR ORDINARY SHARES

WE MAY IN THE FUTURE BE CLASSIFIED AS A PASSIVE FOREIGN INVESTMENT COMPANY, OR PFIC, WHICH WILL SUBJECT OUR U.S. INVESTORS TO ADVERSE TAX RULES.

Holders of our ordinary shares who are United States residents face income tax risks. There is a substantial risk that we may become a passive foreign investment company, commonly referred to as PFIC. Our treatment as a PFIC could result in a reduction in the after-tax return to the holders of our ordinary shares and would likely cause a reduction in the value of such shares. For U.S. Federal income tax purposes, we will be classified as a PFIC for any taxable year in which either (i) 75% or more of our gross income is passive income, or (ii) at least 50% of the average value of all of our assets for the taxable year produce or are held for the production of passive income. For this purpose, cash is considered to be an asset, which produces passive income. As a result of our relatively substantial cash position at the time, we believe that we were a PFIC in certain periods over the last few years under a literal application of the asset test described above, which looks solely to the market value of our assets. We do not believe that we were a PFIC in 2006. If we are classified in the future as a PFIC for U.S. federal income tax purposes, highly complex rules would apply to U.S. Holders owning ordinary shares. Accordingly, you are urged to consult your tax advisors regarding the application of such rules.

OUR SHARE PRICE HAS BEEN VOLATILE IN THE PAST AND MAY DECLINE IN THE FUTURE.

Our ordinary shares have experienced significant market price and volume fluctuations in the past and may experience significant market price and volume fluctuations in the future in response to factors such as the following, some of which are beyond our control:

- quarterly variations in our operating results;

- operating results that vary from the expectations of securities analysts and investors;
- changes in expectations as to our future financial performance, including financial estimates by investors;
- announcements of technological innovations or new products by us or our competitors;
- announcements by us or our competitors of significant contracts, acquisitions, strategic partnerships, joint ventures or capital commitments;
- announcements by third parties of significant claims or proceedings against us;
- changes in the status of our intellectual property rights;
- additions or departures of key personnel;
- future sales of our ordinary shares; and
- general stock market prices and volume fluctuations.

Domestic and international stock markets often experience extreme price and volume fluctuations. Market fluctuations, as well as general political and economic conditions, such as a recession or interest rate or currency rate fluctuations or political events or hostilities in or surrounding Israel, could adversely affect the market price of our ordinary shares.

In the past, securities class action litigation has often been brought against a company following periods of volatility in the market price of its securities. We may in the future be the target of similar litigation. Securities litigation could result in substantial costs and divert management's attention and resources.

WE DO NOT EXPECT TO DISTRIBUTE CASH DIVIDENDS.

We do not anticipate paying cash dividends in the foreseeable future. According to the Israeli Companies Law, a company may distribute dividends out of its profits (within the meaning of the Israeli Companies Law), so long as the company reasonably believes that such dividend distribution will not prevent the company from paying all its current and future debts. The declaration of dividends is subject to the discretion of our Board of Directors and will depend on various factors, including our operating results, financial condition, future prospects and any other factors deemed relevant by our board of directors. You should not rely on an investment in our company if you require dividend income from your investment in our company. The success of your investment will likely depend entirely upon any future appreciation of the market price of our ordinary shares, which is uncertain and unpredictable. There is no guarantee that our

ordinary shares will appreciate in value or even maintain the price at which you purchased your ordinary shares.

COMPLIANCE WITH CORPORATE GOVERNANCE REGULATIONS COULD INCREASE THE COST OF OUR OPERATIONS.

As a result of changing laws, regulations and standards relating to accounting, corporate governance and public disclosure, the costs of being a public company in general have increased in recent years. The Sarbanes-Oxley Act of 2002 requires changes in some of our corporate governance and securities disclosure or compliance practices. We expect that the on-going implementation of these regulations will further increase our legal compliance costs and will make some activities more time consuming. We are presently evaluating and monitoring regulatory developments and cannot estimate the magnitude of additional costs we may incur as a result of such developments. In connection with our future implementation of Section 404 of the Sarbanes-Oxley Act of 2002, which governs internal controls and procedures for financial reporting, we have expended and will need to further expend significant management time and financial resources to comply with the applicable requirements. This and other proposed legislation may increase the fees of our professional advisors and our insurance premiums.

RISKS RELATING TO OPERATIONS IN ISRAEL

CONDUCTING BUSINESS IN ISRAEL ENTAILS SPECIAL RISKS.

We are incorporated under the laws of, and our principal executive offices and manufacturing and research and development facilities are located in, the State of Israel. As a result, the political, economic and military conditions affecting Israel directly influence us. Any major hostilities involving Israel, a full or partial mobilization of the reserve forces of the Israeli army, the interruption or curtailment of trade between Israel and its present trading partners, or a significant downturn in the economic or financial condition of Israel could have a material adverse effect on our business, financial condition and results of operations.

Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors, and a state of hostility, varying from time to time in intensity and degree, has led to security and economic problems for Israel. Although Israel has entered into various agreements with Egypt, Jordan and the Palestinian Authority, there has been an increase in unrest and terrorist activity in Israel, which began in September 2000 and which has continued with varying levels of severity through 2006. In July 2006, an armed conflict began between Israel and Hezbollah forces in Lebanon, which involved rocket attacks on populated areas in the northern parts of Israel. On August 14, 2006, a cease-fire between Hezbollah and Israel took effect. This situation has had an adverse effect on Israel's economy, primarily in the geographical areas directly harmed by this conflict. Any future armed conflict, political instability or violence in the region may have a negative effect on our business condition, harm our results of operations and adversely affect our share price. No predictions can be made as to whether or when a final resolution of the area's problems will be achieved or the nature thereof and to what extent the situation will impact Israel's economic development or our operations.

Furthermore, there are a number of countries, primarily in the Middle East, as well as Malaysia and Indonesia, that restrict business with Israel or Israeli

companies, and we are precluded from marketing our products to these countries. Restrictive laws or policies directed towards Israel or Israeli businesses may have an adverse impact on our operations, our financial results or the expansion of our business.

OUR RESULTS OF OPERATIONS MAY BE NEGATIVELY AFFECTED BY THE OBLIGATION OF OUR PERSONNEL TO PERFORM MILITARY SERVICE.

Many of our directors, officers and employees in Israel are obligated to perform annual reserve duty in the Israeli Defense Forces and may be called for active duty under emergency circumstances at any time. If a military conflict or war arises, these individuals could be required to serve in the military for extended periods of time. Our operations could be disrupted by the absence for a significant period of one or more of our executive officers or key employees or a significant number of other employees due to military service. Any disruption in our operations could adversely affect our business.

OUR FINANCIAL RESULTS MAY BE ADVERSELY AFFECTED BY INFLATION AND CURRENCY FLUCTUATIONS.

Since we report our financial results in dollars, fluctuations in rates of exchange between the dollar and non-dollar currencies may affect our results of operations. A significant amount of our expenses are paid in NIS (primarily salaries) and are influenced by the timing of, and the extent to which, any increase in the rate of inflation in Israel over the rate of inflation in the United States is not offset by the devaluation of the NIS in relation to the dollar. Our dollar costs in Israel will increase if inflation in Israel exceeds the devaluation of the NIS against the dollar or if the timing of such devaluation lags behind inflation in Israel. Over time, the NIS has been devalued against the dollar, generally reflecting inflation rate differentials. We cannot predict any future trends in the rate of inflation in Israel or the rate of devaluation of the NIS against the dollar. If the dollar cost of our operations in Israel increases, our dollar measured results of operations will be adversely affected. Likewise, our operations could be adversely affected if we are unable to guard against currency fluctuations in the future.

THE GOVERNMENT PROGRAMS AND TAX BENEFITS WE CURRENTLY PARTICIPATE IN OR RECEIVE REQUIRE US TO MEET SEVERAL CONDITIONS AND MAY BE TERMINATED OR REDUCED IN THE FUTURE.

We have benefited from certain Israeli Government grants, programs and tax benefits. In late 2005 and early 2006 and 2007, we applied to the Office of the Chief Scientist of the Israeli Ministry of Industry, Trade and Labor for grants for our research and development projects. We received an approval for the 2005 and 2006 applications and our two 2007 applications are currently pending. The 2007 grant applications may not be approved by the Office of the Chief Scientist and we may not be able to obtain any such grants in the future. To remain eligible for these grants, programs and tax benefits, we must comply with certain conditions, including making specified investments in fixed assets from our own equity and paying royalties with respect to grants received. In addition, some of these programs restrict our ability to manufacture particular products and to transfer particular technology outside of Israel. If we do not meet these conditions in the future, the benefits we received could be canceled and we may have to refund payments previously received under these programs or pay increased taxes. The Government of Israel has reduced the benefits available under these programs in recent years and these programs and tax benefits may be discontinued or curtailed in the future.

SERVICE AND ENFORCEMENT OF LEGAL PROCESS ON US AND OUR DIRECTORS AND OFFICERS MAY BE DIFFICULT TO OBTAIN.

Service of process upon our directors and officers and the Israeli experts named herein, most of whom reside outside the United States, may be difficult to obtain within the United States. Furthermore, since substantially all of our assets, most of our directors and officers and the Israeli experts named herein are located outside the United States, any judgment obtained in the United States against us or these individuals or entities may not be collectible within the United States.

There is doubt as to the enforceability of civil liabilities under the Securities Act and the Securities Exchange Act in original actions instituted in Israel. However, subject to certain time limitations and other conditions, Israeli courts may enforce final judgments of United States courts for liquidated amounts in civil matters, including judgments based upon the civil liability provisions of those Acts.

PROVISIONS OF ISRAELI LAW MAY DELAY, PREVENT OR MAKE DIFFICULT OUR ACQUISITION BY A THIRD-PARTY, WHICH COULD PREVENT A CHANGE OF CONTROL AND THEREFORE DEPRESS THE PRICE OF OUR SHARES.

Provisions of Israeli corporate and tax law may have the effect of delaying, preventing or making more difficult a merger with, or other acquisition of, us. This could cause our ordinary shares to trade at prices below the price for which third parties might be willing to pay to gain control of us. Third parties who are otherwise willing to pay a premium over prevailing market prices to gain control of us may be unable or unwilling to do so because of these provisions of Israeli law.

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, each 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 on, among other things, amendments to a company's articles of association, increases in a company's authorized share capital, mergers and interested party transactions requiring shareholder approval. In addition, a controlling shareholder of an Israeli company or a shareholder who knows that it possesses the power to determine the outcome of a shareholder vote or who has the power to appoint or prevent the appointment of a director or officer in the company has a duty of fairness toward the company. However, Israeli law does not define the substance of this duty of fairness. Because Israeli corporate law has undergone extensive revision in recent years, 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 THE NASDAQ CAPITAL

MARKET, WE MAY FOLLOW CERTAIN HOME COUNTRY CORPORATE GOVERNANCE PRACTICES INSTEAD OF CERTAIN NASDAQ REQUIREMENTS.

As a foreign private issuer whose shares are listed on the NASDAQ Capital Market, we are permitted to follow certain home country corporate governance practices instead of certain requirements of the NASDAQ Marketplace Rules, including the composition of our Board of Directors, director nomination procedure, compensation of officers, distribution of annual reports to shareholders and quorum at shareholders meetings. In addition, we may follow Israeli law instead of the NASDAQ Marketplace Rules that require that we obtain shareholder approval for certain dilutive events, such as for the establishment or amendment of certain equity based compensation plans, an issuance that will result in a change of control of our company, certain transactions other than a public offering involving issuances of a 20% or more interest in our company and certain acquisitions of the stock or assets of another company. Currently, we follow Israeli law and practice instead of the NASDAQ requirements with respect to the directors' nomination process.

ITEM 4. INFORMATION ON THE COMPANY

A. HISTORY AND DEVELOPMENT OF THE COMPANY

Our company was incorporated under the laws of the State of Israel in December 1995. We are a public limited liability company under the Israeli Companies Law 5739-1999 and operate under such law and associated legislation. Our registered offices and principal place of business are located at 22 Zarhin Street, Ra'anana 43662, Israel, and our telephone number is +972-9-762-1777. Our address on the Internet is www.mtsint.com. The information on our website is not incorporated by reference into this annual report.

We are a worldwide provider of solutions for telecommunications expense management, or TEM, used by enterprises, and business support systems, or BSS, used by information and telecommunication service providers, or ITSPs. Our TEM solutions assist enterprises and organizations to make smarter choices with their telecommunications spending at each stage of the service lifecycle, including allocation of cost, proactive budget control, fraud detection, processing of payments and spending forecasting. Our TEM solutions support our clients on an ongoing basis with both sophisticated software applications and a variety of managed services relationship models. Our converged BSS solutions for ITSPs have been successfully implemented worldwide by wireless providers, Voice over Internet Protocol, Internet Protocol Television, and content service providers. Our converged BSS solutions include applications for charging and invoicing customers, interconnect billing and partner revenue management using pre-pay and post-pay schemes. Our pre-configured BSS solutions have been designed to be implemented quickly and are competitively priced.

Call accounting systems afford businesses easy access to complete information on telephone usage, including the dialed number, calling extension, call duration, time of day, destination, trunk line usage, cost of each call and multi-carrier analysis. We started developing the TABS line of call accounting products for the DOS operating system and have upgraded and re-written our call accounting and management systems as the industry and technology advanced providing full compatibility to support the Windows operating systems and most versions of Windows NT. As our sales of TABS were worldwide, we needed to have a flexible and easily updated set of pricing tables to accommodate the different pricing schemes and modes used worldwide and with different carriers. As enterprises expanded and required information from their remote sites, so TABS has expanded to accommodate their needs by providing multi-site solutions and supporting most business telephone switching systems currently available for sale. The TABS solutions are capable of monitoring up to 100,000 extensions. The Application Suite provides for an unlimited number of extensions, subject to the capabilities of the customer's hardware, as well as an unlimited number of

remote sites. The sites can be monitored from a browser at any point as the application is web based. Various modules were developed to service the needs of different vertical markets such as our Property Management System interface, or PMSi, module for the hotel industry and a solution for performing tie-line reconciliation for organizations and utilities having multiple PBXs. TRAK-View, our fault management system, provides an enterprise with early warning problem detection and prevention for multi-site and multi-vendor networks including PBXs. In 1998, we introduced IP.TRAK, a Web-based call accounting and management system that was built on the original model and principles of TABSweb. IP.TRAK was designed to harness the power of the Internet for the needs of information technology managers through its ability to access reports using a standard Internet browser. We added additional modules to IP TRAK that could collect the information from routers, firewalls and gateways. These additional modules provided tools for a comprehensive communications management system. We were able to collect additional data from files, file transfer protocol (FTP) servers, VoIP, and external buffers. We subsequently merged the functionality of PBX systems and IP networks to provide a unified management solution for multiple communication platforms from different vendors supporting voice, VoIP, video and data communications. The functionality of IP TRAK was subsequently superseded by the enhanced Application Suite.

We operate in five geographical areas. Our operations in Israel include research and development, sales, marketing and support. Our operations in the United States, Brazil, Europe and Asia include sales, marketing and customer service.

On April 24, 2000, we acquired all of the assets and assumed certain liabilities of IntegraTRAK Inc., a privately held Seattle-based company, engaged in the development and sale of packaged computer software for tracking telephone calls and costs.

In 2001, we developed our Web Access module that provides access and control to the communications usage database, under strict control and privacy, from anywhere on the web. During the second quarter of 2002, we added FaciliTRAK, which is a comprehensive software system that greatly simplifies the day-to-day task of maintaining and managing the physical layer details for any network. FaciliTRAK allows the user to record the equipment, cables, and pathways for the cable plant and define the connectivity and circuit routes. A user can utilize FaciliTRAK to plan and manage the moves and changes within his or her organization with the aid of the self-documenting service desk functions. The FaciliTRAK system is an essential tool for any enterprise that is thinking of implementing a disaster recovery program.

In December 2004, we completed the acquisition of certain assets and liabilities of Teleknowledge Group Ltd., or Teleknowledge, a provider of carrier class billing and related solutions. In connection with the acquisition, we paid an initial consideration of $2.374 million in cash and agreed to pay additional contingent consideration of up to $3.65 million over a period of three years based on post acquisition revenue performance. The acquisition of the Teleknowledge billing solution enables us to offer an end-to-end customer care and billing solution, including pre/post paid billing, Web self-care, assets management, partner management, help desk and order management modules.

During 2005, we conducted extensive research and development so that our products and solutions could operate in the high-end enterprise market. As a result, an advanced TEM module was developed, based on our Application Suite infrastructure. The modular and scalable architecture topology of our

Application Suite lends itself easily to an open platform where modules can be added and integrated seamlessly into the platform, thus allowing customers to buy such modules as they require.

In addition, in 2005 we strengthened our product offerings to the service provider and carrier market as a result of our release of a new billing solution module that we acquired from Teleknowledge and through significant investment in research and development in order to provide a complete end-to-end billing solution for the wholesale trade. As a result, we introduced an interconnect billing solution and our retail billing solution was expanded to accommodate legacy telephony that carriers can use to bill their subscribers. Also, new value-added services (such as video-on-demand (VOD), multimedia message service, short message service (SMS)) and content (such as news and games) were added to our billing solutions package. We believe that an advantage of our solutions is that they operate off a single data base. We also introduced a partner revenue management module to our billing solutions product, which complements our product line by enabling carriers to reconcile bills among one another.

During 2006, we enhanced our interconnect billing solution to include a sophisticated and user-friendly rate loader, that automatically loads the rates from the various Excel sheets that service providers receive and provides a composite picture of the rates.

In 2006, we also developed solutions for mobile phones based on a patent for which we have filed an international patent application (PCT application), which is currently pending, to track and account for calls made from a mobile phone. One of the solutions provides for reconciliation of calls made from a mobile phone independent of the service provider and is intended for enterprises to check and monitor calls made from mobile phones of their employees. Another solution, Wireless Leak Detector, is intended for service providers to ascertain that all calls made from a mobile phone have been accounted for and charged.

Another development in 2006 was the introduction of our Invoice Management as a stand-alone solution that allows for tracking of vendors, invoices, assets and contracts both for pricing and maintenance, with the ultimate objective of reconciling the invoices for payment or dispute. The solution can be purchased by an enterprise for their own accounting, or outsourced as an Application Service Provider (ASP).

On July 31, 2006, we completed the acquisition of certain assets and liabilities of TelSoft, a California corporation, a provider of call accounting and TEM solutions. The TelSoft products offer a complementary solution to our products. In connection with the acquisition, we paid an initial consideration of $1.1 million and agreed to pay additional contingent consideration based on post acquisition revenue performance during the 12 month period following the acquisition. We believe that the acquisition of TelSoft's TEM and call accounting software will enable us to expand our TEM solutions and will assist us to strengthen our growing business in the United States.

On February 6, 2006, our board of directors approved the sale of all of the shares of TABS Brazil Ltda., our wholly-owned subsidiary in Brazil, to certain Brazilian individuals for an aggregate of $334,850. The purchase price shall be paid in 60 installments, with the first installment, in the sum of $66,972, being due and payable on January 1, 2008, and the remaining balance in equal monthly installments of $5,581 each.

B. BUSINESS OVERVIEW

INDUSTRY BACKGROUND

Technological advances and worldwide deregulation and privatization in the telecommunications industry have resulted in the growth of alternative telecommunication services providers, such as cellular companies, competitive access providers, cable companies and data transmission companies. This growth, in conjunction with dramatic improvements in computing and communications technology, including the convergence of telephony systems and computers, or computer telephony integration, has fostered the rapid expansion of communication services and an increase in the volume of voice and data traffic by business organizations. The diversification of services and providers using varied pricing algorithms and the proliferation of domestic and international networks using varied equipment and technologies for different services and modes of transmission has placed new demands on telecommunication and information technology managers and has created the need for sophisticated and flexible telecommunication management solutions. This has created a demand for telemanagement solutions that are capable of supporting multiple sites, switching platforms, languages and currencies, as well as the generation of telecommunications usage information vital to an enterprise's operations.

Telemanagement solutions have evolved from the stand-alone PC-based telephone call accounting and billing systems of the mid-1980's to local area network or LAN-based systems offering call accounting, fraud detection and fault management solutions for users with complex voice and data networks. Today, the trend is moving more and more to web-based solutions, and to converged solutions where all expenses associated with the usage of a person or device are shown in one report or invoice.

Call accounting products, a fundamental management tool, record, retrieve and process data received from a PBX or other telephone switching system, providing a telecommunications manager with information on telephone usage. This information enables managers to optimize an enterprise's telecommunications resources and reduce communication expenses, typically the second or third highest administrative expense of a business, through cost-tracking and management awareness.

As the trend continues toward enterprises utilizing one infrastructure for both voice and data services, more and more emphasis will be placed on finding efficient solutions to cope with the increasing demand on network resources and for reducing congestion. Enterprises have been required to buy additional communications resources to meet this demand immediately rather than optimizing their existing networks due to the time consuming nature of such projects. Information technology managers are constantly trying to justify the ever increasing expenses created by managing the enormous amount of data that is being transmitted through the Internet.

The abuse and misuse of telephone and data networks, either by employees making unauthorized telephone calls or by outside "hackers" who tap into an organization's long distance service has become a major problem for organizations resulting in great losses. Likewise, employees surfing the web for private use during working hours overloads the network, preventing critical tasks from getting through as well as reducing the overall productivity of the enterprise. These losses have led to the development of intelligent toll fraud detection systems that immediately alert or initiate preventive measures upon detecting a suspicious occurrence in network usage traffic.

Organizations with multiple PBXs and providers of maintenance services require systems that are capable of alerting telecommunications managers of impending or actual problems in a communications network. Financial and operational benefits of a fault management system can be immediate and significant, as down time of the system is reduced due to early problem detection and real information on remote site events. Maintenance costs are significantly lowered through better use of human resources and more efficient inventory management.

In addition, other executives and operational managers are now seeking telemanagement solutions which permit them to assess how efficiently employees are using their time, monitor customer service calls, analyze the effectiveness of marketing expenditures, utilize toll-free responses to determine demographics of callers through the use of caller identification information, know who is using the network and when they are using it, and obtain additional data that aid them in management of the business.

IP telephony and video conferencing are reaching technological maturity and are being adopted by an increasing number of organizations. Enterprises have begun to use the IP platform as a single common telecommunication infrastructure for all services. The convergence of voice, data and video has become commonplace, and there is a trend of data equipment manufacturers and PBX system manufacturers offering platforms that support all services. These developments as well as customer demands will require future management systems to be upgraded to support the convergence of voice, data and video and provide a unified management system that will provide information technology managers with knowledge about the usage of their resources, the ability to ensure the optimal use of these resources and centralized control over their networks.

With today's greater mobility, the need to keep track of moves and changes in an organization requires the use of tools to control, manage and document these changes more effectively. The useful life of a standard cabling structure should be 15 years. This means that existing cables should be able to support an average of three upgrades of communication equipment during its lifetime, plus an average of five changes to all outlets. It is virtually impossible to achieve this performance level without maintaining accurate records reflecting all details of cabling installations.

The continuing increase in use of cellular phones for business, during and outside working hours, has created the need to develop products that will enable an enterprise to generate a true and full record of all the calls made by its employees, including cellular calls and calls made by calling cards and other charge plans.

Telephony over the Internet, which provides voice communications using the Internet, is now becoming more prevalent. In conjunction with these services is "pre-paid", which allows a customer to buy a certain amount of time (expressed as a function of money) either from the web or through the purchase of a "scratch" card (which contains an account or personal identification number (PIN) and units of time) and debits the account with each usage.

Internet Protocol Television, or IPTV, digital television service delivered using the Internet Protocol over a network infrastructure, is also becoming more prevalent. For IPTV services, BSS are required to be able to offer and charge personalized rates, such as rate per content attributes, bundled package discounts and advice-of-charge according to subscriber's attributes before a service is consumed. In addition, since IPTV service providers rely heavily on

revenues from direct advertising and charge the advertiser by exposures and per click, the BSS for IPTV must be able to identify such events and charge the advertiser accordingly.

PRODUCTS AND SERVICES

We offer a range of TEM solutions for enterprises and BSS solutions for ITSPs, based on our standard platforms which can be adjusted to specific customers' needs and requests, as well as fault management systems for networks and PBXs, and facilities management for cabling and equipment. Additionally, some of our products are geared for communications resellers and as such enable them to issue regular bills for the communications services rendered.

BACKGROUND HISTORY

We were the first company to offer a PC-based non-dedicated call accounting system when we introduced the first version of TABS in 1985. To date, over 70,000 TABS accounting systems have been sold to end-users located in over 80 countries. TABS supports worldwide charging methods (pulse and duration), call pricing tables and currencies and is available in different languages. Our PBX interface database includes default formats for the major PBX manufacturers and business phone systems, including those manufactured by Ericsson, Philips, Siemens, Lucent, Nortel, Alcatel, ECI/Tadiran, Harris, NEC, Avaya, Mitel, Damovo, LG and Panasonic, making TABS compatible with substantially all currently available PBX and business phone systems. Our flexible format allows some of the newer equipment such as VoIP PBXs and routers/gateways to be inputted to and reported on TABS. This includes the RADVision and Cisco gateways and gatekeepers.

CALL ACCOUNTING AND TELECOMMUNICATIONS EXPENSE MANAGEMENT SOLUTIONS FOR ENTERPRISES

TABS.IT

TABS.IT is a solution for small offices, medium sized businesses, and Fortune 500 enterprises that want to take full control over their communications network. Specific applications enable hotels, shared tenant environments, hospitals, universities and service bureaus to resell communications services to users employing simple, yet efficient mark-up formulas.

TABS.IT tracks the details of all voice communications usage (dialed numbers, call duration, destination, cost of each call, trunk line usage, etc.) and produces accurately priced individual customer bills. In addition, TABS.IT tracks the details of all data communications (IP address, name, number of bytes, bandwidth usage, nodes, etc.) and can produce a relative cost figure.

The powerful TABS.IT report generator provides a wide variety of usage reports that are easy to read and understand, yet provide all the information necessary to identify how communications network resources are being utilized. These reports can be generated either as a summary of the call data or complete with all the details necessary to make informed management decisions. Their structural flexibility allows the user to quickly zero in on the specific data of greatest interest. Historical reports may be maintained for an unlimited period of time and can become useful tools for assessing budget needs for the coming months or years.

Version 7 of TABS.IT is fully web-based allowing users to see their own call usage on-line from anywhere, and incorporates most of the features that were offered as separate modules in previous versions. This version is easily adapted to companies that have multiple sites, and would want to view the activity from a central site. The administrative functions can also be performed remotely using Internet Explorer. Full security and privacy is assured by use of

various levels of password protection.

APPLICATION SUITE

The Application Suite is an integrated, customized solution to manage and control the entire communications network. The Application Suite implements and monitors real time performance and usage defined by the organization to maintain budget control, usage performance and system health, and utilized by service providers for converged pre and post paid billing. The system's flexible architecture enables organizations to effectively manage their entire billing process, adding on capabilities as their business grows, in accordance with customer's requests, special projects or market trends. Utilizing its web-based user centric capabilities, the platform provides its users, including administrators, employees, and customers, with a single easy-to-use interface self provisioning customer care, while guaranteeing corporate security via the different authentication levels.

The main functions of the TABS.IT and our prior WinTRAK family of products were incorporated into the Application Suite solution, which supersedes these solutions. In addition, budget control monitoring modules were added to the Application Suite solution to verify that the extensions, departments, cost centers operate within budget, and a credit limit may be assigned.

In 2005, we enhanced and expanded our Application Suite to include an invoice management module. This new module checks the rates billed by the service provider against the contracted rates and also reconciles an organization's telecommunications bills reflecting the usage reported by the service provider with the actual usage recorded by the Application Suite. Additionally, the new module checks that the services provider has charged only for communication equipment actually used by the organization, as opposed to equipment that is no longer serviceable or not under current service contracts. An organization's internal procedures for payment of bills can be entered into the Application Suite and it will track the bills and insure that there are no delays in payments, and in the case of discrepancies between the usage and bills, it will provide an analysis of the discrepancies.

BILLING SOLUTIONS

In today's growing telecommunication services world, operators and service providers must have full control and real-time monitoring capabilities of their expenses and revenues associated with the services provided. To achieve that, telecommunication BSS need to manage all aspects of their business, primarily in three main areas:

- Retail Billing - settlement with the end customer (business or residential) who purchases and consumes the services. Services may be consumed by either online or offline charging methods (supporting postpaid and prepaid scenarios).

- Partner Settlement - settlement of all value added services, or VAS, provided (such as content SMS/MMS, pay-by-mobile services and location-based advertising services). The settlement involves the support of advance business models, such as revenue sharing between the operator/service provider and VAS provider based on the end customer's consumption.

- Interconnect Settlement - settlement between the operator / service

provider and other local or international carriers for the traffic which is transferred between them. The basic goal of an interconnect solution is to produce an invoice for the calls you have delivered for another operator and to validate the invoices received from other operators for the calls they have delivered for you. We believe that obtaining interconnect agreements is essential for new entrants that cannot deliver services without other networks to complete their calls.

To efficiently manage the foregoing business requirements, operational and economical wise, carriers and service providers require a convergent billing platform. This kind of platform should simplify the way in which an operator and service provider settles invoices with its customers and interconnects with value added partners.

Our IPTV solution meets market requirements and may be installed side-by-side with legacy systems and may provide an economic solution to new providers of virtual IPTV services. We believe that partnering with network vendors and system integrators is the most advantageous means to generate sales and to focus our resources on product marketing and software development.

OTHER MODULES

An add-on module, Tie Line Reconciliation, or TLR, provides for the accurate costing of calls in a private PBX network by calculating the actual cost of calls routed over private tie lines and assigning charges to the originating extension. The call is resolved into an accurate origination-destination configuration even though the call may pass many "nodes" along the way, with each potentially discharging an independent call record.

Another add-on module, Property Management System interface, or PMSi, provides an interface protocol and format for telecommunication management systems with hotel billing solutions (Front Office or PMS systems). Through the use of this interface, which can also connect to PBXs, the hotel system is able to control the opening and closing of guest extensions on check in or out.

Another add-on module is our Budget Manager, which allows an administrator to assign credit limits to extensions, departments, cost centers, or any other organizational hierarchy, and monitor whether these limits have been exceeded or the calls remain within their allocated budgets.

CUSTOMER SERVICE AND INSTALLATION

We provide customer support to end-user customers in the United States, Israel, Hong Kong, the Netherlands and Brazil on both a service contract and a per-incident basis. Our technical support engineers answer support calls directly and generally seek to provide same-day responses. We provide updated telephone rate tables to customers on a periodic basis under annual service contracts. The rate tables are obtained from third-party vendors who provide this data for all major long-distance service providers. Our distributors provide a full range of service and technical support functions for our products, including rate tables, to their respective end-user customers.

Our support staff installs our call accounting products at end-user locations, if required, from offices in Israel, the United States, Hong Kong, the Netherlands and Brazil. Our TEM products and BSS solutions are installed by our support staff at the and user locations or remotely from our offices in

Israel, the United States, Hong Kong, the Netherlands and Brazil. Customers who maintain their own technical staffs are generally able to install our call accounting products themselves. We charge our customers a fee for each installation performed by our employees. Our distributors are responsible for the installation and support of our products with respect to their end-user customers.

SALES AND MARKETING

We market our TEM products in over 80 countries worldwide through OEM distribution channels and our own direct sales force in the United States, Europe, Israel, Hong Kong and Brazil, and through a network of local distributors in these and various other countries in Europe, Asia, Africa and Latin America. We market our BSS solutions for ITSPs through next generation telecommunications network solutions suppliers and our own direct sales force. We employed 20 persons in sales and marketing and 29 persons in support as of December 31, 2006, as compared to 18 persons in sales and marketing and 30 persons in support as of December 31, 2005.

With the acquisition of IntegraTRAK in April 2000, our marketing efforts in North America were significantly increased. This also enabled us to acquire additional Fortune 500 companies as our customers. We also sell our products to business telephone switching systems manufacturers and vendors, distributors and PTTs. Since 1985, over 70,000 TABS call accounting products have been sold, many of which have been sold to large organizations. In addition, as customers move to consolidate the management of their multi-site telecommunications activities, we intend to capitalize on our initial successes with our customers and expand the use of our products by offering these organizations the added capabilities of expanding and monitoring on the web. By acquiring the FaciliTRAK software in March 2002, we gained access to a whole new realm of opportunities and we now are able to offer a complete solution to the high-end market sector. With the acquisition of TelSoft in July 2006, our marketing efforts in North America increased. The purchase of TelSoft has enabled us to increase our customer base.

MANAGED SERVICES

Our managed services solution is an outsourcing solution geared to multi-national companies that centrally manage their telecommunications usage and is offered as an added value service. This solution has been offered in the United States where our Seattle office acts as a service bureau.

SWITCHING SYSTEMS MANUFACTURERS AND VENDORS. We believe that the most efficient means of selling our telemanagement products is to enter into relationships with major business telephone system manufacturers and vendors who market our products on either an original equipment manufacturer, or OEM, basis, or supplemental sales basis at the time they sell their switching systems. We also utilize our distributors to market our products to local business telephone switching systems manufacturers and distributors. We intend to establish additional strategic relationships with business telephone switching systems manufacturers and vendors and PTTs. These manufacturers have begun to consider telemanagement capability as a competitive tool when selling their products and have begun to offer end-users a complete, integrated solution. Among the companies that sell our telemanagement products are Siemens, Philips, Ericsson, Lucent, Nortel, Alcatel, ECI/Tadiran, Harris, NEC, Avaya, Mitel, Cisco, Damovo, LG and Panasonic. We have also entered into an agreement with Airspan and another major global manufacturer with respect to our billing products. In addition, we work with gateway providers such as Cisco, Mera, ArelNet and

RADVision. The percentages of sales attributable to our three largest OEM customers, Siemens, Philips and Ericsson, in each of the three years ended December 31, 2006 are as follows:

	2004	2005	2006
Siemens	38.0%	36.0%	29.0%
Philips	5.0%	4.0%	4.0%
Ericsson	4.0%	2.0%	1.0%

DISTRIBUTORS. In general, in those countries where we do not have a marketing subsidiary, we distribute our products through a local distributor. Marketing, sales, training, product and client support are provided by our local distributors. A local distributor is typically a telecommunication products marketing organization with the capability to add value with installation, training, and support. Distributors are generally responsible for the localization of our products into their native language. The distributor also translates our standardized product marketing literature and technical documentation. Prior to becoming an authorized distributor, the distributor's employees must undergo sales and technical training. We are available for second-tier support for the distributor and for end-users. In coordination with the distributors, we also provide technical support for large and multinational accounts. We have distributors worldwide and intend to expand our network of distributors and resellers in selected markets.

PTTS. We also market our products to PTTs (post, telephone and telegraph authorities) who integrate our solutions with the telephone systems they sell or lease to their customers. Among the PTTs who sell our products are Telecom Italy, Cable and Wireless, Trinidad PTT and Hong Kong Telecom.

STRATEGIC RELATIONSHIPS. As part of our marketing strategy, we attempt to develop and establish new strategic relationships with manufacturers of voice and data communication systems and IP based equipment as means of entering new markets and channels. We are also continuing our relationship with RADVision, a recognized IP technology leader. Together with RADVision, we offer solutions consisting of RADVision's Gatekeeper and our advanced web-based call management solution. We also signed an agreement with Cisco, pursuant to which Cisco will certify the use of our VoIP solution in their CallManager call processing software, a key component of Cisco's AVVID (Architecture for Voice, Video and Integrated Data). Our software provides validated reports on call records, start time, duration, and origin and final destination. Additional features include the ability to allocate usage-sensitive call costing and, using an integrated fraud module, detect unauthorized or inappropriate system access.

OTHER MARKETING ACTIVITIES. We are conducting a wide range of marketing activities aimed at generating awareness and leads, including public relations, attendance at trade shows and exhibitions, user conferences, direct mail, response mail and seminars. We have joined alliances with strategic partners such as Avaya, Alcatel and Cisco. We regularly advertise our products in prominent trade publications, and we also participate in major regional and international technology and communications trade shows, forums, and fairs worldwide. These activities are intended both to generate leads and maintain the general public awareness of our products. We maintain our website, allowing for correspondence and queries from new potential customers as well as promoting support for our existing customer base.

COMPETITION

The market for telemanagement products and billing solutions is fragmented and is intensely competitive. Competition in the industry is generally based on product performance, depth of product line, technical support and price. We compete both with international and local competitors (including providers of telecommunications and billing services), many of whom have significantly greater financial, technical and marketing resources than we do. Our existing and potential customers, including business telephone switching system manufacturers and vendors, may be able to develop telemanagement and billing products and services that are as effective as, or more effective or easier to use than, those offered by us. Such existing and potential competitors may also enjoy substantial advantages over us in terms of research and development expertise, manufacturing efficiency, name recognition, sales and marketing expertise and distribution channels. Although we believe that the quality of our products is equal to or better than the product quality of our competitors with regard to performance and reliability, we have no quantitative data other than the evaluations of our present customers from which to assess our current ability to compete. There can be no assurance that we will be able to compete successfully against current or future competitors or that competition will not have a material adverse effect on our future revenues and, consequently, on our business, operating results and financial condition.

INTELLECTUAL PROPERTY RIGHTS

We rely upon a combination of security devices, copyrights, trademarks, patents, trade secret laws, confidentiality procedures and contractual restrictions to protect our rights in our products. In 2005, we filed an international patent application (PCT application), which is currently pending, relating to a mobile verification technique that verifies mobile phone usage against the bill received from the service provider. Our policy has been to pursue copyright protection for our software and related documentation and trademark registration of our product names. Some of our products have the added protection afforded by a hardware component which has embedded software that it is difficult to misappropriate. In addition, our key employees and independent contractors are required to sign non-disclosure and confidentiality agreements. All of the intellectual property rights with respect to our current products are held by Mer Telemanagement Solutions Ltd.

Our trademark rights include rights associated with the use of our trademarks and rights obtained by registration of our trademarks. We have obtained trademark registrations in Israel and the United States. The use and registration rights of our trademarks does not ensure that we have superior rights over other third parties that may have registered or used identical related marks on related goods or services. Trademark rights are territorial in nature; therefore we do not have rights in all jurisdictions.

We believe that, because of the rapid pace of technological change in the communication industry, the legal protections for our products are less significant factors in our success than the knowledge, ability and experience of our employees, the frequency of product enhancements and the timeliness and quality of support services provided by us.

C. ORGANIZATIONAL STRUCTURE

Our wholly owned subsidiaries in the United States, Hong Kong, the Netherlands and Brazil, MTS IntegraTRAK Inc., MTS TelSoft Inc., MTS Asia Ltd., JARAGA B.V. and TABS Brazil Ltda., respectively, act as marketing and customer service organizations in those countries. Our 50% owned affiliate in Spain, Jusan S.A., is engaged in the development, manufacture, assembly, sales, distribution and maintenance of vocal server and call billing applications.

D. PROPERTY, PLANTS AND EQUIPMENT

Our executive offices and research and development facilities are located at 22 Zarhin Street, Ra'anana, Israel, where we occupy approximately 16,300 square feet. The lease, which expires on June 15, 2010, has an annual rental charge of approximately $400,000. We have subleased approximately 4,400 square feet of this space until June 15, 2010 for an annual rental charge of approximately $100,000.

Our U.S. subsidiary occupies approximately 2,314 square feet of space in Kirkland, Washington. The lease, which will expire in October 2008, has an annual rental charge of approximately $51,000.

In addition, we have an office in New Jersey, where we occupy approximately 2,150 square feet of space. The lease, which will expire in July 31, 2007, has a remaining obligation of approximately $14,000.

We also have an office in Glendale, California, where we occupy approximately 2,340 square feet of space. The lease is on a month-to-month basis for a rental fee of $4,267 per month.

The combined total annual rental cost for our Hong Kong and Sao Paulo offices is approximately $43,000. The lease agreements for these premises will expire in October 2007 and August 2008, respectively.

ITEM 4A. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

A. OPERATING RESULTS

THE FOLLOWING DISCUSSION OF OUR RESULTS OF OPERATIONS SHOULD BE READ TOGETHER WITH OUR CONSOLIDATED FINANCIAL STATEMENTS AND THE RELATED NOTES, WHICH APPEAR ELSEWHERE IN THIS ANNUAL REPORT. THE FOLLOWING DISCUSSION CONTAINS FORWARD-LOOKING STATEMENTS THAT REFLECT OUR CURRENT PLANS, ESTIMATES AND BELIEFS AND INVOLVE RISKS AND UNCERTAINTIES. OUR ACTUAL RESULTS MAY DIFFER MATERIALLY FROM THOSE DISCUSSED IN THE FORWARD-LOOKING STATEMENTS. FACTORS THAT COULD CAUSE OR CONTRIBUTE TO SUCH DIFFERENCES INCLUDE THOSE DISCUSSED BELOW AND ELSEWHERE IN THIS ANNUAL REPORT.

BACKGROUND

We were incorporated under the laws of the State of Israel in December 1995, as a subsidiary of C.Mer Industries Ltd., an Israeli public company. Since our initial public offering in May 1997, our ordinary shares have been listed on the NASDAQ Stock Market. In June 1999, C.Mer Industries Ltd. distributed to its shareholders all of its remaining shares in our company as a dividend.

We have wholly-owned subsidiaries in the United States, Hong Kong, the Netherlands and Brazil, MTS IntegraTRAK Inc., MTS TelSoft Inc., MTS Asia Ltd., JARAGA B.V. and TABS Brazil Ltda., respectively, which act as marketing and customer service organizations in those countries. We also have a 50% owned affiliate in Spain, Jusan S.A., which is engaged in the development, manufacture, assembly, sales, distribution and maintenance of vocal server and call billing applications.

OVERVIEW

We are a worldwide provider of solutions for TEM used by enterprises and BSS used by ITSPs. Our TEM solutions assist enterprises and organizations to make smarter choices with their telecommunications spending at each stage of the service lifecycle, including allocation of cost, proactive budget control, fraud detection, processing of payments and spending forecasting. Our TEM solutions support our clients on an ongoing basis with both sophisticated software applications and a variety of managed services relationship models. Our converged BSS solutions for ITSPs have been successfully implemented worldwide by wireless providers, Voice over Internet Protocol, Internet Protocol Television, and content service providers. Our converged BSS solutions include applications for charging and invoicing customers, interconnect billing and partner revenue management using pre-pay and post-pay schemes. Our pre-configured BSS solutions have been designed to be implemented quickly and are competitively priced.

On July 31, 2006, we completed the acquisition of certain assets and liabilities of TelSoft, a California corporation, a provider of call accounting and TEM products. The TelSoft products offer a complementary solution to our products. In connection with the acquisition, we paid an initial consideration of $1.1 million and agreed to pay additional contingent consideration based on post acquisition revenue performance during the 12 month period following the acquisition. We believe that the acquisition of TelSoft's TEM and call accounting software will enable us to expand our TEM solutions and will assist us to strengthen our growing business in the United States.

GENERAL

Our consolidated financial statements appearing in this annual report are prepared in U.S. dollars and in accordance with generally accepted accounting principles in the United States, or U.S. GAAP. Transactions and balances originally denominated in dollars are presented at their original amounts. Transactions and balances in other currencies are remeasured into dollars in accordance with the principles set forth in Financial Accounting Standards Board Statement No. 52. The majority of our sales are made outside Israel in dollars. In addition, substantial portions of our costs are incurred in dollars. Since the dollar is the primary currency of the economic environment in which we and certain of our subsidiaries operate, the dollar is our functional and reporting currency and, accordingly, monetary accounts maintained in currencies other than the dollar are remeasured using the foreign exchange rate at the balance sheet date. Operational accounts and non-monetary balance sheet accounts are measured and recorded at the exchange rate in effect at the date of the transaction. The financial statements of certain subsidiaries and an affiliate whose functional currency is not the dollar, have been translated into dollars. All balance sheet accounts have been translated using the exchange rates in effect at the balance sheet date. Statement of operations amounts have been translated using the average exchange rate for the period. The resulting translation adjustments are reported as a component of shareholders' equity in accumulated other comprehensive income (loss).

DISCUSSION OF CRITICAL ACCOUNTING POLICIES AND ESTIMATIONS

The preparation of financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of

contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and the use of different assumptions would likely result in materially different results of operations.

Critical accounting policies are those that are both most important to the portrayal of a company's financial position and results of operations, and require management's most difficult, subjective or complex judgments. Although not all of our significant accounting policies require management to make difficult, subjective or complex judgments or estimates, the following policies and estimates are those that we deem most critical:

REVENUE RECOGNITION. We account for our revenue in accordance with the provisions of SOP No. 97-2, "Software Revenue Recognition," issued by the American Institute of Certified Public Accountants and as amended by SOP No. 98-9 and related interpretations. When an arrangement does not require significant production, modification or customization of software or does not contain services considered to be essential to the functionality of the software, revenue is recognized when the following four criteria are met:

- Persuasive evidence of an arrangement exists. We require evidence of an agreement with a customer specifying the terms and conditions of the products or services to be delivered typically in the form of a purchase order or the customer's signature on our proposal;

- Delivery has occurred. For software licenses, delivery takes place when the software is installed on site or remotely or is shipped via mail on a compact disc or server. For services, delivery takes place as the services are provided;

- The fee is fixed or determinable. Fees are fixed or determinable if they are not subject to a refund or cancellation and do not have payment terms that exceed our customary payment terms; and

- Collection is probable. We perform a credit review of all customers with significant transactions to determine whether a customer is credit worthy and collection is probable.

In general, revenue for transactions that do not involve software customization or services considered essential to the functionality of the software is recognized as follows: (i) software license fees for sales through OEMs are recognized upon receipt of license activity reports; (ii) all other software license fees are recognized upon delivery of the software; (iii) software maintenance and technical support are recognized ratably over the contract term; and (iv) consulting, training and other similar services are recognized as the services are performed.

We exercise judgment and use estimates in connection with the determination of the amount of product software license and services revenues to be recognized in each accounting period. If the fee due from the customer is not fixed or determinable, revenue is recognized as payments become due from the customer. If collection is not considered probable, revenue is recognized when the fee is collected. We record a provision to operating expenses for bad debts resulting from customers' inability to pay for the products or services they have received. These estimates are based on historical bad debt expense, analyses of credit memo data, and other known factors, such as bankruptcy. If the historical data we use to calculate these estimates do not accurately reflect future

returns or bad debts, adjustments to these reserves may be required that would increase or decrease revenue or net income.

Many of our software arrangements involve multiple elements. Such elements typically include any or all of the following: software licenses, software maintenance, technical support and training services. For multiple-element arrangements that do not involve significant modification or customization of the software and do not involve services that are considered essential to the functionality of the software, we allocate value to each undelivered element based on vendor specific objective evidence, or VSOE, of the fair value of each undelivered element in the arrangement, in accordance with the "residual method" prescribed by SOP No. 98-9, "Modification of SOP No. 97-2, Software Revenue Recognition With Respect to Certain Transactions." The VSOE used by us to allocate the sales price to support services and maintenance is based on the renewal rate charged when these elements are sold separately. License revenues are recorded based on the residual method. Under the residual method, revenue is recognized for the delivered elements when (i) there is VSOE of the fair values of all the undelivered elements, and (ii) all revenue recognition criteria of SOP No. 97-2, as amended, as described above, are satisfied. Under the residual method any discount in the arrangement is allocated to the delivered element.

Revenues from billing products which involve significant customization of our software to customer specific specifications are recognized in accordance with SOP No. 81-1, "Accounting for Performance of Construction-Type and Certain Production-Type Contracts," using contract accounting on a percentage of completion method, over the period from signing of the license through to customer acceptance in accordance with the "input method." The amount of revenue recognized is based on the total license fees under the license agreement and the percentage to completion achieved. The percentage to completion is measured by monitoring progress using records of actual costs incurred to date in the project compared with the total estimated project requirements. Estimates of total project requirements are based on prior experience of customization, delivery and acceptance of the same or similar technology and are reviewed and updated regularly by management.

Where arrangements recognized according to SOP No. 81-1 involve maintenance and support services, revenues are recognized according to Emerging Issues Task Force, or EITF, Issue No. 00-21, "Revenues Arrangements with Multiply Deliveries," or EITF 00-21. According to EITF 00-21, a multiple-element arrangement (an arrangement that involves the delivery or performance of multiple products, services and/or rights to use assets) is separated into more than one unit of accounting, if the functionality of the delivered element is not dependent on the undelivered element, there is VSOE of fair value of the undelivered element and delivery of the delivered element represents the culmination of the earnings process for this element. We have established VSOE for maintenance and support services based on the renewal rate that will be charged when these elements are sold separately and therefore the arrangement consideration is allocated to maintenance and support services based on their relative VSOE.

After delivery, if uncertainty exists about customer acceptance of the software, license revenue is not recognized until acceptance. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are first determined, in the amount of the estimated loss on the entire contract. As of December 31, 2006, no such estimated losses were identified.

Estimated gross profit or loss from long-term contracts may change due to

changes in estimates resulting from differences between actual performance and original forecasts. Such changes in estimated gross profit are recorded in results of operations when they are reasonably determinable by management, on a cumulative catch-up basis.

We believe that the use of the percentage of completion method is appropriate as we have the ability to make reasonably dependable estimates of the extent of progress towards completion, contract revenues and contract costs. In addition, contracts executed include provisions that clearly specify the enforceable rights regarding services to be provided and received by the parties to the contracts, the consideration to be exchanged and the manner and terms of settlement. In all cases we expect to perform our contractual obligations and our licensees are expected to satisfy their obligations under the contract.

ALLOWANCES FOR DOUBTFUL ACCOUNTS. We perform ongoing credit evaluations of our customers' financial condition and we require collateral as deemed necessary. We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make payments. In judging the adequacy of the allowance for doubtful accounts, we consider multiple factors including the aging of our receivables, historical bad debt experience and the general economic environment. Management applies considerable judgment in assessing the realization of receivables, including assessing the probability of collection and the current credit worthiness of each customer. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

INCOME TAXES. Estimates and judgments are required in the calculation of certain tax liabilities and in the determination of the recoverability of certain of the deferred tax assets, which arise from net operating losses tax carryforwards and temporary differences between the tax and financial statement recognition of revenue and expense. Statement of Financial Accounting Standards, or SFAS, No. 109, "Accounting for Income Taxes," also requires that the deferred tax assets be reduced by a valuation allowance, if based on the weight of available evidence, it is more likely than not that some portion or all of the recorded deferred tax assets will not be realized in future periods.

In evaluating our ability to recover our deferred tax assets, in full or in part, we consider all available positive and negative evidence including our past operating results, the existence of cumulative losses in the most recent fiscal years and our forecast of future taxable income on a jurisdiction by jurisdiction basis. In determining future taxable income, we are responsible for assumptions utilized, including the amount of Israeli and international pre-tax operating income, the reversal of temporary differences and the implementation of feasible and prudent tax planning strategies. These assumptions require significant judgment about the forecasts of future taxable income and are consistent with the plans and estimates we use to manage the underlying businesses.

Based on estimates of future taxable profits and losses in certain foreign tax jurisdictions, we determined that a valuation allowance of $2.9 million was required for tax loss carryforwards and other temporary differences as of December 31, 2006. If these estimates prove inaccurate, a change in the valuation allowance could be required in the future.

CONTINGENCIES. We are involved in legal proceedings and other claims from time to time. We are required to assess the likelihood of any adverse judgments or outcomes to these matters, as well as potential ranges of probable losses. A

determination of the amount of reserves required, if any, for any contingencies are made after careful analysis of each individual claim. The required reserves may change due to future developments in each matter or changes in approach, such as a change in the settlement strategy in dealing with any contingencies, which may result in higher net loss. If actual results are not consistent with our assumptions and judgments, we may be exposed to gains or losses that could be material. See "Item 8A. Financial Information - Consolidated Statements and Other Financial Information - Legal Proceedings."

IMPAIRMENT OF LONG-LIVED ASSETS. We review our long-lived assets and certain identifiable intangible assets for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors that could indicate an impairment include significant underperformance of the asset as compared to historical or projected future operating results, significant changes in the actual or intended use of the asset, or significant negative industry or economic trends. When we determine that the carrying value of an asset may not be recoverable, the related estimated future undiscounted cash flows expected to result from the use and eventual disposition of the asset are compared to the carrying value of the asset. If the sum of the estimated undiscounted future cash flows is less than the carrying amount, we record an impairment charge based on the difference between the carrying value of the asset and its fair value, which we estimate based on discounted expected future cash flows. In determining whether an asset is impaired, we must make assumptions regarding recoverability of costs, estimated future cash flows from the asset, intended use of the asset and other related factors. If these estimates or their related assumptions change, we may be required to record impairment charges for these assets. As of December 31, 2006, no impairment losses have been identified.

GOODWILL. We have recorded goodwill as a result of acquisitions. Goodwill is not amortized, but rather is subject to an annual impairment test. Statement of Financial Accounting Standard, or SFAS, No. 142 requires goodwill to be tested for impairment at least annually or between annual tests if certain events or indicators of impairment occur. The impairment test consists of a comparison of the fair value of goodwill with its carrying amount. If the carrying amount of goodwill exceeds its fair value, an impairment loss is recognized in an amount equal to that excess. Goodwill is tested for impairment at the reporting unit level by a comparison of the fair value of a reporting unit with its carrying amount. We have elected to perform our analysis of goodwill at the end of the third quarter of the year. During 2004, 2005 and 2006, no impairment losses were identified.

RESULTS OF OPERATIONS

The following table presents certain financial data expressed as a percentage of total revenues for the periods indicated:

	Year Ended December 31,		
	2004	2005	2006
Revenues			
Product sales	75.1%	66.0%	71.7%
Services	24.9	34.0	28.3
Total revenues	100.0%	100.0%	100.0%
Cost of revenues			

Product sales	25.6	25.7	25.1
Services	4.3	7.2	6.9
Total cost of revenues	29.9	32.9	32.0
Gross profit	70.1	67.1	68.0
Selling and marketing	66.9	41.5	29.4
Research and development, net	25.1	38.0	34.7
General and administrative	22.3	24.5	25.3
Operating loss	(44.2)	(36.9)	(21.4)
Financial income (expenses), net	0.8	0.5	(0.5)
Loss before taxes on income	(43.4)	(36.4)	(21.9)
Taxes on income	2.8	0.1	1.1
Net loss before equity in earnings of affiliate	(46.2)	(36.5)	(23.0)
Equity in earnings of affiliate	2.4	0.0	1.5
Net loss	(43.8)%	(36.5)	(21.5)

YEARS ENDED DECEMBER 31, 2006 AND 2005

REVENUES FROM PRODUCTS AND SERVICES. Revenues consist primarily of software license fees sales, hardware sales and revenues from services, including service bureau, maintenance, training, professional services and support. Revenues decreased by 9.3% to $10.48 million for the year ended December 31, 2006 from $11.56 million for the year ended December 31, 2005. Revenues from our wholly-owned U.S. subsidiary, MTS IntegraTRAK, decreased by 11.4% to $5.35 million, or 51.1% of our total revenues, for the year ended December 31, 2006 from $6.04 million, or 52.3% of our total revenues, for the year ended December 31, 2005. The decrease in revenues in 2006 is primarily attributable to a longer sales cycle for our solutions during the year ended December 31, 2006 compared with the year ended December 31, 2005. We anticipate that our revenues will slightly increase in 2007.

COST OF REVENUES FROM PRODUCTS AND SERVICES. Cost of revenues consists primarily of (i) production costs (including hardware, media, packaging, freight and documentation); (ii) certain royalties and licenses payable to third parties (including the Office of the Chief Scientist of the Ministry of Industry, Trade and Labor of the State of Israel), (iii) professional services costs; and (iv) warranty and support costs for up to one year for end-users and up to 15 months for our OEM distributors. Cost of revenues decreased by 11.8% to $3.34 million for the year ended December 31, 2006 from $3.80 million for the year ended December 31, 2005. The decrease in cost of revenues is consistent with the decrease in revenues and principally a result of a reduction in the number of employees in professional services and technical support departments.

RESEARCH AND DEVELOPMENT, NET. Research and development expenses, net consist primarily of salaries of employees engaged in on-going research and development activities, outsourcing subcontractor development and other related costs, net of grants that were approved by the Office of the Chief Scientist of the Ministry of Industry, Trade and Labor of the State of Israel. Research and development, net expenses decreased by 17.3% to $3.63 million for the year ended December 31, 2006 (net of the grant from the Office of the Chief Scientist in the amount of $578,000) from $4.40 million for the year ended December 31, 2005 (net of the grant from the Office of the Chief Scientist in the amount of $130,000). The decrease in research and development, net expenses is primarily attributable to the reduction in the number of employees engaged in research and development and the increase in the participation of the Office of the Chief Scientist in 2006. We expect that our research and development expenses will slightly decrease in 2007.

SELLING AND MARKETING. Selling and marketing expenses consist primarily of costs relating to sales representatives and their travel expenses, trade shows and marketing exhibitions, advertising and presales support. Selling and marketing expenses decreased by 35.8% to $3.08 million for the year ended December 31, 2006 from $4.80 million for the year ended December 31, 2005. The decrease in selling and marketing expenses is primarily attributable to our reliance on establishing and maintaining partnerships with leading OEMs and vendors for various initiatives and a reduction in the number of our selling and marketing personnel.

GENERAL AND ADMINISTRATIVE. General and administrative expenses consist primarily of compensation costs for administration, finance and general management personnel, professional fees and office maintenance and administrative costs. General and administrative expenses decreased by 6.3% to $2.65 million for the year ended December 31, 2006 from $2.83 million for the year ended December 31, 2005. The decrease in general and administrative expenses is primarily attributable to the decrease in expenses associated with the integration of the activity of Teleknowledge Group Ltd., or Teleknowledge, that were incurred in the year ended December 31, 2005.

FINANCIAL INCOME (EXPENSES), NET. Financial income (expenses), net consists primarily of gains on marketable securities, interest income on bank deposits, bank commissions, bank interest and foreign currency translation adjustments. Financial expenses for the year ended December 31,2006 were $54,000 compared to financial income of $53,000 for the year ended December 31,2005. The decrease in our financial income for the year ended December 31, 2006 is primarily attributable to the decrease in our holdings of cash and cash equivalents, interest paid on a bank loan and decrease in gains on marketable securities.

TAXES ON INCOME. Our tax expenses were $118,000 for the year ended December 31, 2006, compared to tax expenses of $10,000 for the year ended December 31, 2005. The increase in taxes on income expenses is primarily attributable to a tax reserve that we established in 2006 for possible tax liabilities relating to prior years.

EQUITY IN RESULTS OF AFFILIATE. We recognize income and loss from the operations of our 50%-owned affiliate, Jusan S.A. For the year ended December 31, 2006 and 2005, we recognized income of $159,000 and $2,000, respectively.

YEARS ENDED DECEMBER 31, 2005 AND 2004

REVENUES FROM PRODUCTS AND SERVICES. Revenues increased by 22.8% to $11.56 million for the year ended December 31, 2005 from $9.41 million for the year ended December 31, 2004. In 2005, the revenues from our wholly owned U.S. subsidiary, MTS IntegraTRAK, increased by 22% from the year ended December 31, 2004 and accounted for 52.3% of our total revenues. The increase in revenues in 2005 was primarily attributable to revenues from billing solutions that were based on the technology that we acquired from Teleknowledge and revenues from sales of our new telemanagement solutions.

COST OF REVENUES FROM PRODUCTS AND SERVICES. Cost of revenues increased by 35.1% to $3.80 million for the year ended December 31, 2005 from $2.81 million for the year ended December 31, 2004. This increase in cost of revenues corresponds with the increase in revenues and was primarily a result of the change in our product mix from "shelf products" to customized telecommunications equipment manufacturer products and billing solutions.

RESEARCH AND DEVELOPMENT, NET. Research and development, net expenses increased by 86.1% to $4.40 million for the year ended December 31, 2005 (net of the grant from the Office of the Chief Scientist in the amount of $130,000) from $2.36 million for the year ended December 31, 2004 (after the capitalization of $386,000 of software development costs). The increase in research and development, net expenses was primarily due to the continued integration of Teleknowledge's research and development group, as well as to our continuing investment in product development.

SELLING AND MARKETING. Selling and marketing expenses decreased by 23.9% to $4.80 million for the year ended December 31, 2005 from $6.30 million for the year ended December 31, 2004. The decrease in selling and marketing expenses is primarily attributable to our reliance on establishing and maintaining partnerships with leading OEMs and vendors for various initiatives and a reduction in the number of our selling and marketing personnel.

GENERAL AND ADMINISTRATIVE. General and administrative expenses increased by 34.7% to $2.83 million for the year ended December 31, 2005 from $2.10 million for the year ended December 31, 2004. The increase in general and administrative expenses was primarily attributable to the increase in our overall activity.

FINANCIAL INCOME, NET. Financial income, net decreased by 32.1% to $53,000 for the year ended December 31, 2005 from $78,000 for the year ended December 31, 2004. In the year ended December 31, 2005, our interest income was negatively affected by the decrease in our holdings of cash and cash equivalents and by foreign currency translation adjustments expenses. These expenses were offset in part by gains on marketable securities, net in the amount of $81,000.

TAXES ON INCOME. Our taxes on income were $10,000 for the year ended December 31, 2005, compared to $266,000 for the year ended December 31, 2004. Most of our taxes in 2004 were the result of our provision for the Israeli tax authorities' demand for tax payment for the 1997-1999 period. We made a provision in our financial statements for this tax demand for the amount deemed probable.

EQUITY IN RESULTS OF AFFILIATE. We recognize income and loss from the operations of our 50%-owned affiliate, Jusan S.A. For the year ended December 31, 2005 and 2004, we recognized income of $2,000 and $225,000, respectively.

QUARTERLY RESULTS OF OPERATIONS

The following tables set forth certain unaudited quarterly financial information for each of the eight fiscal quarters ended December 31, 2006, in dollars and as a percentage of revenues. In management's opinion, this data has been prepared on a basis consistent with our audited consolidated financial statements included elsewhere in this annual report and include all necessary adjustments, consisting only of normal recurring adjustments, that we consider necessary for a fair presentation of the unaudited information for the quarters presented. The operating results for any quarter are not necessarily indicative of results that we might achieve for any future periods.

	For the Three Month			
	Mar. 31, 2005	Jun. 30, 2005	Sept. 30, 2005	Dec. 31, 2005

Revenues	$ 2,726	$ 2,812	$ 3,013	$ 3,012
Cost of revenues	887	1,006	1,061	848
Gross profit	1,839	1,806	1,952	2,164
Selling and marketing	1,527	1,370	984	916
Research and development, net	1,294	1,030	1,118	953
General and administrative	1,045	677	588	520
Operating expenses	3,866	3,077	2,690	2,389
Operating loss	(2,027)	(1,271)	(738)	(225)
Financial income (expense), net	21	83	(6)	(45)
Other income (loss), net	--	--	(2)	2
Loss before taxes on income	(2,006)	(1,188)	(746)	(268)
Taxes on income	--	--	--	10
Net loss before equity in results of affiliate	(2,006)	(1,188)	(746)	(278)
Equity in results of affiliate	(28)	39	48	(57)
Net loss	$ (2,034)	$ (1,149)	$ (698)	$ (335)
Basic and diluted net loss per share	$ (0.44)	$ (0.24)	$ (0.13)	$ (0.06)
Weighted average number of ordinary shares used in computing basic net loss per share	4,638,004	4,712,561	5,306,565	5,724,504
Weighted average number of ordinary shares used in computing diluted net loss per share	4,638,004	4,712,561	5,306,565	5,724,504
Revenues	100.0%	100.0%	100.0%	100.0%
Cost of revenues	32.5	35.8	35.2	28.2
Gross profit	67.5	64.2	64.8	71.8
Selling and marketing	56.0	48.7	32.7	30.4
Research and development, net	47.5	36.6	37.1	31.6
General and administrative	38.3	24.1	19.5	17.3
Operating expenses	141.8	109.4	89.3	79.3
Operating loss	(74.3)	(45.2)	(24.5)	(7.5)
Financial income (expense), net	0.8	3.0	(0.2)	(1.5)
Other income (loss), net	-	-	(0.1)	0.1
Loss before taxes on income	(73.5)	(42.2)	(24.8)	(8.9)
Taxes on income	-	-	-	0.3
Net loss before equity in results of affiliate	(73.5)	(42.2)	(24.8)	(9.2)
Equity in results of affiliate	(1.0)	1.4	1.6	(1.9)
Net loss	(74.6)%	(40.8)%	(23.2)%	(11.1)%

SEASONALITY

Our operating results are generally not characterized by a seasonal pattern except that our volume of sales in Europe is generally lower in the summer months.

IMPACT OF INFLATION AND DEVALUATION ON RESULTS OF OPERATIONS, LIABILITIES AND ASSETS

The dollar cost of our operations in Israel is influenced by the extent to which any increase in the rate of inflation in Israel is not offset, or is offset on a lagging basis, by a devaluation of the NIS in relation to the dollar. When the rate of inflation in Israel exceeds the rate of devaluation of the NIS against the dollar, companies experience increases in the dollar cost of their operations in Israel. Unless offset by a devaluation of the NIS, inflation in Israel will have a negative effect on our profitability, as we receive payments in dollars for most of our sales, while we incur a portion of our expenses in NIS.

In addition, since part of our sales are quoted in NIS and a portion of our expenses are incurred in NIS, our results have in the past been and would in the future be adversely affected by a change in the rate of inflation in Israel when the amount of our revenues in NIS is less than the amount of our expenses in NIS or if such change in the rate of inflation is not offset, or is offset on a lagging basis, by a corresponding devaluation of the NIS against the dollar and other foreign currencies.

The following table presents information about the rate of inflation in Israel, the rate of devaluation of the NIS against the dollar, and the rate of inflation in Israel adjusted for the devaluation:

Year ended December 31,	Israeli inflation rate %	NIS devaluation rate %	Israeli inflation adjusted for devaluation %
2002	6.5	7.3	(0.7)
2003	(1.9)	(7.6)	6.2
2004	1.2	(1.6)	2.8
2005	2.4	6.8	(4.1)
2006	(0.1)	(8.2)	8.8

A devaluation of the NIS in relation to the dollar has the effect of reducing the dollar amount of any of our expenses or liabilities which are payable in NIS, unless those expenses or payables are linked to the dollar. This devaluation also has the effect of decreasing the dollar value of any asset which consists of NIS or receivables payable in NIS, unless the receivables are linked to the dollar. Conversely, any increase in the value of the NIS in relation to the dollar has the effect of increasing the dollar value of any unlinked NIS assets and the dollar amounts of any unlinked NIS liabilities and expenses.

Because exchange rates between the NIS and the dollar fluctuate continuously, with a historically declining trend in the value of the NIS, exchange rate fluctuations, particularly larger periodic devaluations, may have an impact on our profitability and period-to-period comparisons of our results. We cannot assure you that in the future our results of operations may not be materially adversely affected by currency fluctuations.

CONDITIONS IN ISRAEL

We are incorporated under the laws of, and our principal executive offices and manufacturing and research and development facilities are located in, the State of Israel. Accordingly, our operations in Israel are directly influenced by political, economic and military conditions affecting Israel. Specifically, we could be adversely affected by any major hostilities involving Israel, a full or partial mobilization of the reserve forces of the Israeli army, the interruption or curtailment of trade between Israel and its present trading partners, and a significant downturn in the economic or financial condition of Israel.

POLITICAL CONDITIONS

Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors, and a state of hostility, varying from time to time in intensity and degree, has led to security and economic problems for Israel. Although Israel has entered into various agreements with Egypt, Jordan and the Palestinian Authority, there has been an increase in unrest and terrorist activity in Israel, which began in September 2000 and which has continued with varying levels of severity through 2006. In July 2006, an armed conflict began between Israel and Hezbollah forces in Lebanon, which involved rocket attacks on populated areas in the northern parts of Israel. On August 14, 2006, a cease-fire between Hezbollah and Israel took effect. This situation has had an adverse effect on Israel's economy, primarily in the geographical areas directly harmed by this conflict. Any future armed conflict, political instability or violence in the region may have a negative effect on our business condition, harm our results of operations and adversely affect our share price. No predictions can be made as to whether or when a final resolution of the area's problems will be achieved or the nature thereof and to what extent the situation will impact Israel's economic development or our operations.

Furthermore, there are a number of countries, primarily in the Middle East, as well as Malaysia and Indonesia, that restrict business with Israel or Israeli companies, and we are precluded from marketing our products to these countries. Restrictive laws or policies directed towards Israel or Israeli businesses may have an adverse impact on our operations, our financial results or the expansion of our business.

In addition, some of our executive officers and employees in Israel are obligated to perform annual reserve duty in the Israeli Defense Forces and may be called for active duty under emergency circumstances at any time. If a military conflict or war arises, these individuals could be required to serve in the military for extended periods of time. Our operations could be disrupted by the absence for a significant period of one or more of our executive officers or key employees or a significant number of other employees due to military service. Any disruption in our operations could adversely affect our business.

ECONOMIC CONDITIONS

In recent years Israel has been going through a period of recession in economic activity, resulting in low growth rates and growing unemployment. Although economic activity in Israel has improved recently, our operations could be adversely affected if the economic conditions in Israel begin to deteriorate again.

TRADE RELATIONS

Israel is a member of the United Nations, the International Monetary Fund,

the International Bank for Reconstruction and Development and the International Finance Corporation. Israel is a member of the World Trade Organization and is a signatory to the General Agreement on Tariffs and Trade, which provides for reciprocal lowering of trade barriers among its members. In addition, Israel has been granted preferences under the Generalized System of Preferences from the United States, Australia, Canada and Japan. These preferences allow Israel to export products covered by such programs either duty-free or at reduced tariffs.

Israel and the European Union Community concluded a Free Trade Agreement in July 1975, which confers certain advantages with respect to Israeli exports to most European countries and obligates Israel to lower its tariffs with respect to imports from these countries over a number of years. In 1985, Israel and the United States entered into an agreement to establish a Free Trade Area. The Free Trade Area has eliminated all tariff and specified non-tariff barriers on most trade between the two countries. On January 1, 1993, an agreement between Israel and the European Free Trade Association, known as EFTA, established a free-trade zone between Israel and the EFTA nations. In November 1995, Israel entered into a new agreement with the European Union, which includes redefinement of rules of origin and other improvements, including providing for Israel to become a member of the research and technology programs of the European Union. In recent years, Israel has established commercial and trade relations with a number of other nations, including China, India, Russia, Turkey and other nations in Eastern Europe and Asia.

EFFECTIVE CORPORATE TAX RATE

Israeli companies are generally subject to income tax on their taxable income. The applicable rate for 2006 was 31%, which was reduced to 29% in 2007, and will be further reduced to 27% in 2008, 26% in 2009 and 25% in 2010 and thereafter.

However, certain of our manufacturing facilities have been granted "Approved Enterprise" status under the Law for the Encouragement of Capital Investments, 1959, as amended, commonly referred to as the Investment Law, and, consequently, are eligible, subject to compliance with specified requirements, for tax benefits beginning when such facilities first generate taxable income. Subject to certain restrictions, we are entitled to a tax exemption in respect of income derived from our approved facilities for a period of two years, commencing in the first year in which such income is earned, and will be entitled to a reduced tax rate of 10%-25% for an additional five to eight years if we qualify as a foreign investors' company. If we do not qualify as a foreign investors' company, we will instead be entitled to a reduced rate of 25% for an additional five, rather than eight, years.

Our taxes outside Israel are dependent on our operations in each jurisdiction as well as relevant laws and treaties. Under Israeli tax law, the results of our foreign consolidated subsidiaries, which have generally been unprofitable, cannot be consolidated for tax purposes with the results of operations of the parent company.

ADOPTION OF NEW ACCOUNTING STANDARD

ACCOUNTING FOR EQUITY-BASED COMPENSATION

Effective January 1, 2006, we adopted Financial Accounting Standards Board, or FASB, SFAS No. 123 (revised 2004), "Share-Based Payment," or SFAS No. 123(R). SFAS 123(R) supersedes Accounting Principles Board Opinion No. 25, "Accounting

for Stock Issued to Employees," or APB No. 25, and related interpretations, and amends FASB SFAS No. 95, "Statement of Cash Flows." Generally, the approach in SFAS 123(R) is similar to the approach described in SFAS 123. However, SFAS 123(R) requires all equity-based payments to employees, including grants of employee stock options, to be recognized in the statement of income based on their fair values. Pro-forma disclosure is no longer an alternative. In 2006, we recognized equity-based compensation expense under SFAS 123(R) in the amount of $210,000.

As of December 31, 2006, we had $209,000 of unrecognized compensation expense related to non-vested stock options. For options granted before January 1, 2006 and which had graded vesting, we recognized compensation expenses based on the accelerated attribution method over the requisite service period of each of the awards. Forfeitures were accounted for as they occurred, but have been estimated with the adoption of SFAS 123(R) for those awards not yet vested. For options granted after January 1, 2006, we recognize compensation costs using the straight-line method over the requisite service period of each of the awards, net of estimated forfeitures, and for stock options granted before adoption of FAS 123(R) we use the accelerated method. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Estimated forfeitures are based on actual historical pre-vesting forfeitures.

We adopted SFAS 123(R) using the modified prospective method. Under this transition method, compensation costs recognized in 2006 include (a) compensation costs for all stock-based payments granted prior to, but that had not yet vested as of, January 1, 2006, based on the grant date fair value estimated in accordance with the pro-forma provisions of SFAS 123, adjusted for the effect of estimating forfeitures, and (b) compensation costs for the equity-based payments granted subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with SFAS 123(R). Our consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123(R). We selected the Black-Scholes option pricing model as the most appropriate fair value method for our stock-options awards and value restricted stock based on the market value of the underlying shares at the date of grant.

As a result of adopting SFAS 123(R) on January 1, 2006, our income before income taxes for 2006 is $144,000 lower than if we had continued to account for equity-based compensation under APB No. 25. Basic and diluted earning per share for 2006 is $0.03 lower than if we had continued to account for equity-based compensation under APB No. 25.

The fair value for options granted in 2004, 2005 and 2006 is estimated at the date of grant using a Black-Scholes options pricing model with the following weighted average assumptions:

	Year ended December 31,		
Employee Stock Options	2004	2005	2006
Expected volatility	71.8%	56.9%	74.5%
Risk-free interest	2.0%	3.9%	4.6%
Dividend yield	0.0%	0.0%	0.0%
Expected life (years)	2.2	4	4

RECENTLY ISSUED ACCOUNTING STANDARDS

In July 2006, the FASB issued FASB Interpretation No. 48 "Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109," or FIN 48. FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 utilizes a two-step approach for evaluating tax positions. Recognition (step one) occurs when an enterprise concludes that a tax position, based solely on its technical merits, is more-likely-than-not to be sustained upon examination. Measurement (step two) is only addressed if step one has been satisfied (when the position is more-likely-than-not to be sustained). Under step two, the tax benefit is measured as the largest amount of benefit, determined on a cumulative probability basis that is more-likely-than-not to be realized upon ultimate settlement. FIN 48 applies to all tax positions related to income taxes subject to the FASB SFAS No. 109, "Accounting for income taxes". This includes tax positions considered to be "routine" as well as those with a high degree of uncertainty. FIN 48 has expanded disclosure requirements, which include a tabular roll forward of the beginning and ending aggregate unrecognized tax benefits as well as specific detail related to tax uncertainties for which it is reasonably possible the amount of unrecognized tax benefit will significantly increase or decrease within twelve months. These disclosures are required at each annual reporting period unless a significant change occurs in an interim period. FIN 48 is effective for fiscal years beginning after December 15, 2006. The cumulative effect of applying FIN 48 will be reported as an adjustment to the opening balance of retained earnings. We are currently evaluating the effect of the adoption of FIN 48 on our financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements," or SFAS No. 157. SFAS No. 157 provides a single definition of fair value, a framework for measuring fair value, and expanded disclosures concerning fair value. Previously, different definitions of fair value were contained in various accounting pronouncements creating inconsistencies in measurement and disclosures. SFAS No. 157 applies under those previously issued pronouncements that prescribe fair value as the relevant measure of value, except SFAS No. 123(R) and related interpretations. SFAS No. 157 does not apply to accounting standards that require or permit measurement similar to fair value but are not intended to measure fair value. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. We are currently evaluating the impact of adopting SFAS No. 157.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities," or SFAS No. 159. SFAS No. 159 provides companies with an option to report selected financial assets and liabilities at fair value. Generally accepted accounting principles have required different measurement attributes for different assets and liabilities that can create artificial volatility in earnings. The Standard's objective is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. SFAS No. 159 is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. We are currently evaluating the impact of adopting SFAS No. 159.

B. LIQUIDITY AND CAPITAL RESOURCES

On December 31, 2006, we had $1.5 million in cash and cash equivalents,

$100,000 in short-term bank deposits, $159,000 in marketable securities and working capital of $186,000 compared to $3.2 million in cash and cash equivalents, $0 in short-term bank deposits, $132,000 in marketable securities and working capital of $2.1 million on December 31, 2005. The decrease in cash and cash equivalents and working capital at December 31, 2006 was primarily due to our losses in 2006.

In order to finance the acquisition of TelSoft in July 2006, we obtained a loan from Bank Hapoalim in the amount of approximately $1 million. The loan principal will be repaid in 12 equal monthly installments commencing August 31, 2007. The loan bears annual interest at a rate of the monthly LIBOR + 2%, payable on a monthly basis on the outstanding loan amount commencing August 31, 2006. Under the loan agreement, we are required to comply with the following covenants: (i) the ratio between shareholders equity and total shareholders equity and liabilities may not be less than 40% and in no event may our shareholders equity decrease below $ 5,000 thousand; (ii) we must generate operating income for each of the two subsequent quarters commencing the second quarter of 2007 and onwards; and (iii) our cash and cash equivalents may not decrease below $1 million at any given time. To secure the loan, we granted the Bank a floating charge on all of our current and long term assets and a fixed charge on our goodwill and on authorized but not outstanding shareholders equity.

On August 10, 2005, we raised $2.8 million (before issuance costs) in a private placement of 937,500 ordinary shares to institutional and private investors. The private placement also involved the acquisition by the investors of warrants to purchase an aggregate of 375,000 ordinary shares at an exercise price of $4.00 per share (subject to anti-dilution adjustments), exercisable from February 10, 2006 until August 10, 2009.

One of the principal factors affecting our working capital is the payment cycle on our sales. Any material change in the current aging of our accounts receivable could have an adverse effect on our working capital.

CASH FLOWS

The following table summarizes our cash flows for the periods presented:

	Year ended December 31,	
	2005	2006
	($ in thousands)	
Net cash used in operating activities	(4,422)	(1,609)
Net cash provided by (used in) investing activities	893	(1,206)
Net cash provided by financing activities	2,906	1,098
Net decrease (increase) in cash and cash equivalents	(623)	(1,717)
Cash and cash equivalents at beginning of period	3,814	3,191
Cash and cash equivalents at end of period	3,191	1,474

Net cash used in operating activities was approximately $1.6 million for the year ended December 31, 2006. The use of our funds in 2006 was primarily attributable to our continuing investment in product development. Net cash used in operating activities was approximately $4.4 million for the year ended December 31, 2005. The use of our funds in 2005 was primarily attributable to our research and development expenses associated with the integration of the Teleknowledge activity, as well as to our continuing investment in product development.

Net cash used in investing activities was approximately $1.2 million for the year ended December 31, 2006, primarily attributable to the acquisition of certain assets and liabilities of TelSoft in July 2006. Net cash provided by investing activities was approximately $893,000 for the year ended December 31, 2005, primarily attributable to the sales of available-for-sale marketable securities.

Net cash provided by financing activities was approximately $1.1 million for the year ended December 21, 2006 compared to approximately $2.9 million for the year ended December 31, 2005. Of the cash provided by financing activities in 2006, approximately $1 million was attributable to the loan we obtained form Bank Hapoalim to finance the acquisition of TelSoft and $100,000 was attributable to proceeds from exercise of stock options. Of the cash provided by financing activities in 2005, approximately $2.6 million was attributable to proceeds from a private offering of our securities in the United States in August 2005 and approximately $300,000 was attributable to proceeds from exercise of stock options.

In December 2000, we publicly announced our stock repurchase program, under which our officers were authorized to repurchase up to 300,000 of our ordinary shares. In May 2003, our Board of Directors increased the number of shares to be repurchased to 600,000 ordinary shares. Through December 31, 2004, we repurchased an aggregate 395,410 ordinary shares, at a total cost of $486,000. We did not continue this program during 2005 and 2006 and based on our current financial situation, we do not expect to repurchase any shares during 2007. We cancelled 384,610 of the repurchased ordinary shares.

We currently do not have significant capital spending or purchase commitments, but we expect to engage in capital spending consistent with the level of our operations. We anticipate that our cash on hand and cash flow from operations will be sufficient to meet our working capital and capital expenditure requirements for at least 12 months. However, if we do not generate sufficient cash from operations, we may be required to obtain additional financing or to reduce level of expenditure. There can be no assurance that such financing will be available in the future, or, if available, will be on terms satisfactory to us.

C. RESEARCH AND DEVELOPMENT

Our product development plans are market-driven and address the major, fast-moving trends that are influencing the telecommunications industry. We intend to expand upon our existing family of TEM solutions by adding new features and functions to address evolving market needs. We work closely with our customers and prospective customers to determine their requirements and design enhancements and new releases to meet their needs. Research and development activities take place in our facilities in Israel. On December 31, 2006, we employed 37 persons in research and development.

Our quality management system has been ISO 9001:2000 certified since the beginning of 2006, and prior thereto was ISO 9001:1994 certified.

We are evaluating approaches to solutions which will permit an information technology manager to effectively measure the quality of the services received from their service providers and to ensure that the users within the organization received such services according to their needs and the overall policy and priorities of the organization.

We have committed substantial financial resources to research and development for our TEM and BSS activities. During 2004, 2005 and 2006, our net research and development expenditures were $2.4 million, $4.4 million and $3.6

million, respectively. In the past, we received funding from the Israeli Ministry of Industry, Trade and Labor's Office of the Chief Scientist for selected research and development projects, but we stopped seeking funding for a number of years. In late 2005 and early 2006 and 2007, we applied to the Office of the Chief Scientist for new grants for our research and development projects. We received an approval for the 2005 and 2006 applications and our two 2007 applications are currently pending.

Under the terms of research and development grants that we have received from the Office of the Chief Scientist, we are required to pay royalties on the revenues derived from products incorporating know-how developed with such grants and ancillary services in connection therewith, up to 100% to 150% of the dollar-linked value of the total grants, plus interest. We are required to pay royalties at a rate of 3%-5%. The obligation to pay these royalties is contingent on actual sales of the products and in the absence of such sales, no payment is required. Since June 1997, we have paid the Office of the Chief Scientist royalties on all call accounting product sales at the applicable rates at the time of payment. See Item 10E. "Additional Information - Taxation - Grants under the Law for the Encouragement of Industrial Research and Development, 1984."

We have expensed royalties relating to the repayment of the Office of the Chief Scientist grants in the amounts of $181,000, $198,000 and $187 for the years ended December 31, 2004, 2005 and 2006, respectively.

As of December 31, 2006, we had a contingent obligation to pay royalties in the amount of approximately $9.49 million (including a contingent obligation in the amount of $1.64 million relating to royalties from revenues derived from products that we acquired from Teleknowledge that were funded by the Office of the Chief Scientist). The $5.5 million of grants received after January 1999 are subject to interest at a rate equal to the 12 month LIBOR rate.

D. TREND INFORMATION

As a result of a less predictable business environment and the decline in worldwide sales of PBX systems, we are unable to provide any guidance as to current sales and profitability trends. We expect that our results will continue to be impacted by a shift to a new line of products and increased marketing and research and development expenditures.

E. OFF-BALANCE SHEET ARRANGEMENTS

We are not a party to any material off-balance sheet arrangements. In addition, we have no unconsolidated special purpose financing or partnership entities that are likely to create material contingent obligations.

F. TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS

The following table summarizes our minimum contractual obligations and commercial commitments, including obligations of discontinued operations, as of December 31, 2006 and the effect we expect them to have on our liquidity and cash flow in future periods.

Contractual Obligations	Payments Due By Period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years

		(U.S. dollars in thousands)			
Operating lease obligations	$1,135	$ 357	$ 644	$ 134	$ --
Accrued severance pay*	946	--	--	--	946
Total	$2,081	$ 357	$ 644	$ 134	$ 946

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* See Item 6D. "Directors, Senior Management and Employees - Employees."

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

A. DIRECTORS AND SENIOR MANAGEMENT

Set forth below are the name, age, principal position and a biographical description of each of our directors and executive officers:

NAME	AGE	POSITION WITH THE COMPANY
Chaim Mer	59	Chairman of the Board
Eytan Bar	41	President and Chief Executive Officer
Shlomi Hagai	36	Corporate Chief Operating Officer and Chief Financial Office
Hanoch Magid	51	General Manager MTS Asia and Vice President Sales - Europe,
Alon Aginsky	44	Director
Isaac Ben-Bassat	53	Director
Dr. Orna Berry (1)	57	Outside Director
Dr. Yehoshua Gleitman (1)	57	Outside Director
Steven J. Glusband	60	Director
Yaacov Goldman (1)	52	Director

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(1) Member of our Audit Committee

Messrs. Mer, Aginsky, Ben-Bassat, Glusband and Goldman will serve as directors until our 2007 Annual General Meeting of Shareholders. Dr. Gleitman and Dr. Berry will serve as outside directors pursuant to the provisions of the Israeli Companies Law for a three-year term until our 2007 annual general meeting of shareholders and January 28, 2008, respectively, following which the service of Dr. Gleitman as an outside director may not be extended and the service of Dr. Berry as an outside director may be renewed for only one additional three-year term.

CHAIM MER has served as Chairman of our Board of Directors and a director since our inception in December 1995. Mr. Mer has been the Chairman of the Board of Directors of C. Mer Industries Ltd., or C. Mer, a publicly traded company, since 1988 and served as its President and Chief Executive Officer from 1988 until January 2005. Mr. Mer holds a B.Sc. degree in Computer Sciences and Mathematics from the Technion - Israel Institute for Technology.

EYTAN BAR has served as our President and Chief Executive Officer since December 2003. Prior to joining our company and from 2001, Mr. Bar served as General Manager of the CEM product division of NICE Systems Ltd. From 2000 through 2001, Mr. Bar served as Vice President of Professional Services at NICE Systems Inc. From 1993 through 1999, Mr. Bar served as General Manager of STS Software Systems Ltd., a company that developed a unique VoIP technology for

recording solutions.

SHLOMI HAGAI has served as our Corporate Chief Operating Officer and Chief Financial Officer since March 2005. Prior to that and from 2000, Mr. Hagai served as our financial controller. Prior to joining our company and from 1998, Mr. Hagai served as audit team manager in the Professional Department of Ernst & Young Israel, supervising privately held and publicly traded companies engaged in the hi-technology, industrial, services and infrastructure sectors. Mr. Hagai is a certified public accountant since 1999 and holds a B.A. degree in Business Administration (majoring in accounting) from the College of Management and LLM degree from Bar-Ilan University.

HANOCH MAGID has served as our Vice President Sales- Europe, Middle East and Africa since 2002 and as General Manager of MTS Asia since 2006. Prior to joining our company and from 2001, Mr. Magid served as Vice President of Operating and Professional Services of Xcitel Ltd., a start up company engaged in the field of mobile communication. Prior to that and from 2000, Mr. Magid served as Chief Operating Officer of Cellonet Interactive Mobile Commerce Ltd. From 1992 to 2000, Mr. Magid served in various positions of sales, operating and customer support at Scitex Corporation Ltd. Mr. Magid holds a B.Sc degree in Mechanical Engineering from the Ben Gurion University, Be'er Sheva.

ALON AGINSKY has served as a director since June 1996. Since July 2000, Mr. Aginsky has served as President and Chief Executive Officer of cVidya Inc., which is engaged in the development of a service assurance platform for next generation broadband service providers. Mr. Aginsky served as our Vice President Sales and Marketing from October 1996 until April 1999. From April 1999 to July 2000, Mr. Aginsky served as sales manager of C. Mer, when he was appointed Manager of C. Mer. From 1990 until September 1996, Mr. Aginsky served as President of MTS Inc., our U.S.-based marketing subsidiary. Mr. Aginsky holds a B.A. degree in Business Administration from the New York Technology Institute.

ISAAC BEN-BASSAT has been a director since our inception in December 1995. Mr. Ben-Bassat has been Executive Vice President and a director of C. Mer Industries Ltd. since 1988. Mr. Ben-Bassat holds a B.Sc. degree in Civil Engineering from the Technion - Israel Institute for Technology.

DR. ORNA BERRY has served as an outside director since January 2005 and is a member of our audit committee. Dr. Berry is a Venture Partner in Gemini Israel Funds Ltd. and since 2000 has served as Chairperson of Lambda Crossing, Ltd. and Riverhead Networks, Inc., which was sold to Cisco in March 2004. Dr. Berry served as the Chief Scientist of the Ministry of Industry and Trade of the Government of Israel from 1997 to 2000 and Co-President of Ornet Data Communications Technologies Ltd., a provider of high-speed switches, which was acquired by Siemens AG, from 1993 to 1997. From 1992 to 1993, Dr. Berry served as a consultant to Intel Communications Division and Elbit Systems, Ltd. Dr. Berry holds a B.A. degree in statistics and mathematics from Haifa University, an M.A. degree in statistics and mathematics from Tel Aviv University and a Ph.D. in computer science from the University of Southern California.

DR. YEHOSHUA GLEITMAN has served as an outside director since July 2001 and is a member of our audit committee. Since March 2000, Dr. Gleitman has been Chief Executive Officer of SFKT, a company whose activities include venture capital management, finance and investments in high-tech and telecommunications. Mr. Gleitman was Chief Executive Officer of Ampal-American Israel Corporation, or Ampal, from May 1997 and Managing Director of Ampal's Israeli wholly-owned subsidiaries and head of Ampal's Israeli operations from April 1, 1997 until his

resignation in July 1999. From August 1996 until February 1997, Mr. Gleitman was Director General of the Israeli Ministry of Industry and Trade and was Chief Scientist at the Ministry of Industry and Trade of the Government of Israel from January 1993 through February 1997. From 1991 through 1992, Mr. Gleitman was the general manager of AIMS Ltd., and between 1990-1991, he was an advisor in charge of marketing and business for Ashtrom Ltd. Dr. Gleitman holds a B.Sc., M.Sc. and Ph.D. degrees in Physical Chemistry, all from the Hebrew University of Jerusalem.

STEVEN J. GLUSBAND has served as a director since August 1, 1996. Mr. Glusband has been a partner with Carter Ledyard & Milburn LLP, our U.S. counsel, since March 1987. Mr. Glusband holds a B.B.A. degree from the City College of the City University of New York, a J.D. degree from Fordham University School of Law and an L.L.M. degree from the New York University School of Law.

YAACOV GOLDMAN has served as a director since May 2004 and is a member of our audit committee. Mr. Goldman provides consulting services to companies in strategic-financial areas, through his wholly owned company, Maanit-Goldman Management & Investments (2002) Ltd. Mr. Goldman serves as a director of Bank Leumi Le-Israel Ltd., Elron Electronic Industries Ltd, Golden House Ltd., Tagor capital Ltd. and Renewable Resources Ltd. Mr. Goldman serves as the Professional Secretary of the Peer Review Institute of the Certified Public accountants Institute in Israel. From September 2000 until November 2001, Mr. Goldman served as Managing Director of Argoquest Holdings, LLC, a U.S.-based investment company focused on early stage high-technology companies. From November 1981 until August 2000, Mr. Goldman was associated with Kessleman & Kessleman, the Israeli member firm of PricewaterhouseCoopers, and was a Partner and Senior Partner at such firm from January 1991 through August 2000. Mr. Goldman is a Certified Public Accountant (Israel) since 1981 and holds a B.A. degree in Economics and Accounting from Tel Aviv University.

B. COMPENSATION

The following table sets forth all compensation we paid with respect to all of our directors and executive officers as a group for the year ended December 31, 2006.

	Salaries, fees, commissions and bonuses	Pension, retirement and similar benefits
All directors and executive officers as a group (14 persons)	$1,081,573	$ 162,803

All our executive officers work full time for us. Mr. Chaim Mer, the Chairman of our Board of Directors, devotes approximately 20% of his time to the management of our company in consideration of which we pay him a monthly salary of $7,000 per month (as approved by our Audit Committee and Board of Directors on November 8, 1999). We provide automobiles to our executive officers at our expense.

During the year ended December 31, 2006, we paid to each of our directors an annual fee of approximately $8,400 and a per meeting attendance fee of $300, except for Mr. Yaacov Goldman, an independent director and our financial expert, to whom we paid an annual fee of approximately $16,800 and a per meeting attendance fee of $400.

As of December 31, 2006, our directors and executive officers as a group, consisting of 14 persons, held options to purchase an aggregate 238,625 ordinary shares, having exercise prices ranging from $1.844 to $3.87. The options vest over a four-year period. Of such options, options to purchase 228,625 ordinary shares were granted under our 2003 Israeli Share Option Plan (of which, options to purchase 205,000 ordinary shares will expire in December 2008, options to purchase 7,500 ordinary shares will expire in August 2009, options to purchase 2,500 ordinary shares will expire in May 2010, options to purchase 7,500 ordinary shares will expire in September 2010, options to purchase 2,500 ordinary shares will expire in November 2010 and options to purchase 3,625 ordinary shares will expire on March 2011) and options to purchase 10,000 ordinary shares were granted under our 1996 Stock Option Plan (all of which will expire in December 2008). See Item 6.E., "Directors, Senior Management and Employees - Share Ownership - Stock Option Plans."

C. BOARD PRACTICES

ELECTION OF DIRECTORS

Our Articles of Association provide for a Board of Directors consisting of up to ten members or such other number as may be determined from time to time at a general meeting of shareholders. Our Board of Directors is currently composed of seven directors.

Pursuant to our articles of association, all of our directors (except the outside directors) are elected at our annual general meeting of shareholders by a vote of the holders of a majority of the voting power represented and voting at such meeting and hold office until the next annual general meeting of shareholders and until their successors have been elected. All the members of our Board of Directors (except the outside directors) may be reelected upon completion of their term of office. All of our current directors (except our outside directors) were elected by our shareholders at our annual general meeting of shareholders of July 2006.

We do not follow the requirements of the NASDAQ Marketplace Rules with regard to the nomination process of directors, and instead, we follow Israeli law and practice, in accordance with which our directors are recommended by our board of directors for election by our shareholders. See below in this Item 6C. "Directors, Senior Management and Employees - Board Practices - NASDAQ Marketplace Rules and Home Country Practices."

OUTSIDE AND INDEPENDENT DIRECTORS

OUTSIDE DIRECTORS. Under the Israeli Companies Law, companies incorporated under the laws of the State of Israel whose shares have been offered to the public are required to appoint at least two outside directors. The Israeli Companies Law provides that a person may not be appointed as an outside director if the person, or the person's relative, partner, employer or an entity under that person's control, has or had during the two years preceding the date of appointment any affiliation with the company, or any entity controlling, controlled by or under common control with the company. The term "relative" means a spouse, sibling, parent, grandparent, child or child of spouse or spouse of any of the above. The term affiliation includes:

- an employment relationship;
- a business or professional relationship maintained on a regular basis;

- control; and

- service as an officer holder, excluding service as an outside director of a company that is offering its shares to the public for the first time.

In addition, no person may serve as an outside director if the person's position or other activities create, or may create, a conflict of interest with the person's responsibilities as director or may otherwise interfere with the person's ability to serve as director. If, at the time an outside director is appointed all members of the board of directors are of the same gender, then that outside director must be of the other gender. A director of one company may not be appointed as an outside director of another company if a director of the other company is acting as an outside director of the first company at such time.

As of 2006, at least one of the outside directors elected must have "accounting and financial expertise" and any other outside director must have "accounting and financial expertise" or "professional qualification," as such terms are defined by regulations promulgated under the Israeli Companies Law. This requirement does not apply to outside directors appointed prior to 2006.

Outside directors are elected by shareholders. The shareholders voting in favor of their election must include at least one-third of the shares of the non-controlling shareholders of the company who voted on the matter. This minority approval requirement need not be met if the total shareholdings of those non-controlling shareholders who vote against their election represent 1% or less of all of the voting rights in the company.

In general, outside directors serve for a three-year term, which may be renewed for only one additional three-year term. Outside directors can be removed from office only by the same special percentage of shareholders as can elect them, or by a court, and then only if the outside directors cease to meet the statutory qualifications with respect to their appointment or if they violate their duty of loyalty to the company.

Any committee of the board of directors must include at least one outside director and the audit committee must include all of the outside directors. An outside director is entitled to compensation as provided in regulations adopted under the Israeli Companies Law and is otherwise prohibited from receiving any other compensation, directly or indirectly, in connection with such service.

INDEPENDENT DIRECTORS. In general, NASDAQ Marketplace Rules require that a majority of our board of directors qualify as independent directors within the meaning of the NASDAQ Marketplace Rules and our audit committee must have at least three members and be comprised only of independent directors each of whom satisfies the respective "independence" requirements of the Securities and Exchange Commission and NASDAQ.

Our Board of Directors has determined that Dr. Yehoshua Gleitman and Dr. Orna Berry both qualify as independent directors under the rules of the Securities and Exchange Commission and NASDAQ and as outside directors under the requirements of the Israeli Companies Law. Our Board of Directors has further determined that Messrs. Alon Aginsky and Yaacov Goldman both qualify as independent directors under the requirements of the Securities and Exchange Commission and NASDAQ.

AUDIT COMMITTEE

Our audit committee, which was established in accordance with Section 114 of the Israeli Companies Law and Section 3(a)(58)(A) of the Securities Exchange Act of 1934, assists our board of directors in overseeing the accounting and financial reporting processes of our company and audits of our financial statements, including the integrity of our financial statements, compliance with legal and regulatory requirements, our independent public accountants' qualifications and independence, the performance of our internal audit function and independent public accountants, finding any defects in the business management of our company for which purpose the audit committee may consult with our independent auditors and internal auditor, proposing to the board of directors ways to correct such defects, and such other duties as may be directed by our board of directors.

The responsibilities of the audit committee also include approving related-party transactions as required by law. Under Israeli law an audit committee may not approve an action or a transaction with a controlling shareholder, or with an office holder, unless at the time of approval two outside directors are serving as members of the audit committee and at least one of the outside directors was present at the meeting in which an approval was granted.

Our audit committee consists of three members of our Board of Directors who satisfy the respective "independence" requirements of the Securities and Exchange Commission, NASDAQ and Israeli Law for audit committee members. Our audit committee is currently composed of Dr. Yehoshua Gleitman, Dr. Orna Berry and Mr.Yaacov Goldman. Our Board of Directors has determined that Mr. Goldman qualifies as a financial expert. The audit committee meets at least once each quarter.

INTERNAL AUDIT

Under the Israeli Companies Law, the board of directors of a public company must appoint an internal auditor nominated by the audit committee. A person who does not satisfy the Israeli Companies Law's independence requirements may not be appointed as an internal auditor. The role of the internal auditor is to examine, among other things, the compliance of the company's conduct with applicable law and orderly business practice. Mr. Shaul Sofer, Certified Public Accountant (Israel), serves as our internal auditor.

DIRECTORS' SERVICE CONTRACTS

We do not have any service contracts with our directors. There are no arrangements or understandings between us and any of our subsidiaries, on the one hand, and any of our directors, on the other hand, providing for benefits upon termination of their employment or service as directors of our company or any of our subsidiaries.

APPROVAL OF RELATED PARTY TRANSACTIONS UNDER ISRAELI LAW

The Israeli Companies Law codifies the fiduciary duties that "office holders," including directors and executive officers, owe to a company. An office holder's fiduciary duties consist of a duty of care and a duty of loyalty. The duty of care requires an office holder to act at a level of care that a reasonable office holder in the same position would employ under the same circumstances. The duty of loyalty includes avoiding any conflict of interest between the office holder's position in the company and any other position or his personal affairs, avoiding any competition with the company, avoiding exploiting any business opportunity of the company in order to receive personal gain for the office holder or others, and disclosing to the company any

information or documents relating to the company's affairs which the office holder has received due to his position as an office holder. Each person listed as a director or executive officer in the table under Item 6A. "Directors, Senior Management and Employees -- Directors and Senior Management" is an office holder.

Under the Israeli Companies Law, all arrangements as to compensation of office holders who are not directors require approval of our board of directors, and the compensation of office holders who are directors must be approved by our audit committee, board of directors and shareholders, in that order.

The Israeli Companies Law requires that an office holder promptly disclose any personal interest that he or she may have and all related material information known to him or her, in connection with any existing or proposed transaction by us. In addition, if the transaction is an extraordinary transaction, that is, a transaction other than in the ordinary course of business, other than on market terms, or likely to have a material impact on the company's profitability, assets or liabilities, the office holder must also disclose any personal interest held by the office holder's spouse, siblings, parents, grandparents, descendants, spouse's descendants and the spouses of any of the foregoing, or by any corporation in which the office holder or a relative is a 5% or greater shareholder, director or general manager or in which he or she has the right to appoint at least one director or the general manager. Some transactions, actions and arrangements involving an office holder (or a third party in which an office holder has an interest) must be approved by the board of directors or as otherwise provided for in a company's articles of association, as not being adverse to the company's interest. In some cases, including in the case of an extraordinary transaction, such a transaction, action and arrangement must be approved by the audit committee and by the board of directors itself, and further shareholder approval is required to approve the terms of compensation of an office holder who is a director. An office holder who has a personal interest in a matter, which is considered at a meeting of the board of directors or the audit committee, may not be present during the board of directors or audit committee discussions and may not vote on this matter, unless the majority of the members of the board or the audit committee have a personal interest, as the case may be.

The Israeli Companies Law also provides that an extraordinary transaction with a controlling shareholder or in which a controlling shareholder of the company has a personal interest (including private offerings in which a controlling shareholder has a personal interest) and a transaction with a controlling shareholder or his relative regarding terms of service and employment, must be approved by the audit committee, the board of directors and shareholders. The shareholder approval for an extraordinary transaction must include at least one-third of the shareholders who have no personal interest in the transaction who voted on the matter. The transaction can be approved by shareholders without this one-third approval, if the total shareholdings of those shareholders who have no personal interest and voted against the transaction do not represent more than one percent of the voting rights in the company.

However, under the Companies Regulations (Relief from Related Party Transactions), 5760-2000, promulgated under the Israeli Companies Law and amended in January 2002, certain transactions between a company and its controlling shareholder(s) and certain transaction with its director(s) regarding terms of compensation do not require shareholder approval.

In addition, directors' compensation and employment arrangements do not require the approval of the shareholders if both the audit committee and the board of directors agree that such arrangements are for the benefit of the company. If the director or the office holder is a controlling shareholder of the company, then the employment and compensation arrangements of such director or office holder do not require the approval of the shareholders provided that certain criteria are met.

The above exemptions will not apply if one or more shareholders, holding at least 1% of the issued and outstanding share capital of the company or of the company's voting rights, objects to the grant of such relief, provided that such objection is submitted to the company in writing not later than seven (7) days from the date of the filing of a report regarding the adoption of such resolution by the company pursuant to the requirements of the Israeli Securities Law. If such objection is duly and timely submitted, then the compensation arrangement of the directors will require shareholders' approval as detailed above.

The Israeli Companies Law provides that an acquisition of shares in a public company must be made by means of a tender offer if as a result of the acquisition the purchaser would become a 25% or greater shareholder of the company. This rule does not apply if there is already another 25% or greater shareholder of the company. Similarly, the Israeli Companies Law provides that an acquisition of shares in a public company must be made by means of a tender offer if as a result of the acquisition the purchaser would hold greater than a 45% shareholder of the company, unless there is another shareholder holding more than a 45% interest in the company. These requirements do not apply if, in general, the acquisition (1) was made in a private placement that received shareholder approval, (2) was from a 25% or greater shareholder of the company which resulted in the acquiror becoming a 25% or greater shareholder of the company, or (3) was from a shareholder holding more than a 45% interest in the company which resulted in the acquiror becoming a holder of more than a 45% interest in the company.

If, as a result of an acquisition of shares, the acquiror will hold more than 90% of a company's outstanding shares, the acquisition must be made by means of a tender offer for all of the outstanding shares. If less than 5% of the outstanding shares are not tendered in the tender offer, all the shares that the acquirer offered to purchase will be transferred to the acquirer. The Israeli Companies Law provides for appraisal rights if any shareholder files a request in court within three months following the consummation of a full tender offer. If more than 5% of the outstanding shares are not tendered in the tender offer, then the acquiror may not acquire shares in the tender offer that will cause his shareholding to exceed 90% of the outstanding shares

Regulations under the Israeli Companies Law provide that the Israeli Companies Law's tender offer rules do not apply to a company whose shares are publicly traded outside of Israel, if pursuant to the applicable foreign securities laws and stock exchange rules there is a restriction on the acquisition of any level of control of the company, or if the acquisition of any level of control of the company requires the purchaser to make a tender offer to the public shareholders.

EXCULPATION, INDEMNIFICATION AND INSURANCE OF DIRECTORS AND OFFICERS

EXCULPATION OF OFFICE HOLDERS. The Israeli Companies Law provides that an Israeli company cannot exculpate an office holder from liability with respect to

a breach of his or her duty of loyalty. If permitted by its articles of association, a company may exculpate in advance an office holder from his or her liability to the company, in whole or in part, with respect to a breach of his or her duty of care. However, a company may not exculpate in advance a director from his or her liability to the company with respect to a breach of his duty of care in the event of distributions.

INSURANCE OF OFFICE HOLDERS. Israeli law provides that a company may, if permitted by its articles of association, enter into a contract to insure its office holders for liabilities incurred by the office holder with respect to an act or omission performed in his or her capacity as an office holder, as a result of: (i) a breach of the office holders duty of care to the company or another person; (ii) a breach of office holders duty of loyalty to the company, provided that the office holder acted in good faith and had reasonable cause to assume that the act would not prejudice the company's interests; and (iii) a financial liability imposed upon the office holder in favor of another person.

INDEMNIFICATION OF OFFICE HOLDERS. Under Israeli law a company may, if permitted by its articles of association, indemnify an office holder for acts or omissions performed by the office holder in such capacity for (a) monetary liability imposed upon the office holder in favor of another person pursuant to a court judgment, including a settlement or an arbitration award approved by a court; (b) reasonable litigation expenses, including attorney's fees, actually incurred by the office holder as a result of an investigation or proceeding instituted against him or her by a competent authority, provided that such investigation or proceeding concluded without the filing of an indictment against the office holder or the imposition of any monetary liability in lieu of criminal proceedings, or concluded without the filing of an indictment against the office holder and a monetary liability was imposed on him or her in lieu of criminal proceedings with respect to a criminal offense that does not require proof of criminal intent; and (c) reasonable litigation expenses, including attorneys' fees, actually incurred by the office holder or imposed upon the office holder by a court: (i) in an action, suit or proceeding brought against the office holder by or on behalf of the company or another person, (ii) in connection with a criminal action in which the office holder was acquitted, or (iii) in connection with a criminal action in which the office holder was convicted of a crime that does not require proof of criminal intent.

Israeli law provides that a company's articles of association may permit the company to (a) indemnify an office holder retroactively, following a determination to this effect made by the company after the occurrence of the event in respect of which the office holder will be indemnified; and (b) undertake in advance to indemnify an office holder, except that with respect to a moentary liability imposed on the office holder by any judgment, settlement or court-approved arbitration award, the undertaking must be limited to types of occurrences, which, in the opinion of the company's board of directors, are, at the time of the undertaking, foreseeable due to the company's activities and to an amount or standard that the board of directors has determined is reasonable under the circumstances.

LIMITATIONS ON EXCULPATION, INSURANCE AND INDEMNIFICATION. These provisions are specifically limited in their scope by Israeli law, which provides that a company may not indemnify an office holder, nor exculpate an office holder, nor enter into an insurance contract which would provide coverage for any monetary liability, incurred as a result of certain improper actions.

The term "office holder" of a company includes a director, general manager,

chief business manager, deputy general manager, vice general manager, or any person filling any of these positions in a company even if he or she holds a different title, and also includes any other manager directly subordinate to the general manager.

Pursuant to the Israeli Companies Law, exculpation of, procurement of insurance coverage for, and an undertaking to indemnify or indemnification of, our office holders must be approved by our audit committee and our board of directors and, if the office holder is a director, also by our shareholders.

Our Articles of Association allow us to insure, indemnify and exempt our office holders, to the fullest extent permitted by the provisions of the Israeli Companies Law. We maintain a directors' and officers' liability insurance policy with a per claim and aggregate coverage limit of $5 million, including legal costs incurred in Israel. We have provided several of our directors and officers a letter of indemnification for liabilities or expenses incurred as a result of their acts in their capacity as directors and officers of our company, in an aggregate amount not to exceed $3 million.

NASDAQ MARKETPLACE RULES AND HOME COUNTRY PRACTICES

Under NASDAQ Marketplace Rule 4350, or Rule 4350, foreign private issuers, such as our company, are permitted to follow certain home country corporate governance practices instead of certain provisions of Rule 4350. A foreign private issuer that elects to follow a home country practice instead of any of such provisions of Rule 4350, must submit to NASDAQ, in advance, a written statement from an independent counsel in such issuer's home country certifying that the issuer's practices are not prohibited by the home country's laws.

On June 21, 2005, we provided NASDAQ with a notice of non-compliance with Rule 4350 with respect to the requirements regarding the directors' nominations process. Instead, we follow Israeli law and practice in accordance with which our directors are recommended by our board of directors for election by our shareholders. See above in this Item 6C. "Directors, Senior Management and Employees - Board Practices - Election of Directors."

D. EMPLOYEES

On December 31, 2006, we and our consolidated subsidiaries employed 104 persons, of which 37 persons were employed in research and development, 29 in training and technical support, 20 in sales and marketing and 18 in operations and administration. As of December 31, 2006, 60 of our employees were located in Israel, 30 of our employees were located in the United States, 4 of our employees were located in Hong Kong and 10 of our employees were located in Brazil.

On December 31, 2005, we and our consolidated subsidiaries employed 124 persons, of which 58 persons were employed in research and development, 30 in training and technical support, 18 in sales and marketing and 18 in operations and administration. As of December 31, 2005, 85 of our employees were located in Israel, 23 of our employees were located in the United States, 5 of our employees were located in Hong Kong, 1 of our employees was located in Holland and 10 of our employees were located in Brazil.

On December 31, 2004, we and our consolidated subsidiaries employed 153 persons, of which 47 persons were employed in research and development, 45 in training and technical support, 35 in sales and marketing and 26 in operations and administration. As of December 31, 2004, 86 of our employees were located in Israel, 39 of our employees were located in the United States, 9 of our employees were located in Hong Kong, 2 of our employees were located in Holland and 17 of our employees were located in Brazil.

Certain provisions of the collective bargaining agreements between the Histadrut (General Federation of Labor in Israel) and the Coordination Bureau of Economic Organizations (including the Industrialists Association) are applicable to our employees by order of the Israeli Ministry of Labor. These provisions concern mainly the length of the workday, minimum daily wages for professional workers, contributions to a pension fund, insurance for work-related accidents, procedures for dismissing employees, determination of severance pay and other conditions of employment. We generally provide our employees with benefits and working conditions beyond the required minimums.

Cost of living adjustments of employees' wages are determined on a nationwide basis and are legally binding. Under the current inflation rates, these adjustments compensate employees for approximately 40% of the change in the cost of living, with certain lag factors in implementation. Israeli employers and employees are required to pay predetermined amounts to the National Insurance Institute, which is similar to the United States Social Security Administration. In 2006, payments to the National Insurance Institute amounted to approximately 14.5% of wages, of which approximately two-thirds was contributed by employees with the balance contributed by the employer.

Pursuant to Israeli law, we are legally required to pay severance benefits upon certain circumstances, including the retirement or death of an employee or the termination of employment of an employee without due cause. We partly satisfy this obligation by contributing approximately 8.3% of between 80%-100% of the employee's annual gross salary to a fund known as "Managers' Insurance" or to pension fund. This fund provides a combination of savings plans, insurance and severance pay benefits to the employee, giving the employee a lump sum payment upon retirement and a severance payment, if legally entitled, upon termination of employment. The remaining part of this obligation is presented in our balance sheet as the difference between the "accrued severance pay" and "severance pay fund."

E. SHARE OWNERSHIP

The following table sets forth certain information as of March 28, 2007 regarding the beneficial ownership of our ordinary shares by each of our directors and executive officers.

NAME	Number of Ordinary Shares Beneficially Owned(1)	Percentage of Outstanding Ordinary Shares(2)
Chaim Mer	2,023,954 (3)	35.05%
Eytan Bar	227,725 (4)	3.80%
Shlomi Hagai	7,625 (4)	*
Hanoch Magid	1,750 (4)	*
Alon Aginsky	16,918	*
Isaac Ben-Bassat	689,214 (5)	11.94%
Dr. Orna Berry	--	--
Dr. Yehoshua Gleitman	--	--
Steven J. Glusband	11,000 (6)	*
Yaacov Goldman	--	--

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* Less than 1%.

(1) Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and generally includes voting or investment power with respect to securities. Ordinary shares relating to options currently exercisable or exercisable within 60 days of the date of this table are deemed outstanding for computing the percentage of the person holding such securities but are not deemed outstanding for computing the percentage of any other person. Except as indicated by footnote, and subject to community property laws where applicable, the persons named in the table above have sole voting and investment power with respect to all shares shown as beneficially owned by them.

(2) The percentages shown are based on 5,773,845 ordinary shares (excluding 10,800 ordinary shares held in treasury) issued and outstanding as of March 28, 2007.

(3) Mr. Chaim Mer and his wife, Mrs. Dora Mer, are the holders of 267,821 ordinary shares, and are the beneficial owners of 1,744,453 ordinary shares through their controlling interest in Mer Ofekim Ltd., 11,539 ordinary shares through their controlling interest in Mer Services Ltd., 95 ordinary shares through their controlling interest in Mer & Co. (1982) Ltd. and 46 ordinary shares through their controlling interest in C. Mer Industries Ltd.

(4) Subject to currently exercisable stock options.

(5) Includes 630,045 ordinary shares held by Ron Dan Investments Ltd., a corporation controlled by Mr. Ben-Bassat.

(6) Includes 10,000 ordinary shares subject to currently exercisable stock options.

STOCK OPTION PLANS

1996 STOCK OPTION PLAN

Under our 1996 Stock Option Plan, as amended, or the 1996 Plan, options to purchase up to 400,000 ordinary shares were issuable under options granted to our employees, management, officers and directors or those of our subsidiaries. Any options which are canceled or forfeited within the option period became available for future grants. The 1996 Plan terminated on May 31, 2006.

The 1996 Plan provides that it is administered by the Board of Directors or an Option Committee which may be appointed by the Board of Directors, which has the authority, subject to applicable law, to determine the persons to whom options will be granted, the number of ordinary shares to be covered by each option the time or times at which options will be granted or exercised, and the terms and conditions of the options. The exercise price of options granted under the 1996 Plan may not be less than 100% of the fair market value of our ordinary shares on the date of the grant of incentive stock options and 75% in the case of options not designated as incentive stock options. Fair market value is the mean between the highest and lowest quoted selling prices on the date of grant of our shares traded on NASDAQ or a stock exchange on which such shares are principally traded.

Options granted under the 1996 Plan are generally exercisable under such circumstances as the Board or Option Committee determines. Such options are not transferable by an optionee other than by will or by laws of descent and

distribution, and during an option holder's lifetime are exercisable only by such option holder or by his or her legal representative. Options granted under the 1996 Plan terminate at such time and under such circumstances as the Board or Option Committee determines.

During 2006, options to purchase 15,000 ordinary shares were granted under our 1996 Plan, with an average exercise price of $3.45, and no options were exercised into ordinary shares. At December 31, 2006, options to purchase 62,400 ordinary shares were outstanding under the 1996 Plan, exercisable at an average exercise price of $3.44 per share.

1996 SECTION 102 STOCK OPTION PLAN

In 1996, we adopted a Section 102 Stock Option Plan, as amended, or the 1996 102 Plan, providing for the grant of options to our Israeli employees, management, officers and directors or those of our subsidiaries. The 1996 102 Plan was adopted pursuant to Section 102 of the Israeli Income Tax Ordinance [New Version] - 1961, or Section 102, and provided recipients with tax advantages under the Israeli Income Tax Ordinance. As of January 1, 2003, Section 102 was amended, pursuant to which certain new tax advantages are afforded with respect to option grants to employees and directors. In order to enable employees and directors to benefit from such tax advantages with respect to future grants of options and issuance of shares upon exercise thereof, such grants have to be performed under a share option plan that is adjusted to the amended Section 102, and therefore we adopted our 2003 Israeli Share Option Plan. Upon the adoption of our 2003 Israeli Share Option Plan, we did not intend to grant any more options under the 1996 102 Plan and the ordinary shares that remained available for grant under the 1996 102 Plan were rolled-over into our 2003 Israeli Share Option Plan for issuance thereunder. The 1996 102 Plan terminated on May 31, 2006.

Options granted under our 1996 102 Plan are exercisable under such circumstances as the Board of Directors or Option Committee determined. Options granted under the this plan are not transferable by an optionee other than by will or by laws of descent and distribution, and during an option holder's lifetime will be exercisable only by such option holder or by his or her legal representative.

During 2006, no options were granted under the 1996 102 Plan and options to purchase 30,000 ordinary shares were exercised. At December 31, 2006, no options were outstanding under the 1996 102 Plan.

2003 ISRAELI SHARE OPTION PLAN

Under our 2003 Israeli Share Option Plan, or the 2003 Plan, options to purchase up to 893,915 ordinary shares may be granted to directors, employees, consultants, advisors, service providers, controlling shareholders and other persons not employed by us or by our affiliates. Any options which are canceled or forfeited within the option period will become available for future grants. The 2003 Plan will terminate in 2013, unless earlier terminated by the Board of Directors.

Options to Israeli employees, directors and officers, other than controlling shareholders (as such term is defined in the Israeli Income Tax Ordinance), under the 2003 Plan may only be granted under Section 102. Under amended Section 102, options granted pursuant to Section 102 may be designated as "Approved 102 Options" or "Unapproved 102 Options." An Approved 102 Option

may either be classified as a capital gains option or an ordinary income option. We elected to initially grant our options pursuant to Section 102 as capitals gain options. Such election is effective as of the first date of grant of such capital gains options under the 2003 Plan and shall remain in effect at least until the lapse of one year following the end of the tax year during which we first granted capital gains options. All Approved 102 Options (or the ordinary shares issued upon exercise thereof) must be held in trust by a trustee for the requisite holding period under Section 102 in order to benefit from the certain tax advantages. We may also grant Unapproved 102 Options, which do not have any tax benefit and are not held by a trustee. Options granted under Section 102 are taxed on the date of sale of the exercised ordinary shares and/or the date of the release of the options or such exercised ordinary shares from the trust.

The 2003 Plan is administered by the Board of Directors or a committee of the Board of Directors, if appointed, which has the authority, subject to applicable law, to determine, the persons to whom options will be granted, the terms and conditions of the respective options, including the time and the extent to which the options may be exercised, may designate the type of options, make an election as to the type of Approved 102 Option. The exercise price of options granted under the 2003 Plan will be based on the fair market value of our ordinary shares and are determined by the Board of Directors or the committee at the time of the grant.

Options granted under the 2003 Plan are not assignable or transferable by an optionee, other than by will or by laws of descent and distribution, and during the lifetime of an optionee may be exercised only by the optionee or by the optionee's legal representative. Such options may be exercised as long as the optionee is employed by, or providing services to us or any of our affiliates, to the extent the options have vested.

During 2006, options to purchase an aggregate of 45,000 ordinary shares were granted under the 2003 Plan at an average exercise price of $3.33 per share and options to purchase 10,341 ordinary shares were exercised. At December 31, 2006, options to purchase 608,000 ordinary shares were outstanding under the 2003 Plan, exercisable at an average exercise price of $2.66 per share.

2006 STOCK OPTION PLAN

In June 2006, we adopted our 2006 Stock Option Plan, or the 2006 Plan, under which up to 400,000 ordinary shares may be issued (subject to standard adjustments) to employees, officers and non-employee directors of ours and our affiliates. Ordinary shares as to which an option granted under the 2006 Plan has not been exercised at the time of its expiration, cancellation or forfeiture may again be subject to new awards under the 2006 Plan. The total number of ordinary shares with respect to which options may be granted to any eligible employee during any period of 12 consecutive months may not exceed 100,000 ordinary shares (subject to adjustment as provided in the 2006 Plan).

The 2006 Plan will be administered by our Board of Directors or to the extent permitted by Israeli law, a Compensation Committee of our Board of directors, if established by our Board of Directors at its discretion. All references below to the "Committee" refers to the Board of Directors or compensation committee established by our Board of Directors, as applicable. The Committee will have the authority, in its discretion, to establish from time to time guidelines or regulations for the administration of the 2006 Plan, to interpret the 2006 Plan, and to make all determinations it considers necessary or advisable for the administration of the 2006 Plan, in addition to the other

responsibilities and powers assigned to the Committee in the 2006 Plan. All decisions, actions or interpretations of the Committee under the 2006 Plan will be final, conclusive and binding upon all parties.

Each option granted under the 2006 Plan will be either an option intended to be treated as an "incentive stock option," within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended, or the Code, or an option that will be treated as a "non-qualified stock option." No incentive stock may be granted to any individual who is not an eligible employee of our company or a "subsidiary" within the meaning of the Code. No incentive stock option may be granted to an employee if, as of the date of grant of such option, such employee owns stock possessing more than ten percent of the total combined voting power of all classes of stock of our company or any affiliated company, a "10% Holder," unless (a) the exercise price per share under such option is at least 110% of the fair market value of an ordinary share determined as of the date of grant of such option, and (b) such option is not exercisable after the expiration of five years from the date of grant of such option. No incentive stock option may be granted under the 2006 Plan after the ten year anniversary of its adoption.

In no event may the term of any option exceed ten years from the date of grant of the option. However, in no event may the term of any option granted to a 10% Holder exceed five years from the date of grant of the option. No Option may be exercised after its expiration.

Each option granted under the 2006 Plan will become exercisable, in whole or in part, at such time or times during its term as the instrument evidencing the grant of such option may specify.

The price at which ordinary shares may be purchased upon any exercise of an option granted under the 2006 Plan will be the price per share determined by the Committee, and specified in the instrument evidencing the grant of such option, but in no event may the exercise price per share be less than (i) the fair market value of an ordinary share determined as of the date of grant of the option, or (ii), if greater, the par value of an ordinary share. However, with respect to an option granted to a 10% Holder, in no event may the exercise price per share be less than 110% of the fair market value of our ordinary shares determined as of the date of grant of such option.

Options granted under the 2006 Plan will be nontransferable, other than by will or the laws of descent and distribution, and may be exercised during the grantee's lifetime only by the grantee. However, if the instrument evidencing the grant of an option other than an incentive stock option so provides, the grantee may transfer his or her rights with respect to such option or any portion thereof, without consideration, to any "family member," as such term is defined in the 2006 Plan.

The terms and conditions of an option grant may not be waived or amended without the consent of the grantee if it would adversely affect, to any material extent, any of the rights or obligations of the grantee with respect to such grant, or in the case of any option that was intended to constitute an incentive stock option, if such waiver or amendment would cause such option to fail to be treated as an incentive stock option.

Our Board of Directors may, with prospective or retroactive effect, amend, suspend or terminate the 2006 Plan or any portion of the 2006 Plan at any time. However, no amendment, suspension or termination of the 2006 Plan may adversely

affect the rights of any grantee with respect to any options previously granted to the grantee without his or her written consent. Also, no amendment which constitutes a "material revision" of the 2006 Plan, as the term material revision is defined in the applicable rules of the National Association of Securities Dealers, may be effective unless approved by our shareholders in the manner required by such rules and by applicable law.

During 2006, no options were granted under the 2006 Plan and no options were outstanding under the 2006 Plan.

WARRANTS

On August 3, 2005, we issued a warrant to purchase 37,000 ordinary shares to Mr. Avraham Ziv in connection with financial services that he provided to our company. The warrant has an exercise price of $4.00 per share, subject to anti-dilution adjustments, and is exercisable from February 3, 2006 until August 3, 2009. Mr. Ziv has provided financial services to us from to time during the last five years.

In connection with our August 2005 private placement to institutional and private investors, we issued to the investors warrants to purchase an aggregate 375,000 ordinary shares at an exercise price of $4.00 per share (subject to anti-dilution adjustments), exercisable from February 10, 2006 until August 10, 2009.

On December 7, 2005, we issued a one-year warrant to purchase 100,000 ordinary shares to one of our consultants in connection with certain business development services performed on our behalf. The warrant, which had an exercise price of $3.12 per share (subject to anti-dilution adjustments), expired on December 7, 2006.

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

A. MAJOR SHAREHOLDERS

The following table sets forth certain information as of March 28, 2007 regarding the beneficial ownership by all shareholders known to us to own beneficially 5.0% or more of our ordinary shares:

NAME	Number of Ordinary Shares Beneficially Owned(1)	Percentage of Outstanding Ordinary Shares(2)
Chaim Mer and Dora Mer	2,023,954(3)	35.05%
Isaac Ben-Bassat	689,214(4)	11.94%

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(1) Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and generally includes voting or investment power with respect to securities. Ordinary shares relating to options currently exercisable or exercisable within 60 days of the date of this table are deemed outstanding for computing the percentage of the person holding such securities but are not deemed outstanding for computing the percentage of any other person. Except as indicated by footnote, and subject to community property laws where applicable, the persons named in the table above have sole voting and investment power with respect to all shares shown as beneficially owned by them.

(2) The percentages shown are based on 5,773,845 ordinary shares (excluding 10,800 ordinary shares held in treasury) issued and outstanding as of March

28, 2007.

(3) Mr. Chaim Mer and his wife, Mrs. Dora Mer, are the holders of 267,821 ordinary shares, and are the beneficial owners of 1,744,453 ordinary shares through their controlling interest in Mer Ofekim Ltd., 11,539 ordinary shares through their controlling interest in Mer Services Ltd., 95 ordinary shares through their controlling interest in Mer & Co. (1982) Ltd. and 46 ordinary shares through their controlling interest in C. Mer Industries Ltd.

(4) Includes 630,045 ordinary shares held by Ron Dan Investments Ltd., a corporation controlled by Mr. Ben-Bassat.

MAJOR SHAREHOLDERS VOTING RIGHTS

Our major shareholders do not have different voting rights

RECORD HOLDERS

Based on a review of the information provided to us by our transfer agent, as of March 28, 2007, there were 42 holders of record of our ordinary shares, of which six record holders holding approximately 58.35% of our ordinary shares had registered addresses in the United States and 36 record holders holding approximately 41.65% of our ordinary shares had registered addresses in Israel. These numbers are not representative of the number of beneficial holders of our shares nor are they representative of where such beneficial holders reside, since many of these ordinary shares were held of record by brokers or other nominees (including one U.S. nominee company, CEDE & Co., which held approximately 41.63% of our otstanding ordinary shares as of such date).

B. RELATED PARTY TRANSACTIONS

Ms. Dora Mer, the wife of Chaim Mer, provides legal services to us and receives a monthly retainer of $5,000. The conditions of retaining the services of Ms. Mer were approved by our Board of Directors and Audit Committee.

Our subsidiaries, MTS Asia Ltd. and MTS IntegraTRAK, entered into an agreement with C. Mer Industries Ltd., or C. Mer, pursuant to which they distribute and support certain of C. Mer's products and provide certain services on behalf of C. Mer. Generally, C. Mer compensates MTS Asia Ltd. for these activities at cost plus 10% and compensates MTS IntegraTRAK at cost plus 5%. C. Mer is a publicly traded company controlled by Mr. Chaim Mer, and Mr. Mer has been the Chairman of its Board of Directors since 1988 and served as its President and Chief Executive Officer from 1988 until January 2005.

Presently, the only service provided to us by C. Mer is our participation in its umbrella liability insurance coverage. We believe that the terms under which C. Mer provides such participation to us is on a basis no less favorable than could be obtained from an unaffiliated third party.

On August 10, 2005, we entered into definitive agreements with institutional and private investors, including our President, Mr. Eytan Bar, for a private placement of ordinary shares and warrants to purchase ordinary shares that raised $2.8 million. Pursuant to the agreements, the investors, other than our President, Mr. Eytan Bar, paid $3.00 per share for the aggregate 937,500 ordinary shares issued in the private placement. Mr. Bar purchased 14,000 shares at $3.88 per share, the closing price of our ordinary shares on the day prior to

the closing of the private placement. The private placement also involved the acquisition by the investors of warrants to purchase an aggregate 375,000 additional ordinary shares at an exercise price of $4.00 per share (subject to anti-dilution adjustments), exercisable from February 10, 2006 until August 10, 2009. Each investor, including Mr. Eytan Bar, received warrants to purchase two ordinary shares for each five ordinary shares purchased.

Mr. Chaim Mer, the Chairman of our Board of Directors, devotes approximately 20% of his time to the management of our company in consideration of which we pay him a monthly salary of $7,000 per month (as approved by our Audit Committee and Board of Directors on November 8, 1999). Mr. Isaac Ben-Bassat, a director and one of our major shareholders, receives an annual fee of approximately $8,400 and a per meeting attendance fee of $300 in connection with his service as a director of our company. See Item. 6B. "Directors and Senior Management - Compensation."

C. INTERESTS OF EXPERTS AND COUNSEL

Not applicable.

ITEM 8. FINANCIAL INFORMATION

A. CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION

FINANCIAL STATEMENTS

See the consolidated financial statements, including the notes thereto, and the exhibits listed in Item 19 hereof and incorporated herein by this reference.

EXPORT SALES

See Note 17 of our Consolidated Financial Statements.

LEGAL PROCEEDINGS

On April 18, 2005, Amdocs (Israel) Ltd. and Amdocs Ltd. filed a complaint in the Tel Aviv District Court naming our company, our chief executive officer and others as defendants (Civil File No. 32419-05/05). The complaint alleges, among other things, that professional and commercial information belonging to the plaintiffs was transferred to the defendants for use in our company's activity. The plaintiffs are seeking an injunction prohibiting the defendants from making any use of the information and trade secrets that were allegedly transferred, and mandatory injunctions requiring the return of any such information and the payment of estimated damages of NIS 14,775,000 (approximately US$3.5 million). On June 27, 2005, we and the other defendants filed a statement of defense, claiming that the factual and legal allegations made by the plaintiffs have no basis and the causes of action and relief requested are without merit. On March 22, 2007, the complaint was dismissed without prejudice by mutual agreement and following a settlement between all parties to the complaint and with no payment by any of the litigants.

In April 2000, the tax authorities in Israel issued to us a demand for a tax payment in the amount of approximately NIS 6.0 million (approximately $1.4 million) for the 1997-1999 period. We have appealed to the Israeli district court in respect of this tax demand. We believe that certain defenses can be raised against the demand of the tax authorities. We have made a provision in our financial statements for this tax demand for the amount deemed probable,

based on the current evidence, which we believe is adequate. We believe that the outcome of this matter will not have a material adverse effect on our financial position or results of operations.

On November 22, 2005, we received a letter from one of our customer's legal counsel alleging, among other things, that we materially breached an agreement relating to our billing solutions that we entered into with the customer on March 9, 2005, as subsequently amended on June 6, 2005. The customer is seeking full repayment of the amounts that were paid by him under the agreement in the amount of approximately $100,000, plus interest and indemnification for damages that he claims to have suffered as a result of our alleged breach. We and the customer have since exchanged correspondence. We cannot currently assess the outcome or possible adverse effect on our financial position or results of operations.

On February 21, 2007, one of our suppliers filed a complaint in the Kfar-Saba Magistrate Court against us, under which he seeks the payment of NIS 179,000 (approximately $42,000) for electronic components that were ordered by us for a third party, which is the customer referred to in the foregoing paragraph. On March 13, 2007, we filed a statement of defense. We have made a provision in our financial statements for the claimed amount. Due to the preliminary stage of this litigation, we and our legal advisors cannot currently assess the outcome or possible adverse effect on our financial position or results of operations.

On July 24, 2006, a claim was filed in the Tel-Aviv Superior Court against our company and Tim Computers and Systems Ltd, or TIM, for an order of inspection and monetary relief in the total amount of NIS 312,933 ($74,000), of which NIS 112,933 ($27,000) is demanded from our company and NIS 200,000 ($47,000) is demanded from TIM. The plaintiff is a former minority shareholder of a company in which we were the major shareholder. The claim relates to the rights to proceeds received under a software development project in which TIM and our company participated and in which the plaintiff was involved. A preliminary hearing was held on Jan. 15, 2007. Due to the preliminary stage of this litigation, we and our legal advisors cannot currently assess the outcome or possible adverse effect on our financial position or results of operations.

On March 15, 2007, we received a letter from one of our customer's legal counsel alleging, among other things, that we materially breached an agreement relating to our billing solutions that we entered into with the customer on March 30, 2006. The customer is seeking full repayment of the amounts that were paid by him under the agreement in the amount of approximately $141,000, plus liquidated damages as provided in the agreement. We believe that the agreement cancellation was unfounded and intend to vigorously pursue our rights under the contract. Due to the preliminary stage of this matter, we and our legal advisors cannot currently assess the outcome or possible adverse effect on our financial position or results of operations.

Other than the above, we are not involved in any legal proceedings nor are we subject to any threatened litigation that are material to our business or financial condition.

DIVIDEND DISTRIBUTION POLICY

We have never paid cash dividends to our shareholders. We intend to retain future earnings for use in our business and do not anticipate paying cash dividends on our ordinary shares in the foreseeable future. Any future dividend

policy will be determined by our Board of Directors and will be based upon conditions then existing, including our results of operations, financial condition, current and anticipated cash needs, contractual restrictions and other conditions as the Board of Directors may deem relevant.

According to the Israeli Companies Law, a company may distribute dividends out of its profits (as such term is defined in the Israeli Companies Law), provided that there is no reasonable concern that payment of the dividend will prevent the company from satisfying all its current and foreseeable obligations, as they become due. Notwithstanding the foregoing, dividends may be paid with the approval of a court, at the company's request, provided that there is no reasonable concern that payment of the dividend will prevent the company from satisfying its current and foreseeable obligations, as they become due. In the event cash dividends are declared, such dividends will be paid in NIS.

B. SIGNIFICANT CHANGES

Except as otherwise disclosed in this annual report, no significant change has occurred since December 31, 2006.

ITEM 9. THE OFFER AND LISTING

A. OFFER AND LISTING DETAILS

ANNUAL STOCK INFORMATION

The following table sets forth, for each of the years indicated, the range of high ask and low bid prices of our ordinary shares on the NASDAQ Capital Market.

YEAR	HIGH	LOW
2006	$3.50	$1.50
2005	$4.23	$3.01
2004	$4.00	$1.90
2003	$3.56	$0.87
2002	$1.65	$0.75

QUARTERLY STOCK INFORMATION

The following table sets forth, for each of the full financial quarters in the years indicated, the range of high ask and low bid prices of our ordinary shares on the NASDAQ Capital Market.

	HIGH	LOW
2005		
First Quarter	$4.00	$3.15
Second Quarter	$3.83	$3.10
Third Quarter	$4.23	$3.01
Fourth Quarter	$3.98	$3.05
2006		
First Quarter	$3.50	$2.94
Second Quarter	$3.34	$2.32

Third Quarter	$2.85	$2.01
Fourth Quarter	$2.49	$1.50

MONTHLY STOCK INFORMATION

The following table sets forth, for each of the most recent six months, the range of high ask and low bid prices of our ordinary shares on the NASDAQ Capital Market.

MONTH	HIGH	LOW
October 2006	$2.49	$2.01
November 2006	$2.26	$1.70
December 2006	$1.97	$1.50
January 2007	$1.92	$1.53
February 2007	$1.77	$1.60
March 2007 (until 28)	$1.73	$1.60

B. PLAN OF DISTRIBUTION

Not applicable.

C. MARKETS

Our ordinary shares were listed on the NASDAQ National Market in connection with our initial public offering on May 21, 1997. On December 23, 1998, the listing of our ordinary shares was transferred to the NASDAQ Capital Market (symbol: MTSL).

D. SELLING SHAREHOLDERS

Not applicable.

E. DILUTION

Not applicable.

F. EXPENSE OF THE ISSUE

Not applicable.

ITEM 10. ADDITIONAL INFORMATION

A. SHARE CAPITAL

Not applicable.

B. MEMORANDUM AND ARTICLES OF ASSOCIATION

SET OUT BELOW IS A DESCRIPTION OF CERTAIN PROVISIONS OF OUR ARTICLES OF ASSOCIATION AND OF THE ISRAELI COMPANIES LAW RELATED TO SUCH PROVISIONS. THIS DESCRIPTION IS ONLY A SUMMARY AND DOES NOT PURPORT TO BE COMPLETE AND IS QUALIFIED BY REFERENCE TO THE FULL TEXT OF THE ARTICLES OF ASSOCIATION, WHICH ARE INCORPORATED BY REFERENCE AS EXHIBITS TO THIS ANNUAL REPORT, AND TO ISRAELI LAW.

PURPOSES AND OBJECTS OF THE COMPANY

We are a public company registered under the Israel Companies Law, 1999-5759, or the Israeli Companies Law, as MER Telemanagement Solutions Ltd., registration number 520042904. Our objects and purposes, as provided by our Articles of Association, are to carry on any lawful activity.

On February 1, 2000, the Israeli Companies Law came into effect and superseded most of the provisions of the Israeli Companies Ordinance (New Version), 5743-1983, except for certain provisions which relate to bankruptcy, dissolution and liquidation of companies. Under the Israeli Companies Law, various provisions, some of which are detailed below, overrule the current provisions of our Articles of Association.

THE POWERS OF THE DIRECTORS

Under the provisions of the Israeli Companies Law and our Articles of Association, a director cannot participate in a meeting nor vote on a proposal, arrangement or contract in which he or she is materially interested. In addition, our directors cannot vote compensation to themselves or any members of their body without the approval of our audit committee and our shareholders at a general meeting. See Item 6C. "Directors, Senior Management and Employees - Board Practices - Approval of Related Party Transactions Under Israeli Law."

The authority of our directors to enter into borrowing arrangements on our behalf is not limited, except in the same manner as any other transaction by us.

Under our articles of association, retirement of directors from office is not subject to any age limitation and our directors are not required to own shares in our company in order to qualify to serve as directors.

RIGHTS ATTACHED TO SHARES

Our authorized share capital consists of 12,000,000 ordinary shares of a nominal value of NIS 0.01 each. All outstanding ordinary shares are validly issued, fully paid and non-assessable.

The rights attached to the ordinary shares are as follows:

DIVIDEND RIGHTS. Holders of our ordinary shares are entitled to the full amount of any cash or share dividend subsequently declared. The board of directors may declare interim dividends and propose the final dividend with respect to any fiscal year only out of the retained earnings, in accordance with the provisions of the Israeli Companies Law. Our Articles of Association provide that the declaration of a dividend requires approval by an ordinary resolution of the shareholders, which may decrease but not increase the amount proposed by the board of directors. See Item 8A. "Financial Information - Consolidated and Other Financial Information - Dividend Distribution Policy." If after one year a dividend has been declared and it is still unclaimed, the board of directors is entitled to invest or utilize the unclaimed amount of dividend in any manner to our benefit until it is claimed. We are not obligated to pay interest or linkage differentials on an unclaimed dividend.

VOTING RIGHTS. Holders of ordinary shares have one vote for each ordinary share held on all matters submitted to a vote of shareholders. Such voting rights may be affected by the grant of any special voting rights to the holders of a class of shares with preferential rights that may be authorized in the future.

The quorum required for an ordinary meeting of shareholders consists of at least two shareholders present in person or represented by proxy who hold or represent, in the aggregate, at least one third of the voting rights of the issued share capital. 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 directors designate in a notice to the shareholders. At the reconvened meeting, the required quorum consists of any two members present in person or by proxy.

An ordinary resolution, such as a resolution for the declaration of dividends, requires approval by the holders of a majority of the voting rights represented at the meeting, in person, by proxy or by written ballot, and voting thereon. Under our Articles of Association, a special resolution, such as amending our memorandum of association or articles of association, approving any change in capitalization, winding-up, authorization of a class of shares with special rights, or other changes as specified in our Articles of Association, requires approval of a special majority, representing the holders of no less than 65% of the voting rights represented at the meeting in person, by proxy or by written ballot, and voting thereon.

Pursuant to our articles of association, our directors (other than outside directors) are elected at our annual general meeting of shareholders by a vote of the holders of a majority of the voting power represented and voting at such meeting and hold office until the next annual general meeting of shareholders and until their successors have been elected. All the members of our Board of Directors (except the outside directors) may be reelected upon completion of their term of office. For information regarding the election of outside directors, see Item 6C. "Directors, Senior Management and Employees - Board Practices - Election of Directors."

RIGHTS TO SHARE IN OUR COMPANY'S PROFITS. Our shareholders have the right to share in our profits distributed as a dividend and any other permitted distribution. See this Item 10B. "Additional Information - Memorandum and Articles of Association - Rights Attached to Shares - Dividend Rights."

RIGHTS TO SHARE IN SURPLUS IN THE EVENT OF LIQUIDATION. In the event of our liquidation, after satisfaction of liabilities to creditors, our assets will be distributed to the holders of ordinary shares in proportion to the nominal value of their holdings. This right may be affected by the grant of preferential dividend or distribution rights to the holders of a class of shares with preferential rights that may be authorized in the future.

LIABILITY TO CAPITAL CALLS BY OUR COMPANY. Under our memorandum of association and the Israeli Companies Law, the liability of our shareholders is limited to the par value of the shares held by them.

LIMITATIONS ON ANY EXISTING OR PROSPECTIVE MAJOR SHAREHOLDER. See Item 6C. "Directors and Senior Management -Board Practices - Approval of Related Party Transactions Under Israeli Law."

CHANGING RIGHTS ATTACHED TO SHARES

According to our Articles of Association, in order to change the rights attached to any class of shares, unless otherwise provided by the terms of the class, such change must be adopted by a general meeting of the shareholders and by a separate general meeting of the holders of the affected class with a majority of 75% of the voting power participating in such meeting.

ANNUAL AND EXTRAORDINARY MEETINGS

Under the Israeli Companies Law a company must convene an annual meeting of shareholders at least once every calendar year and within fifteen months of the last annual meeting. Depending on the matter to be voted upon, notice of at least 21 days or 35 days prior to the date of the meeting is required. Our board of directors may, in its discretion, convene additional meetings as "special general meetings." With respect to "special general meetings notice of at least 35 days prior to the date of the meeting is required. In addition, the board must convene a special general meeting upon the demand of two of the directors, 25% of the nominated directors, one or more shareholders having at least 5% of the outstanding share capital and at least 1% of the voting power in the company, or one or more shareholders having at least 5% of the voting power in the company. See Item 10B. "Additional Information - Memorandum and Articles of Association - Rights Attached to Shares - Voting Rights."

LIMITATIONS ON THE RIGHTS TO OWN SECURITIES IN OUR COMPANY

Neither our memorandum of association or our articles of association nor the laws of the State of Israel restrict in any way the ownership or voting of shares by non-residents, except with respect to subjects of countries, which are in a state of war with Israel.

PROVISIONS RESTRICTING CHANGE IN CONTROL OF OUR COMPANY

The Israeli Companies Law requires that mergers between Israeli companies be approved by the board of directors and general meeting of shareholders of both parties to the transaction. The approval of the board of directors of both companies is subject to such boards' confirmation that there is no reasonable doubt that after the merger the surviving company will be able to fulfill its obligations towards its creditors. Each company must notify its creditors about the contemplated merger. Under our articles of association, such merger must be approved by a resolution of the shareholders, as explained above. The approval of the merger by the general meetings of shareholders of the companies is also subject to additional approval requirements as specified in the Israeli Companies Law and regulations promulgated thereunder. See also Item 6C. "Directors, Senior Management and Employees - Board Practices - Approval of Related Party Transactions Under Israeli Law."

DISCLOSURE OF SHAREHOLDERS OWNERSHIP

The Israeli Securities Law and regulations promulgated thereunder do not require a company whose shares are publicly traded solely on a stock exchange outside of Israel, as in the case of our company, to disclose its share ownership.

CHANGES IN OUR CAPITAL

Changes in our capital are subject to the approval of the shareholders at a general meeting by a special majority of 65% of the votes of shareholders participating and voting in the general meeting.

C. MATERIAL CONTRACTS

On August 10, 2005, we entered into definitive agreements with institutional and private investors, including our President, Mr. Eytan Bar, for a private placement of ordinary shares and warrants to purchase ordinary shares that raised $2.8 million. Pursuant to the agreements, the investors, other than Mr. Bar, paid $3.00 per share for the aggregate 923,500 ordinary shares issued

in the private placement. Mr. Bar purchased 14,000 shares at $3.88 per share, the closing price of our ordinary shares on the day prior to the closing of the private placement. The private placement also involved the acquisition by the investors of warrants to purchase an aggregate 375,000 additional ordinary shares at an exercise price of $4.00 per share (subject to anti-dilution adjustments), exercisable from February 10, 2006 until August 10, 2009. Each investor, including Mr. Eytan Bar, received warrants to purchase two ordinary shares for each five ordinary shares purchased. To date, no warrants have been exercised.

On July 31, 2006, we completed the acquisition of certain assets and liabilities of TelSoft, a California-based provider of call accounting and TEM solutions. TelSoft products offer a complementary solution to our products. In connection with the acquisition, we paid an initial consideration of $1.1 million and agreed to pay additional contingent consideration based on post acquisition revenue performance during the 12 month period following the acquisition.

D. EXCHANGE CONTROLS

Israeli law and regulations do not impose any material foreign exchange restrictions on non-Israeli holders of our ordinary shares. In May 1998, a new "general permit" was issued under the Israeli Currency Control Law, 1978, which removed most of the restrictions that previously existed under such law, and enabled Israeli citizens to freely invest outside of Israel and freely convert Israeli currency into non-Israeli currencies.

Non-residents of Israel who purchase our ordinary shares will be able to convert dividends, if any, thereon, and any amounts payable upon our dissolution, liquidation or winding up, as well as the proceeds of any sale in Israel of our ordinary shares to an Israeli resident, into freely repatriable dollars, at the exchange rate prevailing at the time of conversion, provided that the Israeli income tax has been withheld (or paid) with respect to such amounts or an exemption has been obtained.

E. TAXATION

The following is a discussion of Israeli and United States tax consequences material to our shareholders. To the extent that the discussion is based on new tax legislation which has not been subject to judicial or administrative interpretation, the views expressed in the discussion might not be accepted by the tax authorities in question. The discussion is not intended, and should not be construed, as legal or professional tax advice and does not exhaust all possible tax considerations.

HOLDERS OF OUR ORDINARY SHARES SHOULD CONSULT THEIR OWN TAX ADVISORS AS TO THE UNITED STATES, ISRAELI OR OTHER TAX CONSEQUENCES OF THE PURCHASE, OWNERSHIP AND DISPOSITION OF ORDINARY SHARES, INCLUDING, IN PARTICULAR, THE EFFECT OF ANY FOREIGN, STATE OR LOCAL TAXES.

ISRAELI TAX CONSIDERATIONS

The following is a summary of the current tax structure applicable to companies in Israel, with special reference to its effect on us. The following also contains a discussion of the material Israeli tax consequences to purchasers of our ordinary shares and Israeli government programs benefiting us. This summary does not discuss all the aspects 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.

GENERAL CORPORATE TAX STRUCTURE

Israeli companies are generally subject to income tax on their taxable income. The applicable rate for 2006 was 31%, which was reduced to 29% in 2007, and will be further reduced to 27% in 2008, 26% in 2009 and 25% in 2010 and thereafter. However, the effective tax rate payable by a company, which derives income from an approved enterprise (as further discussed below), may be considerably less.

CONTROLLED FOREIGN COMPANIES

Under the controlled foreign companies rules an Israeli company may become subject to Israeli taxes (as deemed dividends) on non-distributed profits of a non-Israeli subsidiary if the subsidiary's primary source of income is passive income (such as interest, dividends, royalties, rental income or capital gains) and if the taxes imposed outside of Israel are no more than 20% of the profits.

TAX BENEFITS UNDER THE LAW FOR THE ENCOURAGEMENT OF CAPITAL INVESTMENTS, 1959

The Law for the Encouragement of Capital Investments, 1959, commonly referred to as the Investment Law, provides that a proposed capital investment in eligible facilities may, upon application to the Investment Center of the Ministry of Industry, Trade and Labor of the State of Israel, be designated as an approved enterprise. Each certificate of approval for an approved enterprise relates to a specific investment program delineated both by its financial scope, including its capital sources, and by its physical characteristics, E.G., the equipment to be purchased and utilized pursuant to the program. An approved enterprise is entitled to benefits including Israeli Government cash grants and tax benefits in specified development areas. The tax benefits derived from any such certificate of approval relate only to taxable income attributable to the specific approved enterprise. If a company has more than one approval or only a portion of its capital investments is approved, its effective tax rate is the result of a weighted average of the applicable rates.

Taxable income of a company derived from an approved enterprise is subject to corporate tax at the maximum rate of 25% (rather than the regular corporate tax rate) for the benefit period. This period is ordinarily seven years (or ten years if the company qualifies as a foreign investors' company as described below) commencing with the year in which the approved enterprise first generates taxable income, and is limited to twelve years from commencement of production or 14 years from the date of approval, whichever is earlier. Tax benefits under the Investments Law also apply to income generated from the grant of a usage right with respect to know-how developed by the approved enterprise, income generated from royalties, and income derived from a service which is auxiliary to such usage right or royalties, provided that such income is generated within the approved enterprise's ordinary course of business. The Investment Law also provides that a company that has an approved enterprise within Israel will be eligible for a reduced tax rate and is entitled to claim accelerated depreciation on buildings, machinery and equipment used by the approved enterprise during the first five years of use.

A company owning an approved enterprise may elect to forego entitlement to the grants otherwise available under the Investment Law and in lieu thereof

participate in an alternative track of benefits. Under the alternative track of benefits, a company's undistributed income derived from an approved enterprise will be exempt from company tax for a period of two years from the first year of taxable income and such company will be eligible for a reduced tax rate for the remainder, if any, of the otherwise applicable benefits period.

A company that has an approved enterprise program is eligible for further tax benefits if it qualifies as a foreign investors' company. A foreign investors' company is a company that more than 25% of its share capital and combined share and loan capital is owned by non-Israeli residents. A company, which qualifies as a foreign investors' company and has an approved enterprise program is eligible for tax benefits for a ten-year benefit period. The company tax rate applicable to income from the approved enterprise earned in the benefit period (distributed or not) is as follows:

For a company with foreign investment of	The company tax rate is
over 25% but less than 49%	25%
49% or more but less than 74%	20%
74% or more but less than 90%	15%
90% or more	10%

In addition, the dividend recipient is taxed at the reduced rate applicable to dividends from approved enterprises income (15%), if the dividend, deriving from the approved enterprises, is distributed during the tax benefit period or within 12 years thereafter, yet, no time limit is applicable to dividends from a foreign investment company. The company must withhold this tax at source, regardless of whether the dividend is converted into foreign currency. However, if retained tax-exempt income is distributed in a manner other than upon the complete liquidation of the company, the company would be taxed at the reduced corporate tax rate applicable to such profits (between 10%-25%). Our company is not obliged to distribute exempt retained profits under the alternative track of benefits, and may generally decide from which source of income to declare dividends. We intend to reinvest any income derived from our approved enterprise programs and not to distribute such income as a dividend.

We have been granted approved enterprise status with respect to several investment programs and chose the alternative track with respect to each of these programs. See Item 5A. "Operating and Financial Review and Prospects - Operating Results - Effective Corporate Tax Rate."

The benefits available to an approved enterprise are conditional upon the fulfillment of conditions stipulated in the Investment Law and its regulations and the criteria set forth in the specific certificate of approval, as described above. In the event that a company does not meet these conditions, its tax benefits could be canceled, in whole or in part, and it would be required to refund the amount of tax benefits, with the addition of the Israeli consumer price index linkage adjustment and interest.

AMENDMENT TO THE INVESTMENTS LAW

An amendment to the Investments Law, which came into effect on April 1, 2005, has changed certain provisions of such law, including the criteria for investments qualified to receive tax benefits under such law. An eligible investment program under the amendment will qualify for benefits as a "Privileged Enterprise" (rather than the previous terminology of Approved Enterprise). As a result of the amendment, a company is no longer obliged to acquire approved enterprise status in order to receive the tax benefits previously available under the alternative benefits track, and therefore there is no need to apply to the Investment Center for this purpose (however, approved

enterprise status remains mandatory for companies seeking grants). Rather, a company may claim the tax benefits offered by the Investment Law directly in its tax returns, provided that its facilities meet the criteria for tax benefits set out by the amendment. Companies may also approach the Israeli Tax Authority for a pre-ruling regarding its eligibility for benefits under the amendment. The amendment does not apply to investment programs approved prior to December 31, 2004. The new tax regime will apply only to new investment programs.

Tax benefits are available under the April 2005 amendment to production facilities (or other eligible facilities), which are generally required to derive more than 25% of their business income from export. In order to receive the tax benefits, a company must make an investment in the Privileged Enterprise exceeding a minimum amount specified in the Investment Law. Such investment may be made over a period of no more than three years ending at the end of the year in which the company requested to have the tax benefits apply to the Privileged Enterprise, referred to as the Year of Election. Where the company requests to have the tax benefits apply to an expansion of existing facilities, only the expansion will be considered a Privileged Enterprise and the company's effective tax rate will be the result of a weighted combination of the applicable rates. In such case, the minimum investment required in order to qualify as a Privileged Enterprise is required to exceed a certain percentage of the company's production assets before the expansion.

TAX BENEFITS FOR RESEARCH AND DEVELOPMENT

Israeli tax law allows, under specified conditions, a tax deduction for expenditures, including capital expenditures, in the year incurred relating to scientific research and development projects, if the expenditures are approved by the relevant Israeli Government ministry, determined by the field of research, and the research and development is for the promotion of the company and is carried out by or on behalf of the company seeking such deduction. However, the amount of such deductible expenses shall be reduced by the sum of any funds received through government grants for the finance of such scientific research and development projects. Expenditures not so approved are deductible over a three-year period.

TAX BENEFITS UNDER THE LAW FOR THE ENCOURAGEMENT OF INDUSTRY (TAXES), 1969

Under the Law for the Encouragement of Industry (Taxes), 1969, or the Industry Encouragement Law, Industrial Companies are entitled to certain corporate tax benefits, including, among others:

- deduction, under certain conditions, of purchases of know-how and patents over an eight-year period for tax purposes;
- right to elect, under specified conditions, to file a consolidated tax return with additional related Israeli Industrial Companies;
- accelerated depreciation rates on equipment and buildings; and
- deductions over a three-year period of expenses involved with the issuance and listing of shares on the Tel Aviv Stock Exchange or, on or after January 1, 2003, on a recognized stock market outside of Israel.

Eligibility for benefits under the Industry Encouragement Law is not subject to receipt of prior approval from any governmental authority. Under the

Industry Encouragement Law, an "Industrial Company" is defined as a company resident in Israel, at least 90% of the income of which, in any tax year, determined in Israeli currency, exclusive of income from government loans, capital gains, interest and dividends, is derived from an "Industrial Enterprise" owned by it. An "Industrial Enterprise" is defined as an enterprise owned by an Industrial Company, whose major activity in a given tax year is industrial production activity.

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

GRANTS UNDER THE LAW FOR THE ENCOURAGEMENT OF INDUSTRIAL RESEARCH AND DEVELOPMENT, 1984

The Government of Israel encourages research and development projects through the Office of Chief Scientist of the Israeli Ministry of Industry, Trade and Labor, or the Office of the Chief Scientist, pursuant to the Law for the Encouragement of Industrial Research and Development, 1984, and the regulations promulgated thereunder, commonly referred to as the Research Law. Grants received under such programs are repaid through a mandatory royalty based on revenues from products incorporating know-how developed with the grants. This government support is conditioned upon the ability of the participant to comply with certain applicable requirements and conditions specified in the Office of the Chief Scientist's programs and with the provisions of the Research Law.

Under the Research Law, research and development programs which meet specified criteria and are approved by a research committee of the Office of the Chief Scientist are eligible for grants of up to 50% of certain of the project's approved expenditure, as determined by the research committee.

In exchange, the recipient of such grants is required to pay the Office of the Chief Scientist royalties from the revenues derived from products incorporating technology developed within the framework of the approved research and development program or derived from such program (including ancillary services in connection with such program), usually up to100% of the U.S. dollar-linked value of the total grants received in respect of such program, plus LIBOR interest.

The terms of the Israeli Government participation generally requires that the products developed with such grants be manufactured in Israel. However, under regulations promulgated under the Research Law, upon the approval of the Chief Scientist, some of the manufacturing volume may be performed outside Israel, provided that the grant recipient pays royalties at an increased rate. The Research Law also allows for the approval of grants in cases in which the applicant declares that part or all of the manufacturing will be performed outside of Israel or by non-Israeli residents and the research committee is convinced that this is essential for the execution of the program. The Research Law also provides that know-how developed under an approved research and development program may not be transferred to third parties in Israel without the prior approval of the research committee. The Research Law further provides that the know-how developed under an approved research and development program may not be transferred to any third parties outside Israel. No approval is required for the sale or export of any products resulting from such research and development.

However, in June 2005, an amendment to the Research Law became effective, which amendment was intended to make the Research Law more compatible with the global business environment by, among other things, relaxing restrictions on the transfer of manufacturing rights outside Israel and on the transfer of Office of the Chief Scientist-funded know-how outside of Israel. The amendment permits the Office of the Chief Scientist, among other things, to approve the transfer of manufacturing rights outside Israel in exchange for an import of different manufacturing into Israel as a substitute, in lieu of demanding the recipient to pay increased royalties as described above. The amendment further permits, under certain circumstances and subject to the Office of the Chief Scientist's prior approval, the transfer outside Israel of know-how that has been funded by Office of the Chief Scientist, generally in the following cases: (a) the grant recipient pays to the Office of the Chief Scientist a portion of the consideration paid for such funded know-how (according to certain formulas), (b) the grant recipient receives know-how from a third party in exchange for its funded know-how, or (c) such transfer of funded know-how arises in connection with certain types of cooperation in research and development activities.

The Research Law imposes reporting requirements with respect to certain changes in the ownership of a grant recipient. The law requires the grant recipient and its controlling shareholders and interested parties to notify the Office of the Chief Scientist of any change in control of the recipient or a change in the holdings of the means of control of the recipient that results in a non-Israeli becoming an interested party directly in the recipient and requires the new interested party to undertake to the Office of the Chief Scientist to comply with the Research Law. In addition, the rules of the Office of the Chief Scientist may require prior approval of the Office of the Chief Scientist or additional information or representations in respect of certain of such events. For this purpose, "control" is defined as the ability to direct the activities of a company other than any ability arising solely from serving as an officer or director of the company. A person is presumed to have control if such person holds 50% or more of the means of control of a company. "Means of control" refers to voting rights or the right to appoint directors or the chief executive officer. An "interested party" of a company includes a holder of 5% or more of its outstanding share capital or voting rights, its chief executive officer and directors, someone who has the right to appoint its chief executive officer or at least one director, and a company with respect to which any of the foregoing interested parties owns 25% or more of the outstanding share capital or voting rights or has the right to appoint 25% or more of the directors. Accordingly, any non-Israeli who acquires 1% or more of our ordinary shares will be required to notify the Office of the Chief Scientist that it has become an interested party and to sign an undertaking to comply with the Research Law. Additionally, procedures regulated under the Research Law require the grant recipient to obtain the approval of the Office of the Chief Scientist prior to a change in the holdings of the recipient or change in the holdings of the means of control of the recipient if the recipient's shares are being issued to a non-Israeli person or entity and require the new non-Israeli party to undertake to the Office of the Chief Scientist to comply with the Research Law.

In the past, we received funding from the Office of the Chief Scientist for selected research and development projects, but we stopped seeking funding for a number of years. In 2005, we received the approval of the Office of the Chief Scientist for a new research and development grant in the amount of $130,000. In 2006, we received the approval of the Office of the Chief Scientist for two new research and development grants in an aggregate amount of $578,000, and in 2007, we submitted two additional grant applications that are currently pending. See Item 5C. "Operating and Financial Review and Prospects - Research and

Development, Patents and Licenses" for additional details on the grants that we have received and our contingent liability to the Office of the Chief Scientist.

SPECIAL PROVISIONS RELATING TO TAXATION UNDER INFLATIONARY

The Income Tax Law (Inflationary Adjustments), 1985, generally referred to as the Inflationary Adjustments Law, represents an attempt to overcome the problems presented to a traditional tax system by an economy undergoing rapid inflation. The Inflationary Adjustments Law is highly complex. Its features, which are material to us, can be summarized as follows:

- There is a special tax adjustment for the preservation of equity whereby some corporate assets are classified broadly into fixed assets and non-fixed assets. Where a company's equity, as defined in such law, exceeds the depreciated cost of fixed assets, a deduction from taxable income that takes into account the effect of the applicable annual rate of inflation on such excess is allowed up to a ceiling of 70% of taxable income in any single tax year, with the unused portion permitted to be carried forward on a linked basis. If the depreciated cost of fixed assets exceeds a company's equity, then such excess multiplied by the applicable annual rate of inflation is added to taxable income.

- Subject to specific limitations, depreciation deductions on fixed assets and losses carried forward are adjusted for inflation based on the increase in the consumer price index.

TAXATION OF NON-ISRAELI SHAREHOLDERS ON RECEIPT OF DIVIDENDS

Under Israeli tax law, a distribution of dividends from income attributable to an Approved Enterprise and Privileged Enterprise will be subject to tax in Israel at the rate of 15%, which is withheld and paid by the company paying the dividend, if the dividend is distributed during the benefits period or within the following 12 years (but the 12-year limitation does not apply to a Foreign Investors Company). Any distribution of dividends from income that is not attributable to an Approved Enterprise will be subject to tax in Israel at the rate of 25%, except that dividends distributed on or after January 1, 2006 to an individual and an entity who is deemed "a non-substantial shareholder" will be subject to tax at the rate of 20%.

Under the U.S.-Israel tax treaty, the maximum tax on dividends paid to a holder of ordinary shares who is a U.S. resident is 25%. Dividends received by a U.S. company that holds at least 10% of our voting rights will be subject to withholding tax at the rate of 12.5%, provided certain other conditions in the tax treaty are met (or at the tax rate of 15% in respect of dividends paid from income attributable to our Approved Enterprises and Privileged Enterprises).

CAPITAL GAINS TAXES APPLICABLE TO NON-ISRAELI SHAREHOLDERS

Capital gains from the sale of our ordinary shares by non-Israeli shareholders are exempt from Israeli taxation, provided that the capital gain is not derived from a permanent establishment in Israel. However, non-Israeli corporations will not be entitled to such exemption, if an Israeli resident (i) has a controlling interest of 25% or more in such non-Israeli corporation, or (ii) is the beneficiary or is entitled to 25% or more of the revenues or profits of such non-Israeli corporation, whether directly or indirectly. In the event that an exemption is not available, taxation of the non-Israeli resident may be

subject to the provisions of a tax treaty, if such treaty exists between Israel and the applicable country. In some instances where our shareholders may be subject 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.

In addition, the United States-Israel tax treaty exempts U.S. residents who hold less than 10% of our voting rights, and who held less than 10% of our voting rights during the 12 months prior to a sale of their shares, from Israeli capital gains tax in connection with such sale.

FOREIGN EXCHANGE REGULATIONS

Dividends (if any) paid to the holders of our ordinary shares, and any amounts payable with respect to our ordinary shares upon dissolution, liquidation or winding up, as well as the proceeds of any sale in Israel of the ordinary shares to an Israeli resident, may be paid in non-Israeli currency or, if paid in Israeli currency, may be converted into freely reparable U.S. dollars 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.

UNITED STATES FEDERAL INCOME TAX CONSEQUENCES

The following is a summary of certain material U.S. federal income tax consequences that apply to U.S. Holders who hold ordinary shares as capital assets. This summary is based on the United States Internal Revenue Code of 1986, as amended, or the Code, Treasury regulations promulgated thereunder, judicial and administrative interpretations thereof, and the U.S.-Israel Tax Treaty, all as in effect on the date hereof and all of which are subject to change either prospectively or retroactively. This summary does not address all tax considerations that may be relevant with respect to an investment in ordinary shares. This summary does not account for the specific circumstances of any particular investor, such as:

- broker-dealers,
- financial institutions,
- certain insurance companies,
- regulated investment companies,
- investors liable for alternative minimum tax,
- tax-exempt organizations,
- non-resident aliens of the U.S. or taxpayers whose functional currency is not the U.S. dollar,

- persons who hold the ordinary shares through partnerships or other pass-through entities,
- persons who acquired their ordinary shares through the exercise or cancellation of employee stock options or otherwise as compensation for services,
- certain expatriates or former long-term residents of the United States,

- investors that own or have owned, directly, indirectly or by attribution, 10 percent or more of our voting shares, and

- investors holding ordinary shares as part of a straddle or appreciated financial position or a hedging or conversion transaction.

If a partnership or an entity treated as a partnership for U.S. federal income tax purposes owns ordinary shares, the U.S. federal income tax treatment of a partner in such a partnership will generally depend upon the status of the partner and the activities of the partnership. A partnership that owns ordinary shares and the partners in such partnership should consult their tax advisors about the U.S. federal income tax consequences of holding and disposing of ordinary shares.

This summary does not address the effect of any U.S. federal taxation other than U.S. federal income taxation. In addition, this summary does not include any discussion of state, local or foreign taxation.

You are urged to consult your tax advisors regarding the foreign and United States federal, state and local tax considerations of an investment in ordinary shares.

For purposes of this summary, a U.S. Holder is any beneficial owner of ordinary shares that is:

- an individual who is a citizen or, for U.S. federal income tax purposes, a resident of the United States;

- a corporation or other entity created or organized in or under the laws of the United States or any political subdivision thereof;

- an estate whose income is subject to U.S. federal income tax regardless of its source; or

- a trust that (a) is subject to the primary supervision of a court within the United States and the control of one or more U.S. persons or (b) has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person.

TAXATION OF DIVIDENDS

SUBJECT TO THE DISCUSSION BELOW UNDER THE HEADING "PASSIVE FOREIGN INVESTMENT COMPANIES," the gross amount of any distributions received with respect to ordinary shares, including the amount of any Israeli taxes withheld therefrom, will constitute dividends for U.S. federal income tax purposes, to the extent of our current and accumulated earnings and profits as determined for U.S. federal income tax purposes. You will be required to include this amount of dividends in gross income as ordinary income. Distributions in excess of our earnings and profits will be treated as a non-taxable return of capital to the extent of your tax basis in the ordinary shares, and any amount in excess of your tax basis will be treated as gain from the sale of ordinary shares. See "--Disposition of Ordinary Shares" below for the discussion on the taxation of capital gains. Dividends will not qualify for the dividends-received deduction generally available to corporations under Section 243 of the Code.

Dividends that we pay in NIS, including the amount of any Israeli taxes withheld therefrom, will be included in your income in a U.S. dollar amount calculated by reference to the exchange rate in effect on the day such dividends are received. A U.S. Holder who receives payment in NIS and converts NIS into U.S. dollars at an exchange rate other than the rate in effect on the day of receipt may have a foreign currency exchange gain or loss that would be treated as ordinary income or loss. U.S. Holders should consult their own tax advisors concerning the U.S. tax consequences of acquiring, holding and disposing of NIS.

Subject to complex limitations, any Israeli withholding tax imposed on such dividends will be a foreign income tax eligible for credit against a U.S. Holder's U.S. federal income tax liability, subject to certain limitations set out in the Code (or, alternatively, for deduction against income in determining such tax liability). The limitations set out in the Code include computational rules under which foreign tax credits allowable with respect to specific classes of income cannot exceed the U.S. federal income taxes otherwise payable with respect to each such class of income. Dividends generally will be treated as foreign-source passive category income or general category income for United States foreign tax credit purposes. A U.S. Holder will be denied a foreign tax credit with respect to Israeli income tax withheld from dividends received on the ordinary shares to the extent such 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 or to the extent such U.S. Holder is under an obligation to make related payments with respect to 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 16-day holding period required by the statute. Further, there are special rules for computing the foreign tax credit limitation of a taxpayer who receives dividends subject to a reduced tax rate. The rules relating to the determination of the foreign tax credit are complex, and you should consult with your personal tax advisors to determine whether and to what extent you would be entitled to this credit.

Subject to certain limitations, "qualified dividend income" received by a noncorporate U.S. Holder through 2010 will be subject to tax at a reduced maximum tax rate of 15 percent. THE RATE REDUCTION DOES NOT APPLY TO DIVIDENDS RECEIVED FROM PASSIVE FOREIGN INVESTMENT COMPANIES, SEE DISCUSSION BELOW. Distributions taxable as dividends paid on the ordinary shares should qualify for the 15 percent rate provided that either: (i) we are entitled to benefits under the income tax treaty between the United States and Israel (the "Treaty") or (ii) the ordinary shares are readily tradable on an established securities market in the United States and certain other requirements are met. We believe that we are entitled to benefits under the Treaty and that the ordinary shares currently are readily tradable on an established securities market in the United States. However, no assurance can be given that the ordinary shares will remain readily tradable. The rate reduction does not apply unless certain holding period requirements are satisfied. With respect to the ordinary shares, the U.S. Holder must have held such shares for at least 61 days during the 121-day period beginning 60 days before the ex-dividend date. The rate reduction also does not apply in respect of certain hedged positions or in certain other situations. The legislation enacting the reduced tax rate contains special rules for computing the foreign tax credit limitation of a taxpayer who receives dividends subject to the reduced tax rate. U.S. Holders of ordinary shares should consult their own tax advisors regarding the effect of these rules in their particular circumstances.

DISPOSITION OF ORDINARY SHARES

If you sell or otherwise dispose of ordinary shares, you will recognize gain or loss for U.S. federal income tax purposes in an amount equal to the difference between the amounts realized on the sale or other disposition and the

adjusted tax basis in ordinary shares. SUBJECT TO THE DISCUSSION BELOW UNDER THE HEADING "PASSIVE FOREIGN INVESTMENT COMPANIES," such gain or loss generally will be capital gain or loss and will be long-term capital gain or loss if you have held the ordinary shares for more than one year at the time of the sale or other disposition. In general, any gain that you recognize on the sale or other disposition of ordinary shares will be U.S.-source for purposes of the foreign tax credit limitation; losses will generally be allocated against U.S. source income. Deduction of capital losses is subject to certain limitations under the Code.

In the case of a cash basis U.S. Holder who receives NIS in connection with the sale or disposition of ordinary shares, the amount realized will be based on the U.S. dollar value of the NIS received with respect to the ordinary shares as determined on the settlement date of such exchange. A U.S. Holder who receives payment in NIS and converts NIS into United States dollars at a conversion rate other than the rate in effect on the settlement date may have a foreign currency exchange gain or loss that would be treated as ordinary income or loss.

An accrual basis U.S. Holder may elect the same treatment required of cash basis taxpayers with respect to a sale or disposition of ordinary shares, provided that the election is applied consistently from year to year. Such election may not be changed without the consent of the Internal Revenue Service. In the event that an accrual basis U.S. Holder does not elect to be treated as a cash basis taxpayer (pursuant to the Treasury regulations applicable to foreign currency transactions), such U.S. Holder may have a foreign currency gain or loss for U.S. federal income tax purposes because of differences between the U.S. dollar value of the currency received prevailing on the trade date and the settlement date. Any such currency gain or loss would be treated as ordinary income or loss and would be in addition to gain or loss, if any, recognized by such U.S. Holder on the sale or disposition of such ordinary shares.

PASSIVE FOREIGN INVESTMENT COMPANIES

There is a substantial risk that we may become a passive foreign investment company, or PFIC, for U.S. federal income tax purposes. Our treatment as a PFIC could result in a reduction in the after-tax return to the U.S. Holders of our ordinary shares and may cause a reduction in the value of such shares.

For U.S. federal income tax purposes, we will be classified as a PFIC for any taxable year in which either (i) 75% or more of our gross income is passive income, or (ii) at least 50% of the average value of all of our assets for the taxable year produce or are held for the production of passive income. For this purpose, cash is considered to be an asset which produces passive income. Passive income generally includes dividends, interest, royalties, rents, annuities and the excess of gains over losses from the disposition of assets which produce passive income. As a result of our relatively substantial cash position at the time, we believe that we were a PFIC in certain periods in the past under a literal application of the asset test described above, which looks solely to the market value of our assets. We do not believe that we were a PFIC in 2006.

If we are a PFIC, dividends will not qualify for the reduced maximum tax rate, applicable to qualified dividend income, discussed above, and, unless you timely elect to "mark-to-market" your ordinary shares, as described below:

- you will be required to allocate income recognized upon receiving certain dividends or gain recognized upon the disposition of ordinary

shares ratably over the holding period for such ordinary shares,

- the amount allocated to each year during which we are considered a PFIC other than the year of the dividend payment or disposition would be subject to tax at the highest individual or corporate tax rate, as the case may be, in effect for that year and an interest charge would be imposed with respect to the resulting tax liability allocated to each such year,

- the amount allocated to the current taxable year and any taxable year before we became a PFIC would be taxable as ordinary income in the current year, and

- you will be required to make an annual return on IRS Form 8621 regarding distributions received with respect to ordinary shares and any gain realized on your ordinary shares.

In addition, holders of stock in a PFIC may not receive a "step-up" in basis on shares acquired from a decedent.

The PFIC provisions discussed above apply to U.S. persons who directly or indirectly hold stock in a PFIC. Generally, a U.S. person is considered an indirect shareholder of a PFIC if it is:

- A direct or indirect owner of a pass-through entity, including a trust or estate, that is a direct or indirect shareholder of a PFIC,

- A shareholder of a PFIC that is a shareholder of another PFIC, or

- A 50%-or-more shareholder of a foreign corporation that is not a PFIC and that directly or indirectly owns stock of a PFIC.

An indirect shareholder may be taxed on a distribution paid to the direct owner of the PFIC and on a disposition of the stock indirectly owned. Indirect shareholders are strongly urged to consult their tax advisors regarding the application of these rules.

If we cease to be a PFIC in a future year, a U.S. Holder may avoid the continued application of the tax treatment described above by electing to be treated as if it sold its ordinary shares on the last day of the last taxable year in which we were a PFIC. Any gain would be recognized and subject to tax under the rules described above. Loss would not be recognized. A U.S. Holder's basis in its ordinary shares would be increased by the amount of gain, if any, recognized on the sale. A U.S. Holder would be required to treat its holding period for its ordinary shares as beginning on the day following the last day of the last taxable year in which we were a PFIC.

If the ordinary shares are considered "marketable stock" and if you elect to "mark-to-market" your ordinary shares, you would not be subject to the rules described above. Instead, you will generally include in income any excess of the fair market value of the ordinary shares at the close of each tax year over your adjusted basis in the ordinary shares. If the fair market value of the ordinary shares had depreciated below your adjusted basis at the close of the tax year, you may generally deduct the excess of the adjusted basis of the ordinary shares over its fair market value at that time. However, such deductions generally would be limited to the net mark-to-market gains, if any, that you included in

income with respect to such ordinary shares in prior years. Income recognized and deductions allowed under the mark-to-market provisions, as well as any gain or loss (to the extent of net mark-to-market gains) on the disposition of ordinary shares with respect to which the mark-to-market election is made, is treated as ordinary income or loss. Loss on a disposition, to the extent in excess of net mark-to-market gains, would be treated as capital loss. Gain or loss from the disposition of ordinary shares (as to which a "mark-to-market" election was made) in a year in which we are no longer a PFIC will be capital gain or loss. Loss on a disposition, to the extent in excess of net mark-to-market gains, would be treated as capital loss. Our ordinary shares should be considered "marketable stock" if they traded at least 15 days during each calendar quarter of the relevant calendar year in more than de minimis quantities.

A U.S. Holder of ordinary shares will not be able to avoid the tax consequences described above by electing to treat us as a qualified electing fund, or QEF, because we do not intend to prepare the information that U.S. Holders would need to make a QEF election.

BACKUP WITHHOLDING AND INFORMATION REPORTING

Payments in respect of ordinary shares may be subject to information reporting to the U.S. Internal Revenue Service and to U.S. backup withholding tax at a rate equal to the fourth lowest income tax rate applicable to individuals which, under current law, is 28%. Backup withholding will not apply, however, if you (i) are a corporation or come within certain exempt categories, and demonstrate the fact when so required, or (ii) furnish a correct taxpayer identification number and make any other required certification.

Backup withholding is not an additional tax. Amounts withheld under the backup withholding rules may be credited against a U.S. Holder's U.S. tax liability, and a U.S. Holder may obtain a refund of any excess amounts withheld under the backup withholding rules by filing the appropriate claim for refund with the IRS.

Any U.S. Holder who holds 10% or more in vote or value of our ordinary shares will be subject to certain additional United States information reporting requirements.

U.S. GIFT AND ESTATE TAX

An individual U.S. Holder of ordinary shares will be subject to U.S. gift and estate taxes with respect to ordinary shares in the same manner and to the same extent as with respect to other types of personal property.

F. DIVIDEND AND PAYING AGENTS

Not applicable.

G. STATEMENT BY EXPERTS

Not applicable.

H. DOCUMENTS ON DISPLAY

We are subject to the reporting requirements of the United States Securities Exchange Act of 1934, as amended, as applicable to "foreign private

issuers" as defined in Rule 3b-4 under the Exchange Act, and in accordance therewith, we file annual and interim reports and other information with the Securities and Exchange Commission.

As a foreign private issuer, we are exempt from certain provisions of the Exchange Act. Accordingly, our proxy solicitations are not subject to the disclosure and procedural requirements of Regulation 14A under the Exchange Act, transactions in our equity securities by our officers and directors are exempt from reporting and the "short-swing" profit recovery provisions contained in Section 16 of the Exchange Act. In addition, we are not required under the Exchange Act to file periodic reports and financial statements as frequently or as promptly as U.S. companies whose securities are registered under the Exchange Act. However, we distribute annually to our shareholders an annual report containing financial statements that have been examined and reported on, with an opinion expressed by, an independent public accounting firm, and we file reports with the Securities and Exchange Commission on Form 6-K containing unaudited financial information for the first three quarters of each fiscal year.

This annual report and the exhibits thereto and any other document we file pursuant to the Exchange Act may be inspected without charge and copied at prescribed rates at the following Securities and Exchange Commission public reference rooms: 100 F Street, N.E., Room 1580, Washington, D.C. 20549; and on the Securities and Exchange Commission Internet site (http://www.sec.gov) and on our website www.mtsint.com. You may obtain information on the operation of the Securities and Exchange Commission's public reference room in Washington, D.C. by calling the Securities and Exchange Commission at 1-800-SEC-0330 or by visiting the Securities and Exchange Commission's website at http://www.sec.gov, and may obtain copies of our filings from the public reference room by calling 1-800-SEC-0330. The Exchange Act file number for our Securities and Exchange Commission filings is 0-28950.

The documents concerning our company referred to in this annual report may also be inspected at our offices located at 22 Zarhin Street, Ra'anana 43662, Israel.

I. SUBSIDIARY INFORMATION

Not applicable.

ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

EXPOSURE TO MARKET RISKS

We are exposed to a variety of risks, including changes in interest rates affecting primarily the interest received on short-term deposits, and foreign currency fluctuations. We do not use derivative financial instruments to hedge against such exposure.

INTEREST RATE RISK

Our exposure to market risk for changes in interest rates relates primarily to our short term deposits. Our short term deposits are held in dollars and bear annual interest of 3.5% to 4.5%, which is based upon the London Inter Bank Offered Rate (LIBOR). We place our short term deposits with major financial center U.S. banks. For purposes of specific risk analysis, we use sensitivity analysis to determine the impact that market risk exposure may have on the financial income derived from our short term deposits. The potential loss to us

over one year that would result from a hypothetical change of 10% in the LIBOR rate would be approximately $20,000.

FOREIGN CURRENCY EXCHANGE RISK

We have operations in several countries in connection with the sale of our products. A substantial portion of our sales and expenditures are denominated in dollars. We have mitigated, and expect to continue to mitigate, a portion of our foreign currency exposure through salaries, marketing and support operations in which all costs are local currency based. As a result, our results of operations and cash flows can be affected by fluctuations in foreign currency exchange rates (primarily the Euro and NIS). A hypothetical 10% movement in foreign currency rates (primarily the Euro and NIS) against the dollar, with all other variables held constant on the expected sales, would result in a decrease or increase in expected 2007 sales revenues of $200,000.

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

Not applicable.

ITEM 15. CONTROLS AND PROCEDURES

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

ITEM 15T. CONTROLS AND PROCEDURES

Not applicable.

ITEM 16. [RESERVED]

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Our board of directors has determined that Mr. Yaacov Goldman, an independent director, meets the definition of an audit committee financial expert, as defined by rules of the Securities and Exchange Commission.

ITEM 16B. CODE OF ETHICS

We have adopted a code of ethics that applies to our chief executive officer and all senior financial officers of our company, including the chief financial officer, chief accounting officer or controller, or persons performing similar functions. Our code of ethics has been filed as an exhibit to this annual report. Written copies are available upon request. If we make any substantive amendment to the code of ethics or grant any waivers, including any implicit waiver, from a provision of the codes of ethics, we will disclose the nature of such amendment or waiver on our website.

ITEM 16C. PRINCIPAL ACCOUNTING FEES AND SERVICES

FEES PAID TO INDEPENDENT PUBLIC ACCOUNTANTS

The following table sets forth, for each of the years indicated, the fees paid to our principal independent registered public accounting firm. All of such fees were pre-approved in advance by our Audit Committee.

	Year Ended December 31,	
Services Rendered	2006	2005
Audit (1)	$ 83,173	$123,162
Audit-related(2)	8,601	7,500
Tax (3)	20,528	19,537
Other (4)	--	1,734
Total	$112,302	$151,933

(1) Audit fees consist of services that would normally be provided in connection with statutory and regulatory filings or engagements, including services that generally only the independent registered public accounting firm can reasonably provide.

(2) Audit-related fees relate to services provided in connection with the filing of a Report on Form 6-K for the six months period ended June 30, 2006.

(3) Tax fees relate to services performed by the tax division for tax compliance, planning, and advice.

(4) Other fees relate to services provided by our principal independent registered public accounting firm other than services covered by above categories.

PRE-APPROVAL POLICIES AND PROCEDURES

Our audit committee has adopted a policy and procedures for the pre-approval of audit and non-audit services rendered by our independent registered public accountants, Kost Forer Gabbay & Kasierer, a member firm of Ernst & Young Global. Pre-approval of an audit or non-audit service may be given as a general pre-approval, as part of the audit committee's approval of the scope of the engagement of our independent auditor, or on an individual basis. Any proposed services exceeding general pre-approved levels also require specific pre-approval by our audit committee. The policy prohibits retention of the independent public accountants to perform the prohibited non-audit functions defined in Section 201 of the Sarbanes-Oxley Act or the rules of the Securities

and Exchange Committee, and also requires the audit committee to consider whether proposed services are compatible with the independence of the public accountants.

ITEM 16D. EXEMPTIONS FROM THE LISTING REQUIREMENTS AND STANDARDS FOR AUDIT COMMITTEE

Not applicable.

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

ISSUER PURCHASE OF EQUITY SECURITIES

Neither we nor any affiliated purchaser has purchased any of our securities during 2006.

PART III

ITEM 17. FINANCIAL STATEMENTS

We have elected to furnish financial statements and related information specified in Item 18.

ITEM 18. FINANCIAL STATEMENTS

CONSOLIDATED FINANCIAL STATEMENTS OF MER TELEMANAGEMENT SOLUTIONS LTD.

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ITEM 19. EXHIBITS

Index to Exhibits

EXHIBIT	DESCRIPTION
1.1	Memorandum of Association of the Registrant (1)
1.2	Articles of Association of the Registrant (1)
2.1	Specimen of Ordinary Share Certificate (1)
4.1	1996 Employee Stock Option Plan (1)
4.2	Section 102 Stock Option Plan (1)
4.3	2003 Israeli Share Option Plan (2)
4.4	2006 Stock Option Plan (3)
4.5	Asset Purchase Agreement dated December 30, 2004 among the Registrant and Teleknowledge Group Ltd. (4)
4.6	Securities Purchase Agreement dated August 10, 2005 among the Registrant and the Investors therein (5)
4.7	Form of Warrant (6)
4.8	Registration Rights Agreement dated August 10, 2005 (7)
4.9	Form of Warrant issued to Mr. Avi Ziv (8)
5.0	Asset Purchase Agreement dated July 25, 2006 by and among MTS Acquisition Corp. (now named MTS TelSoft Inc.), MTS IntegraTRAK Inc., TelSoft Solutions, Inc. (now named Strategic Sciences Inc.), Consulting Sciences, Inc., Donald Simons and Dale Zuehls
8.1	List of Subsidiaries of the Registrant
11.1	Code of Ethics (9)
12.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended.
12.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended.
13.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
13.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

15.1 Consent of Kost Forer Gabbay & Kasierer, a Member of Ernst & Young Global

15.2 Consent of BDO Audiberia Auditores, S.L.

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(1) Filed as an exhibit to the Registrant's Registration Statement on Form F-1, registration number 333-05814, filed with the Securities and Exchange Commission, and incorporated herein by reference.

(2) Filed as Exhibit 10.3 to the Registrant's Annual Report on Form 20-F for the year ended December 31, 2003, and incorporated herein by reference.

(3) Filed as Appendix B to Item 1 of the Registrant's Report on Form 6-K for the month of June 2006 submitted on June 23, 2006, and incorporated herein by reference.

(4) Filed as Exhibit 4.1 to the Registrant's Annual Report on Form 20-F for the year ended December 31, 2004, and incorporated herein by reference.

(5) Filed as Item 1 to the Registrant's Report on Form 6-K for the month of August 2005 submitted on August 19, 2005, and incorporated herein by reference.

(6) Filed as Item 3 to the Registrant's Report on Form 6-K for the month of August 2005 submitted on August 19, 2005, and incorporated herein by reference.

(7) Filed as Item 2 to the Registrant's Report on Form 6-K for the month of August 2005 submitted on August 19, 2005, and incorporated herein by reference.

(8) Filed as Exhibit 4.6 to the Registrant's Registration Statement on Form F-3, registration number 333-128225, and incorporated herein by reference.

(9) Filed as Exhibit 14.1 to the Registrant's Annual Report on Form 20-F for the year ended December 31, 2003, and incorporated herein by reference.

MER TELEMANAGEMENT SOLUTIONS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2006

U.S. DOLLARS IN THOUSANDS

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

TO THE BOARD OF DIRECTORS AND SHAREHOLDERS OF

MER TELEMANAGEMENT SOLUTIONS LTD.

We have audited the accompanying consolidated balance sheets of Mer Telemanagement Solutions Ltd. ("the Company") and its subsidiaries as of December 31, 2005 and 2006, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2006. 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 did not audit the financial statements of Jusan SA, a 50% owned affiliate for the years ended December 31, 2005 and 2006, in which the Company's investments totaled $ 1,615 thousand and $ 1,598 thousand as of December 31, 2005 and 2006, respectively and the Company's equity in its income in 2004, 2005 and 2006 constitutes $ 225 thousand $ 2 thousand and $ 159 thousand, respectively. We also did not audit the financial statements of MTS Asia Ltd., a wholly-owned subsidiary, which statements reflect total assets of $ 302 thousand as of December 31, 2006, and total revenues of $ 624 thousand for the year then ended. Those statements were audited by other auditors whose reports have been furnished to us and our opinion, insofar as it relates to amounts emanating from the financial statements of Jusan SA and MTS Asia Ltd., is based solely on the reports of the other auditors.

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. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits and the reports of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of the other auditors, 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, 2005 and 2006, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2006, in conformity with accounting principles generally accepted in the United States.

As discussed in Note 2 to the consolidated financial statements, in 2006, the Company adopted Financial Accounting Standard Board Statement No. 123(R), "Share-Based Payment".

/s/ Kost Forer Gabbay & Kasierer

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

Tel-Aviv, Israel
March 30, 2007

MER TELEMANAGEMENT SOLUTIONS LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

U.S. DOLLARS IN THOUSANDS

	DECEMBER 31,	
	2005	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 3,191	$
Short term bank deposits	-	
Marketable securities (Note 3)	132	
Trade receivables (net of allowance for doubtful accounts of $ 402 and $ 505 at December 31, 2005 and 2006, respectively)	1,895	
Unbilled receivables	104	
Other accounts receivable and prepaid expenses (Note 4)	491	
Inventories (Note 5)	181	
TOTAL current assets	5,994	
LONG-TERM ASSETS:		
Investments in an affiliate (Note 6)	1,615	
Long-term loans, net of current maturities (Note 7)	3	
Severance pay fund	478	
Other investments (Note 8)	347	
Deferred income taxes (Note 14)	115	
TOTAL long-term assets	2,558	
PROPERTY AND EQUIPMENT, NET (Note 9)	571	
OTHER ASSETS:		
Goodwill (Note 10a)	3,700	
Other intangible assets, net (Note 10b)	993	

TOTAL other assets	4,693	
TOTAL assets	$13,816	$1

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

MER TELEMANAGEMENT SOLUTIONS LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

U.S. DOLLARS IN THOUSANDS (EXCEPT SHARE AND PER SHARE DATA)

	DECEMBER	
	2005	
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Short term bank credit and current maturities on bank loan	$ -	$
Trade payables	735	
Accrued expenses and other liabilities (Note 11)	2,306	
Deferred revenues	888	
TOTAL current liabilities	3,929	
LONG-TERM LIABILITIES:		
Long term bank loan (Note 12)	-	
Accrued severance pay	713	
TOTAL long-term liabilities	713	
COMMITMENTS AND CONTINGENT LIABILITIES (Note 13)		
SHAREHOLDERS' EQUITY (Note 16):		
Share capital -		
Ordinary shares of NIS 0.01 par value - Authorized: 12,000,000 shares at December 31, 2005 and 2006; Issued: 5,744,304 and 5,784,645 shares at December 31, 2005 and 2006, respectively; Outstanding: 5,733,504 and 5,773,845 shares at December 31, 2005 and 2006, respectively	17	
Additional paid-in capital	15,966	
Treasury shares (10,800 Ordinary shares at December 31, 2005 and 2006)	(29)	
Deferred stock compensation	(142)	
Accumulated other comprehensive income (loss)	(75)	
Accumulated deficit	(6,563)	
TOTAL shareholders' equity	9,174	

TOTAL liabilities and shareholders' equity	$ 13,816	$

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

MER TELEMANAGEMENT SOLUTIONS LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

U.S. DOLLARS IN THOUSANDS (EXCEPT SHARE AND PER SHARE DATA)

	YEAR ENDED	
	2004	2
Revenues (Note 17):		
Product sales	$ 7,070	$
Services	2,343	
TOTAL revenues	9,413	
Cost of revenues:		
Product sales	2,407	
Services	407	
TOTAL cost of revenues	2,814	
Gross profit	6,599	
Operating expenses:		
Research and development, net of grants from the OCS in the amount of $ 0, $ 130, $ 578 in 2004, 2005 and 2006, respectively	2,362	
Selling and marketing	6,300	
General and administrative	2,101	
TOTAL operating expenses	10,763	
Operating loss	(4,164)	
Financial income (expenses), net	78	
Loss before taxes on income	(4,086)	
Taxes on income (Note 14)	266	
Loss before equity in earnings of affiliate	(4,352)	
Equity in earnings of affiliate	225	

Net loss	$ (4,127)	$
Net loss per share:		
Basic and diluted net loss per Ordinary share	$ (0.89)	$
Weighted average number of Ordinary shares used in computing basic and diluted net loss per share	4,634,413	5,0

(*) Including stock-based employee compensation in the amounts of $ 21, $ 101, $ 17 and $ 71 in cost of revenues, research and development, selling and marketing and general and administrative, respectively.

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

MER TELEMANAGEMENT SOLUTIONS LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. DOLLARS IN THOUSANDS

	SHARE CAPITAL		ADDITI PAID-
	NUMBER	AMOUNT	CAPIT
Balance as of January 1, 2004	4,624,471	$ 14	$ 12,
Exercise of options	17,333	*) -	
Employee stock based compensation	-	-	
Amortization of deferred stock compensation	-	-	
Purchase of treasury shares	(3,800)	-	
Other comprehensive loss:			
Unrealized gains on available-for-sale marketable securities, net	-	-	
Foreign currency translation adjustments	-	-	
Gain from cash flows hedging transaction	-	-	
Total other comprehensive income	-		
Net loss	-	-	
Total comprehensive loss			
Balance as of December 31, 2004	4,638,004	14	12,
Issuance of shares, net	937,500	2	2,
Exercise of options	158,000	1	
Stock based compensation related to warrants issued to non employees	-	-	
Amortization of deferred stock compensation	-	-	
Other comprehensive loss:			
Unrealized losses on available-for-sale marketable securities, net	-	-	

Foreign currency translation adjustments	-	-	
Total other comprehensive loss			
Net loss	-	-	
Total comprehensive loss			
Balance as of December 31, 2005	5,733,504	17	15,
Exercise of options	40,341	*)	-
Stock based compensation related to warrants issued to non employees	-	-	
Stock based compensation related to options issued to employees	-	-	
Reclassification of deferred stock compensation due to implementation of SFAS 123R	-	-	(
Other comprehensive loss:			
Unrealized gains on available-for-sale marketable securities, net	-	-	
Foreign currency translation adjustments	-	-	
Total other comprehensive income	-	-	
Net loss	-	-	
Total comprehensive loss			
Balance as of December 31, 2006	5,773,845	$ 17	$ 16,
Accumulated unrealized gains from available-for-sale marketable securities			
Accumulated foreign currency translation adjustments			

*) Represents an amount lower than $ 1.

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

MER TELEMANAGEMENT SOLUTIONS LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. DOLLARS IN THOUSANDS

	YEAR ENDED DECEMBER 3		
	2004	2005	2
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net loss	$ (4,127)	$ (4,216)	$ (
Adjustments required to reconcile net loss to net cash used in operating activities:			
Gains on sale of available-for-sale marketable securities	-	(77)	

Loss on sale of property and equipment	1	-	
Impairment of other investments	-	27	
Equity in earnings of affiliate	(225)	(2)	
Depreciation and amortization	399	655	
Deferred income taxes, net	33	10	
Employee stock-based compensation	66	66	
Stock based compensation related to warrants issued to non employees	-	156	
Accrued severance pay, net	2	119	
Decrease (increase) in trade receivables and unbilled receivables	144	(672)	
Decrease (increase) in other accounts receivable and prepaid expenses	175	(99)	
Decrease (increase) in inventories	15	(3)	
Increase (decrease) in trade payables	326	16	
Increase (decrease) in accrued expenses and other liabilities	611	(46)	
Increase (decrease) in deferred revenues	(41)	(366)	
Increase in related parties, net	20	15	
Net cash used in operating activities	(2,601)	(4,417)	(
CASH FLOWS FROM INVESTING ACTIVITIES:			
Proceeds from sale of property and equipment	22	7	
Purchase of property and equipment	(293)	(251)	
Capitalization of research and development costs	(386)	-	
Investment in short term bank deposit	-	-	
Investment in lease deposits	(5)	(26)	
Investment in available-for-sale marketable securities	(220)	(163)	
Proceeds from sale of available-for-sale marketable securities	891	1,089	
Additional investment in goodwill in consideration of TeleKnowledge acquisition	-	(21)	
Acquisition of certain assets and liabilities of Teleknowledge (a)	(2,445)	-	
Acquisition of certain assets and liabilities of Telsoft (a)	-	-	(
Dividend from an affiliate	136	195	
Others	50	63	
Net cash provided by (used in) investing activities	(2,250)	893	(

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 3		
	2004	2005	2

CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from long term loan	$ -	$ -	$
Proceeds from short term bank credit	-	-	
Repayment of long-term loans	(8)	-	
Proceeds from issuance of shares and warrants, net	-	2,625	
Proceeds from exercise of options and warrants	2	281	
Purchase of treasury shares	(9)	-	
Net cash provided by (used in) financing activities	(15)	2,906	
Effect of exchange rate changes on cash and cash equivalents	(4)	(5)	
Decrease in cash and cash equivalents	(4,870)	(623)	(
Cash and cash equivalents at the beginning of the year	8,684	3,814	
Cash and cash equivalents at the end of the year	$ 3,814	$ 3,191	$
SUPPLEMENTAL DISCLOSURE OF CASH FLOWS ACTIVITIES:			
Cash paid during the year for:			
Interest	$ 1	$ 3	$
Income taxes	$ 25	$ 17	$
(a) IN CONJUNCTION WITH THE ACQUISITIONS, THE FAIR VALUES OF ASSETS ACQUIRED AND LIABILITIES ASSUMED AT THE DATE OF ACQUISITION WERE AS FOLLOWS (SEE NOTE 1C AND NOTE 1D):			
Working capital (excluding cash and cash equivalents)	$ 24	$ -	$
Estimated fair value of assets acquired and liabilities assumed at the acquisition date:			
Property and equipment	40	-	
Goodwill	1,391	-	
Developed technology	690	-	
Customer relationship	300	-	
	$ 2,445	$ -	$
(b) SUPPLEMENTAL DISCLOSURE OF NON-CASH ACTIVITIES:			
Earn out in respect of Teleknowledge acquisition	$ -	$ 264	$

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS (EXCEPT SHARE AND PER SHARE DATA)

NOTE 1: - GENERAL

a. Mer Telemanagement Solutions Ltd. ("the Company" or "MTS") was incorporated on December 27, 1995. MTS and its subsidiaries ("the Group") design, develop, market and support a comprehensive line of telecommunication management and customer care & billing ("CC&B") solutions that enable business organizations and other enterprises to improve the efficiency and performance of all IP operations, and reduce associated costs. The Group products include call accounting and management products, fault management systems and web based management solutions for converged voice, voice over Internet Protocol, IP data and video and CC&B solutions. As for MTS's subsidiaries, see Note 18.

b. MTS's products are designed to provide telecommunication and information technology managers with tools to reduce communication costs, recover charges payable by third parties, and to detect and prevent abuse and misuse of telephone networks including fault telecommunication usage.

The Group markets its products worldwide through distributors, business telephone switching systems manufacturers and vendors and its direct sales force. Several international private automatic branch exchange ("PBX") manufacturers market the Group's products as part of their PBX selling efforts or on an Original Equipment Manufacturer ("OEM") basis. The Group is highly dependent upon the active marketing and distribution of its OEM's. If the Group is unable to effectively manage and maintain a relationship with its OEM or any event negatively affecting such dealer's financial condition, could cause a material adverse effect on the Group's results of operations and financial position. In 2004, 2005 and 2006, one major customer generated 38%, 36% and 29% of the Group's revenues, respectively.

Certain components and subassemblies included in the Group's products are obtained from a single source or a limited group of suppliers and subcontractors. If such supplier fails to deliver the necessary components or subassemblies, the Company may be required to seek alternative sources of supply. A change in supplier could result in manufacturing delays, which could cause a possible loss of sales and, consequently, could adversely affect the Company's results of operations and financial position.

MTS's shares are listed for trade on the Nasdaq Capital Market.

c. On December 30, 2004, the Company and Teleknowledge Group Ltd. ("Teleknowledge") consummated an Assets Purchase Agreement ("the Agreement"). TeleKnowledge is a leading provider of carrier-class billing and rating solutions. The integration of Teleknowledge's billing solution enables MTS to offer an end-to-end customer care and billing solution. Under the terms

of the Agreement, the Company acquired certain assets and liabilities of Teleknowledge for the following consideration:

1. An initial consideration of $ 2,374 in cash.

NOTE 1: - GENERAL (CONT.)

2. Additional contingent consideration of up to an amount of $ 3,650, based on post acquisition revenue performance (calculated as 10% of renewal maintenance fees and 20% of all other revenues from sales which included Teleknowledge products), over a period of three years. Such payments will be recorded as additional goodwill, during the contingency period, when actual revenue performance will be evaluated (see Note 10a). In 2005 and 2006 additional considerations of $285 and $192, respectively, were recorded, in accordance with the agreement.

3. In addition, the Company incurred transaction costs totaling $ 71.

Prior to the acquisition, MTS and Teleknowledge had an OEM relationship. The commercial arrangements and transactions were settled before the date of the acquisition.

The acquisition was accounted for under the purchase method of accounting in accordance with SFAS 141, "Business Combination" ("SFAS 141"). Accordingly, the purchase price has been allocated to the assets acquired and the liabilities assumed based on the estimated fair value at the date of acquisition. The excess of the purchase price over the estimated fair value of the net assets acquired has been recorded as goodwill.

Based upon a valuation of the tangible and intangible assets acquired and the liabilities assumed, the Company has allocated the total cost of the acquisition to Teleknowledge's net assets at the date of acquisition, as follows:

Trade receivables	$ 100
Property and equipment	40
Intangible assets:	
Developed technology (four-year useful life)	690
Customer relationship (six-year useful life)	300
Goodwill	1,391
Total assets acquired	2,521
Liabilities assumed - Deferred revenues	(76)

Net assets acquired	$ 2,445

The valuation of the Company's developed technology was based on the income approach, which reflects the future economic benefits from Teleknowledge products. The value assigned to customer relationship was based on the cost approach. Under this approach, the customer relationship was valued by calculating the savings realized by the Company through obtaining a pre-existing customer relationship of Teleknowledge.

Goodwill including accumulated earnout as of December 31, 2006 amounted to $ 1,868.

NOTE 1: - GENERAL (CONT.)

d. On July 25, 2006, the Company and Telsoft Solutions, Inc. ("Telsoft") consummated an Asset Purchase Agreement ("APA"). Telsoft is a provider of call accounting and TEM solutions to organizations and the acquisition shall enable the Company to increase its customer base. Under the terms of the APA, the Company acquired certain assets and assumed certain enumerated liabilities of Telsoft for the following consideration:

1. An initial consideration of $ 1,100 in cash.

2. Additional earn-out payments based on revenue milestones for the 12 months period following the acquisition. Such payments will be recorded as additional goodwill, during the contingency period, when actual revenue performance will be evaluated (see Note 10a).

The acquisition was completed on July 31, 2006.

In order to finance the acquisition, the Company signed a loan agreement with Bank Hapoalim (the "Bank"), according to which the Bank granted the Company a loan in the amount of approximately $ 1,000 (see also Note 12).

The acquisition was accounted for under the purchase method of accounting in accordance with SFAS 141, "Business Combination" ("SFAS 141"). Accordingly, the purchase price has been allocated to the assets acquired and the liabilities assumed based on the estimated fair value at the date of acquisition. The excess of the purchase price over the estimated fair value of the net assets acquired has been recorded as goodwill.

Based upon a valuation of the tangible and intangible assets

acquired and the liabilities assumed, the Company has allocated the total cost of the acquisition to TelSoft's net assets at the date of acquisition, as follows:

Property and equipment	5
Intangible assets:	
Developed technology - ProductA (six-year useful life)	270
Developed technology - Product B (four-year useful life)	163
Customer relationship (six-year useful life)	645
Goodwill	166
Total assets acquired	1,249
Liabilities assumed - Deferred maintenance	(47)
Net assets acquired	$ 1,202

The valuation of the Company's developed technology was based on the income approach, which reflects the future economic benefits from TelSoft products. The value assigned to customer relationship was based on the income approach. The fair value of customer relationship was estimated by discounting to present value, the cash flows that will be derived from TelSoft's customers retained by MTS.

NOTE 1: - GENERAL (CONT.)

Pro forma results (Unaudited):

The following unaudited proforma information does not purport to represent what the Company's results of operations would have been had the acquisitions occurred on January 1, 2005 and 2006, nor does it purport to represent the results of operations of the Company for any future period.

	YEAR ENDED 2005
Revenues	$ 13,045
Net loss from continuing operations	$ (3,923
Basic and diluted net loss per share for continuing operations	$ (0.77

Weighted average number of Ordinary shares in computation of basic and diluted net loss per share	5,092,117

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP").

a. Use of estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

b. Financial statements in U.S. dollars:

The majority of the revenues of the Company and certain of its subsidiaries are generated in or linked to the U.S. dollar ("dollar"). In addition, a substantial portion of the Company's and certain of its subsidiaries' costs is incurred in dollars. Company's management believes that the dollar is the currency of the primary economic environment in which the Company and certain of its subsidiaries operate. Thus, the functional and reporting currency of the Company and certain of its subsidiaries is the dollar.

Accordingly, monetary accounts maintained in currencies other than the dollar are remeasured into dollars in accordance with SFAS No. 52, "Foreign Currency Translation". All transaction gains and losses of the remeasurement of monetary balance sheet items are reflected in the consolidated statements of operations as financial income or expenses, as appropriate.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT.)

For those foreign subsidiaries and affiliates, whose functional currency has been determined to be their local currency, assets and liabilities are translated at the year end exchange rates and statements of operations items are translated at the average exchange rate prevailing during the period. The resulting translation adjustments are recorded as a separate component of accumulated other comprehensive income (loss) in shareholders' equity.

c. Principles of consolidation:

The consolidated financial statements include the accounts of MTS and its wholly-owned subsidiaries. Intercompany transactions and balances, including profits from intercompany sales not yet realized outside the Group, have been eliminated upon consolidation.

d. Cash equivalents:

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

e. Marketable securities:

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

Management determines the classification of investments in marketable debt and equity securities at the time of purchase and reevaluates such determinations at each balance sheet date.

The Company classifies all of its securities as available for sale. Available for sale securitiesare carried at fair value, with unrealized gains and losses reported in "accumulated other comprehensive income (loss)" in shareholders' equity. Realized gains and losses on sales of investments, are included in earnings and are derived using the specific identification method for determining the cost of securities.

Interest and dividends on securities are included in financial income, net.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT.)

f. Inventories:

Inventories are stated at the lower of cost or market value. Inventory write-offs and write-down provisions are provided to cover risks arising from slow moving items or technological obsolescence.

The Company and its subsidiaries periodically evaluate the quantities on hand relative to current and historical selling prices and historical and projected sales volume. Based on this evaluation, provisions are recorded when required to

write-off inventory according to its market value.

Cost is determined as follows:

Raw materials - using the "first in, first out" method.

Finished products are recorded on the basis of direct manufacturing costs with the addition of allocable indirect manufacturing costs.

g. Investments in an affiliate:

In these financial statements, the affiliated company is Jusan S.A., a company held at a rate of 50% (which is not a subsidiary), where the Company can exercise significant influence over the operating and financial policy of the affiliate.

The investment in the affiliate is accounted for by the equity method, in accordance with Accounting Principle Board Opinion No.18, "The Equity Method of Accounting for Investments in Common Stock", ("APB No.18"). Profits on intercompany sales, not realized through sales to third parties, were eliminated. The excess of the purchase price over the fair value of net tangible assets acquired has been attributed to goodwill.

Goodwill is reviewed annually (or more frequently if circumstances indicate impairment has occurred) for impairment in accordance with the provisions of Statement of Financial Accounting Standard No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142").

Under APB 18, an impairment of value of an investment accounted for under the equity method, which is other than a temporary decline, should be recognized as a realized loss, establishing a new carrying value for the investment. Factors the Company considers in making this evaluation include: the length of time and the extent to which the market value has been lower than cost, the financial condition and near-term prospects of the issuer, including cash flows of the investee and any specific events which may influence the operations of the issuer and the intent and ability of the Company to retain its investments for a period of time sufficient to allow for any anticipated recovery in market value. A current fair value of an investment that is less than its carrying amount may indicate an impairment of value of the investment. No impairment losses were recorded during 2006.

h. Investment in other companies:

The investment in these companies is stated at cost, since the Group does not have the ability to exercise significant influence over operating and financial policies of those investments. The Company's investments in other companies are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an investment may not be recoverable, in accordance with APB No.18. As of December 31, 2006 and 2005, based on management's most recent analyses, impairment losses in the amount of $ 0 and $ 27, respectively, have been identified and recorded.

i. 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 depreciation rates:

	%
Computers and peripheral equipment	33
Office furniture and equipment	6 - 20
Motor vehicles	15
Leasehold improvements	Shorter of useful life or lease term

j. Impairment of long-lived assets:

The Company's long-lived assets and certain identifiable intangibles are reviewed for impairment in accordance with Statement of Financial Accounting Standard No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"), 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. As of December 31, 2006, no impairment losses have been identified.

k. Goodwill:

Goodwill has been recorded as a result of acquisitions. Goodwill is not amortized, but rather is subject to an annual impairment test.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT.)

SFAS No. 142 requires goodwill to be tested for impairment at least annually or between annual tests if certain events or indicators of impairment occur. The impairment test consists of a comparison of the fair value of goodwill with its carrying amount. If the carrying amount of goodwill exceeds its fair value, an impairment loss is recognized in an amount equal to that excess. Goodwill is tested for impairment at the reporting unit level by a comparison of the fair value of a reporting unit with its carrying amount. The Company has elected to perform its analysis of goodwill at the end of the third quarter of the year. During 2004, 2005 and 2006, no impairment losses were identified (see also Note 10a).

l. Intangible assets:

Intangible assets are amortized over their useful lives using a method of amortization that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used up, in accordance with SFAS 142. Developed technology is amortized over a weighted average of four-six years and customer relationship is amortized over a period of six years. As for capitalized software costs, see n below.

m. Revenue recognition:

The Company generates revenues mainly from licensing the rights to use its software products. Certain software licenses require significant customization. The Company also generates revenues from rendering maintenance, service bureau, support and training. The Company sells its products directly to end-users and indirectly through resellers and OEM's (who are considered end users).

Revenues from software license agreements are recognized when all criteria outlined in Statement of Position No. 97-2, "Software Revenue Recognition" ("SOP No. 97-2") as amended are met. Revenue from license fees is recognized when persuasive evidence of an agreement exists, delivery of the product has occurred, no significant obligations with regard to implementation remain, the fee is fixed or determinable and collectibility is probable. The Company does not grant a right of return to its customers.

Where software arrangements involve multiple elements, revenue is allocated to each undelivered element based on vendor specific objective evidence ("VSOE") of the fair values of each undelivered element in the arrangement, in accordance with the "residual method" prescribed by SOP No. 98-9, "Modification of SOP No. 97-2, Software Revenue Recognition With Respect to Certain Transactions". The VSOE used by the Company to allocate the sales price to support services and maintenance is based on the renewal rate charged when these elements are sold separately. License revenues are recorded based on the residual method. Under the residual method, revenue is recognized for the delivered elements when (1) there is VSOE of the fair values of all the undelivered elements, and (2) all revenue recognition criteria of SOP No. 97-2, as amended, are satisfied. Under the residual method any discount in the arrangement is allocated to the delivered

element.

Revenues from maintenance and support services are recognized over the term of the maintenance and support agreement on a straight line basis.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT.)

Deferred revenues include unearned amounts received under maintenance and support contracts, not yet recognized as revenues.

Revenues from billing products which involve significant customization of the Company's software to customer specific specifications are recognized in accordance with Statement of Position 81-1, "Accounting for Performance of Construction-Type and Certain Production-Type Contracts", using contract accounting on a percentage of completion method, over the period from signing of the license through to customer acceptance in accordance with the "Input Method". The amount of revenue recognized is based on the total arrangement and the percentage to completion achieved. The percentage to completion is measured by monitoring progress using records of actual costs incurred to date in the project compared with the total estimated project requirement. Estimates of total project requirements are based on prior experience of customization, delivery and acceptance of the same or similar technology and are reviewed and updated regularly by management.

After delivery, if uncertainty exists about customer acceptance of the software, license revenue is not recognized until acceptance. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are first determined, in the amount of the estimated loss on the entire contract. As of December 31, 2006, no such estimated losses were identified.

Estimated gross profit or loss from long-term contracts may change due to changes in estimates resulting from differences between actual performance and original forecasts. Such changes in estimated gross profit are recorded in results of operations when they are reasonably determinable by management, on a cumulative catch-up basis.

The Company believes that the use of the percentage of completion method is appropriate as the Company has the ability to make reasonably dependable estimates of the extent of progress towards completion, contract revenues and contract costs. In addition, contracts executed include provisions that

clearly specify the enforceable rights regarding services to be provided and received by the parties to the contracts, the consideration to be exchanged and the manner and terms of settlement. In all cases the Company expects to perform its contractual obligations and its licensees are expected to satisfy their obligations under the contract.

Where arrangements recognized according to SOP 81-1 involve maintenance and support services, revenues are recognized according to Emerging Issues Task Force ("EITF"), Issue No. 00-21 "Revenue Arrangement with Multiple Deliverables" ("EITF 00-21").

According to EITF 00-21 a multiple-element arrangement (an arrangement that involves the delivery or performance of multiple products, services and/or rights to use assets) is separated into more than one unit of accounting, if the functionality of the delivered element is not dependent on the undelivered element, there is vendor-specific objective evidence (VSOE) of fair value of the undelivered element and delivery of the delivered element(s) represents the culmination of the earnings process for these elements. The Company has established VSOE for maintenance and support services based on the renewal rate charged when these elements are sold separately and therefore, the arrangement consideration is allocated to maintenance and support services based on their relative VSOE.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT.)

n. Research and development costs:

Statement of Financial Accounting Standards No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed" ("SFAS No. 86"), requires capitalization of certain software development costs subsequent to the establishment of technological feasibility. Based on the Company's and its subsidiaries' product development process, technological feasibility is established upon completion of a working model.

Research and development costs incurred in the process of developing product improvements or new products, are generally charged to expenses as incurred, net of grants received from the Office of the Chief Scientist of Israel's Ministry of Industry, Trade and Labor (see Note 13b).

Significant costs incurred by the Company and its subsidiaries between completion of the working model and the point at which the product is ready for general release, have been

capitalized.

Capitalized software costs are amortized by the greater of the amount computed using the: 1) ratio that current gross revenues from sales of the software to the total of current and anticipated future gross revenues from sales of that software, or 2) the straight-line method over the estimated useful life of the product (three years). The Company assesses the recoverability of this intangible asset on a regular basis by determining whether the amortization of the asset over its remaining life can be recovered through undiscounted future operating cash flows from the specific software product sold. Based on its most recent analyses, management believes that no impairment of capitalized software development costs exists as of December 31, 2006.

o. Government grants:

Royalty-bearing grants from the Government of Israel for funding certain approved research and development projects are recognized at the time the Company is entitled to such grants, on the basis of the related costs incurred and recorded as a deduction of research and development costs. Research and development grants amounted $ 0, $ 130 and $ 578 in 2004, 2005 and 2006, respectively. Total royalties accrued or paid amounted to $ 181, $ 198 and $ 187 in 2004, 2005 and 2006, respectively and were recorded as part of the cost of goods sold.

p. Income taxes:

The Company accounts for income taxes, in accordance with Statement of Financial Accounting Standard No. 109, "Accounting for Income Taxes" ("SFAS No. 109"). 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. Valuation allowances are provided to reduce deferred tax assets to their estimated realizable value.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT.)

q. Accounting for stock-based compensation:

On January 1, 2006, the Company adopted SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS No. 123(R)") 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. SFAS No. 123(R) supersedes Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB No. 25"), for periods beginning in fiscal year 2006. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 ("SAB 107") relating to SFAS No. 123(R). The Company has applied the provisions of SAB 107 in its adoption of SFAS No. 123(R). SFAS No. 123(R) 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 operations statements.

Prior to the adoption of SFAS No. 123(R), the Company accounted for equity-based awards to employees and directors using the intrinsic value method in accordance with APB No. 25 as allowed under SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123"). Pursuant to these accounting standards, the Company recorded deferred compensation for stock options granted to employees at the date of grant equal to the excess of the market value of the underlying shares at that date over the exercise price of the options.

The Company adopted SFAS No. 123(R) using the modified prospective transition method, which requires the application of the accounting standard starting from January 1, 2006, the first day of the Company's fiscal year 2006. Under that transition method, compensation cost recognized in the year ended December 31, 2006, includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R). Results for prior periods have not been restated.

The Company recognizes compensation expenses for the value of its awards granted subsequent to January 1, 2006 based on the straight line method over the requisite service period of each of the awards, net of estimated forfeitures. SFAS No. 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Estimated forfeitures are based on actual historical pre-vesting forfeitures. Forfeitures were previously accounted for as they occurred, but have been estimated with the adoption of SFAS No. 123(R) for those awards not yet vested. For awards granted prior to January 1, 2006, the Company recognizes compensation expenses based on the accelerated attribution method over the requisite service period of each of the awards. The net loss for the 12 months period ended December 31, 2006 was $ 22 lower than if the Company had continued to account for share-based compensation according to the accelerated attribution method.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS (EXCEPT SHARE AND PER SHARE DATA)

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT.)

As a result of adopting SFAS No. 123(R) on January 1, 2006, the Company's loss before taxes on income and operating loss and net loss for the year ended December 31, 2006, were $ 144 lower, than if the Company had continued to account for stock-based compensation under APB No. 25. Basic and diluted net loss per share for the year ended December 31, 2006 were $ 0.03 lower, than if the Company had continued to account for stock-based compensation under APB No. 25.

The Company estimates the fair value of stock options granted using the Black-Scholes-option pricing model. The option-pricing model requires a number of assumptions, of which the most significant are the expected stock price volatility and the expected option term. Expected volatility was calculated based upon actual historical stock price movements. The expected term of options granted is based upon historical experience and represents the period of time that options granted are expected to be outstanding. The risk-free interest rate is based on the yield from U.S. treasury bonds with an equivalent term. The Company has historically not paid dividends and has no foreseeable plans to pay dividends.

The fair value for options granted in 2004, 2005 and 2006 is estimated at the date of grant using a Black-Scholes options pricing model with the following weighted average assumptions:

	YEAR ENDED DECEMBER 31,		
EMPLOYEE STOCK OPTIONS	2004	2005	2006
Expected volatility	71.8%	56.9%	74.5%
Risk-free interest	2.0%	3.9%	4.6%
Dividend yield	0.0%	0.0%	0.0%
Expected life (years)	2.2	4	4

The following table illustrates the effect on 2004 and 2005 net loss and earnings per share, assuming that the Company had applied the fair value recognition provision of SFAS No. 123 on its stock-based employee compensation:

	YEAR ENDED D
	2004
Net loss available to Ordinary shares, as reported	$ (4,127)
Add: Stock-based employee compensation - intrinsic value	66
Deduct: Stock-based compensation expense determined under fair value method for all awards, net of related tax effect	(274)

Pro forma net loss	$ (4,335)
Basic and diluted net loss per share, as reported	$ (0.89)
Basic and diluted net loss per share, pro forma	$ (0.94)

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT.)

r. Warranty costs:

The Company provides free warranty for up to 15 months for the "OEM" distributors. A provision is recorded for probable costs in connection with these services based on the Company's experience.

The Company estimates the costs that may be incurred under its basic limited warranty and records a liability in the amount of such costs at the time product revenue is recognized. Factors that affect the Company's warranty liability include the number of sold units, historical and anticipated rates of warranty claims, and cost per claim. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary.

No changes to the provision have been recorded during 2006.

s. Fair value of financial instruments:

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

The carrying amounts of cash and cash equivalents, short-term bank deposits, trade receivables, other accounts receivable, short-term bank credit and trade payables approximate their fair value, due to the short-term maturity of such instruments.

The fair value for marketable securities is based on quoted market prices (see Note 3).

t. Severance pay:

The Company's liability for severance pay is calculated pursuant to Israel's Severance Pay Law based on the most recent salary of the employees multiplied by the number of years of employment, as of the balance sheet date. Employees

are entitled to one month's salary for each year of employment or a portion thereof. The Company's liability for all of its employees is fully provided by monthly deposits with insurance policies and by an accrual. The value of these policies is recorded as an asset in the Company's balance sheet.

The deposited funds may be withdrawn only upon the fulfillment of the obligation pursuant to Israel's Severance Pay Law or labor agreements. The value of the deposited funds is based on the cash surrendered value of these policies, and includes immaterial profits.

Severance expense for the years ended December 31, 2004, 2005 and 2006 amounted to approximately $ 344, $ 585 and $ 339, respectively.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT.)

u. Concentrations of credit risk:

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

Cash and cash equivalents and short-term bank deposits are deposited with major banks in Israel and major banks in United States. Such deposits in the U.S. may be in excess of insured limit and are not insured in other jurisdictions. Management believes that the financial institutions that hold the Company's investments are financially sound, and accordingly, minimal credit risk exists with respect to these investments.

The customers of the Company are located mainly in the U.S. and Europe (see Note 17). The Company performs ongoing credit evaluations of its customers. In certain circumstances, the Company may require letters of credit, other collateral or additional guarantees. The allowance for doubtful accounts is determined with respect to specific debts that are doubtful of collection according to management estimates.

The Company's marketable securities include investments in equity securities and Israeli government securities. Management believes that the portfolio is well diversified, and accordingly, minimal credit risk exists with respect to these marketable securities.

The Company has no off-balance-sheet concentration of credit risk such as foreign exchange contracts, option contracts or other foreign hedging arrangements.

v. Basic and diluted net earnings (loss) per share:

Basic net earnings (loss) per share is computed based on the weighted average number of Ordinary shares outstanding during each year. Diluted net earnings (loss) per share is computed based on the weighted average number of Ordinary shares outstanding during each year, plus potential Ordinary shares considered outstanding during the year, in accordance with Statement of Financial Accounting Standard No. 128, "Earnings Per Share" ("SFAS No. 128").

The total number of shares related to the outstanding options excluded from the calculation of diluted net loss per share was 667,101, 1,011,584 and 685,410 for the years ended December 31, 2004, 2005 and 2006, respectively.

w. Impact of recently issued accounting standards:

In July 2006, the FASB issued FASB Interpretation No. 48 "Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 utilizes a two-step approach for evaluating tax positions. Recognition (step one) occurs when an enterprise concludes that a tax position, based solely on its technical merits, is more-likely-than-not to be sustained upon examination.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (CONT.)

Measurement (step two) is only addressed if step one has been satisfied (i.e., the position is more-likely-than-not to be sustained). Under step two, the tax benefit is measured as the largest amount of benefit, determined on a cumulative probability basis that is more-likely-than-not to be realized upon ultimate settlement.

FIN 48 applies to all tax positions related to income taxes subject to the Financial Accounting Standard Board Statement No. 109, "Accounting for income taxes" ("FAS 109"). This includes tax positions considered to be "routine" as well as those with a high degree of uncertainty.

FIN 48 has expanded disclosure requirements, which include a tabular roll forward of the beginning and ending aggregate unrecognized tax benefits as well as specific detail related to tax uncertainties for which it is reasonably possible the amount of unrecognized tax benefit will significantly increase

or decrease within twelve months. These disclosures are required at each annual reporting period unless a significant change occurs in an interim period.

FIN 48 is effective for fiscal years beginning after December 15, 2006. The cumulative effect of applying FIN 48 will be reported as an adjustment to the opening balance of retained earnings.

The Company is currently evaluating the effect of the adoption of FIN 48 on its financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"). This statement provides a single definition of fair value, a framework for measuring fair value, and expanded disclosures concerning fair value. Previously, different definitions of fair value were contained in various accounting pronouncements creating inconsistencies in measurement and disclosures. SFAS No. 157 applies under those previously issued pronouncements that prescribe fair value as the relevant measure of value, except SFAS No. 123(R) and related interpretations. The statements does not apply to accounting standard that require or permit measurement similar to fair value but are not intended to measure fair value. This pronouncement is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of adopting SFAS 157.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS No. 159"). This statement provides companies with an option to report selected financial assets and liabilities at fair value. Generally accepted accounting principles have required different measurement attributes for different assets and liabilities that can create artificial volatility in earnings. The Standard's objective is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. This Statement is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. The Company is currently evaluating the impact of adopting SFAS 159.

NOTE 3: - MARKETABLE SECURITIES

The following is a summary of the Company's investment in marketable securities:

	DECEMBER 31, 2005	

	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	FAIR MARKET VALUE	AMORTIZED COST	U
Available-for-sale:						
Equity securities	$ 35	$ 12	$ (5)	$ 42	$ 40	$
Corporate bonds	-	-	-	-	45	
Israeli Government debts	87	4	(1)	90	63	
	$ 122	$ 16	$ (6)	$ 132	$ 148	$

The gross realized gains on sales of available-for-sale securities totaled $ 0, $ 77 and $ 13 in 2004, 2005 and 2006, respectively, recorded in financial income. The net adjustment to unrealized holding gains (losses) on available-for-sale securities included as a separate component of shareholders' equity, "Accumulated other comprehensive gains (losses)" amounted to $ 83, $ (76) and $ 1 in 2004, 2005 and 2006, respectively.

None of the unrealized loss as of December 31, 2006, are outstanding over than 12 months period.

The amortized cost and fair value of debt and marketable equity securities as of December 31, 2006, by contractual maturity, are shown below.

	DECEMBER 31, 2006	
	AMORTIZED COST	FAIR MARKET VALUE
Matures after one year through five years	$ 63	$ 70
Matures after five years through ten years	29	30
Matures after ten years	16	16
Equity securities - No definite maturity date	40	43
Total	$ 148	$ 159

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NOTE 4: - OTHER ACCOUNTS RECEIVABLE AND PREPAID EXPENSES

	DECEMBER 31,

	2005	2006
Grants receivable from the Office of the Chief Scientist	$ 130	$ 454
Government authorities	75	77
Prepaid expenses	142	147
Deferred income taxes (1)	14	14
Others	130	71
	$ 491	$ 763

(1) See Note 14d.

NOTE 5: - INVENTORIES

	DECEMBER 31,	
	2005	2006
Raw materials	$ 58	$ 57
Finished products	123	81
	$ 181	$ 138

NOTE 6: - INVESTMENTS IN AFFILIATE

a. Composed as follows:

	DECEMBER 31,	
	2005	2006
Investment in Jusan S.A. (50% owned)		
Equity, net (1)	$ 1,580	$ 1,563
Goodwill	35	35
	$ 1,615	$ 1,598
(1) Investment as of purchase date	$ 1,171	$ 1,171
Retained earnings (Net of dividends)	409	392
	$ 1,580	$ 1,563
Dividend received from Jusan S.A. during the year	$ 195	$ 409

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NOTE 6: - INVESTMENTS IN AFFILIATE (CONT.)

b. Summarized financial information of Jusan S.A. (50% owned):

	DECEMBER 31,	
	2005	2006
Current assets	$ 4,177	$ 3,743
Non-current assets	$ 45	$ 88
Current liabilities	$ (1,057)	$ (694)

	YEAR ENDED DECEMBER 31,		
	2004	2005	2006
Revenues	$ 6,892	$ 5,682	$ 5,462
Gross profit	$ 3,158	$ 2,530	$ 2,658
Net income	$ 444	$ 4	$ 318

NOTE 7: - LONG-TERM LOAN, NET OF CURRENT MATURITIES

The Company's long term loans include a loan granted to the purchaser of Silverbyte Ltd. shares which were sold by the Company in July, 2000. The loan will be fully repaid in April 2007.

a. Composed as follows:

	DECEMBER 31,	
	2005	2006
Loan to others in NIS - unlinked (1)	$ 21	$ 4
Less - current maturities (2)	18	4
	$ 3	$ -

(1) The weighted average interest rate for the years ended December 31, 2005 and 2006 is 7.65%.

(2) Included in other accounts receivable.

b. As of December 31, 2006, the aggregate annual maturities of long-term loans are as follows:

2007 (current maturities)	$ 4

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NOTE 8: - OTHER INVESTMENTS

	DECEMBER 31,	
	2005	2006
Long-term leasing deposits (1)	$ 27	$ 46
Investment in other companies	320	320
	$ 347	$ 366

(1) Linked to the Israeli CPI.

NOTE 9: - PROPERTY AND EQUIPMENT

	DECEMBER 31,	
	2005	2006
Cost:		
Computers and peripheral equipment	$ 3,022	$ 3,118
Office furniture and equipment	566	572
Motor vehicles	48	48
Leasehold improvements	140	150
	3,776	3,888
Accumulated depreciation:	3,205	3,449
Depreciated cost	$ 571	$ 439

The depreciation expense for the years ended December 31, 2004, 2005 and 2006 amounted to $ 211, $ 254 and $ 243, respectively.

NOTE 10: - GOODWILL AND OTHER INTANGIBLE ASSETS

a. Goodwill:

The changes in the carrying amount of goodwill for the year ended December 31, 2005 are as follows:

Balance as of January 1, 2005	$ 3,415
Additional consideration in conjunction with TK acquisition based on post-contract billing revenues, see Note 1(c)	285
Balance as of December 31, 2005	3,700

Additional consideration in conjunction with TK acquisition based on post-contract billing revenues, see Note 1(c)	192
Goodwill acquired during the year (see Note 1d)	166
Balance as of December 31, 2006	$ 4,058

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NOTE 10: - GOODWILL AND OTHER INTANGIBLE ASSETS (CONT.)

b. Other intangibles consist of the following:

	DECEMBER 31,	
	2005	2006
Cost:		
Development technology	$ 1,440	$ 1,873
Capitalized software development costs	386	386
Customer relationship	300	945
	2,126	3,204
Accumulated amortization:		
Development technology	923	1,131
Capitalized software development costs	160	289
Customer relationship	50	145
	1,133	1,565
Amortized cost	$ 993	$ 1,639

Intangible assets resulted from acquisitions of IntegraTrak and TelSoft (see Note 1d), the Company's U.S. subsidiaries and TeleKnowledge (see Note 1c).

c. Amortization expenses amounted to $ 188, $ 401 and $ 432 for each of the years ended December 31, 2004, 2005 and 2006, respectively.

d. Estimated amortization expenses for:

YEAR ENDED DECEMBER 31,

2007	$ 512
2008	416
2009	243
2010	227
2011	153
2012	88
	$ 1,639

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NOTE 11: - ACCRUED EXPENSES AND OTHER LIABILITIES

	DECEMBER 31,	
	2005	2006
Employees and payroll accruals	$ 991	$ 949
Income tax payable	291	498
Accrued expenses	760	638
Customer advances	187	205
Related parties	77	217
	$ 2,306	$ 2,507

NOTE 12: - LONG-TERM BANK LOAN

a. Composed as follows:

	2006
Long-term loan	$ 1,000
Less - current maturities	417
	$ 583

The loan bears annual interest at a rate of the monthly LIBOR + 2%, payable on a monthly basis on the outstanding loan amount commencing August 31, 2006. The loan principal shall be repaid in twelve equal monthly installments commencing August 31, 2007.

b. As of December 31, 2006, the aggregate annual maturities of long-term loans are as follows:

2007 (current maturities)	$ 417
2008	583
	$ 1,000

c. The loan agreement includes the following covenants:

(i) The ratio between shareholders equity and total shareholders equity and liabilities shall not be less than 40% and in no event shall the Company's shareholders equity decrease below $ 5,000 thousand.

(ii) The Company will generate operating income for each of the two subsequent quarters commencing the second quarter of 2007 and onwards.

(iii) The Company's cash and cash equivalents shall not decrease below $ 1,000 at any given time.

In the event that the Company violates one of the above covenants the loan shall become immediately due.

d. To secure the loan, the Company provided the Bank a floating charge on all its current and long term assets and a fixed charge on its goodwill and on its authorized but not outstanding shareholders equity.

NOTE 13: - COMMITMENTS AND CONTINGENT LIABILITIES

a. Lease commitments:

The facilities of the Company and its subsidiaries are rented under operating leases for periods ending May 2007 through June 2010.

Future minimum lease commitments under non-cancelable operating leases as of December 31, 2006 are as follows:

2007	$ 357
2008	352
2009	292
2010	134
	$ 1,135

========

Lease expenses for the years ended December 31, 2004, 2005 and 2006 were approximately $ 334, $ 489 and $ 479, respectively.

b. Royalty commitments:

1. The Company is committed to pay royalties to the Office of the Chief Scientist of the Ministry of Trade ("OCS") of the Government of Israel on proceeds from sales of products resulting from the research and development projects in which the Government participated. In the event that development of a specific product in which the OCS participated is successful, the Company will be obligated to repay the grants through royalty payments at the rate of 3% to 5% based on the sales of the Company, up to 100%-150% of the grants received linked to the dollar. As of December 31, 2006, the Company has a contingent liability to pay royalties in the amount of $ 9,486. The obligation to pay these royalties is contingent upon actual sales of the products and, in the absence of such sales, no payment is required.

   The Company has paid or accrued royalties in its cost of revenues relating to the repayment of such grants in the amount of $ 181, $ 198 and $ 186 for the years ended December 31, 2004, 2005 and 2006, respectively.

2. The Israeli Government, through the Fund for Encouragement of Marketing Activities, awarded the Company grants for participation in foreign marketing expenses. The Company is committed to pay royalties at the rate of 3% of the increase in export sales, up to the amount of the grants received linked to the U.S. dollar. As of December 31, 2006, the Company has a contingent obligation to pay royalties in the amount of $ 259.

NOTE 13: - COMMITMENTS AND CONTINGENT LIABILITIES (CONT.)

c. Claims and demands:

1. In April 2000, the Tax Authorities in Israel issued to the Company a demand for a tax payment, for the period of 1997-1999, in the amount of approximately NIS 6,000 thousand ($ 1,420).

   The Company has appealed to the Israeli Tel Aviv district court in respect of the abovementioned tax demand. The Company believes that certain defenses can

be raised against the demand of the tax authorities. The Company believes that the outcome of this matter will not have a material adverse effect on its financial position or results of operations. The Company has provided a provision for the amount considered probable.

2. On April 18, 2005, Amdocs (Israel) Ltd. and Amdocs Ltd. ("the plaintiffs") filed a complaint with the Tel-Aviv District Court against the Company, its Chief Executive Officer and others ("the Defendants") alleging, among other things, that professional and commercial information belonging to the plaintiffs was transferred to the defendants for use in the Company's activity. The plaintiffs are seeking an injunction prohibiting the defendants from making any use of the information and trade secrets that were allegedly transferred, injunctions requiring the return of such information and estimated damages of NIS 14,775 thousand (approximately $ 3,500).

   On June 27, 2005, the defendants filed a statement of defense, in which the defendants claim that the factual and legal allegations by the plaintiffs are baseless, and the causes of action and relief requested are without merit.

   On March 22, 2007, the complaint had been dismissed without prejudice by mutual agreement and following a settlement between all parties to the complaint and with no payment by any of the litigants.

3. On November 22, 2005, the Company received a letter from one of its customer's legal counsel alleging, among other things, that the Company materially breached the agreement that was entered into with the customer who is seeking full repayment of the amounts that were paid by him under the agreement, including interest and indemnification for damages. The Company cannot currently assess the outcome of this claim or its adverse effect on the Company's financial position or results of operations.

4. On February 21, 2007, one of the Company's suppliers ("the plaintiffs") filed a complaint with the Kfar-Saba Magistrate Court against the Company, in which he demands payment of NIS 179 thousand (approximately $ 42) with respect to electronic components that were ordered by the Company. The Company made a provision in its financial statements for this claimed amount. The abovementioned claim is related to the claims raised in Note 13c(3).

U.S. DOLLARS IN THOUSANDS (EXCEPT SHARE AND PER SHARE DATA)

NOTE 13: - COMMITMENTS AND CONTINGENT LIABILITIES (CONT.)

5. On March 15, 2007, the Company received a letter from one of its customer's legal counsel alleging, among other things, that the Company materially breached an agreement relating to its billing solutions which was entered into on March 30, 2006. The customer is seeking full repayment of the amounts that were paid by him under the agreement in the amount of approximately $141 plus compensating damages as provided in the agreement. The Company believes that the agreement cancellation was unfounded and intends to vigorously pursue its rights under the agreement. Due to the preliminary stage of this matter, the Company and its legal advisors cannot currently assess the outcome or possible adverse effect on the Company's financial position or results of operations.

d. Guarantees:

1. The Company provided a bank guarantee through April 2007 in the amount of $ 60 to secure its obligations under one of its leasing agreements.

2. The Company provided a bank guarantee through February 2007 in the amount of $ 55 in favor of one of its customers to secure its obligations under the agreement that was signed by the parties.

3. The Company provided a bank guarantee through September 2010 in the amount of $ 190 to secure its obligations under one of its leasing agreements.

NOTE 14: - TAXES ON INCOME

a. ISRAELI TAXATION:

1. CORPORATE TAX STRUCTURE:

Taxable income of Israeli companies is subject to tax at the rate of 31% in 2006, 29% in 2007, 27% in 2008, 26% in 2009 and 25% in 2010 and thereafter.

2. Tax benefits under the Law for the Encouragement of Capital Investments, 1959 ("the Law"):

The Investment Law empowers the Israeli Investment Center to grant Approved Enterprise status to capital investments in production facilities that meet certain relevant criteria ("Approved Enterprise"). In general, such capital investments will receive Approved Enterprise status if the enterprise is expected to contribute to the development of the productive capacity of the economy, absorption of immigrants, creation of employment opportunities, or improvement in the balance of payments.

NOTE 14: - TAXES ON INCOME (CONT.)

The tax benefits derived from any such Approved Enterprise relate only to taxable income attributable to the specific program of investment to which the status was granted. Since MTS is operating more than one "Approved Enterprise" program and since part of its taxable income is not entitled to tax benefits under the abovementioned law and is taxed at the regular corporate tax rate, its effective tax rate is the result of a weighted combination of the various applicable rate and tax exemptions, and the computation is made for income derived from each program on the basis of formulas specified in the law and in the approvals.

MTS was granted the status of an "Approved Enterprise" under the Law in respect of several different capital expenditure programs. For all of such Approved Enterprises, the Company elected to apply for alternative tax benefits ("Alternative Package").

Accordingly, MTS Ltd.'s income attributed to the Approved Enterprise under the alternative package is tax exempt for a period of two years, commencing with the year the Company earns taxable income, and subject to corporate tax at the rate of 10% - 25% (depending on the rate of foreign holdings in the Company), for additional periods of five to eight years.

In the event of distribution of dividends from the said tax-exempt income, the amount distributed will be subject to corporate tax at the rate ordinarily applicable to the Approved Enterprise's income.

The duration of tax benefits, for each of the Programs is subject to limitations of the earlier of 12 years from completion of the investment or commencement of production, or 14 years from receipt of approval, as an Approved Enterprise under the Law.

The entitlement to the above benefits is conditional upon the Company's fulfilling the conditions stipulated by the Law and regulations published thereunder.

Should MTS Ltd. fail to meet such requirements in the future, income attributable to its Approved Enterprise programs could be subject to the statutory Israeli corporate tax rate and the Company could be required to refund a portion of the tax benefits already received, with respect to such programs.

On April 1, 2005, an amendment to the Investment Law came into effect ("the Amendment") and has significantly

changed the provisions of the Investment Law. The Amendment limits the scope of enterprises which may be approved by the Investment Center by setting criteria for the approval of a facility as a "Privileged Enterprise" (rather than the previous terminology of Approved Enterprise), such as a provision requiring that at least 25% of the "Privileged Enterprise's" income will be derived from export. Additionally, the Amendment enacted major changes in the manner in which tax benefits are awarded under the Investment Law so that companies are no longer required for Investment Center approval in order to qualify for tax benefits. The period of tax benefits for a new "Privileged Enterprise" commences in the "Year of Commencement". This year is the later of: (1) the year in which taxable income is first generated by the company, or (2) the Year of Election.

NOTE 14: - TAXES ON INCOME (CONT.)

If a company requested the "Alternative Package" of benefits for an Approved Enterprise under the old law before the 2005 amendment, it is precluded from filing a Year of Election notice for a "Privileged Enterprise" for three years after the year in which the Approved Enterprise was activated.

In addition, the Investment Law provides that terms and benefits included in any certificate of approval already granted will remain subject to the provisions of the law as they were on the date of such approval. Therefore, the existing Approved Enterprises will not be subject to the provisions of the Amendment.

As a result of the amendment, tax-exempt income generated under the provisions of the amended law, will subject the Company to taxes upon dividend distribution or complete liquidation.

Dividend distributed by an Approved Enterprise and "Privileged Enterprise" will be subject to withholding tax of 15%.

Out of the Company's retained earnings as of December 31, 2006 approximately $ 2,250 are tax exempt attributable to its Approved Enterprise programs. . If such tax exempt income is distributed in a manner other than upon the complete liquidation of the Company, it would be taxed at the reduced corporate tax rate applicable to such profits (between 10%-25%) and an

income tax liability of up to approximately $ 562 would be incurred as of December 31, 2006.

The Company's board of directors has determined that it would not distribute any amounts of its undistributed tax exempt income as dividend. The Company intends to reinvest the amount of its tax exempt income. Accordingly, no deferred income taxes have been provided on income attributable to the Company's "Approved Enterprise" as the undistributed tax exempt income is essentially permanent in duration.

Income from sources other than the Approved Enterprise is subject to tax at regular Israeli corporate tax rate.

3. Tax assessments:

Regarding the claim from the tax authorities in Israel, see Note 13c(1). The Company has received final tax assessments until the 1996 tax year.

4. Measurement of results for tax purposes under the Income Tax (Inflationary Adjustments) Law, 1985:

Results for tax purposes are measured in terms of earnings in NIS after certain adjustments for increases in the Israeli Consumer Price Index ("CPI"). As explained in Note 2b, the financial statements are presented in dollars. The difference between the annual change in the CPI and in the NIS/dollar exchange rate causes a further difference between taxable income and the income before taxes presented in the financial statements. In accordance with paragraph 9(f) of SFAS 109, MTS and its Israeli subsidiary have not provided for deferred income taxes on the difference between the functional currency and the tax bases of assets and liabilities.

NOTE 14: - TAXES ON INCOME (CONT.)

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

MTS is currently qualified as an "industrial company" under the above law and, as such, is entitled to certain tax benefits, mainly accelerated depreciation of machinery and equipment, as prescribed by regulations published under the Inflationary Adjustments Law, the right to claim public issuance expenses and amortization of intangible property rights as a deduction for tax

purposes.

b. Income taxes on non-Israeli subsidiaries:

Non Israeli subsidiaries are taxed according to the tax laws in their respective country of residence.

c. Net operating losses carryforward:

As of December 31, 2006, the Company and its subsidiaries in Israel, Asia and U.S. have an estimated total amount of available carryforward tax losses of $ 10,705, $ 381 and $ 437, respectively to offset against future taxable profits. The operating tax loss carryforwards in Israel and in Hong Kong (Asia) may be offset indefinitely against operating income.

MTS IntegraTrak and MTS TelSoft are subject to U.S. income taxes and have a net operating loss carryforward amounting to approximately $ 437 as of December 31, 2006, which expires in the years 2015 to 2021. Utilization of the 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.

d. Deferred income taxes:

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax liabilities and assets are as follows:

	DECEMBER 31,	
	2005	2006
Tax loss carryforward of the Company	$ 1,985	$ 2,416
Allowances for doubtful accounts and accruals for employee benefits	57	69
In respect of marketable securities	47	47
Goodwill and other intangible assets-liability	(208)	(253)
Capitalized software and other intangible assets	76	304
Other	208	442
Net deferred tax asset before valuation allowance	2,176	3,025
Valuation allowance	(2,036)	(2,899)
Net deferred income taxes	$ 129	$ 126
Presented as follows:		
Current assets - foreign	$ 14	$ 14
Other assets - foreign	$ 115	$ 112

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NOTE 14: - TAXES ON INCOME (CONT.)

MTS and certain of its subsidiaries have provided valuation allowances in respect of deferred tax assets resulting from tax loss carryforward and other temporary differences, since they have a history of losses over the past years. Management currently believes that it is more likely than not that part of the deferred tax regarding the loss carryforward in the Company and other temporary differences will not be realized in the foreseeable future.

e. A reconciliation between the theoretical tax expense, assuming all income is taxed at the statutory tax rate applicable to income of the Company and the actual tax expense as reported in the statements of operations, is as follows:

	YEAR ENDED DECEMBER 31,		
	2004	2005	2006
Loss before taxes as reported in the statements of operations	$ (4,086)	$ (4,208)	$ (2,287)
Tax rates	35%	34%	31%
Theoretical tax benefit	$ (1,430)	$ (1,431)	$ (709)
Increase in taxes resulting from:			
Effect of different tax rates	2	38	(17)
Tax adjustment in respect of inflation in Israel and others	12	(17)	(9)
Utilization of carryforward tax losses for which valuation allowance was provided	(21)	-	(22)
Non-deductible expenses and tax exempt income	-	10	13
Taxes and deferred taxes in respect of previous years	256	(21)	112
Deferred taxes for which valuation allowance was provided	1,447	1,431	750
Taxes on income as reported in the statements of operations	$ 266	$ 10	$ 118

f. Loss before income taxes is comprised as follows:

Domestic	$ (3,918)	$ (4,042)	$ (1,511)
Foreign	(168)	(166)	(776)

$ (4,086)	$ (4,208)	$ (2,287)

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NOTE 14: - TAXES ON INCOME (CONT.)

g. Taxes on income are comprised as follows:

	YEAR ENDED DECEMBER 31,		
	2004	2005	2006
Current taxes	$ 10	$ -	$ 5
Deferred taxes	33	10	3
Taxes and deferred taxes in respect of previous years	223	-	110
	$ 266	$ 10	$ 118
Domestic	$ 256	$ -	$ -
Foreign	10	10	118
	$ 266	$ 10	$ 118

NOTE 15: - RELATED PARTIES TRANSACTIONS AND BALANCES

a. On November 8, 1999, the Board of Directors and the audit committee approved, subject to the shareholders' approval, an increase in the monthly salary of the Chairman of the Board of Directors from $ 5 to $ 7 per month and the grant of options to purchase 98,824 Ordinary shares. The options were granted to him at his request in lieu of salary for the 12 month period ending December 31, 2000. The exercise price of the options is $ 6 per share, expected dividend yield is 0%, and the risk free interest rate is 6%. The options will vest ratably over an eight-month period beginning January 1, 2000 and will terminate five years from the date of grant. The options were forfeited by the end of the year 2004.

The wife of the Chairman of the Board of Directors provides ongoing legal services to the Company and receives a monthly retainer of $ 5. The conditions for retaining her services were approved by the Company's Board of Directors and audit committee.

MTS's subsidiaries, MTS Asia Ltd. and MTS IntegraTRAK, entered into an agreement with C. Mer, pursuant to which they distribute and support certain of C. Mer's (company under common control) products and provide certain services on behalf of C. Mer. Generally, C. Mer compensates MTS Asia Ltd. for these activities at cost plus 10% and compensates MTS IntegraTRAK at cost plus 5%.

b. In 2005 and 2006, the balance with C. Mer reflects short-term debt and other receivables. Due to the short-term nature, no interest was charged by or paid to C. Mer through December 31, 2005 and 2006.

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NOTE 15: - RELATED PARTIES TRANSACTIONS AND BALANCES (CONT.)

c. Transactions with related parties were as follows:

	YEAR ENDED DECEMBER 31,		
	2004	2005	2006
Sales through related parties	$ 15	$ -	$ -
Amounts charged by related parties:			
Cost of revenues	$ 32	$ 8	$ 10
Operating expenses	7	42	60
	$ 39	$ 50	$ 70
Amounts charged by MTS Integra TRAK and MTS Asia to related parties:			
Selling and marketing	$ 18	$ -	$ 246
Payments from (repayments to) the related parties, net	$ 20	$ (80)	$ (38)

d. Amounts due from an affiliate:

	DECEMBER 31,

	2005	2006
Jusan S.A	$ (18)	$ (137)

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NOTE 16: - SHAREHOLDERS' EQUITY

a. Share capital:

The Ordinary shares entitle their holders the right to receive notice to participate and vote in general meetings of MTS and the right to receive cash dividends, if declared.

b. Private placement agreement:

On August 10, 2005, the Company has entered into definitive agreements with institutional and private investors for a private placement of Ordinary shares and warrants to purchase Ordinary shares that has raised $ 2,625 (net of issuance costs of approximately $ 200).

Pursuant to the agreements, MTS has issued an aggregate 937,500 Ordinary shares at $ 3.00 per share. In addition, the Company provided the investors with warrants to purchase an aggregate 375,000 additional Ordinary shares of MTS at an exercise price of $ 4.00 per share. Each investor received warrants to purchase two Ordinary shares for each five Ordinary shares purchased. The warrants became exercisable six months after their issuance and will expire within three and a half years after they become exercisable.

c. Stock options:

MTS has authorized, through its 1996 Incentive Share Option plan, the grant of options to officers, management, employees and directors of MTS or any subsidiary of up to 1,900,000 of MTS's Ordinary shares. Up to 1,500,000 options shall be granted under the option plan pursuant to section 102 of the Israel Income Tax Ordinance. Any option, which is canceled or forfeited before expiration, will become available for future grants.

Each option granted under the Plan is exercisable until the earlier of five years from the date of the grant of the option or the expiration dates of the option plan. The exercise price of the options granted under the plans may not be less than the nominal value of the shares into which such options were exercised. The options vest primarily gradually over three or four years of employment.

In 2003, Section 102 of the Israeli Income Tax Ordinance was amended effective as of January 1, 2003. Therefore MTS has rolled-over the remaining options available at that time to be granted under a new plan that conforms with the newly amended provisions of Section 102 of the Israel Income Tax Ordinance. The Incentive Share Option Plan will terminate in 2013, unless cancelled earlier by MTS's board of directors.

In June 2006, MTS has authorized, through its 2006 Stock Option plan ("2006 Plan"), the grant of options to officers, management, employees and directors of MTS or any subsidiary of up to 400,000 of MTS's Ordinary shares. Each option granted under the 2006 Plan will be either an option intended to be treated as an "incentive stock option," within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended, or an option that will be treated as a "non-qualified stock option."

NOTE 16: - SHAREHOLDERS' EQUITY (CONT.)

Each option granted under the Plan is exercisable until the earlier of five years from the date of the grant of the option or the expiration dates of the option plan. The exercise price of the options granted under the plans may not be less than the fair market value of an ordinary share determined as of the date of grant of the option.

As of December 31, 2006, 665,574 options are available for future grant.

d. A summary of option activity under the Company's Stock Option as of December 31, 2006 and changes during the twelve months ended December 31, 2006 are as follows:

	NUMBER OF OPTIONS	WEIGHTED-AVERAGE EXERCISE PRICE	WEIGHTED-AVERAGE REMAINING CONTRACTUAL TERM (IN YEARS)	AG IN
			AUDITED	
Outstanding at December 31, 2005	725,500	$ 2.66	2.68	$
Granted	60,000	$ 3.34	-	
Exercised	(40,341)	$ 1.61	-	
Forfeited	(144,759)	$ 3.17	-	

Outstanding at December 31,2006	600,400	$ 2.67	2.79	$
Exercisable at December 31,2006	286,425	$ 2.24	2.31	$
Vested and expected to vest	545,383	$ 2.65	2.76	$

The weighted average grant-date fair value of options granted during 2004, 2005 and 2006, was $ 0.781, $ 1.70 and $ 1.94 per option, respectively.

The aggregate intrinsic value in the table above represents the total intrinsic value (the difference between the Company's closing stock price on the last trading day of the fiscal year 2006 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on December 31, 2006. This amount changes based on the fair market value of the Company's stock. The total intrinsic value of options exercised during the years ended December 31, 2006, 2005, and 2004, was $ 55, $ 188, and $ 53, respectively. As of December 31, 2006, there was $ 209 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the Company's stock option plans. That cost is expected to be recognized over a weighted-average period of 3 years.

NOTE 16: - SHAREHOLDERS' EQUITY (CONT.)

The options outstanding as of December 31, 2006 have been separated into ranges of exercise prices, as follows:

RANGE OF EXERCISE PRICE	OUTSTANDING	REMAINING CONTRACTUAL LIFE (YEARS)	WEIGHTED AVERAGE EXERCISE PRICE	EXERCISABLE	REMA CONTR LIFE
$ 1.844	250,000	1.94	$ 1.844	187,500	
$ 2.2-2.35	83,500	2.70	$ 2.29	41,750	
$ 2.9-2.95	15,900	1.95	$ 2.91	11,925	
$ 3.27-3.4	70,000	3.60	$ 3.38	14,500	
$ 3.45-3.49	77,000	3.82	$ 3.47	7,750	
$ 3.87	104,000	3.74	$ 3.87	23,000	
	600,400		$ 2.67	286,425	

e. Options and warrants to non-employees:

ISSUANCE DATE	IN CONNECTION WITH	NUMBER OF OPTIONS GRANTED	OPTIONS EXERCISED	OPTIONS EXERCISABLE	OPTIONS FORFEITED OR EXPIRED
January 2000	Advisory Board	98,824	-	-	98,824
February 2001	Service provider	25,000	-	-	25,000
January 2005	Service provider	70,000	-	70,000	-
May 2005	Service provider	10,000	-	10,000	-
August 2005	Service provider	37,000	-	37,000	-
September 2005	Service provider	10,000	-	-	10,000
December 2005	Service provider	100,000	-	-	100,000
		350,824	-	117,000	233,824

During 2006, no options to consultants were granted by the Company. The Company had accounted for its outstanding options to non-employees under the fair value method of SFAS No. 123 and EITF 96-18. The fair value for these options was estimated at the measurement date using the Black-Scholes option-pricing model with the following weighted-average assumptions for 2006 and 2005: risk-free interest rates of 5.23% and 4.06%, respectively, dividend yields of 0%, volatility factors of the expected market price of the Company's Ordinary shares of 34.22% and 52.37%, respectively, and a contractual life of 0.85 and 3.3 years, respectively.

Compensation expenses related to the granting of stock options to consultants amounted to $ 0, $ 156 and $ 10 for the years ended December 31, 2004, 2005 and 2006, respectively.

f. Treasury shares:

During 2004, 2005 and 2006, the Company purchased 3,800, 0 and 0 treasury shares in consideration of $ 9 $ 0 and $ 0, respectively, according to the stock repurchase program, which authorized the Company's officers to repurchase up to 600,000 Ordinary shares of MTS and was approved by the Company's Board of Directors.

During 2003, MTS cancelled $457 of its treasury shares, which represent 384,610 Ordinary shares.

NOTE 16: - SHAREHOLDERS' EQUITY (CONT.)

g. Dividends:

Dividends, if any, will be paid in NIS. Dividends paid to shareholders outside Israel will be converted into dollars, on the basis of the exchange rate prevailing at the date of payment.

NOTE 17: - GEOGAPHIC INFORMATION AND MAJOR CUSTOMERS AND PRODUCTS

The Company adopted Statement of Financial Accounting Standard No. 131, "Disclosures About Segments of an Enterprise and Related Information" ("SFAS No. 131"). The Company operates in one reportable segment (see Note 1 for a brief description of the Company's business). The total revenues are attributed to geographic areas based on the location of the customer.

The following is a summary of revenues within geographic areas based on end customer location and long-lived assets:

	YEAR ENDED DECEMBER 31,		
	2004	2005	2006
Revenues from sales:			
United States	$ 4,967	$ 6,043	$ 5,353
Germany	1,724	2,059	1,881
Asia	635	359	624
Holland	798	747	561
Others	1,289	2,355	2,065
	$ 9,413	$ 11,563	$ 10,484

Total revenues from external customers divided on the basis of the Company's product lines are as follows:

	DECEMBER 31,	
	2005	2006
TABS	$ 7,454	$ 5,329
Application suits	2,603	4,044
Billing products	1,506	1,111
	$ 11,563	$ 10,484
Long-lived assets:		
Israel	$ 3,013	$ 3,177
United States	2,194	2,913
Others	57	46
	$ 5,264	$ 6,136

MER TELEMANAGEMENT SOLUTIONS LTD.
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS (EXCEPT SHARE AND PER SHARE DATA)

NOTE 18: - SUBSIDIARIES AND AFFILIATES

	PERCENTAGE OF OWNERSHIP	JURISDICT INCORPOR
SUBSIDIARIES:		
MTS IntegraTRAK Inc.	100%	Delawa
MTS TelSoft Inc. (a subsidiary of MTS IntegraTRAK Inc.)	100%	Delawa
MER Fifth Avenue Realty Inc. (a subsidiary of MTS IntegraTRAK Inc.) *)	100%	New Yo
MTS Asia Ltd.	100%	Hong K
Telegent Ltd. *)	100%	Isra
Jaraga B.V.	100%	Netherl
Verdura B.V. (a subsidiary of Jaraga B.V.) *)	100%	Netherl
Voltera Technologies V.O.F. (a partnership held 99% by Jaraga B.V. and 1% by Verdura B.V.) *)	100%	Netherl
Bohera B.V. (a subsidiary of Jaraga B.V.) *)	100%	Netherl
Tabs Brazil Ltd. (a subsidiary of Bohera B.V.)	100%	Braz
AFFILIATE:		
Jusan S.A. (an affiliate of Jaraga B.V.)	50%	Spai

*) Inactive, or having immaterial activity.

NOTE 18: - SUBSEQUENT EVENTS

On February 6, 2006, the Board of Directors of the Company approved the sale of the shares of TABS Brazil Ltda., to local Brazilian individuals in consideration for $ 335 (the "Price"). The Price shall be paid in 60 monthly installments, commencing January 1, 2008 with the first installment being in the amount of $ 67 and the remaining installments in the amount of $ 6 each.

JUSAN, S.A.

FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2006 AND 2005

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders of JUSAN, S.A.

1. We have audited the accompanying balance sheets of JUSAN, S.A. ("the Company") as of December 31, 2006 and 2005 and the related statements of income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2006. 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.

2. 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 the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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.

3. In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of JUSAN, S.A. as of December 31, 2006 and 2005 and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America.

BDO AUDIBERIA AUDITORES, S.L.

/s/ BDO Anderson

Madrid, Spain, January, 19, 2007

FINANCIAL STATEMENTS AS OF DECEMBER 31, 2005 JUSAN, S.A.

JUSAN, S.A.
BALANCE SHEETS AS OF DECEMBER 31, 2006 AND 2005
EUROS IN THOUSANDS

	DECEM 2006
ASSETS	
CURRENT ASSETS:	
Cash and cash equivalents	236
Short-term bank deposits	867
Trade receivables (net of allowance for doubtful accounts of - thousand euros as of December 31, 2006 and 57 thousand euros as of December 31, 2005 and net of provision for returns of 4 thousand euros as of December 31, 2006 and 4 thousand euros as of December 31, 2005) (Note 5)	1,098
Other accounts receivable and prepaid expenses (Note 3)	138
Inventories (Note 4)	503
Total current assets	2,842
PROPERTY AND EQUIPMENT, NET (Note 6)	67
Total assets	2,909
LIABILITIES AND SHAREHOLDERS' EQUITY	
CURRENT LIABILITIES:	
Short-term bank debt (Note 7)	17
Trade payables	324
Accrued expenses and other liabilities (Note 8)	176
Deferred revenues	10
Total current liabilities	527
COMMITMENTS (Note 9)	
SHAREHOLDERS' EQUITY (Note 12):	
Share capital - 15,052 Ordinary shares of (euro) 0.0042 par value - Authorized, issued and outstanding as of December 31, 2006 and 2005	63
Retained earnings	2,319
Total shareholders' equity	2,382

Total liabilities and shareholders' equity	2,909

The accompanying notes are an integral part of the financial statements

FINANCIAL STATEMENTS AS OF DECEMBER 31, 2005 JUSAN, S.A.

JUSAN, S.A.

STATEMENTS OF INCOME AS OF DECEMBER 31, 2006, 2005 AND 2004
EUROS IN THOUSANDS (EXCEPT SHARE AND PER SHARE DATA)

	YEAR ENDED DECEMBER	
	2006	2005
Revenues (Note 13):		
Product sales	3,833	3,935
Services	520	632
Total revenues	4,353	4,567
Cost of revenues:		
Product sales	1,812	2,098
Services	423	435
Total cost of revenues	2,235	2,533
Gross profit	2,118	2,034
Operating expenses:		
Research and development	456	449
Selling and marketing	746	849
General and administrative	667	831
Total operating expenses	1,869	2,129
Operating income / (loss)	249	(95)
Financial income, net (Note 14)	6	20
Income before taxes on income	255	(75)
Income taxes (Note 10)	59	(55)
Net income / (loss)	196	(20)

Basic and diluted net earnings per share	13.02	(1.33)
Weighted average number of shares used in computing basic net earnings per share	15,052	15,052

The accompanying notes are an integral part of the financial statements

FINANCIAL STATEMENTS AS OF DECEMBER 31, 2005 JUSAN, S.A.

JUSAN, S.A.

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
AS OF DECEMBER 31, 2006, 2005 AND 2004
EUROS IN THOUSANDS

	SHARE CAPITAL	RETAINED EARNINGS	TOTAL SHAREHOLDERS' EQUITY
Balance as of December 31, 2003	63	2,710	2,773
Net income	-	373	373
Balance as of December 31, 2004	63	3,083	3,146
Dividend paid	-	(300)	(300)
Net income	-	(20)	(20)
Balance as of December 31, 2005	63	2,763	2,826
Dividend paid	-	(640)	(640)
Net income	-	196	196
Balance as of December 31, 2006	63	2,319	2,382

The accompanying notes are an integral part of the financial statements

FINANCIAL STATEMENTS AS OF DECEMBER 31, 2005 JUSAN, S.A.

JUSAN, S.A.
STATEMENTS OF CASH FLOWS AS OF DECEMBER 31, 2006, 2005 AND 2004
EUROS IN THOUSANDS

YEAR ENDED DECEMB

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	196	(20)
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	29	38
Deferred taxes	2	(30)
Decrease (increase) in trade receivables	600	367
Decrease (increase) in other accounts receivable and prepaid expenses	22	12
Decrease (increase) in inventories	168	241
Increase (decrease) in trade payables	(158)	(177)
Increase (decrease) in accrued expenses and other liabilities	(165)	14
Increase (decrease) in deferred revenues	(39)	(11)
Net cash (provided by) operating activities	655	434
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment in short-term bank deposits	(467)	50
Purchase of property and equipment	(58)	(26)
Net cash provided by (used in) investing activities	(525)	24
CASH FLOWS FROM FINANCING ACTIVITIES:		
Dividend paid	(640)	(300)
Short-term bank debt	9	(10)
Net cash used in financing activities	(631)	(310)
Increase (decrease) in cash and cash equivalents	(501)	148
Cash and cash equivalents at the beginning of the year	737	589
Cash and cash equivalents at the end of the year	236	737
NON-CASH FINANCING INFORMATION:		
Accrued dividend	-	-
SUPPLEMENTAL DISCLOSURE OF CASH FLOWS ACTIVITIES:		
Cash paid during the year for:		
Interest	6	20
Income taxes	-	-

The accompanying notes are an integral part of the financial statements

NOTES TO FINANCIAL STATEMENTS AS OF DECEMBER 31, 2006 AND 2005

NOTE 1: ORGANIZATION AND OPERATIONS

a. JUSAN, S.A. ("the Company") was incorporated in Spain on June 19, 1959. The Company is engaged on development, manufacturing and assembly, sales and distribution, and maintenance of vocal server and call billing applications, as well as is in the television rental business.

b. The Company has five major customers (see also Note 13a).

c. In accordance with Spanish Companies' Law the directors present, for comparative purposes, each of the balance sheet and profit and loss account, the figures for the previous financial years, in addition to those for the financial year 2006.

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES

The financial statements have been prepared in accordance with generally accepted accounting principles in the United States ("US GAAP").

a. Use of estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

b. Financial statements in euros

Monetary accounts maintained in currencies other than the Euro are remeasured into Euros in accordance with Statement of Financial Accounting Standard No. 52, "Foreign Currency Translation" ("SFAS No. 52"). All effects of foreign currency remeasurement of monetary balance sheet items are reflected in the statements of operations as financial income or expenses, as appropriate.

c. Cash equivalents:

The Company considers all highly liquid investments originally purchased with maturities of three months or less to be cash equivalents.

There are no restrictions for cash and cash equivalents.

d. Short-term bank deposits:

Short-term bank deposits are deposits with maturities of more than three months but less than one year. The deposits are in Euro and bear interest at an average rate of 3%. The short-term deposits are presented at their cost, including accrued interest.

e. Inventories:

Inventories are stated at the lower of cost or market value. Cost is determined as follows: Raw materials, parts and supplies -using the weighted average cost

method. Work in progress and finished products are recorded on the basis of direct manufacturing costs. Inventories write-offs are provided to cover risks arising from slow moving items or technological obsolescence.

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 depreciation rates:

	%
Computers and peripheral equipment	33
Office furniture and equipment	20
Motor vehicles	20

The Company's long-lived assets are reviewed for impairment in accordance with Statement of Financial Accounting Standard No. 144 "Accounting for the Impairment or Disposal of Long- Lived Assets" ("SFAS No. 144") 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.

g. Research and development costs:

Research and development costs are charged to the Statement of Operations as incurred. Statement of Financial Accounting Standard No. 86 "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed" ("SFAS No. 86"), requires capitalization of certain software development costs subsequent to the establishment of technological feasibility.

Based on the Company's product development process, technological feasibility is established upon completion of a working model. Costs incurred by the Company between completion of the working models and the point at which the products are ready for general release have been insignificant. Therefore, all research and development costs have been expensed.

h. Income taxes:

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standard No. 109, "Accounting for Income Taxes" ("SFAS No. 109"). 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. Valuation allowances are provided to reduce deferred tax assets to an amount whose realization is considered more likely than not.

i. Revenue recognition:

The Company generates revenues from selling software-based products through

resellers and distributors who are considered end-users. The Company also generates revenues from rendering maintenance and support services.

Revenues are recognized when all criteria outlined in Statement of Position No. 97-2 "Software Revenue Recognition" ("SOP No. 97-2") as amended are met. Revenue from products is recognized when persuasive evidence of an agreement exists, delivery of the product has occurred, no significant obligations with regard to implementation remain, the fee is fixed or determinable and collectibility is probable.

Where the arrangements involve multiple elements, revenue is allocated to each element based on vendor specific objective evidence ("VSOE") of the relative fair values of each element in the arrangement, in accordance with the "residual method" prescribed by SOP No. 98-9, "Modification of SOP No. 97-2, Software Revenue Recognition With Respect to Certain Transactions". The VSOE used by the Company to allocate the sales price to support services and maintenance is based on the renewal rate charged when these elements are sold separately. Revenues from products are recorded based on the residual method. Under the residual method, revenue is recognized for the delivered elements when (1) there is VSOE of the fair values of all the undelivered elements, and (2) all revenue recognition criteria of SOP No. 97-2, as amended, are satisfied. Under the residual method any discount in the arrangement is allocated to the delivered element.

Provision for returns in the amount of thousand (euro) 3 is determined principally on the basis of past experience.

Revenues from maintenance and support services are recognized over the life of the maintenance agreement or at the time support services are rendered.

Deferred revenues include unearned amounts received under maintenance and support contracts, not yet recognized as revenues.

j. Warranty costs:

The Company provides free warranty for up to one year. A provision in the amount of thousand (euro) 10 (thousand (euro) 20 in 2005) is recorded for probable costs in connection with these services based on the Company's experience.

The Company estimates the costs that may be incurred under its basic limited warranty and records a liability in the amount of such costs at the time product revenue is recognized. Factors that affect the Company's warranty liability include the number of installed units, historical and anticipated rates of warranty claims, and cost per claim. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary.

k. Fair value of financial instruments:

The carrying amounts of cash and cash equivalents, short-term bank deposits, trade receivables, other accounts receivable and trade payables approximate their fair value, due to the short-term maturity of such instruments.

There are short term fixed-rate securities as an amount of thousand (euro) 867.

l. Concentrations of credit risk:

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, short-term bank deposits and trade receivables.

Cash and cash equivalents and short-term bank deposits are deposited with major banks in Spain. Management believes that the financial institutions that hold the Company's investments are financially sound, and accordingly, minimal credit risk exists with respect to these investments.

The trade receivables of the Company are mainly derived from sales to customers in Spain and Europe (see Note 13b). The Company performs ongoing credit evaluations of its customers. The allowance for doubtful accounts is determined with respect to specific debts that are doubtful of collection according to management estimates (when the ageing of account receivable is more than 180 days). In certain circumstances, the Company may require letters of credit, other collateral or additional guarantees.

The Company has no off-balance-sheet concentration of credit risk such as foreign exchange contracts, option contracts or other foreign hedging arrangements.

FINANCIAL STATEMENTS AS OF DECEMBER 31, 2005 JUSAN, S.A.

m. Basic and diluted net earnings per share:

Basic net earnings per share is computed based on the weighted average number of ordinary shares outstanding during each year. Diluted earnings per share is computed based on the weighted average number of ordinary shares outstanding during each year, plus potential ordinary shares considered outstanding during the year, in accordance with Statement of Financial Accounting Standard No. 128, "Earnings Per Share" ("SFAS No. 128").

NOTE 3: OTHER ACCOUNTS RECEIVABLE AND PREPAID EXPENSES

	DECEMBER 31,	
	2006	2005
Tax authorities	99	100
Deferred taxes	17	43
Employee advances	6	27
Deposits	16	16
	138	186

NOTE 4: INVENTORIES

	DECEMBER 31,	
	2006	2005

Materials	479	735
Work in progress	31	29
Provision for obsolescence	(7)	(93)
	503	671

FINANCIAL STATEMENTS AS OF DECEMBER 31, 2005 JUSAN, S.A.

NOTE 5: TRADE RECEIVABLES

	DECEMBER 31,	
	2006	2005
Trade receivables	840	1,510
Bills receivable	258	245
Allowance for doubtful accounts	-	(57)
	1,098	1,698

NOTE 6: PROPERTY AND EQUIPMENT

	DECEMBER 31,			
	2005	ADDITIONS	DISPOSALS	2006
COST:				
Computers and peripheral equipment	122	21	-	143
Office furniture and equipment	307	14	(3)	318
Motor vehicles	98	23	(21)	100
Leasehold improvements	-			-
	527	58	(24)	561
ACCUMULATED DEPRECIATION:				
Computers and peripheral equipment	(113)	(10)	-	(123)
Office furniture and equipment	(278)	(8)	3	(283)
Motor vehicles	(98)	(11)	21	(88)
Leasehold improvements	-	-	-	-
	(489)	(29)	24	(494)
DEPRECIATED COST	38	29	-	67

Depreciation expenses for the years ended December 31, 2006, 2005 and 2004 were thousand (euro) 29, 38 and 47, respectively.

FINANCIAL STATEMENTS AS OF DECEMBER 31, 2005 JUSAN, S.A.

NOTE 7: SHORT-TERM BANK DEBT

The Company has a short-term bank debt in the amount of thousand (euro) 17, bearing interest of 5%.

NOTE 8: ACCRUED EXPENSES AND OTHER LIABILITIES

	DECEMBER 31,	
	2006	2005
Employees and payroll accruals	52	75
Income tax payable	59	-
Deferred tax	-	24
Tax authorities	135	182
Current Accounts	(80)	64
Warranty costs	10	20
	176	365

NOTE 9: COMMITMENTS

The facilities of the Company are rented under operating leases for periods ending in 2009.

Future minimum lease commitments under non-cancelable operating leases as of December 31, are as follows:

2007	8
2008	8
2009	5
	21

Rent expenses for years ended December 31, 2006, 2005 and 2004, were approximately thousand (euro) 172, 157 and 152, respectively. Rent expenses will be reviewed every year with the variation of the Consumer Price Index.

FINANCIAL STATEMENTS AS OF DECEMBER 31, 2005 JUSAN, S.A.

NOTE 10: TAXES ON INCOME

Reconciliation between the theoretical tax expense, assuming all income is taxed at the statutory tax rate applicable to income of the Company and the actual tax expense as reported in the statements of operations, is as follows:

	YEAR ENDED DECEMBER 31,		
	2006	2005	2004

Income before taxes as reported in the statements of operations	255	(75)	516
Non-deductible bad debt allowance and others 2004	-	(82)	82
Non-deductible bad debt allowance 2005	(20)	20	-
Tax depreciation	37	(37)	-
Increase (decrease) in the taxable base - Forward sales	33	29	(62)
Increase (decrease) in the taxable base - Unrealized severance allowance	(75)	75	-
Taxable income	230	(70)	536
Tax rates	35%	35%	35%
Tax expense (benefit)	80	(25)	188
Decrease in taxes resulting from:			
Tax deduction for development	(21)	-	(66)
Deferred tax liability (asset)	-	(30)	21
TAXES ON INCOME, TAX EXPENSE (BENEFIT), AS REPORTED IN THE STATEMENTS OF OPERATIONS	59	(55)	143

Under the current tax legislation, 35% of development expense can be deducted from the income tax with the limits of 35% of the theoretical tax charge. All the income before income taxes is domestic.

FINANCIAL STATEMENTS AS OF DECEMBER 31, 2005 JUSAN, S.A.

NOTE 11: RELATED PARTIES TRANSACTIONS

The balances with and the revenues derived from related parties (related parties are shareholders, directors and family of both) were as follows:

a. Payments to related parties:

	YEAR ENDED DECEMBER 31,		
	2006	2005	2004
Wages	332	299	255

In 2006 the payments of wages to related parties are based on the payments to the directors (thousand (euro) 290), the social security paid to the directors (thousand (euro) 18) and 20% from the leases (thousand (euro) 24).

b. Transactions with related parties were as follows:

	YEAR ENDED DECEMBER 31,		
	2006	2005	2004

Sales to related parties	29	39	18
AMOUNTS CHARGED BY RELATED PARTIES:			
Cost of revenues	41	18	100

FINANCIAL STATEMENTS AS OF DECEMBER 31, 2005 JUSAN, S.A.

c. Amounts receivable from and payables to related parties:

	DECEMBER 31,	
	2006	2005
RECEIVABLES:		
Mer Telemagement Solutions	5	36
MTS Asia	-	4
MTS IntegraTRAK	1	-
Jaraga BV	100	-
PAYABLES:		
Mer Telemagement Solutions	-	18

NOTE 12: SHAREHOLDERS' EQUITY

a. Share capital:

The ordinary shares entitle their holders the right to receive notice, to participate and vote in general meetings of the Company and the right to receive dividends, if declared.

b. Legal reserve

As established by the Spanish Companies' Act, 10% of profits must be allocated to the legal reserve, until such reserve is equal to 20% of share capital. The legal reserve shall not be distributed and may only be used for compensation of losses or to increase capital.

c. Shareholding

There are 15,052 ordinary shares of (euro) 0.0042 par value, authorized, issued and outstanding as of December 31, 2006.

The shareholders at December 31, 2006 are:

	%
Jaraga, B.V.	50%
Jose Lasry Nahon	25%
Mauricio Toledano Marques	25%

FINANCIAL STATEMENTS AS OF DECEMBER 31, 2005 JUSAN, S.A.

d. Distribution of dividends.

The distribution of dividends amounting thousand (euro) 640 as a result of reserves distribution, has been paid to the shareholders in direct proportion of their shares.

Jaraga, B.V.	320
Jose Lasry Nahon	160
Mauricio Toledano Marques	160

NOTE 13: - SEGMENTS, CUSTOMERS AND GEOGRAPHIC INFORMATION

a. Major customers as a percentage of total revenues:

	YEAR ENDED DECEMBER 31,		
	2006	2005	2004
		%	
Adictis	10%	13%	14%
Liberty Voz, S.L	6%	-	-
Cableuropa, S.A	6%	8%	8%
Siemens, S.A	-	-	8%
Telefonica de Espana	5%	5%	5%
Eurotelefonia del Sur, S.L	4%	-	4%
Siemens Chile	-	2%	-
Accentic	-	2%	4%

FINANCIAL STATEMENTS AS OF DECEMBER 31, 2005 JUSAN, S.A.

b. The following is a summary of revenues within geographic areas based on end customer location:

	YEAR ENDED DECEMBER 31,		
	2006	2005	2004
Spain	2,586	2,275	2,287
European Community	1,280	1,437	2,796
Other	487	855	711
	4,353	4,567	5,794

NOTE 14: SELECTED STATEMENTS OF OPERATIONS DATA

Financial income, net

	YEAR ENDED DECEMBER 31,		
	2006	2005	2004
Financial expenses:			

Interest expenses	6	3	3
Other expenses	27	6	11
	33	9	14
Financial income:			
Interest income	39	29	16
FINANCIAL INCOME, NET	6	20	2

S I G N A T U R E S

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.

MER TELEMANAGEMENT SOLUTIONS LTD.

By: /s/ Eytan Bar
Eytan Bar
Chief Executive Officer

By: /s/ Shlomi Hagai
Shlomi Hagai
Chief Financial Officer

Dated: March 30, 2007