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

# FORM 20-F

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

OR

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

For the fiscal year ended December 31, 2006

OR

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

For the transition period from ____ to _____
Commission File No. 000-50867

OR

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

Date of event requiring this shell company report: Not applicable

# SYNERON MEDICAL LTD.
(Exact Name of Registrant as specified in its charter)

N/A
(Translation of Registrantâ€™s name into English)

ISRAEL
(Jurisdiction of incorporation or organization)

Industrial Zone, Yokneam Illit, 20692, P.O.B. 550, 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, par value NIS 0.01 per share | Nasdaq Global 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 issuerâ€™s classes of capital or common stock as of the close of

the period covered by the annual report.

As of December 31, 2006, the Registrant had 27,522,740 ordinary shares outstanding (excluding treasury shares).

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

☐ Yes ☒ No

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

☐ Yes ☒ No

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

Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer.

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐

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

Item 17 ☐ Item 18 ☒

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

☐ Yes ☒ No

*As used herein, and unless the context suggest otherwise, the terms â€œwe,â€□ â€œusâ€□ or â€œoursâ€□ refer to Syneron Medical Ltd. and its consolidated subsidiaries.*

*This annual report on Form 20-F contains forward-looking statements within the meaning of Section 27a of the Securities Act of 1933 and section 21e of the securities exchange act of 1934, as amended relating to future events or our future performance. The use of the words â€œprojects,â€□ â€œmay,â€□ plansâ€□ or â€œintends,â€□ or words of similar import, identifies a statement as â€œforward looking.â€□ The forward-looking statements included herein are based on current expectations that involve a number of known and unknown risks and uncertainties. These forward-looking statements are based on certain assumptions, including the assumption that we will not lose a significant customer or customers or experience increased fluctuations of demand or rescheduling of purchase orders, that our products will be approved by appropriate regulatory authorities, that our markets will continue to grow, that our products will remain accepted within their respective markets and will not be replaced by new technologies, that competitive conditions within our markets will not change materially or adversely, that we will retain key technical and management personnel, that our forecasts will accurately anticipate market demand and that there will be no material adverse change in our operations or business. Assumptions relating to the foregoing involve judgment with respect to, among other things, future economic, competitive and market conditions, and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond our control. In light of the significant uncertainties inherent in the forward-looking information included herein, the inclusion of such information should not be regarded as a representation by us or any other person that our objectives or plans will be achieved. Factors that could cause actual results to differ from our expectations or projections include the risks and uncertainties relating to our business described in this annual report at â€œItem 3.D Risk Factors.â€□*

*We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this annual report might not occur.*

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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 is qualified by reference to and should be read in conjunction with our consolidated financial statements and notes thereto included elsewhere in this annual report on Form 20-F.

The selected consolidated balance sheet data as of December 31, 2002, 2003 and 2004 and the selected consolidated statement of operations data for the full years ended December 31, 2002 and 2003 have been derived from our audited financial statements not included in this annual report. The selected consolidated balance sheet data as of December 31, 2005 and 2006 and the selected consolidated statements of income data for each of the years ended December 2004, 2005 and 2006 have been derived from our audited consolidated financial statements, included elsewhere in this annual report, which have been prepared in accordance with accounting principles generally accepted in the United States and audited by Kost, Forer, Gabay & Kasierer, an independent registered public accounting firm, and a member firm of Ernst & Young Global.

| | Year ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2002 | 2003 | 2004 | 2005 | 2006 |
| | (U.S. Dollars, in thousands, except per share data) | | | | |
| **Consolidated Statement of Operations Data:** | | | | | |
| Revenues | $ 11,500 | $ 35,021 | $ 57,918 | $ 87,406 | $ 116,976 |
| Cost of revenues(1) | 2,024 | 4,439 | 6,914 | 11,428 | 17,921 |
| Gross profit | 9,476 | 30,582 | 51,004 | 75,978 | 99,055 |
| Operating expenses: | | | | | |
| Research and development, net(1) | 1,004 | 1,701 | 3,078 | 5,030 | 8,515 |
| Selling and marketing, net(1) | 5,819 | 13,900 | 19,625 | 25,188 | 46,434 |
| General and administrative(1) | 342 | 878 | 2,725 | 3,534 | 9,455 |
| Other expenses(2) | 612 | 6,225 | - | 3,494 | - |
| Total operating expenses(1)(2) | 7,777 | 22,704 | 25,428 | 37,246 | 64,404 |
| Operating income (loss)(1)(2) | 1,699 | 7,878 | 25,576 | 38,732 | 34,651 |
| Financial income (expense), net | 272 | 881 | 2,384 | 3,081 | 6,492 |
| Income (loss) before taxes on income | 1,971 | 8,759 | 27,960 | 41,813 | 41,143 |
| Taxes on income | - | (170) | (620) | (750) | (1,489) |
| Net income (loss) | $ 1,971 | $ 8,589 | $ 27,340 | $ 41,063 | $ 39,654 |
| Net earnings (loss) per share: | | | | | |
| Basic | $ 0.12 | $ 0.51 | $ 1.45 | $ 1.65 | $ 1.46 |
| Diluted | $ 0.10 | $ 0.42 | $ 1.14 | $ 1.48 | $ 1.44 |

| | | | | | |
|---|---|---|---|---|---|
| Weighted-average number of shares used in actual per share calculations: | | | | | |
| Basic | 16,398 | 16,814 | 18,917 | 24,888 | 27,202 |
| Diluted | 18,780 | 20,512 | 24,083 | 27,664 | 27,601 |
| (1) Includes the following stock-based compensation charges: | | | | | |
| Cost of revenues | $ - | $ - | $ - | $ - | $ 267 |
| Research and development | - | - | 16 | 16 | 644 |
| Selling and marketing | 34 | 363 | 112 | 112 | 5,054 |
| General and administrative | - | 32 | 20 | 20 | 2,291 |
| Total stock-based compensation charge | $ 34 | $ 295 | $ 148 | $ 148 | $ 8,256 |

(2) Consists of settlement and litigation costs in 2002, 2003 and 2005 associated with litigation with competitors as set forth in Note 11(d) of the Notes to our Consolidated Financial Statements, and of follow-on secondary offering expenses set forth in Note 1(c) of the Notes to our Consolidated Financial Statements.



| | As of December 31, | | | | |
|---|---|---|---|---|---|
| | 2002 | 2003 | 2004 | 2005 | 2006 |
| | (U.S. Dollars, in thousands) | | | | |
| **Consolidated Balance Sheet Data** | | | | | |
| Cash and cash equivalents, deposits and securities | $ 4,126 | $ 17,563 | $ 858 | $ 134,059 | $ 171,676 |
| Working capital | 4,966 | 14,513 | 95,071 | 144,490 | 127,259 |
| Total assets | 8,650 | 26,999 | 109,546 | 170,281 | 225,241 |
| Total liabilities | 4,182 | 13,558 | 15,145 | 25,117 | 30,844 |
| Retained earnings (deficit) | 683 | 9,272 | 36,612 | 77,675 | 117,329 |
| Shareholders' equity | 4,468 | 13,441 | 94,401 | 145,164 | 194,397 |

### *B. CAPITALIZATION AND INDEBTEDNESS*

Not applicable.

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

Not applicable.

### *D. RISK FACTORS*

*This annual report contains certain statements that are intended to be, and are hereby identified as, â€œforward-looking statementsâ€□. We have based these â€œforward-looking statementsâ€□ on our current expectations and projections about future events, which are subject to risks and uncertainties. The Companyâ€™s actual future results may differ significantly from those stated in any forward-looking statements. Factors that may cause such differences include, but are not limited to, the factors discussed below.*

**Risks Related to Our Business and Industry**

**Our success depends upon market acceptance of our products, our ability to develop and commercialize new products and our ability to identify new markets for our technology.**

We have created products that apply our technology to rejuvenate the skinâ€™s appearance through the treatment of superficial benign vascular and pigmented lesions, hair removal, wrinkle reduction, the treatment of acne and leg veins and the treatment for the temporary reduction in the appearance of cellulite. We introduced our first product in December 2001, the Aurora, and have expanded our product offerings to include eight additional product platforms, the Pitanga, Polaris, Galaxy, Comet, Vela, eLight, eLaser and eMax. It is difficult for us to predict the success of our recently introduced products over the long term. Our failure to significantly penetrate current or new markets with our products and manage the manufacturing and distribution of multiple products could negatively impact our business, financial condition and results of operations. The success of our products depends on adoption and acceptance of our proprietary Electro-Optical Synergy, or ELOS â„¢ technology. The rate of adoption and acceptance may be affected adversely by perceived issues relating to quality and safety, customersâ€™ reluctance to invest in new technologies, and widespread acceptance of other technologies. Our business strategy is based, in part, on our expectation that we will continue to make novel product introductions and upgrades that we can sell to new and existing users of our products and that we will be able to identify new markets for our existing ELOS technology.



To successfully increase our revenues, we must:

- convince our target customers that our products or product upgrades would be an attractive revenue-generating addition to their practices;
- sell our products to customers which have traditionally not engaged in aesthetics procedures, including primary care physicians, obstetricians/gynecologists, ear, nose and throat specialists, other specialists and non-medical professionals;
- develop or acquire new products that either add to or significantly improve our current products;
- identify new markets and emerging technological trends in our target markets and react effectively to technological changes; and
- maintain effective sales and marketing strategies.

We may be unable, however, to continue to develop new upgrades, products and technologies at the rate we expect, or at all, which could affect adversely our expected growth rate. In addition, the market for aesthetic devices is highly competitive and dynamic, and marked by rapid and substantial technological development and product innovations. Demand for our products could be diminished by equivalent or superior products and technologies offered by competitors.

**We may have difficulty managing our growth which could limit our ability to increase sales and cash flow.**

We have been experiencing significant growth in the scope of our operations and the number of our employees. This growth has placed significant demands on our management, as well as our financial and operational resources. In order to achieve our business objectives, we anticipate that we will need to continue to grow. Continued growth would increase the challenges involved in:

- implementing appropriate operational and financial systems;
- expanding manufacturing capacity and scaling up production;
- expanding our sales and marketing infrastructure and capabilities;
- providing adequate training and supervision to maintain high quality standards; and

- preserving our culture and values.

If this growth occurs, it will continue to place additional significant demands on our management and our financial and operational resources, and will require that we continue to develop and improve our operational, financial and other internal controls. If we cannot scale and manage our business appropriately, we will not experience our projected growth and our financial results will suffer.

**Our financial results may fluctuate from quarter to quarter.**

Demand for our products varies from quarter to quarter and these variations may cause revenue to fluctuate significantly from quarter to quarter. As a result, it is difficult for us to predict sales for subsequent periods accurately. In addition, we base our production, inventory and operating expenditure levels on anticipated orders. If orders are not received when expected in any given quarter, expenditure levels could be disproportionately high in relation to revenue for that quarter. A number of additional factors, over which we have limited control, may contribute to fluctuations in our financial results, including:

- the willingness of individuals to pay directly for aesthetic medical procedures, in light of the lack of reimbursement by third-party payers;

- continued availability of attractive equipment leasing terms for our customers, which may be negatively influenced by interest rate increases;



- changes in our ability to obtain and maintain regulatory approvals;

- increases in the length of our sales cycle;

- performance of our independent distributors; and

- delays in, or failure of, product and component deliveries by our subcontractors and suppliers.

**If we are unable to protect our intellectual property rights, our competitive position could be harmed.**

Our success and ability to compete depends in large part upon our ability to protect our proprietary technology. As of March 31, 2007, our patent portfolio consisted of six issued U.S. patents, one of which we purchased in December 2004 (with the corresponding US and international family members), and 23 patent applications pending in the United States (with an additional 22 applications pending internationally and 7 international patents), related to 24 patent families relating to our technology and products. Our pending and future patent applications may not issue as patents or, if issued, may not issue in a form that will be advantageous to us. Any issued patents may be challenged, invalidated or legally circumvented by third parties. We cannot be certain that our patents will be upheld as valid and enforceable or prevent the development of competitive products. Consequently, competitors could develop, manufacture and sell products that directly compete with our products, which could decrease our sales and diminish our ability to compete. In addition, competitors could purchase one of our products and attempt to replicate some or all of the competitive advantages we derive from our development efforts, design around our protected technology, or develop their own competitive technologies that fall outside of our intellectual property rights. If our intellectual property does not adequately protect us from our competitorsâ€™ products and methods, our competitive position could be adversely affected, as could our business.

We rely on a combination of patent and other intellectual property laws and confidentiality, non-disclosure and assignment of inventions agreements, as appropriate, with our employees, consultants and customers, to protect and otherwise seek to control access to, and distribution of, our proprietary information. These measures may not be adequate to protect our technology from unauthorized disclosure, third-party infringement or misappropriation. We also rely on trade secret protection for our technology, in part through confidentiality agreements with our employees, consultants and third parties. However, these parties may breach these agreements, and we may not have adequate remedies for any breach. Also, others may learn of our trade secrets through a variety of methods. In addition, the laws of certain countries in which we develop, manufacture or sell our products may not protect our intellectual property rights to the same extent as the laws

of the United States or Israel.

**Existing and future third-party claims of infringement or other claims against us could require us to redesign our products, seek licenses, or engage in future costly intellectual property litigation, which could impact our future business and financial performance.**

New patent applications may be pending or may be filed in the future by third parties covering technology that we currently use or may ultimately use. Third parties may from time to time claim that our current or future products infringe their patent or other intellectual property rights, and seek to prevent, limit or interfere with our ability to make, use, sell or import our products. For example, one of our competitors, Lumenis Ltd., sued us for unfair competition, misappropriation of trade secrets and alleged infringement in 2002. In March 2004, without admitting liability or any infringement of any of Lumenis Ltdâ€™s patents, we entered a settlement to resolve this litigation and entered a license agreement for certain Lumenis patents, under which license fees were capped at $4.2 million. We paid in full the total amount during 2005. Another competitor, Thermage, Inc. sued us for patent infringement in 2004. We filed a counterclaim, also alleging patent infringement, and this litigation was settled with the parties entering into a cross-licensing agreement in June 2005. Legal fees and our settlement costs in connection with our settlement with Thermage amounted to $2.2 million.



On July 29, 2004, Shaldot Metal Works Ltd. (â€œShaldotâ€□), a privately owned Israeli company, sued us and Dr. Eckhouse, in the District Court in Haifa, claiming that in 1999 Dr. Eckhouse had access to confidential material regarding an Israeli patent, which he allegedly used in violation of a confidentiality agreement in connection with forming Syneron. The complaint alleges that our products infringe Shaldotâ€™s Israeli patent. In its lawsuit Shaldot is suing us for $2.3 million (NIS 10 million) and has requested an injunction against us which will prohibit manufacturing, marketing and selling some or all of our products, which, if successful, could have a material adverse effect on our business in Israel. On October 10, 2004, we submitted our Statements of Defense to the court, claiming that Shaldotâ€™s patent is invalid due to the existence of prior art, lack of novelty and no improvement over existing art in the field. Shaldotâ€™s patent is under review by the Israeli Patent Office, based on a request submitted to the Patent Office by a third party claiming that Shaldotâ€™s patent is invalid. Moreover, we claimed that even if the patent would have been valid, none of our devices infringe any of Shaldotâ€™s patents. The dispute was referred by the court to mediation and the parties attempted to resolve the dispute. The mediation process was not successful and was terminated by Shaldot. In January 2007, we learned that Shaldot had transferred all of its rights to the patent to a subsidiary, Qray Ltd. We submitted a motion to dismiss Shaldotâ€™s lawsuit, claiming that due to the transfer of rights, Shaldot no longer had standing to continue the proceedings. A hearing on our motion was held on February 19, 2007. At the hearing, the court ordered that Qray be added as an additional plaintiff to the lawsuit and that the parties submit revised statements of claims and defenses. On February 25, 2007, Shaldot submitted its revised statement of claims. On March 14, 2007, we submitted our revised statement of defense and also a revised statement of counterclaim. We are in the process of ongoing evidentiary hearings with the next hearing scheduled to take place on June 18, 2007. We believe that Shaldotâ€™s lawsuit is without merit, and we intend to defend ourselves vigorously. Therefore, we do not believe that this lawsuit will result in a loss to us and accordingly, no reserve was recorded in the financial statement with respect to this claim.

We also may become involved in intellectual property litigation in the future. Although we may try to resolve any potential future claims or actions as we did with the competitors described above, we may not be able to do so on reasonable terms, if at all. Following a successful third-party action for infringement, we may be required to pay substantial damages and if we cannot obtain a license or redesign our products, we may have to stop manufacturing, selling and marketing our products, and our business could suffer as a result. Infringement and other intellectual property claims, with or without merit, can be expensive and time-consuming to litigate, and could divert managementâ€™s attention from our core business. If we lose this kind of litigation, a court could require us to pay substantial damages, and prohibit us from using technologies essential to our products. Any of these events would have a material adverse effect on our business, results of operations and financial condition. Furthermore, we do not know whether necessary licenses would be available to us on satisfactory terms, or whether we could redesign our products or processes to avoid infringement.

We may become involved in litigation to protect the trademark rights associated with our company name or the names of our products. We do not know whether others will assert that our company name infringes their trademark rights. In addition, names we choose for our products may be claimed to infringe names held by others. If we have to change the name of our company or products, we may experience a loss in goodwill associated with our brand name, customer confusion and a loss of sales.

We may also become involved in litigation not only as a result of alleged infringement of a third-partyâ€™s intellectual property rights, but also to protect our own intellectual property rights, which would divert our managementâ€™s attention from our core business and may be expensive and time consuming to litigate.

Please see â€œItem 8. Financial Informationâ€“Consolidated statements and Other Financial Informationâ€ for further details regarding legal proceeding and the risk arising under those proceedings.

**We compete against companies that have longer operating histories, more established products and greater resources, which may prevent us from achieving significant market penetration or maintaining or improving operating results.**

Our products compete against products offered by public companies, including Candela Corporation, Lumenis Ltd., Cutera, Inc., Cynosure, Inc. , Thermage, Inc. and Palomar Medical Technologies, Inc., as well as by private companies such as Sciton, Inc., Radiancy Inc., Reliant Technologies, Inc. UltraShape, Ltd. and several other smaller specialized companies. Competition with these companies could result in reduced prices and profit margins and loss of market share, any of which could harm our business, financial condition and results of operations. We also face competition from medical products, including Botox and collagen injections, and aesthetic procedures, such as sclerotherapy, electrolysis, liposuction and chemical peels, that are unrelated to radio frequency and light or laser-based technologies. We also may face competition from manufacturers of pharmaceutical and other products that have not yet been developed. Our ability to compete effectively depends upon our ability to distinguish our company and our products from our competitors and their products, and includes the following factors:

- product performance;
- product pricing;



- intellectual property protection;
- quality of customer support;
- success and timing of new product development and introductions; and
- development of successful distribution channels.

Some of our competitors have more established products and customer relationships than we do, which could inhibit our market penetration efforts. Potential customers also may need to recoup the cost of expensive products that they already have purchased from our competitors and may decide not to purchase our products, or to delay such purchases. If we are unable to achieve continued market penetration, we will be unable to compete effectively and our business will be harmed.

In addition, some of our current and potential competitors have significantly greater financial, research and development, manufacturing, and sales and marketing resources than we have. Our competitors could use their greater financial resources to acquire other companies to gain enhanced name recognition and market share, as well as to develop new technologies or products that could effectively compete with our existing product lines.

**Due to our limited history of operations, we may not be able to predict our future performance or continue our revenue growth and profitability.**

We were incorporated in July 2000 and commercially launched our first product in the fourth quarter of 2001. Consequently, we have a limited history of operations. The future success of our business will depend on our ability to increase product sales, successfully introduce new products, expand our sales force and distribution network, and control costs, which we may be unable to do. As a result, we may not be able to continue our revenue growth and profitability.

**We outsource the manufacturing of our products to a small number of manufacturing subcontractors. If our**

**subcontractorsâ€™ operations are interrupted or if our orders exceed our subcontractorsâ€™ manufacturing capacity, we may not be able to deliver our products to customers on time.**

We outsource the manufacturing of our products to four subcontractors located in Israel. These subcontractors have limited manufacturing capacity that may be inadequate if our customers place orders for unexpectedly large quantities of our products. In addition, because our subcontractors are located in Israel, they on occasion may feel the impact of potential economic or political instability in the region. If the operations of one or more of these subcontractors were halted or limited, even temporarily, or if they were unable or unwilling to fulfill large orders, we could experience business interruption, increased costs, damage to our reputation and loss of our customers. In addition, qualifying new subcontractors could take several months.

**We depend upon third-party suppliers, making us vulnerable to supply shortages and price fluctuations, which could harm our business.**

Many of the components that comprise our products are currently manufactured by a limited number of suppliers. Although most of our components are obtained from at least three separate suppliers, we do not have the ability to manufacture these components. A supply interruption or an increase in demand beyond current suppliersâ€™ capabilities could harm our ability to manufacture our products until we identify and qualify a new source of supply, which could take several months.

Any interruption in the supply of components or materials, or our inability to obtain substitute components or materials from alternate sources at acceptable prices in a timely manner, could impair our ability to meet the demand of our customers, which would have an adverse effect on our business.



**We sell our products in a number of countries and therefore our results of operations could suffer if we are unable to manage our international operations effectively.**

We are headquartered in Israel and have offices in the United States, Canada, Germany and Hong-Kong. We depend on third-party distributors in Europe, except in Germany and Austria, and in Asia, Australia, South America and Japan. We also depend on relatively new direct sales operations to sell our products in North America, Germany and Austria. Therefore, we are subject to risks associated with having worldwide operations. Substantially all of our revenue in 2004, 2005 and 2006 was generated outside of Israel, primarily in North America and to a lesser extent in Western Europe and Asia. Only an immaterial amount of our revenues in 2004, 2005 and 2006 was generated in countries in the Middle East other than Israel. Part of our strategy is to expand our sales in existing markets and to enter new foreign markets. Expansion of our international business will require significant management attention and financial resources. Our international sales and operations subject us to many risks inherent in international business activities, including:

- foreign certification and regulatory requirements;
- lengthy payment cycles and difficulty in collecting accounts receivable;
- customs clearance and shipping delays;
- import and export controls;
- multiple and possibly overlapping tax structures;
- greater difficulty in safeguarding intellectual property in some countries;
- difficulties staffing and managing our international operations;
- difficulties in penetrating markets in which our competitors' products are more established; and
- economic instability.

In addition, we face particular risks associated with doing business in international markets, including, political instability and the threat of terror attacks. If our international sales do not continue at the expected pace or suffer from higher challenges than expected, we will not experience our projected growth or have decreased revenue and our financial results will suffer.

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

A majority of our revenues and a substantial portion of our expenses are denominated in U.S. dollars. However, a portion of our revenues and a portion of our costs, including personnel and some marketing and facilities expenses, are incurred in New Israeli Shekels and the Euro. Inflation in Israel or Europe may have the effect of increasing the U.S. dollar cost of our operations in that country. If the U.S. dollar declines in value in relation to one or more of these currencies, it will become more expensive for us to fund our operations in the countries that use those other currencies. During 2006, the exchange rate of U.S. dollar to the New Israeli Shekel has decreased 8.2%, the exchange rate of U.S. dollar to the Euro has decreased -11.4%. The net effect was a net gain of $1 million in our financial results.

Although we may use hedging techniques to reduce the risk associated with fluctuations in currency exchange rates, we may not be able to eliminate the effects of currency fluctuations. Thus exchange rate fluctuations could have a material adverse impact on our results of operations.

**If we fail to obtain and maintain necessary U.S. Food and Drug Administration clearances for our products and indications, if clearances for future products and indications are delayed or not issued, or if there are U.S. federal or state level regulatory changes, our commercial operations could be harmed.**

Most of our products are medical devices subject to extensive regulation in the United States by the Food and Drug Administration, or FDA, for manufacturing, labeling, sale, promotion, distribution and shipping. Before a new medical device, or a new use of, or claim for, an existing product can be marketed in the United States, it must first receive either 510(k) clearance or premarket approval from the FDA, unless an exemption applies. Either process can be expensive and lengthy. The FDAâ€™s 510(k) clearance process usually takes from three to twelve months, but it can last longer. The process of obtaining premarket approval is much more costly and uncertain than the 510(k) clearance process and it generally takes from one to three years, or even longer, from the time the application is filed with the FDA. We believe that very few of our existing or currently planned products are subject to FDA premarket approval. All products that we currently market in the United States have received 510(k) clearance for the uses for which they are marketed. In addition, in June 2005, the FDA granted 510(k) clearance to our Vela platform for the temporary reduction in the appearance of cellulite and for the relief of minor muscle aches, pain and spasms, as well as the temporary improvement of local blood circulation. In March 2006, the FDA granted 510(k) clearance to our new ST applicator for non-invasive wrinkle treatment a technique based on our ReFirmeâ„¢ procedure. As a result of these 510(k) clearances we are now able to sell the Vela platform and our ReFirmeâ„¢ procedure using our new ST applicator in the United States to physicians. In October 2006, the FDA granted 510(k) clearance to our new LiteTouch product for Dental Laser treatment. As a result of this 510(k) clearance we are now able to sell our LiteTouch products to dentists in the United States.



Medical devices may be marketed only for the indications for which they are approved or cleared. We have obtained 510(k) clearance for the current treatments for which we offer our products. However, our clearances can be revoked if safety or effectiveness problems develop. Any modifications to an FDA-cleared device that would significantly affect its safety or effectiveness or that would constitute a major change in its intended use would require a new 510(k) clearance or possibly premarket approval. We may not be able to obtain additional 510(k) clearances or premarket approvals for new products or for modifications to, or additional indications for, our existing products in a timely fashion, or at all. Delays in obtaining future clearances would adversely affect our ability to introduce new or enhanced products in a timely manner, which in turn would harm our revenue and future profitability.

We have made modifications to our devices in the past and may make additional modifications in the future that we believe do not or will not require additional clearances or approvals. If the FDA disagrees, and requires new clearances or approvals for the modifications, we may be required to recall and to stop marketing the modified devices. We also are subject to Medical Device Reporting regulations, which require us to report to the FDA if our products cause or contribute to a death or serious injury, or malfunction in a way that would likely cause or contribute to a death or serious injury. Our products and/or their use are also subject to state regulations, which are, in many instances, in flux. Changes in state regulations may impede sales. We cannot predict the impact or effect of future legislation or regulations at the federal or state levels.

The FDA and state authorities have broad enforcement powers. Our failure to comply with applicable regulatory requirements could result in enforcement action by the FDA or state agencies, which may include any of the following sanctions:

- warning letters, fines, injunctions, consent decrees and civil penalties;
- repair, replacement, refunds, recall or seizure of our products;
- issuing an import alert to block entry of products the FDA has reason to believe violate applicable regulatory requirements;
- operating restrictions or partial suspension or total shutdown of production;
- refusing our requests for 510(k) clearance or premarket approval of new products, new intended uses, or modifications to existing products;
- withdrawing 510(k) clearance or premarket approvals that have already been granted; and
- criminal prosecution.

If any of these events were to occur, it could harm our business.

**If we or our subcontractors fail to comply with the FDAâ€™s Quality System Regulation and performance standards, manufacturing operations could be halted, and our business would suffer.**

We and our subcontractors are required to demonstrate and maintain compliance with the FDAâ€™s Quality System Regulation, or QSR. The QSR is a complex regulatory scheme that covers the methods and documentation of the design, testing, control, manufacturing, labeling, quality assurance, packaging, storage and shipping of our products. Because our products use optical energy, including lasers, our products also are covered by a performance standard for lasers set forth in FDA regulations. The laser performance standard imposes specific record-keeping, reporting, product testing and product labeling requirements. These requirements include affixing warning labels to laser products, as well as incorporating certain safety features in the design of laser products. The FDA enforces the QSR and laser performance standards through periodic unannounced inspections. We and our subcontractors are subject to such inspections. Although we place our own quality control employee at each of our subcontractorsâ€™ facilities, we do not have complete control over our subcontractorsâ€™ compliance with these standards. Any failure by us or our subcontractors to take satisfactory corrective action in response to an adverse QSR inspection or to comply with applicable laser performance standards could result in enforcement actions against us or our subcontractors, including a public warning letter, a shutdown of manufacturing operations, a recall of our products, civil or criminal penalties, or other sanctions, such as those described in the preceding paragraph, which could cause our sales and business to suffer. In addition, we are subject to standards imposed on our activities outside of the United States, such as obtaining KEMA certification (electrical safety testing and certification in Europe) and the Standards Institution of Israel (imposed on our activities in Israel), and failure to comply with such standards could adversely impact our business.



**We may be unable to obtain or maintain international regulatory qualifications or approvals for our current or future products and indications, which could harm our business.**

Sales of our products outside the United States are subject to foreign regulatory requirements that vary widely from country to country. Complying with international regulatory requirements can be an expensive and time-consuming process and approval is not certain. The time required to obtain clearance or approvals, if required by other countries, may be longer than that required for FDA clearance or approvals, and requirements for such clearances or approvals may significantly differ from FDA requirements. Although we have obtained regulatory approvals in the European Union and other countries outside the United States, such as approvals for the use of our Aurora, Polaris, VelaSmooth, Galaxy and Comet product platforms in Korea or approvals for the use of our Aurora and Polaris product platforms in China, we may be unable to maintain regulatory qualifications, clearances or approvals in these countries or to obtain approvals in other countries. We also may incur significant costs in attempting to obtain and in maintaining foreign regulatory approvals or qualifications. If we experience delays in receiving necessary qualifications, clearances or approvals to market our products outside the United States, or if we fail to receive those qualifications, clearances or approvals, we may be unable to market some of our products or enhancements in certain international markets effectively, or at all.

**New regulations may limit our ability to sell to non-physicians.**

We sell our products to physicians and, outside the United States, to aestheticians. In addition, we sell our products in the developing U.S. medical spa market, where aesthetic procedures are being performed at dedicated facilities by non-physicians under physician supervision. However, U.S., state and international regulations could change at any time, disallowing sales of our products to aestheticians, and limiting the ability of aestheticians and non-physicians to operate our products. We cannot predict the impact or effect of changes in U.S., state or international laws or regulations.

**Because we do not require training for users of our products, and sell our products to non-physicians, there exists potential for misuse of our products, which could harm our reputation and our business.**

In the United States, federal regulations allow us to sell our products to or on the order of â€œlicensed practitioners.â€ The definition of â€œlicensed practitionersâ€ varies from state to state. As a result, depending on state law, our products may be purchased or operated by physicians or other licensed practitioners, including nurse practitioners, chiropractors and technicians. Outside the United States, many jurisdictions do not require specific qualifications or training for purchasers or operators of our products. We do not supervise the procedures performed with our products, nor do we require that direct medical supervision occur. While we offer our users the opportunity to receive on-site clinical training through our â€œUltimate Customer Careâ€ program, we and our distributors do not require purchasers or operators of our products to attend training sessions. The lack of required training and the purchase and use of our products by non-physicians may result in product misuse and adverse treatment outcomes, which could harm our reputation and expose us to costly product liability litigation.

**Product liability suits could be brought against us due to defective material or design, or due to misuse of our products, and could result in expensive and time-consuming litigation, payment of substantial damages and an increase in our insurance rates.**

If our products are defectively designed, manufactured or labeled, contain defective components or are misused, we may become subject to substantial and costly litigation by our customers or their patients. Misusing our products or failing to adhere to operating guidelines could cause significant eye and skin damage, and underlying tissue damage. In addition, if our operating guidelines are found to be inadequate, we may be subject to liability. We have been involved, and may in the future be involved, in claims related to the use of our products. Product liability claims could divert managementâ€™s attention from our core business, be expensive to defend and result in sizable damage awards against us. We have been involved in a number of disputes or legal claims between our customers and their patients that involved potential product liability claims since inception. To date, none of these disputes resulted in legal verdicts against us, although in some cases payments were made or might be made by an insurance carrier. We may not be able to obtain insurance in amounts or scope sufficient to provide us with adequate coverage against all potential liabilities. Any product liability claims brought against us, with or without merit, could increase our product liability insurance rates or prevent us from securing continuing coverage, could harm our reputation in the industry and reduce product sales. Product liability claims in excess of our insurance coverage would be paid out of cash reserves harming our financial condition and reducing our operating results.



**Components used in our products are complex in design, and defects may not be discovered prior to shipment to customers, which could result in warranty obligations, reducing our revenue and increasing our costs.**

In manufacturing our products, we and our subcontractors depend upon third-party suppliers for various components. Many of these components require a significant degree of technical expertise to produce. If our suppliers fail to produce components to specification, or if the suppliers, our subcontractors, or we, use defective materials or workmanship in the manufacturing process, the reliability and performance of our products will be compromised.

If our products contain defects that cannot be repaired easily and inexpensively, we may experience:

- loss of customer orders and delay in order fulfillment;
- damage to our brand reputation;

- increased cost of our warranty program due to product repair or replacement;
- inability to attract new customers;
- diversion of resources from our manufacturing and research and development departments into our service department;
- product recalls; and
- legal action.

The occurrence of any one or more of the foregoing could materially harm our business.

**We forecast sales to determine requirements for our products and if our forecasts are incorrect, we may experience either shipment delays or increased costs.**

Our subcontractors keep limited materials and components on hand. To help them manage their manufacturing operations and minimize inventory costs, we forecast anticipated product sales to predict our inventory needs up to six months in advance and enter into purchase orders on the basis of these requirements. Our limited historical experience may not provide us with enough data to accurately predict future demand. If our business expands, our demand would increase and our suppliers may be unable to meet our demand. If we overestimate our requirements, our subcontractors will have excess inventory, and may transfer to us any increase in costs. If we underestimate our requirements, our subcontractors may have inadequate components and materials inventory, which could interrupt, delay or prevent delivery of our products to our customers. Any of these occurrences would negatively affect our financial performance and the level of satisfaction our customers have with our business.

**In order to effectively manage our collaboration with P&G, we may divert the attention of key technical personnel and management from the core business. If P&G terminates the agreement, our stock price could fall, and we may be unable to bring a home-use device to the market.**

Effective February 25, 2007, we entered into a Joint Development and Supply Framework Agreement with the Proctor & Gamble Company (NYSE: PG) for the commercialization of patented and patent pending, ELOS based, home-use devices and compositions for the enhancement of skin appearance through the treatment of fine lines, wrinkles, age and sun spots and cellulite. Under the agreement, significant resources and the attention of key technical personnel and management will be directed to the development of such devices even though such devices may not be commercialized for several years, if ever. In addition, we cannot be sure that the agreement will result in marketable products or that we will receive payments for any products developed pursuant to the agreement. Procter & Gamble has the option under certain circumstances to terminate the agreement, including following the failure to successfully complete two milestones. We cannot be sure that P&G will not terminate the agreement. If Procter & Gamble terminates the agreement, the price of our common stock could fall significantly, and we will not receive certain royalty and other payments provided for in the agreement. If P&G terminates the agreement, we may decide to proceed to develop and commercialize the device on our own or with a third party. However, there can be no assurance that we will be able to successfully implement such a decision and successfully bring a home-use device to the market.



**The failure to attract and retain key personnel could adversely affect our business.**

Our success also will depend in large part on our ability to continue to attract, retain and motivate qualified engineering and other highly skilled technical and professional personnel. Competition for certain employees, particularly sales representatives and development engineers, is intense. We may be unable to continue to attract and retain sufficient numbers of highly skilled employees. Our inability to attract and retain additional key employees or the loss of one or more of our current key employees could adversely affect our business, financial condition and results of operations.

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

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

**Risks Related to Our Operations in Israel**

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

We are incorporated under the laws of and our principal executive offices and research and development facilities are located in Israel. In addition, all of our subcontractors are located in Israel. Accordingly, political, economic and military conditions in Israel may affect directly our business. Israeli economy has suffered in the past and may suffer in the future from instability, which may adversely affect our financial condition and results of operations.

Following the recession and the instability that characterized the Israeli economy during the years 2001 and 2003, the Israeli economy showed signs of improvement during 2004 and 2005. The Israeli economy has also been subject to significant changes, as a result of implementation of new economic policies and privatization. If the results of these changes are unsuccessful or the economic deterioration in Israel continues, it may also adversely affect our financial conditions, the results of operations and our ability to obtain financing from Israeli banks.

In addition, since the establishment of the State of Israel in 1948, a number of armed conflicts have occurred between Israel and its Arab neighbors. Any hostilities involving Israel or the interruption or curtailment of trade between Israel and its present trading partners could affect adversely our operations. Since October 2000, terrorist violence in Israel has increased significantly, primarily in the West Bank and Gaza Strip, and Israel has experienced terrorist incidents within its borders. Recently, there has been a further escalation in violence among Israel, Hamas, the Palestinian Authority and other groups. In addition, in July 2006 there have been extensive hostilities along Israelâ€™s northern border with Lebanon and to a lesser extent in the Gaza Strip. Ongoing and revived hostilities or other Israeli political or economic factors could harm our operations and product development and cause our sales to decrease. Furthermore, several countries, principally those in the Middle East still restrict business with Israel and Israeli companies. These restrictive laws and policies may limit seriously our ability to sell our products in these countries.



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

A significant portion of our assets and the assets of our directors and executive officers are located outside the United States. Therefore, a judgment obtained against us or any of them in the United States, including one based on the civil liability provisions of the U.S. federal securities laws, may not be collectible in the United States and may not be enforced by an Israeli court. Further, if a foreign judgment is enforced by an Israeli court, it will be payable in Israeli currency. It also may be difficult for you to assert U.S. securities law claims in original actions instituted in Israel.

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

We have generated income and are able to take advantage of tax exemptions and reductions resulting from the â€œApproved Enterpriseâ€ and â€œBenefited Enterpriseâ€ status of our facilities in Israel. To remain eligible for these tax benefits, we must continue to meet certain conditions, including making specified investments in property and equipment, and financing a percentage of investments with share capital. If we fail to meet these conditions in the future, the tax benefits would be canceled and we could be required to refund any tax benefits we might already have received. In addition, these tax benefits may not be continued in the future at their current levels or at any level. In recent years, the Israeli government has reduced the benefits available and has indicated that it may further reduce or eliminate some of these benefits in the future. The termination or reduction of these tax benefits may increase our expenses in the future, which would reduce our expected profits or increase our losses. Additionally, if we increase our activities outside of Israel, for example, by future acquisitions, our increased activities generally will not be eligible for inclusion in Israeli tax benefit programs. In 2006, the tax benefit derived from our approved enterprise status was approximately $20.3 million, which represents approximately 49.3% of our income before taxes. Under our first tax benefit plan, we have invested approximately $720,000 in fixed assets of which $223,000 was from paid-in capital as required by the financing condition of the approved plan. We are required under our second tax benefit plan, which was approved under the amendment to the law of the engorgement of capital investment 1959, to invest an additional $71,000 in fixed assets. During 2005 we invested the required amount to allow us to benefit from the tax exemptions. See â€œItem 10.E Taxation â€“ Israeli Taxation â€“ Law for the Encouragement of Capital Investments, 1959â€ for more information about these programs.

**The government grants we have received for research and development expenditures restrict our ability to manufacture products and transfer technologies outside of Israel and require us to satisfy specified conditions. If we fail to satisfy these conditions, we may be required to refund grants previously received together with interest and penalties, and may be subject to criminal charges.**

From 2000 to 2003, we received grants totaling $397,000 from the government of Israel through the Office of the Chief Scientist of the Israeli Ministry of Industry, Trade and Labor for the financing of a portion of our research and development expenditures for our Polaris and Galaxy product platforms. The terms of the Chief Scientist grants limit us from manufacturing products or transferring technologies developed using these grants outside of Israel without special approvals. We have no current plan to manufacture products or transfer technologies developed using these grants outside of Israel. Even if we receive approval to manufacture our products outside of Israel, we may be required to pay an increased total amount of royalties, which may be up to 300% of the grant amount plus interest, depending on the manufacturing volume that is performed outside of Israel. This restriction may impair our ability to outsource manufacturing or engage in similar arrangements for those products or technologies. In addition, if we fail to comply with any of the conditions imposed by the Office of the Chief Scientist, we may be required to refund any grants previously received together with interest and penalties, and may be subject to criminal charges. In addition, in recent years, the government of Israel has accelerated the rate of repayment of Chief Scientist grants and may further accelerate them in the future. We have not applied for any new grants since 2004 and currently have no plans to apply for such grants.

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

Israeli corporate law regulates mergers, requires tender offers for acquisitions of shares above specified thresholds, requires special approvals for transactions involving directors, officers or significant shareholders and regulates other matters that may be relevant to these types of transactions. In addition, our articles of association contain provisions that may make it more difficult to acquire our company, such as classified board provisions. Furthermore, Israeli tax considerations may make potential transactions unappealing to us or to some of our shareholders. See â€œItem 7.B Related Party Transactionsâ€ and â€œItem 10.E Taxation â€“ Israeli Taxationâ€ for additional discussion about some anti-takeover effects of Israeli law.



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

## Risks Related to Our Ordinary Shares

**The price of our ordinary shares has fluctuated substantially and we expect will continue to do so.**

The market price for our ordinary shares has been, and we expect will continue to be, affected by a number of factors, including:

- the gain or loss of significant orders or customers;
- recruitment or departure of key personnel;
- the announcement of new products or service enhancements by us or our competitors;
- announcements regarding clearance or non-clearance of regulatory approval;
- quarterly variations in our or our competitors' results of operations;
- announcements related to litigation;
- changes in earnings estimates, investors' perceptions, recommendations by securities analysts or our failure to achieve analysts' earning estimates;
- developments in our industry; and
- general market conditions and other factors unrelated to our operating performance or the operating performance of our competitors.

In addition, the stock prices of many companies in the medical device industry have experienced wide fluctuations that often have been unrelated to the operating performance of those companies. These factors and price fluctuations may materially and adversely affect the market price of our ordinary shares.

**We are controlled by a small number of existing shareholders, who may make decisions with which you may disagree.**

Our directors and officers, along with our five largest shareholders, in the aggregate, beneficially owned or controlled approximately 16% of our outstanding ordinary shares as of May 31, 2007. These shareholders are not prohibited from selling a controlling interest in us to a third party. While these shareholders do not have the right to appoint board members directly, these shareholders, acting together, could exercise significant influence over our operations and business strategy and may have sufficient voting power to influence all matters requiring approval by our shareholders, including the ability to elect or remove directors, to approve or reject mergers or other business combination transactions, the raising of future capital and the amendment of our articles of association, which govern the rights attached to our ordinary shares. In addition, this concentration of ownership may delay, prevent or deter a change in control, or deprive you of a possible premium for your ordinary shares as part of a sale of our company.

**We have not paid dividends in the past and do not expect to pay dividends in the future, and any return on investment may be limited to the value of our stock.**

We have never paid cash dividends on our ordinary shares and do not anticipate paying cash dividends on our ordinary shares in the foreseeable future. The payment of dividends on our ordinary shares will depend on our earnings, financial condition and other business and economic factors affecting us at such time as our board of directors may consider relevant. Furthermore, the payment of dividends may be considered as income which is non tax-exempt under the â€œApproved Enterpriseâ€ status of our facilities in Israel. We may only pay dividends in any fiscal year out of â€œprofits,â€ as defined by the Israeli Companies Law, or Companies Law, and, provided that the distribution is not reasonably expected to impair our ability to fulfill our outstanding and expected obligations. If we do not pay dividends, our stock may be less valuable because a return on your investment will only occur if our stock price appreciates. We have decided to reinvest the amount of tax exempt income derived from our â€œApproved Enterpriseâ€ status and not to distribute that income as dividends.

**U.S. investors in our company could suffer adverse tax consequences if we are characterized as a passive foreign investment company.**

If, for any taxable year, our passive income or our assets that produce passive income exceed levels provided by law, we may be characterized as a passive foreign investment company, or PFIC, for U.S. federal income tax purposes. This characterization could result in adverse U.S. tax consequences to our shareholders. If we were classified as a passive foreign investment company, a U.S. Holder could be subject to increased tax liability upon the sale or other disposition of ordinary shares or upon the receipt of amounts treated as â€œexcess distributionsâ€□. Under these rules, the excess distribution and any gain would be allocated ratably over the U.S. Holderâ€™s holding period for the ordinary shares, and the amount allocated to the current taxable year and any taxable year prior to the first taxable year in which we were a passive foreign investment company would be taxed as ordinary income. The amount allocated to each of the other taxable years would be subject to tax at the highest marginal rate in effect for the applicable class of taxpayer for that year, and an interest charge for the deemed deferral benefit would be imposed on the resulting tax allocated to such other taxable years. The tax liability with respect to the amount allocated to years prior to the year of the disposition, or â€œexcess distributionâ€□, cannot be offset by any net operating losses. In addition, holders of shares in a passive foreign investment company may not receive a â€œstep-upâ€□ in basis on shares acquired from a decedent. U.S. shareholders should consult with their own U.S. tax advisors with respect to the U.S. tax consequences of investing in our ordinary shares as well as the specific application of the â€œexcess distributionâ€□ and other rules discussed in this paragraph. For a discussion of how we might be characterized as a PFIC and related tax consequences, please see â€œItem 10.E. Taxation â€“ United States Federal Income Tax Considerations â€“ Passive Foreign Investment Company Considerationsâ€□.

## ITEM 4. INFORMATION ON THE COMPANY

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

**Our History**

Syneron Medical Ltd. was incorporated in the State of Israel in July 2000. Our headquarters are located at Industrial Zone, Yokneam Illit, 20692, P.O.B. 550, Israel. Our phone number is (972-4) 909-6200. The agent for service of process in the United States is Syneron Inc., incorporated in the State of Delaware and located at 1104 Heinz Drive, Unit B, East Dundee, Illinois 60118. Our website address is www.syneron.com.

We first offered our shares to the public in August, 2004. Upon the closing of our initial public offering, all our then outstanding preferred shares automatically converted into ordinary shares and we affected a 3.4 for one split of our ordinary shares.

We design, develop and market innovative aesthetic medical products based on our proprietary ELOS technology, which uses the synergy between electrical energy, including radiofrequency or RF energy, and optical energy to provide effective, safe and affordable aesthetic medical treatments. Our products, which we sell primarily to physicians and other practitioners, target a wide array of non-invasive aesthetic medical procedures, including hair removal, wrinkle reduction, rejuvenation of the skinâ€™s appearance through the treatment of superficial benign vascular and pigmented lesions, and treatment for the temporary reduction in the appearance of cellulite. We believe ELOS provides performance advantages over existing technologies that rely solely on optical energy. We believe using optical energy alone limits the safety and efficacy of many aesthetic medical procedures due to limited skin penetration and unwanted epidermal absorption. Our proprietary ELOS technology, which combines optical and electrical energy, enhances the userâ€™s ability to accurately target the tissue to be treated and enables real-time measurement of skin temperature, resulting in increased patient safety and comfort and improved treatment results.

During 2000 and 2001, our primary activity was the development and approval of our first product platform, the Aurora, which utilizes our ELOS technology. We received our CE Mark approval in Europe in November 2001 and launched sales of the Aurora product platform in December 2001. We received 510(k) clearance from the FDA for hair removal for the Aurora product platform in July 2002. In October 2002, we received 510(k) clearance from the FDA to market the Aurora product platform for the treatment of superficial benign vascular and pigmented lesions. In August 2002, we introduced the Aurora product platform commercially in the United States.

We launched the Polaris product platform in May 2003 after receiving our CE Mark approval in Europe for the product in December 2002. In April 2003, we received 510(k) clearance from the FDA to market the Polaris product platform for leg vein treatment as well as other types of vascular lesions. In December 2003, we introduced the Polaris product platform commercially in the United States.

We received our CE Mark approval in Europe for the Pitanga product platform in May 2003. During the fourth quarter of 2003, we launched the Pitanga product platform for the treatment of acne and hair removal in Europe and Canada.

We launched the Galaxy product platform in May 2004. We received our CE Mark approval in Europe for the Galaxy product platform in May 2004. The 510(k) clearances from the FDA also provide the regulatory basis for the marketing of the Galaxy product for all applications. We introduced the Galaxy product platform commercially in the United States in May 2004.

During 2004, we significantly expanded our direct sales and marketing organization in North America to approximately 50 employees, established a distribution network in eleven countries in the Asia-Pacific region and increased our sales and marketing efforts in Europe. We increased our sales and marketing effort in 2004 in connection with new product introductions and other marketing activities planned for 2004. In 2004, we introduced three new product platforms: the Galaxy, which combines the applications of the Aurora and the Polaris product platforms, the Vela, for the temporary reduction in the appearance of cellulite and the Comet, for hair removal. Our Galaxy and Comet platforms are covered by our present FDA clearances. In addition, in June 2005, the FDA granted 510(k) clearance to our Vela platform for the temporary reduction in the appearance of cellulite and for the relief of minor muscle aches, pain and spasms, as well as the temporary improvement of local blood circulation. As a result of this 510(k) clearance we are now able to sell the Vela in the United States to physicians.

In the third quarter of 2005, we had entered into an agreement with EuropeLab, Inc.â€˜s Platinum Equipment Division, or EuropeLab, as our North American distributor for the dental spa, day spa, aesthetic and chiropractic spa markets. Under this agreement, EuropeLab, which is a distributor of specialized equipment for the spa market, will distribute our VelaSmoothâ„¢ and the Pitangaâ„¢ systems to the spa market in North American. In April 2006, we launched our new cosmetic division, Syneron Cosmedicsâ„¢ to target our products to aesthetic practitioners, spas and the cosmetic market. Our products for these markets incorporate the safety feature of active dermal monitoring, as well as contact cooling which are very important for these professionals and medical spas.

In the first quarter of 2006, we have formed strategic alliances in Canada with two of the countryâ€™s large medical equipment and supply distributors â€“ Medical Mart Supplies Ltd. and Dufort & Lavigne Ltee.

Also, in the first quarter of 2006, we launched three new platforms to address medical aesthetic applications based on our ELOS technology. The new eLightâ„¢ platform combines Broad Spectrum Light with Bi-Polar Radio Frequency. The system provides a full facial solution for skin rejuvenation, including the treatment of superficial vascular and pigmented lesions, and acne applications. It also supports hair removal applications. The system also includes a new skin tightening modality using wrinkle reduction â€“ the ST, which received FDA clearance in March 2006.

The new eLaserâ„¢ platform combines Diode Laser technology with Bi-Polar Radio Frequency and offers ultra fast hair removal, as well as upgradeability to Syneronâ€™s leg vein and wrinkle reduction treatments. Finally, the new eMaxâ„¢ platform combines Bi-Polar Radio Frequency with multiple forms of Broad Spectrum Light energy and Diode Laser energy to deliver the complete range of Syneronâ€™s elos modalities in one multi-platform system. All the applications on the eLight, eLaser and eMax have received 510(k) clearance from the FDA. In October 2006, the FDA granted 510(k) clearance to our LiteTouch platform which is a Dental Laser system. As a result of this 510(k) clearance we are now able to sell the LiteTouch in the United States to Dentist.

Effective February 25, 2007, we entered into an exclusive Joint Development and Supply Framework Agreement with the Proctor & Gamble Company for the commercialization of patented and patent pending, ELOS based, home-use devices and compositions for the enhancement of skin appearance through the treatment of fine lines, wrinkles, age and sun spots and cellulite. Under the terms of the agreement we will lead the research, development and manufacturing of the devices, while Procter & Gamble will focus on the development of the compositions that may be used in conjunction with our devices, marketing, and distribution of the devices. The agreement provides that Procter & Gamble will purchase the devices exclusively from us. The devices will be marketed under the Procter & Gamble family of skin care products and will be co-branded with our ELOS technology. The agreement contemplates further collaboration between Procter & Gamble that could lead to commercializing additional products in the future. Procter & Gamble may terminate the agreement in certain circumstances, including following the failure to successfully complete two milestones.

**Principal Capital Expenditures**

We had capital expenditures of $1.0 million in 2006, $1.1 million in 2005, $1.5 million in 2004, $0.3 million in 2003 and $0.2 million in 2002. We expect that our capital expenditures will be approximately $1.5 million in 2007. We have financed our capital expenditures with cash generated from operations.

Our capital expenditures in 2006 consisted primarily of purchases of a patent family, software, manufacturing equipment and general equipment. We expect our capital expenditures in 2007 to consist of the same types of capital expenditures that we had in 2006. Our capital expenditures in 2005, 2004 and 2003 consisted primarily of purchases of patent families (including applications for such patents), software, manufacturing equipment, lab equipment, test equipment, computers, software and ERP software.

***B. BUSINESS OVERVIEW***

**Overview**

We design, develop and market innovative aesthetic medical products based on our proprietary ELOS technology, which uses the synergy between electrical energy and optical energy to provide effective, safe and affordable aesthetic medical treatments. Our products, which we sell primarily to physicians and other practitioners, target a wide array of non-invasive aesthetic medical procedures, including hair removal, wrinkle reduction, rejuvenation of the skinâ€™s appearance through the treatment of superficial benign vascular and pigmented lesions, and treatment for the temporary reduction in the appearance of cellulite. We believe ELOS provides performance advantages over existing technologies that rely solely on optical energy. We believe using optical energy alone limits the safety and efficacy of many aesthetic medical procedures due to limited skin penetration and unwanted epidermal absorption. The addition of radiofrequency energy, an electrical energy, lessens absorption in the outer layer of skin, or epidermis, and allows for greater skin penetration. Using radiofrequency and optical energy together enhances the ability of the user to target, or select, accurately the tissue to be treated and enables real-time measurement of skin temperature, enhancing patient safety and comfort. Following the launch of our first product, the Aurora, based on our ELOS technology in December 2001, our revenues have grown from $11.5 million in 2002 to $35.0 million in 2003 to $57.9 million in 2004 to $87.4 million in 2005 and to $117.0 million in 2006.

Our family of aesthetic products is based on our ELOS technology. Each product platform consists of one or more hand pieces and a console that incorporates the multiple energy sources, sophisticated software and a simple, user-friendly interface. Our consoles have a small footprint and are lightweight compared to competitive systems which are typically larger and heavier. Our products can be easily upgraded by the user to perform additional applications by adding hand pieces and installing a software plug in the console. We seek to deliver to our users the ability to generate increased practice revenue through additional service offerings. We also seek to provide predictable costs of ownership by minimizing ongoing disposable and maintenance expenses and providing a parts and services warranty. We support our users with our â€œUltimate Customer Careâ€ program, which includes on-site clinical training, customized practice development consultations and a product maintenance program that offers next-day delivery of replacement products to eliminate unnecessary downtime.

We launched the Aurora, our first product platform, in December 2001. We introduced the Pitanga and the Polaris product platforms in 2003. In 2004, we introduced the Galaxy and the Comet platforms.

In 2005, we introduced the VelaSmooth platform in the US and a few upgrades for the Aurora, Galaxy and Comet. Our products address traditional applications, including rejuvenating the skinâ€™s appearance through the treatment of superficial benign vascular and pigmented lesions, hair removal and the treatment of leg veins, as well as newer applications including wrinkle reduction, permanent reduction of hair and the temporary reduction in the appearance of cellulite. Also, in the first quarter of 2006, we launched three new platforms to address medical aesthetic applications based on our ELOS technology. The new eLightâ„¢ platform combines Broad Spectrum Light with Bi-Polar Radio Frequency. The system provides a full facial solution for skin rejuvenation, including the treatment of superficial vascular and pigmented lesions, and acne applications. It also supports hair removal applications. The system also includes a new skin tightening modality â€“ the ST. The new eLaserâ„¢ platform combines Diode Laser technology with Bi-Polar Radio

Frequency and offers ultra fast hair removal, as well as upgradeability to Syneronâ€™s leg vein and wrinkle reduction treatments. Finally, the new eMaxâ„¢ platform combines Bi-Polar Radio Frequency with multiple forms of light energy and diode laser energy to deliver the complete range of Syneronâ€™s elos modalities in one multi-platform system. All the applications on the eLight, eLaser and eMax have received 510(k) clearance from the FDA.



In the first quarter of 2007 we launched the LiteTouch platform that can be used for treatment of oral soft and hard tissue. The LiteTouch is a compact, lightweight and portable device, it has a small footprint, which saves important floor space and is easily integrates into any dental clinic. The LiteTouch offers both high energy and high frequency, thus providing a wide envelope of treatment parameters.

Effective February 25, 2007, we entered into an exclusive Joint Development and Supply Framework Agreement with the Proctor & Gamble Company for the commercialization of patented and patent pending, ELOS based, home-use devices and topical compositions for the enhancement of skin appearance through the treatment of fine lines, wrinkles, age and sun spots and cellulite. Under the terms of the agreement we will lead the research, development and manufacturing of the devices, while Procter & Gamble will focus on the development of the compositions, marketing, and distribution of the devices. The agreement provides that Procter & Gamble will purchase the devices exclusively from us. The devices will be marketed under the Procter & Gamble family of skin care products and will be co-branded with our ELOS technology. The agreement contemplates further collaboration between Procter & Gamble that could lead to commercializing additional products in the future. Procter & Gamble may terminate the agreement in certain circumstances, including following the failure to successfully complete two milestones.

We have received 510(k) clearances from the FDA for all the professional applications mentioned above. We sell our products in 46 countries through a direct sales force of approximately 50 employees in North America and 39 distributors in Europe, the Middle East, Asia, Australia, New Zealand, Canada and South America. As of May 31, 2007, we had an installed base of over 6,700 products.



**The Syneron Solution**

Our ELOS technology combines electrical and optical energy, each of which has unique characteristics when used alone and, when used together, produce beneficial synergistic effects. We believe that our ELOS technology represents a paradigm shift in non-invasive aesthetic medicine because it is the first approach that combines conducted radiofrequency energy, an electrical energy, and light or laser-based energy, an optical energy. Most previously available technologies have relied solely on optical energy sources or solely on radiofrequency energy.

Optical energy is absorbed in blood, hair follicles and skin pigments, resulting in a typical depth of penetration of approximately 0.5 to 2.0 millimeters. Epidermal pigmentation may limit the amount of optical energy that can be used without burning or damaging the skin. Radiofrequency, or RF, energy differs from optical energy because it is not absorbed by the epidermis. Our products use two electrodes to deliver RF energy, or bipolar RF energy. The distance between the two electrodes controls the depth of penetration of the bipolar RF energy. In our products, we have selected the distance between the two electrodes to enable a depth of penetration of the bipolar RF energy of up to approximately 5.0 millimeters, which permits the treatment of a broad range of dermal and subdermal aesthetic problems. Our products also contain a mechanism which simultaneously cools the skinâ€™s surface and decreases the skinâ€™s conductivity, pushing the RF energy even deeper into the skin. The use of RF energy enables real-time measurement of skin temperature, which allows our products to provide real-time feedback for every pulse, improving control of skin temperature and enhancing safety.

When used together, RF and optical energy produce a unique synergistic effect. Optical energy is used first to heat the target and decrease its resistance to RF energy. The RF energy is attracted to the areas that have been preheated by the optical energy, which results in more selective heating of the target. Heating a target structure will require less total energy

with RF and optical energy combined than with optical energy alone. Using less total energy translates into enhanced safety and less risk of burning the skin.

Our ELOS technology is embedded in our aesthetic product platforms, which consist of multiple hand pieces and a console that incorporates the RF and optical energy sources, sophisticated software and a simple, user-friendly interface. The key benefits of our technology to our customers include: enhanced control of treatment depth and selectivity for enhanced safety and increased patient comfort, and continuous temperature measurement and automated parameter adjustment to reduce the risk of burns.

**Our Products**

Our ELOS-based platform of products addresses a wide range of treatment alternatives.

| Product Platform | Applications(1) | Intended Users | Energy Sources | Market Introduction |
|---|---|---|---|---|
| Aurora | Hair Removal<br>Rejuvenating the skin's appearance(2)<br>Acne | Physicians | Light + RF | U.S.: Third Quarter 2002<br>Rest of World: Fourth Quarter 2001 |
| Pitanga | Hair Removal<br>Acne | Aestheticians<br>Medical Spas | Light + RF | Rest of World: Fourth Quarter 2003 |
| Polaris | Wrinkles<br>Leg Veins<br>Other Vascular Lesions | Physicians | Laser + RF | U.S.: Fourth Quarter 2003<br>Rest of World: Second Quarter 2003 |



| Product Platform | Applications(1) | Intended Users | Energy Sources | Market Introduction |
|---|---|---|---|---|
| Galaxy | Hair Removal<br>Rejuvenating the skin's appearance(2)<br>Acne<br>Wrinkles<br>Leg Veins<br>Other Vascular Lesions | Physicians | Light + RF / Laser + RF | U.S.: Second Quarter 2004<br>Rest of World: Second Quarter 2004 |
| Comet | Fast Hair Removal | Physicians<br>Aestheticians | Laser + RF | U.S.: Fourth Quarter 2004<br>Rest of World: Fourth Quarter 2004 |
| VelaSmooth | Appearance of Cellulite | Physicians<br>Aestheticians<br>Medical Spas | Light + RF+ Vacuum Shaping | U.S.: Second Quarter 2005<br>Rest of World: First Quarter 2005 |
| eLight | Hair Removal<br>Rejuvenating the skin's appearance(2)<br>Acne and Wrinkles (ST) | Physicians | Light + RF | First quarter of 2006 |
| eLaser | Wrinkles Leg Veins | Physicians | Laser + RF | First quarter of 2006 |

| | | | | |
|---|---|---|---|---|
| | Other Vascular Lesions; fast hair removal | | | |
| eMax | Hair Removal<br>Rejuvenating the skin's appearance(2)<br>Acne<br>Wrinkles<br>Leg Veins<br>Other Vascular Lesions and wrinkles with the ST applicator | Physicians | Light + RF / Laser + RF | First quarter of 2006 |
| LiteTouch | Dental Laser | Dentists | | First quarter of 2007 |

(1) Regulatory clearance has been received in the United States and Europe for each indicated application for all products, and in China for the Aurora and Polaris products. In each market in which our products are sold, other than the United States and most European countries, the distributors are responsible for obtaining other regulatory approval.

(2) Rejuvenating the skinâ€™s appearance through the treatment of superficial benign vascular and pigmented lesions.

Our products provide our customers with a broad range of applications among both traditional procedures and emerging applications. Among others, the application we offer include hair removal, rejuvenating the skinâ€™s appearance, treatment of vascular lesions and leg veins, wrinkle and acne treatments and also temporary reduction in the appearance of cellulite.



**Sales and Marketing**

Our strategy to achieve market penetration is to market initially to dermatologists, plastic surgeons and other cosmetic physicians in North America and medical and non-medical practitioners outside North America. Secondarily, in North America, we will continue to target the larger market of primary care physicians, obstetricians/gynecologists, ear, nose and throat specialists, and other practitioners who have started incorporating aesthetic procedures into their practices, along with the developing medical spa market. We also will focus on additional aestheticians throughout the world. We believe our products represent a significant opportunity for practitioners to deliver improved patient treatment results and significantly increase their ability to generate additional revenue.

We sell our products in 46 countries around the world through a combination of 39 distributors as well as salespeople employed by our distributors throughout the world. In the United States and Canada, we sell, market and distribute our products through a direct sales force of approximately 57 individuals. Our U.S. and Canadian sales efforts are headquartered in Toronto and we manage several separate territories in the United Stated and Canada. We rely on a limited, direct sales force to market and sell our products in Germany and Austria. In addition, we have agreements with distributors to market and sell our products throughout the rest of Europe, the Middle East, eleven countries in Asia-Pacific and five countries in Latin America.

Our customer support strategy is to provide customers with a comprehensive program of services and a predictable cost of ownership. To achieve this, we launched our â€œUltimate Customer Careâ€ initiative. The first component of our initiative is to provide responsive customer service. Following the sale of a system, we offer customers an on-site practice development consultation to analyze practitioner office workflow and marketing efforts. In North America, we typically follow the consultation with the delivery of a customized marketing and business plan to guide users on how to effectively integrate our products into their practice. We also provide a trainer to conduct on-site clinical training for our customers and their staff. We also offer Continuing Medical Education accredited offsite training courses such as our â€œadvanced fotofacial workshopâ€ for physicians and office staff.

The second component of our initiative is to provide our customers with a predictable cost of ownership, including minimal ongoing maintenance and disposable costs. In North America, we offer a three-year, parts and services warranty that covers disposable applicator parts and regular system maintenance. The small size and weight of our system enables us to complement our warranty programs with a product maintenance program that offers next-day delivery of replacement products in North America in the case of any problems with the machine. This unique overnight delivery program eliminates unnecessary downtime at the userâ€™s office and results in minimal loss of revenue for our customers.



**Manufacturing**

Our strategy is to use outsourced manufacturing to produce our devices while maintaining full control over every step of the production process. Outsourcing allows us to carry low inventory levels and maintain fixed unit costs without incurring significant capital expenditures. We use four separate manufacturers to produce our products. We believe their manufacturing processes are in compliance with all pertinent U.S. and international quality and safety standards, such as ISO 9001:2000 and EN46001 as well as the FDAâ€™s quality system regulation. We conduct in-house prototype development and present detailed manufacturing documents to our subcontractors, who then purchase most of the necessary components and manufacture the product. These manufacturing subcontractors provide us fully assembled, or â€œturn-keyâ€, services. We control and monitor the quality of our products by installing one of our quality control employees full-time at each of our subcontractorsâ€™ facilities.

The contracts we have with these manufacturers do not have minimum purchase requirements and allow us to purchase end products from the manufacturers on a purchase order basis. The contracts have one-year terms that automatically renew for successive one-year terms unless either we or the manufacturer give three monthsâ€™ written notice prior to the expiration of the term. The time required to qualify new subcontract manufacturers for our products could cause delays in our ability to provide products to our customers. To date, we have not experienced any significant manufacturing delays.

We procure the diode laser component of our products on behalf of our third-party manufacturers from a limited number of suppliers. We have flexibility to adjust the number of diode lasers we procure as well as the delivery schedules. The forecasts we use are based on historical demands and future plans. Lead times may vary significantly depending on the size of the order, time required to fabricate and test the components, specific supplier requirements and current market demand for the components. We reduce the potential for delays of supply by maintaining relationships with multiple suppliers of diode lasers. The time required to qualify new suppliers for the diode laser components, or to redesign them, could cause delays in our manufacturing. To date, we have not experienced significant delays in obtaining our diode laser components.

**Research and Development**

Our research and development activities are conducted internally by a research and development staff consisting of 48 employees. Our research and development efforts are focused on the development of new products, as well as the extension of our existing products to new applications in the non-invasive aesthetic medical market. We intend to develop products and product line extensions that leverage our existing ELOS platform. We have a number of new projects and products under development, mainly focusing on additional non-invasive aesthetic treatments. We expect to develop several major product initiatives in 2007: non-invasive fat reduction; a new product line for aestheticians and the cosmetic market; and products for home use using Syneronâ€™s proprietary elos technology.

To date, our research and development efforts have been focused on the development of products that leverage our existing ELOS platform rather than developing new technologies. Our gross research and development expenditures were $3.1 million in 2004, $ 5.0 million in 2005 and $ 8.5 million in 2006. We expect to continue to increase our expenditures on research and development, but to keep them at a similar level as percentage of revenue in the range of 6-8%.

**Intellectual Property**

We rely on a combination of patent, copyright, trademark and trade secret laws and confidentiality and invention assignment agreements to protect our intellectual property rights. As of March 31, 2007, our patent portfolio consisted of

six issued U.S. patents, one of which we purchased in December 2004 (with the corresponding US and international family members), and 23 patent applications pending in the United States (with an additional 22 applications pending internationally and 7 international patents), related to 24 patent families relating to our technology and products. One of our patents relates to treating the skin by deforming it, applying RF energy to it, and massaging it. This patent was issued in December 2003 and it will remain in force until March 2022, subject to payment of maintenance fees. Our second patent, which relates to skin treatments using a combination of RF and optical energy, covers our ELOS technology. This patent will remain in force until October 2020, subject to payment of maintenance fees. Our third patent, acquired in December 2004, covers, among other things, methods for the controlled contraction of collagen using RF energy. It will remain in force until May 2014, subject to payment of maintenance fees. Our fourth patent, which was issued in May 2005, is directed to systems and methods for treating the skin using RF energy. This patent will remain in force until November 2021, subject to payment of maintenance fees. Our fifth patent is directed to systems and methods for treating the skin with electromagnetic radiation, in which an electrical response of the skin to an applied voltage is measured, and a parameter of the radiation is adjusted based on the measurement. This patent issued in September 2005, and, subject to the payment of maintenance fees, will remain in force until August 2021. Our sixth patent issued in May 2006, and concerns methods for selective thermal destruction of a skin target by RF current. This patent will remain in force until June 2024, subject to payment of maintenance fees. During 2006, we purchased a patent family from PolyOptics Ltd, (and the inventor, Henry Israel) which included a pending US application and a PCT application. The latter application has since been filed in multiple countries internationally.



All of these patent applications are currently pending. All of our patent applications have been filed, and we expect to file future patent applications in the United States for our intellectual properties. We have also filed, or intend to file, foreign counterpart applications in Europe, certain countries in South America and Japan, as well as in Canada, Israel, Australia, Peopleâ€™s Republic of China, Korea and certain other countries in Asia for at least certain applications. We intend to file for additional patents to strengthen our intellectual property rights. Our trademarks include Syneron, the Syneron logo, elos, Active Dermal Monitoring, Aurora, Polaris, Pitanga, VelaSmooth, Syner-Cool, Galaxy, Comet, eLight, eLaser and eMax. All other trademarks, trade names and service marks appearing in this annual report are the property of their respective owners. We have a policy of seeking to register our trademarks in the United States, Canada and certain other countries.

In March 2004, we entered into a settlement and license agreement with Lumenis Ltd., one of our competitors, pursuant to which, among other things, we have a non-exclusive license to utilize Lumenisâ€™ patents relating to the use of incoherent light or gel in aesthetic and medical applications. Our license fee under this agreement is limited to $4.2 million, which as of December 31, 2005, has been fully paid.

In June 2005, we reached an agreement with Thermage which settled patent-related claims of the parties against each other. Under this agreement each party grants the other a non-exclusive paid-up license under the patents in suit and related patents. Legal fees and our settlement costs in connection with our settlement with Thermage amounted to $2.2 million. The license granted to Thermage excludes the right to utilize our ELOS technology and the license granted to us excludes the right to utilize Thermageâ€™s monopolar RF and capacitive electrical coupling.

All professional employees and technical consultants are required to execute confidentiality agreements in connection with their employment and consulting relationships with us. We also require them to agree to disclose and assign to us all inventions conceived in connection with their services to us. However, there can be no assurance that these confidentiality agreements will be enforceable or that they will provide us with adequate protection.

**Competition**

Our industry is subject to intense competition. We compete against products offered by public companies, including Candela Corporation, Lumenis Ltd., Thermage, Inc., Cutera, Inc., Cynosure, Inc. and Palomar Medical Technologies, Inc., as well as by private companies such as Sciton, Inc., Radiancy Inc., Reliant Technologies, Inc. and by several other smaller specialized companies. Our products compete against conventional non-light-based treatments, including Botox and collagen injections, sclerotherapy, electrolysis, liposuction, chemical peels and microdermabrasion. Our products also compete against laser and other light-based products.

Competition among providers of laser and other light-based products for the aesthetic medical market is characterized by extensive research efforts and rapid technological progress. While we attempt to protect our products through patents and other intellectual property rights, there are few barriers to entry that would prevent new entrants or existing competitors from developing products that would compete directly with ours. There are many companies, both public and private, that are developing innovative devices that use laser, light-based and alternative technologies. Many of these competitors have significantly greater financial and human resources than we do and have established reputations, as well as worldwide distribution channels that are more effective than ours. Additional competitors may enter the market and we are likely to compete with new companies in the future. To compete effectively, we have to demonstrate that our products are attractive alternatives to other devices and treatments by differentiating our products on the basis of performance, brand name, reputation and price. We have encountered and expect to continue to encounter potential customers who, due to existing relationships with our competitors, are committed to, or prefer the products offered by, these competitors. We expect that competitive pressures may over time result in price reductions and reduced margins for our products.



**Revenues by Geographic Market**

| Region | Year ended December 31 | | | | | |
|---|---|---|---|---|---|---|
| | 2004 | | 2005 | | 2006 | |
| | *USD in thousands* | *Percentage* | *USD in thousands* | *Percentage* | *USD in thousands* | *Percentage* |
| North America | $32,550 | 56.2% | $54,406 | 62.2% | $ 66,582 | 56.9% |
| Western Europe | 9,915 | 17.1 | 13,984 | 16.0 | 30,662 | 26.2 |
| Asia-Pacific | 14,327 | 24.7 | 16,609 | 19.0 | 16,289 | 13.9 |
| Other | 1,126 | 2.0 | 2,407 | 2.8 | 3,443 | 3.0 |
| Total | 57,918 | 100.0 | 87,406 | 100.0 | 116,976 | 100.0 |

**Government Regulation**

Our products are medical devices subject to extensive and rigorous regulation by the U.S. Food and Drug Administration, as well as other regulatory bodies, to help ensure that medical products are safe and effective for their intended uses. FDA regulations govern the following activities that we perform and will continue to perform:

- product design and development;
- product testing;
- product manufacturing;
- product safety;
- product labeling;
- product storage;
- record keeping;
- premarket clearance or approval;
- advertising and promotion;
- production; and
- product sales and distribution.

Each of our products currently marketed in the United States has received 510(k) clearance for the uses for which they are being marketed.

*FDAâ€™s Premarket Clearance and Approval Requirements.* Unless an exemption applies, each medical device we wish to commercially distribute in the United States will require either prior 510(k) clearance or premarket approval from the FDA. The FDA classifies medical devices into one of three classes. Devices deemed to pose lower risks are placed in either class I or II, which requires the manufacturer to submit to the FDA a premarket notification requesting permission to commercially distribute the device. This process is generally known as 510(k) clearance. Some low risk devices are exempt from this requirement. Devices deemed by the FDA to pose the greatest risk, such as life-sustaining, life-supporting or implantable devices, or devices deemed not substantially equivalent to a previously cleared 510(k) device, are placed in class III, requiring premarket approval. All of our current products that are being marketed in the United States are class II devices.

*510(k) Clearance Pathway.* When a 510(k) clearance is required, we must submit a premarket notification demonstrating that our proposed device is substantially equivalent to a previously cleared 510(k) device or a device that was in commercial distribution before May 28, 1976 for which the FDA has not yet called for the submission of premarket approval applications. By regulation, the FDA is required to clear or deny a 510(k) premarket notification within 90 days of submission of the application. As a practical matter, clearance often takes significantly longer. The FDA may require further information, including clinical data, to make a determination regarding substantial equivalence.



Laser devices used for aesthetic procedures, such as hair removal, have generally qualified for clearance under 510(k) procedures. We received FDA clearances to market our Aurora platform of products for hair removal in July 2002 and for superficial vascular and pigmented lesions in October 2002. We received FDA clearance for the treatment of acne with the Aurora and the Pitanga products in February 2004. We received FDA clearances to market our Polaris product platform for leg vein treatment as well as other types of vascular lesions in April 2003. We received FDA clearance for wrinkle treatment with the Polaris products in December 2003. In June 2005, the FDA granted 510(k) clearance to our Vela platform for the temporary reduction in the appearance of cellulite and for the relief of minor muscle aches, pain and spasms, as well as the temporary improvement of local blood circulation.

These 510(k) clearances also provide the regulatory basis for the marketing of our Galaxy product platform for all of the above mentioned applications and for the Comet products for hair removal. We received FDA clearance for our Aurora and Comet products for permanent hair reduction in October 2004.

*Premarket Approval Pathway.* A premarket approval application must be submitted to the FDA if the device cannot be cleared through the 510(k) process. A premarket approval application must be supported by extensive data, including, but not limited to, technical, preclinical, clinical trials, manufacturing and labeling to demonstrate to the FDAâ€™s satisfaction the safety and effectiveness of the device.

*Pervasive and Continuing Regulation.* After a device is placed on the market, numerous regulatory requirements apply. These include:

- quality system regulations, or QSR, which require manufacturers, including third-party manufacturers, to follow stringent design, testing, control, documentation and other quality assurance procedures during all aspects of the manufacturing process;

- labeling regulations and FDA prohibitions against the promotion of products for uncleared, unapproved or "off-label" uses;

- medical device reporting regulations, which require that manufacturers report to the FDA if their device may have caused or contributed to a death or serious injury or malfunctioned in a way that would likely cause or contribute to a death or serious injury if the malfunction were to recur; and

- post-market surveillance regulations, which apply when necessary to protect the public health or to provide

additional safety and effectiveness data for the device.

The FDA has broad post-market and regulatory enforcement powers. We are subject to unannounced inspections by the FDA to determine our compliance with the QSR and other regulations, and these inspections may include the manufacturing facilities of our manufacturing subcontractors.

We also are regulated under the Radiation Control for Health and Safety Act, which requires laser products to comply with performance standards, including design and operation requirements, and manufacturers to certify in product labeling and in reports to the FDA that their products comply with all such standards. The law also requires laser manufacturers to file new product and annual reports, maintain manufacturing, testing and sales records, and report product defects. Various warning labels must be affixed and certain protective devices installed, depending on the class of the product.

Failure to comply with applicable regulatory requirements can result in enforcement action by the FDA, which may include any of the following sanctions:

- fines, injunctions, consent decrees and civil penalties;
- recall or seizure of our products;
- issuing an import alert to block entry of products the FDA has reason to believe violate applicable regulatory requirements;



- operating restrictions, partial suspension or total shutdown of production;
- refusing our requests for 510(k) clearance or premarket approval of new products or new intended uses;
- withdrawing 510(k) clearance or premarket approvals that are already granted; and
- criminal prosecution.

The FDA also has the authority to require us to repair, replace or refund the cost of any medical device that we have manufactured or distributed. If any of these events were to occur, they could have a material adverse effect on our business.

We also are subject to a wide range of federal, state and local laws and regulations, including those related to the environment, health and safety, land use and quality assurance. We believe that we are in compliance with these laws and regulations as currently in effect, and our compliance with such laws will not have a material adverse effect on our capital expenditures, earnings and competitive and financial position.

*International Regulations.* International sales of medical devices are subject to foreign governmental regulations, which vary substantially from country to country. The time required to obtain clearance or approval by a foreign country may be longer or shorter than that required for FDA clearance or approval, and the requirements may be different.

In May 2005, the Chinese State Food & Drug Administration granted regulatory approval to sell our Aurora and Polaris products in China. A similar regulatory approval was granted by the Korea Food & Drug Administration to sell our Aurora, Polaris, VelaSmooth, Galaxy and Comet products in Korea.

The primary regulatory environment in Europe is that of the European Union, which consists of 25 countries encompassing most of the major countries in Europe. Three member states of the European Free Trade Association have voluntarily adopted laws and regulations that mirror those of the European Union with respect to medical devices. Other countries, such as Switzerland, have entered into Mutual Recognition Agreements and allow the marketing of medical devices that meet European Union requirements. The European Union has adopted numerous directives and European Standardization Committees have promulgated voluntary standards regulating the design, manufacture, clinical trials, labeling and adverse event reporting for medical devices. Devices that comply with the requirements of a relevant directive

will be entitled to bear CE conformity marking, indicating that the device conforms with the essential requirements of the applicable directives and, accordingly, can be commercially distributed throughout the member states of the European Union, the member states of the European Free Trade Association and countries which have entered into a Mutual Recognition Agreement. The method of assessing conformity varies depending on the type and class of the product, but normally involves a combination of self-assessment by the manufacturer and a third-party assessment by a Notified Body, an independent and neutral institution appointed by a country to conduct the conformity assessment. This third-party assessment may consist of an audit of the manufacturerâ€™s quality system and specific testing of the manufacturerâ€™s device. An assessment by a Notified Body in one member state of the European Union, the European Free Trade Association or one country which has entered into a Mutual Recognition Agreement is required in order for a manufacturer to commercially distribute the product throughout these countries. ISO 9001 and ISO 13845 certification are voluntary harmonized standards. Compliance establishes the presumption of conformity with the essential requirements for a CE Marking. In the third quarter of 2001, our facility was awarded the ISO 9001 and EN 46001 certification. In the first quarter of 2003, we received our ISO 9001: 2000 updated certification as well as EN 46001. In the second quarter 2003 we received certification for ISO 13485. All those certifications are valid until 2006.

*Federal Communications Commission and other governmental agencies governing the use of radio frequency energy.* Our products generate and use radio frequency energy, and therefore may be subject to technical, equipment authorization and other regulatory requirements in the countries and regions where they are marketed or distributed. In the United States, our products are subject to the Federal Communications Commissionâ€™s equipment verification procedures, under which the manufacturer is required to determine, or verify, that the equipment complies with the applicable technical standards and to keep a record of test measurements demonstrating compliance before the equipment can be marketed or sold in the United States. Any modifications to our products may require re-verification before we are permitted to market and distribute the modified devices.

We seek to obtain regulatory approvals in countries requiring advance clearance of our products before they are marketed or distributed in those countries. Our failure to comply with the technical, equipment authorization, or other regulatory requirements of a specific country or region could impair our ability to commercially market and distribute our products in that country or region.



### *C. ORGANIZATIONAL STRUCTURE*

We have four active subsidiaries: Syneron GmbH, a wholly-owned subsidiary, was established in Germany in August 2001, to market and sell the Companyâ€™s products in Europe; Syneron Inc. and Syneron Canada Corp., also wholly-owned subsidiaries, were established during 2002 in Delaware and Toronto, Canada, respectively, to market and sell the Companyâ€™s products in North America. Syneron Medical (HK) Ltd, also a wholly-owned subsidiary, was established in Hong Kong in June 2004 and became active promoting, marketing and serving as an agent of the Company in Asia and Australia in January 2007. In July 2005, we also purchased a 51% interest in Light Instruments Ltd., an Israeli start-up specializing in the development of advanced dental laser devices.

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

We lease our main office and research and development facilities, located in the Industrial Zone in Yokneam Illit, Israel pursuant to a lease that expires in December 2010. We occupy approximately 33,422 square feet in this leased facility in Yokneam. Our Canadian subsidiary leases a 9,820 square feet facility in Richmond Hill, Ontario, Canada pursuant to leases that expire in April 2007. Our U.S. subsidiary leases a 2,200 square foot facility in Schaumburg, Illinois pursuant to a lease that expires in May 2010. Our U.S. subsidiary also leases a 5,350 square foot facility and another 15,204 square foot facility, both in Irvine, California pursuant to a lease that expires in October 2007 and October 2011, respectively. Our German subsidiary leases a 1,500 square foot facility in Germany pursuant to a lease renewable on a yearly basis. We believe that our properties are adequate to meet our current needs.

## ITEM 4A. UNRESOLVED STAFF COMMENTS

None

## ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

*The following discussion of our financial condition and results of operations should be read in conjunction with â€œItem 3.A Selected Financial Dataâ€ and our consolidated financial statements and the related notes to those statements included elsewhere in this annual report. In addition to historical consolidated financial information, the following discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. Our actual results and timing of selected events may differ materially from those anticipated in theses forward-looking statements as a result of many factors, including those discussed under â€œItem 3.D Risk Factorsâ€ and elsewhere in this annual report.*

## *A. OPERATING RESULTS*

### Overview

We design, develop and market innovative aesthetic medical products based on our proprietary ELOS, technology, which uses the synergy between electrical energy and optical energy to provide effective, safe and affordable aesthetic medical treatments. Our products, which we sell primarily to physicians and other practitioners, target a wide array of non-invasive aesthetic medical procedures, including hair removal, wrinkle reduction, rejuvenation of the skinâ€™s appearance through the treatment of superficial benign vascular and pigmented lesions, and treatment for the temporary reduction in the appearance of cellulite. We believe ELOS provides performance advantages over existing technologies that rely solely on optical energy. We believe using optical energy alone limits the safety and efficacy of many aesthetic medical procedures due to limited skin penetration and unwanted epidermal absorption. Our proprietary ELOS technology, which combines optical and electrical energy, enhances the userâ€™s ability to accurately target the tissue to be treated and enables real-time measurement of skin temperature, resulting in increased patient safety and comfort and improved treatment results.

We were incorporated in July 2000. During 2000 and 2001, our primary activity was the development and approval of our first product platform, the Aurora, which utilizes our ELOS technology. We received our CE Mark approval in Europe in November 2001 and launched sales of the Aurora product platform in December 2001. We received 510(k) clearance from the FDA for hair removal for the Aurora product platform in July 2002. In October 2002, we received 510(k) clearance from the FDA to market the Aurora product platform for the treatment of superficial benign vascular and pigmented lesions. In August 2002, we introduced the Aurora product platform commercially in the United States.



We launched the Polaris product platform in May 2003 after receiving our CE Mark approval in Europe for the product in December 2002. In April 2003, we received 510(k) clearance from the FDA to market the Polaris product platform for leg vein treatment as well as other types of vascular lesions. In December 2003, we introduced the Polaris product platform commercially in the United States.

We received our CE Mark approval in Europe for the Pitanga product platform in May 2003. During the fourth quarter of 2003, we launched the Pitanga product platform for the treatment of acne and hair removal in Europe and Canada.

We launched the Galaxy product platform in May 2004. We received our CE Mark approval in Europe for the Galaxy product platform in May 2004. The 510(k) clearances from the FDA also provide the regulatory basis for the marketing of the Galaxy product for all applications. We introduced the Galaxy product platform commercially in the United States in May 2004.

During 2004, we significantly expanded our direct sales and marketing organization in North America to approximately 50 employees, established a distribution network in eleven countries in the Asia-Pacific region and increased our sales and marketing efforts in Europe. We increased our sales and marketing effort in 2004 in connection with new product introductions and other marketing activities planned for 2004. In 2004, we introduced three new product platforms: the Galaxy, which combines the applications of the Aurora and the Polaris product platforms, the Vela, for the temporary reduction in the appearance of cellulite and the Comet, for hair removal. Our Galaxy and Comet platforms are covered by our present FDA clearances. In June 2005, the FDA granted 510(k) clearance to our Vela platform for the temporary reduction in the appearance of cellulite and for the relief of minor muscle aches, pain and spasms, as well as the

temporary improvement of local blood circulation.

In the third quarter of 2005, we had entered into an agreement with EuropeLab, Inc.â€˜s Platinum Equipment Division, or EuropeLab, as our North American distributor for the dental spa, day spa, aesthetic and chiropractic spa markets. Under this agreement, EuropeLab, which is a distributor of specialized equipment for the spa market, will distribute our VelaSmoothâ„¢ and the Pitangaâ„¢ systems to the spa market in North American. In April 2006, we launched our new cosmetic division, Syneron Cosmedicsâ„¢ to target our products to aesthetic practitioners, spas and the cosmetic market. Our products for these markets incorporate the safety feature of active dermal monitoring, as well as contact cooling which are very important for these professionals and medical spas

In the first quarter of 2006, we have also reorganized the structure of our North American sales force. Our organization now consists of 60 salespeople in North American organized in seven territories, each with a dedicated regional manager. During this period, we also formed strategic alliances in Canada with two of the countryâ€™s large medical equipment and supply distributors â€“ Medical Mart Supplies Ltd. and Dufort & Lavigne Ltee.

Also, in the first quarter of 2006, we launched three new platforms to address medical aesthetic applications based on our elosâ„¢ (Electro-Optical Synergy) combined energy technology. The new eLightâ„¢ platform combines Broad Spectrum Light with Bi-Polar Radio Frequency. The system provides a full facial solution for skin rejuvenation, including the treatment of superficial vascular and pigmented lesions, and acne applications. It also supports hair removal applications. The system also includes a new skin tightening modality â€“ the ST, which received FDA clearance in March 2006. The new eLaserâ„¢ platform combines Diode Laser technology with Bi-Polar Radio Frequency and offers ultra fast hair removal, as well as upgradeability to Syneronâ€™s leg vein and wrinkle reduction treatments. Finally, the new eMaxâ„¢ platform combines Bi-Polar Radio Frequency with multiple forms of light energy and diode laser energy to deliver the complete range of Syneronâ€™s elos modalities in one multi-platform system. All the applications on the eLight, eLaser and eMax have received 510(k) clearance from the FDA.

In the first quarter of 2007, we launched the LiteTouch platform, which is a Dental Laser system that can be used for treatment of oral soft and hard tissue. The new LiteTouch platform is a compact, lightweight and portable laser system which makes the use of the device very similar to mechanical drills. The LiteTouch system has a small footprint, which saves important floor space and is easily integrates into any clinic. The LiteTouch offers both high energy and high frequency, thus providing a wide envelope of treatment parameters.



**Revenues**

Generally, we recognize revenue when persuasive evidence of an arrangement exists, delivery of the product has occurred, the fee is fixed or determinable, collectibility is probable and we do not have any obligation to customers after the date on which products are delivered.

We generate our revenues primarily from the sales of our ELOS-based medical aesthetic equipment. For the year ended December 31, 2006 our revenues totaled $117 million. From inception through December 31, 2006, we sold over 6,700 products worldwide. In 2006, we derived approximately 6.2% of our revenue from the recognition of service revenue. We expect product service revenue to increase over time as our installed base continues to grow.

We sell our products directly in the United States, Canada, Germany and Austria and use distributors to sell our products in countries where we do not have a direct presence, or to complement our direct sales force. For the year ended December 31, 2006, we derived 43.1% of our revenue from sales of our products outside North America through a combination of direct and distributor sales. As of December 31, 2006, we had approximately 60 salespeople in North America and distributors in more than 43 countries. We believe that our sales will increase over time as we continue to introduce new products with new applications.

The following table provides information regarding the breakdown of our sales by geographical region for the years ended December 31, 2005 and 2006:

**Percent of Sales**

| Region | Year ended December 31, 2005 | Year ended December 31, 2006 |
|---|---|---|
| North America | 62.2% | 56.9% |
| Europe | 16.0 | 26.2 |
| Asia-Pacific | 19.0 | 13.9 |
| Other | 2.8 | 3.0 |
| Total | 100.0% | 100.0% |

**Cost of Revenues**

Our cost of revenues consists of the cost of manufacture and assembly of our ELOS-based medical products by third-party manufacturers. These costs primarily include materials, components and labor used by our third-party manufacturers. We have been able to negotiate competitive terms with the subcontractors that manufacture our products. Also, because our product technology, design and engineering does not require highly sophisticated, time intensive labor for assembly and testing and our products use the off-the-shelf discrete components, we are able to experience low manufacturing costs and relatively high gross margins.

Cost of revenues also includes service and warranty expenses, as well as salaries and personnel-related expenses for our operations management team which includes subcontractor management, purchasing and quality control. The cost of revenue as a percentage of revenues increase from 2005 to 2006 due to increase in sales of products that are more expensive to manufacture and cost of infrastructure required to run our service operations. We anticipate that this trend may continue.

**Research and Development Expenses**

Our research and development expenses consist of salaries and other personnel-related expenses of employees primarily engaged in research and development activities, external engineering fees and materials used and other overhead expenses incurred in connection with the design and development of our products. We expense all our research and development costs as incurred. We expect our research and development expenditures to increase significantly in absolute dollars and moderately as a percentage of revenues as we continue to devote resources to research and develop new products and technologies.



**Selling and Marketing Expenses**

Our selling and marketing expenses consist primarily of salaries, commissions and other personnel-related expenses for those engaged in the sales, marketing and support of our products and trade show, promotional and public relations expenses, as well as management and administration expenses in support of sales and marketing in our subsidiaries. We expect our selling and marketing expenses to increase significantly in absolute dollars, though we do not expect them to increase significantly as a percentage of revenues, as a result of expansion of our marketing efforts.

**General and Administrative Expenses**

Our general and administrative expenses consist primarily of salaries and other personnel-related expenses for executive, accounting and administrative personnel, professional fees and other general corporate expenses. We are experiencing an increase of our general and administrative expenses in absolute dollars and as a percentage of revenues as a result of our becoming a public company in 2004.

**Financial Income, net**

Interest income and other income consists primarily of interest earned on cash, cash equivalents, deposits and

marketable securities, as well as exchange differences resulting from remeasurement of our foreign currency transactions and balances into US dollars.

**Taxes on Income**

In 2002, our facilities in Israel were granted the status of â€œApproved Enterpriseâ€□ and in 2005 the status of â€œBenefited Enterpriseâ€□ (The new program under the Law for the Encouragement of Capital Investments, 1959), both entitling us to a ten-year exemption from Israeli corporate tax. The â€œApproved Enterpriseâ€□ and â€œBenefited Enterpriseâ€□ status only allows corporate tax exemptions on profits generated from operations, requiring regular Israeli corporate tax on income generated from other sources, such as gains from sales of marketable securities and interest earned on cash, cash equivalent and marketable securities. We will seek to maintain the â€œApproved Enterpriseâ€□ and the â€œBenefited Enterpriseâ€□ status by meeting the necessary conditions with respect to our future capital investment programs thus extending our â€œApproved Enterpriseâ€□ benefits beyond the first ten years. For additional description of Israeli Tax please see â€œItem 10.E Taxation â€“ Israeli Taxation.â€□

**Critical Accounting Policies and Estimates**

Our discussion and analysis of our financial condition and results of our operations is based upon our audited consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amount of assets, liabilities, sales and expenses and related disclosure of contingent assets and liabilities. On a periodic basis, we evaluate our estimates, including those related to revenue recognition, warranty reserved, income taxes, litigation and stock-based compensation. We base our estimates on historical experience, authoritative pronouncements and various other assumptions which we believe to be reasonable under the circumstances. Actual results could differ from those estimates. The following are our critical accounting policies and the significant judgments and estimates affecting the application of those policies in our consolidated financial statements. (See Note 2 of the Notes to our Consolidated Financial Statements).

*Revenue Recognition*. We recognize revenues in accordance with Staff Accounting Bulletin No. 104, or SAB 104, when each of the following four criteria are met:

- delivery has occurred;
- there is persuasive evidence of an agreement;
- the fee is fixed or determinable; and
- collection is reasonably assured.



Revenue from product sales to end users in North America usually includes multiple elements within a single contract. We consider the sale of a product and the service element in the agreement to be two separate accounting units of the arrangement and defer the fair value of the service element to the period in which it is earned. Fair value is determined based on the price charged on a stand alone basis for the service provided, and data available from which to estimate the volume of services provided the during term of the arrangement.

In evaluating whether collection is reasonably assured, we review credit and operation histories and customersâ€™ facilities and in the case of independent distributors, we will evaluate creditworthiness and other relevant factors.

If changes in conditions cause management to determine that these criteria are not met for future transactions, revenue recognized for any reporting period could be adversely affected. Although we meet the requirements of SAB 104 upon shipment of product, and the recording of revenue, we continually evaluate our accounts receivable for any bad debts and make estimates for any bad debt allowances.

We do not maintain a general allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. We compute an allowance based upon a specific customer account review of our customers. Our assessment of the ability of our customers to pay generally includes direct contact with the customer, investigation into their financial status, as well as consideration of their payment history with us. If the financial condition of a customer were to deteriorate, resulting in an impairment of its ability to make payments, additional allowance may be required. If we determine, based on our assessment, that it is probable that a customer will be unable to pay, we will write off the account receivable.

*Taxes on Income*. We account for income taxes in accordance with Statement of Financial Accounting Standards No. 109, â€œAccounting for Income Taxesâ€ (â€œSFAS No. 109â€). 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 measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. We provide a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value. Our valuation allowance is based on our judgment on future taxable income that would allow or prevent us from benefiting from our loss carryforwards. Currently, our relatively short history of loss operations does not allow us to record any tax benefit resulting from our subsidiariesâ€™ losses.

In June 2006, FASB issued Interpretation No. 48, â€œAccounting for Uncertainty in Income Taxesâ€, an interpretation of FASB SFAS No. 109, â€œAccounting for Income Taxes,â€ or FIN 48. The Interpretation addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, we may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the tax authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. FIN 48 also provides guidance on de-recognition, classification, interest and penalties on income taxes, accounting in interim periods and requires increased disclosures. The provisions of FIN 48 are effective beginning January 1, 2007. Based on our evaluations, the FIN 48 impact on our consolidated financial statements, is not material.

*Stock-Based Compensation*. In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard SFAS 123 (revised 2004), Share-Based Payment (SFAS 123R). SFAS 123(R) supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees (APB 25), and amends 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 share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values at the date of grant. Pro forma disclosure is no longer an alternative.

On January 1, 2006, we adopted SFAS 123(R) using the modified prospective method as permitted under SFAS 123 (R). Under that transition method, compensation cost recognized during 2006 included: (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 provisions of Statement 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 Statement 123(R). In accordance with the modified prospective method of adoption, our results of operations and financial position for prior periods have not been restated.



We used the Black-Scholes option pricing model in 2003 and 2004 and the Binominal model for options granted thereafter to estimate the fair value of stock option grants. Key input assumptions used to estimate the fair value of stock options include the exercise price of the award, the expected option term, the expected volatility of our stock over the optionâ€™s expected term, the risk-free interest rate over the optionâ€™s expected term, the post-vest cancellation rate, the suboptimal exercise factor and our expected annual dividend yield. Expected volatilities are based on historical volatilities of similar companies. As equity-based compensation expense recognized in the consolidated statement of income is based on awards ultimately expected to vest, it should be reduced for estimated forfeitures. The expected life represents the weighted average period of time that options granted are expected to be outstanding giving consideration to vesting schedules and our historical exercise patterns; and the risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant for periods corresponding with the expected life of the option. The post-vesting cancellation rate and estimated forfeitures are based on our historical experience and the suboptimal exercise factor is based on our

historical experience as well as on academic papers and the common practice which support our assumptions. Assumed dividend yield of zero is based on the fact that we have never paid cash dividends and have no present intention to pay cash dividends.

If factors change and we employ different assumptions for estimating stock-based compensation expense in future periods the stock-based compensation expense we recognize in future periods may differ significantly from what we have recorded in the current period and could materially affect our operating income, net income and earnings per share. It may also result in a lack of comparability with other companies that use different models, methods and assumptions. Existing valuation models, including the Binominal model, may not provide reliable measures of the fair values of our stock-based compensation. Consequently, there is a risk that our estimates of the fair values of our stock-based compensation awards on the grant dates may bear little resemblance to the actual values realized upon the exercise, expiration, early termination or forfeiture of those stock-based payments in the future. Certain stock-based payments, such as employee stock options, may expire with little or no intrinsic value compared to the fair values originally estimated on the grant date and reported in our financial statements. Alternatively, the value realized from these instruments may be significantly higher than the fair values originally estimated on the grant date and reported in our financial statements. The guidance in SFAS 123R is relatively new and the application of these principles may be subject to further interpretation and refinement over time.

Prior to December 31, 2005, we followed the provisions of SFAS No. 123, â€œAccounting for Stock-Based Compensationâ€□. The provisions of SFAS No. 123 allowed companies to either expense the estimated fair value of stock options or to continue to follow the intrinsic value method set forth in Accounting Principles Board Opinion No. 25, â€œAccounting for Stock Issued to Employeesâ€□ (â€œAPB 25â€□), but disclose the pro forma effects on net income had the fair value of the options been expensed. We elected to apply APB 25 in accounting for our stock option incentive plans.

Deferred stock-based compensation is amortized on a straight-line basis to cost of revenues, selling and marketing expenses, research and development expenses, and general and administrative expenses.

*Litigation.* Management sets aside liabilities related to litigation brought against us when the amount of the potential loss is probable and can be estimated. Because of the uncertainties related to an unfavorable outcome of litigation, and the amount and range of loss on pending litigation, management is often unable to make an accurate estimate of the liability that could result from an unfavorable outcome. As litigation progresses, we continue to assess our potential liability and revise our estimates accordingly. Such revisions in our estimates could materially impact our results of operations and financial position. Estimates of litigation liability affect our accrued liability line item in our consolidated balance sheet and our general and administrative expense line item in our statement of operations.



*Warranty Reserve.* We generally provide a one- to three-years standard warranty with our products, depending on the type of product and the country in which we do business. After the warranty period, maintenance and support is provided on a service contract basis or on an individual call basis. On sales to distributors, we provide a warranty on parts only. We provide for the estimated cost of product warranties at the time product revenue is recognized. Factors that affect our warranty reserves include the number of units sold, historical and anticipated rates of warranty repairs and the cost per repair. While we engage in extensive product quality programs and processes, including actively monitoring and evaluating the quality of our component suppliers, our estimated warranty obligation is affected by ongoing product failure rates, specific product class failures outside of our baseline experience, material usage and service delivery costs incurred in correcting a product failure. If actual product failure rates, material usage or service delivery costs differ from our estimates, revisions to the estimated warranty liability would be required. Assumptions and historical warranty experience are evaluated to determine the appropriateness of such assumptions. We assess the adequacy of the warranty provision once a year and we may adjust this provision if necessary.

**Results of Operations**

**Years Ended December 31, 2005 and December 31, 2006**

*Revenues.* Revenues in 2006 have increased by $29.6 million, or 33.8 %, from $87.4 million in 2005 to $117 million. The increase was primarily attributable to increased unit sales as a result of extensive efforts in Europe and Asia as well as

increasing efforts in North America which resulted in an increase of the market share of Syneron products.

*Cost of Revenues.* Cost of revenues increased by $6.5 million in 2006, from $11.4 million in 2005 to $17.9 million. The increase in cost of revenues was primarily attributable to the increase in the number of products manufactured and sold. As a percentage of revenue, cost of revenues increased from 13.1% in 2005 to 15.3 % in 2006 due to change in the mix of products towards products that include Laser instead of IPL. For a detailed explanation on the difference between Laser and IPL, please see â€œBusiness Overviewâ€“Industryâ€ above.

*Research and development*. Research and Development expenses increased by $3.5 million, from $5.0 million in 2005 to $8.5 million in 2006. As a percentage of revenues, research and development expenses increased from 5.8% in 2005 to 7.3% in 2006. The increase was primarily attributable to expansion of our research and development staff and its activities, the increased consulting services from outside engineering companies. In addition Research and Development expenses for the year ended December 31, 2006 include $ 0.6 million of stock based compensation expenses recorded under SFAS 123 (R).

*Selling and Marketing Expenses.* Selling and marketing expenses increased by $21.2 million, from $25.2 million in 2005 to $46.4 million in 2006. The increase in selling and marketing expenses was primarily attributable to an increase in personnel costs associated with the expansion of our North American sales force and increased activities in Europe, Asia-Pacific and South America. In addition Selling and Marketing expenses for the year ended December 31, 2006 include $ 5.0 million of stock based compensation expenses recorded under SFAS 123(R). As a percentage of revenues, selling and marketing expenses increased from 28.8% in 2005 to 39.7% in 2006.

*General and Administrative Expenses.* General and administrative expenses increased by $5.9 million, from $3.5 million in 2005 to $9.4 million in 2006. The increase in general and administrative expenses was primarily attributable to an increase in personnel costs associated with the expansion of our finance and other management functions needed to support our overall growth. In addition General and Administrative expenses for the year ended December 31, 2006 include $ 2.3 million of stock based compensation expenses recorded under SFAS 123(R). As a percentage of revenues, general and administrative expenses increased from 4.0% in 2005 to 8.0% in 2006.

*Financial Income.* Financial income increased $3.4 million, from $3.1 million in 2005 to $6.5 million in 2006. The increase in financial income was primarily attributable to interest earned on our increasing cash balances and marketable securities in 2006. As a percentage of revenues, financial income increased from 3.5% in 2005 to 5.5% in 2006.

*Taxes on Income.* Income taxes increased by $0.8 million, from $0.7 million in 2005 to $1.5 million in 2006. As an â€œApproved Enterpriseâ€ and a â€œBenefited Enterpriseâ€ in Israel, we are exempt from tax on any income derived from our â€œApproved Enterpriseâ€ and â€œBenefited Enterpriseâ€ and we pay taxes only on income from other sources which are not integral to our â€œApproved Enterpriseâ€ and â€œBenefited Enterpriseâ€, such as interest on marketable securities. Our subsidiaries had loss carryforwards of approximately $50.0 million as of December 31, 2006 as compared to approximately $38.9 million as of December 31, 2005. We have recorded a valuation allowance for the deferred taxes on these losses since it is more likely than not that we will not be able to offset such losses against future income.



**Years Ended December 31, 2004 and December 31, 2005**

*Revenues.* Revenues in 2005 have increased $29.5 million, or 51%, from $57.9 million in 2004 to $87.4 million. The increase was primarily attributable to increased unit sales due to increased market share of Syneron products, increased Galaxy and Comet sales in the United States and the rest of the world and the commercial launch of the VelaSmooth in the beginning of 2005 in the international markets and in the third quarter in United States, *Cost of Revenues.* Cost of revenues increased $4.5 million in 2005, from $6.9 million in 2004 to $11.4 million. The increase in cost of revenues was primarily attributable to the increase in the number of products manufactured and sold. As a percentage of revenue, cost of revenues increased from 11.9% in 2004 to 13.1% in 2005 due to change in the mix of products towards products that include Laser instead of IPL. For a detailed explanation on the difference between Laser and IPL, please see â€œBusiness Overviewâ€“Industryâ€ above.

*Research and development*. Research and development expenses increased $1.9 million, from $3.1 million in 2004 to $5.0 million in 2005. As a percentage of revenues, research and development expenses increased from 5.3% in 2004 to 5.8% in 2005. The increase was primarily attributable to expansion of our research and development staff and its activities, as well as increased consulting services from outside engineering companies.

*Selling and Marketing Expenses.* Selling and marketing expenses increased $5.6 million, from $19.6 million in 2004 to $25.2 million in 2005. The increase in selling and marketing expenses was primarily attributable to an increase in personnel costs associated with the expansion of our North American sales force and increased activities in Europe, Asia-Pacific and South America. As a percentage of revenues, selling and marketing expenses decreased from 33.9% in 2004 to 28.8% in 2005. This decrease was primarily due to the increase in our sales in 2005.

*General and Administrative Expenses.* General and administrative expenses increased $0.8 million, from $2.7 million in 2004 to $3.5 million in 2005. The increase in general and administrative expenses was primarily attributable to an increase in personnel costs associated with the expansion of our finance and other management functions needed to support our overall growth. As a percentage of revenues, general and administrative expenses decreased from 4.7% in 2004 to 4.0% in 2005.

Other Expenses of $3.5 million in 2005 were attributable to settlement and litigation costs associated with Thermage Ltd in the amount of 2.7 million and expenses related to the secondary follow-on offering in the amount of $0.8 million.

*Financial Income.* Financial income increased $0.5 million, from $2.4 million in 2004 to $3.1 million in 2005. The increase in financial income was primarily attributable to interest earned on our increasing cash balances and marketable securities in 2005. As a percentage of revenues, financial income decreased from 4.1% in 2004 to 3.5% in 2005.

*Taxes on Income.* Income taxes increased $0.1 million, from $0.6 million in 2004 to $0.7 million in 2005. As an â€œApproved Enterpriseâ€ in Israel, we are exempt from tax on any income derived from our â€œApproved Enterpriseâ€ and we pay taxes only on income from other sources which are not integral to our approved enterprise such as interest on marketable securities. Our subsidiaries had loss carryforwards of approximately $38.9 million in 2005 as compared to approximately $4.0 million in 2004. We have recorded a valuation allowance for these losses since it is more likely than not that we will not be able to offset such losses against future income.

### *B. LIQUIDITY AND CAPITAL RESOURCES*

From December 31, 2002 through August 10, 2004, we funded our operations principally from private placements of preferred shares that resulted in aggregate net proceeds of approximately $3.3 million. On August 11, 2004, we completed our initial public offering, which resulted in net proceeds of approximately $54.0 million. On March 8, 2005, we completed a follow-on secondary offering resulting in net proceeds of $1.6 million from exercise of options. On August 11, 2005, the one-year lock-up period for certain of our shareholders ended, and following that period, we raised $11.7 million from exercise of options. As of May 31, 2007, we did not have any outstanding or available debt financing arrangements. As of December 31, 2006, we had working capital of $127.2 million, and our primary source of liquidity was $171.6 million in cash, cash equivalents and marketable securities and cash flow from operations.



We believe that our cash balances and cash generated from operations will be sufficient to meet our anticipated cash requirements for the foreseeable future. If existing cash and cash generated from operations are insufficient to satisfy our liquidity requirements, we may seek to sell additional equity or debt securities or obtain a credit facility. If we raise additional funds through the issuance of debt securities, these securities could have rights senior to those associated with our ordinary shares and could contain covenants that would restrict our operations. We cannot be sure that we will not require additional capital beyond the amounts currently forecasted by us, nor that any such required additional capital will be available on reasonable terms, if at all.

*Net Cash Provided By Operating Activities.* Net cash provided by operating activities was $22.6 million in 2004, $31.3 million in 2005 and $37.3 million in 2006. The change in net cash provided by operating activities reflects the growth in sales activity as well as our increased profitability and increasing levels of collection of accounts receivables netted against other working capital items. During 2006, trade receivables, other account receivables and prepaid expenses,

and other accrued liabilities increased significantly as a result of increased sales. As revenues grow, we anticipate that our trade receivables and inventory will continue to grow, requiring an increase in our required level of working capital.

*Net Cash Used in Investing Activities.* Net cash used in investing activities $(70.0) million in 2004, $(42.4) million in 2005 and $(34.7) million in 2006. Cash used in investing activities is primarily attributable to marketable securities. For the year ended December 31, 2004, we invested $1.5 million in capital expenditures, consisting primarily of purchases of a patent family (and applications for patents), software, manufacturing equipment and general equipment. For the year ended December 31, 2005, we invested $1.1 million in capital expenditures, consisted primarily of purchases of a patent family (and applications for patents), software, manufacturing equipment and general equipment. For the year ended December 31, 2006, we invested $1.0 million in capital expenditures, consisted primarily of purchases of a patent family, software, manufacturing equipment and general equipment. We expect our capital expenditures in 2007 will be approximately $1 million and will consist of the same types of capital expenditures that we had in 2006.

*Net Cash Provided By Financing Activities.* Net cash provided by financing activities was $53.7 million in 2004, $11.7 million in 2005 and $0.3 million in 2006. Net cash provided by financing activities in 2004 was primarily attributable to the proceeds of our initial public offering. Net cash provided by financing activities in 2005 was primarily attributable to the proceeds of exercise on options and net cash provided by financing activities in 2006 was primarily attributable to the proceeds of exercise of options and the sale of Restricted Shares Units.



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

Our research and development activities are conducted internally by a research and development staff consisting of 48 employees. Our research and development efforts are focused on the development of new products, as well as the extension of our existing products to new applications in the non-invasive aesthetic medical market. We intend to develop products and product line extensions that leverage our existing ELOS platform. We have a number of new projects and products under development, mainly focusing on additional non-invasive aesthetic treatments. We expect to continue and develop four major product initiatives in 2006: dental lasers; non-invasive fat reduction; a new product line for aestheticians and the cosmetic market; and products for home use using Syneronâ€™s proprietary elos technology.

To date, our research and development effort has been focused on the development of products that leverage our existing ELOS platform rather than developing new technologies. Our gross research and development expenditures were $3.1 million in 2004, $ 5.0 million in 2005, and $8.5 million in 2006. We expect to continue to increase our expenditures on research and development.

### *D. TREND INFORMATION*

In 2006, we continued our sales momentum and increased sales from $87 million in 2005 to $117 million in 2006. The increase in sales is attributed to the expansion of our marketing and sales network in Asia, Europe and South America. In 2006, we received a 510(k) premarket clearance from the FDA for our ST Applicator and our LiteTouch Dental Laser products and believe that our ability to market and sell this platform in the United States would further increase our sales in the future.

In 2006, we increased our production capacity through all three outsourcing companies that are serving Syneron as sub-contractors and added a forth sub-contactor. In 2006, we did not increase the average selling price of our platforms.

We intend to continue the development of new products and procedures in the medical aesthetic market in order to maintain the growth in revenue and net income. We currently do not foresee any change in a major trend that can have a material affect on our revenue, profitability and liquidity.

### *E. OFF-BALANCE SHEET ARRANGEMENTS*

We do not have off-balance sheet arrangements (as such term is defined in Item E(2) of the Form 20-F) that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial conditions, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors.

### *F. TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS*

The following table summarizes our contractual commitments as of December 31, 2006 and the effect those commitments are expected to have on our liquidity and cash flow in future periods:

| | Payments Due by Period | | | |
|---|---|---|---|---|
| **Contractual Commitments** | **Total** | **Less than 1 year** | **1-3 years** | **3-5 years** |
| | **(in thousands)** | | | |
| Operating leases | $ 2,280 | $ 664 | $ 986 | $ 630 |



## ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

### *A. DIRECTORS AND SENIOR MANAGEMENT*

The following table sets forth information regarding our executive officers and directors as of May 31, 2007:

| **Name** | **Age** | **Position(s)** |
|---|---|---|
| Dr. Shimon Eckhouse | 62 | Chairman of the Board of Directors |
| Doron Gerstel | 47 | Chief Executive Officer |
| Donald Lee Fagen | 54 | President of Syneron Inc. and Syneron Canada Corporation |
| Dr. Michael Kreindel | 40 | Chief Technology Officer and Director |
| Fabian Tenenbaum | 34 | Chief Financial Officer |
| Dr. Michael Anghel | 68 | External Director |
| Marshall Butler | 80 | Director |
| Yaffa Krindel | 52 | Director |
| David Schlachet | 62 | Director |
| Dan Suesskind | 63 | External Director |

*Dr. Shimon Eckhouse* has served as the chairman of our board of directors since May 2004. Dr. Eckhouse is the chairman of OrSense Ltd., CardioDex Ltd., NanoCyte Ltd. and Edge Medical Devices Ltd. and a director of WideMed Ltd., ColorChip Ltd., Ventor Medical Technologies Ltd. and Matteris Ltd. Dr. Eckhouse was a co-founder of ColorChip and served as its active chairman from 2003 to January 2004 and as its chief executive officer from 2001 to 2003. Dr. Eckhouse was the chairman and chief executive officer of ESC Medical Systems from its inception in 1992 until 1999. Prior to founding ESC Medical Systems, Dr. Eckhouse was head of product development and technical director at Maxwell Technologies in San Diego, California. Before that, Dr. Eckhouse was a scientist, team leader and head of a department in Rafael, Armament Development Authority of Israel and was active in various areas of research and development, including lasers and electro-optics. Dr. Eckhouse holds a B.Sc. in physics from the Technion Israeli Institute of Technology and a Ph.D. in physics from the University of California at Irvine. He has more than 20 registered patents and published more than 50 papers in leading reference journals and conferences. He is also a member of the Board of Directors of the Technion Israeli Institute of Technology. Dr. Eckhouse is the uncle of Amit Meridor, our Vice President of Sales.

*Doron Gerstel* was appoint our Chief Executive Officer on May 14, 2007 and has served as our President of Syneron North America since June 2006. Prior to that Mr. Gerstel was a co-founder of Zend Technologies, Inc., a private technology company that creates modern open source web applications, where he served as Chief Executive Officer from its inception in 1999 until May 2006. Prior to his founding of Zend, Mr. Gerstel was Chief Operating Officer for Lumenis Ltd. (formerly ESC Medical Systems), a public company that develops, manufacturers and sells laser and light-based devices for medical, aesthetic, ophthalmic, dental and veterinary applications. Mr. Gerstel serves on the advisory board of Fritz, Inc. (acquired by UPS), the third largest logistics provider in the U.S. Mr. Gerstel holds a Bachelor of Science in Economics and Information Systems from the Technion, and an M.B.A. from Tel Aviv University.

*Donald Lee Fagen* was appointed the President of Syneron Inc. and Syneron Canada Corporation on May 14, 2007. Mr. Fagen joins Syneron from VISX, Incorporated, a manufacturer of devices in laser vision correction, where he served as the Vice President of Global Sales and Marketing since January 2001. Mr. Fagen holds a Bachelor of Science in Education and Sociology from Texas A&M.

*Dr. Michael Kreindel* has served as our chief technology officer and a member of our board of directors since our inception in July 2000. From 1994 to 2000, Dr. Kreindel was first a senior scientist and then project and program manager in ESC Sharplan. Dr. Kreindel was leader of a scientific group in the Institute of Electrophysics in Russia. Dr. Kreindel has an M.A. in experimental and plasma physics from the Ural Politechnical Institute in Russia and a Ph.D. in pulsed power, gas discharge and plasma physics from the Institute of Electrophysics in Russia.



*Fabian Tenenbaum* was appointed our Chief Financial Officer on May 14, 2007. Mr. Tenenbaum served as our Vice President for Business Development since September 2006 and was responsible for developing the growth strategy for our home-use product, which culminated in the exclusive worldwide joint development and supply agreement with Procter and Gamble. From April 2002 to September 2006, Fabian was Vice President at Radiancy Inc., where he managed the U.S. subsidiary of a late-stage med-tech start-up with the third largest global installed base for light-based devices in the field of dermatology and aesthetic medicine. Mr. Tenenbaum holds a Bachelorâ€™s degree in Medicine from Ben Gurion University and an MBA from Columbia Business School.

*Dr. Michael Anghel* has served as a director since November 2004. Since 2004, Dr. Anghel has served as the President and CEO of Israel Discount Capital Markets & Investments Corp., a subsidiary of the Israel Discount Bank. From 2000 to 2004, Dr. Anghel served as the chief executive officer of CAP Ventures, an operating venture capital company he founded that has invested and established a number of information technology and communications enterprises. Since 1980, Dr. Anghel has been directly involved in founding, managing and directing a variety of industrial, technology and financial enterprises. Dr. Anghel also served as a director of major publicly listed corporations and a number of financial institutions and providence funds. Dr. Anghel is currently a director of PowerDsine Ltd. and Orbotech Ltd. From 1969 to 1977, Dr. Anghel was a full-time member of the faculty of the Graduate School of Business at the Tel-Aviv University teaching in the areas of finance and corporate strategy. Dr. Anghel served on various Israeli governmental policy committees in the areas of communications and public finance. Dr. Anghel received his B.A. in Economics from the Hebrew University in 1960, an M.B.A. in Economics and Finance from Columbia University in 1964, and a Ph.D. in International Finance from Columbia University in 1969.

*Marshall Butler* has served as a director since October 2003. Mr. Butler is a co-founder and has served as chairman of both First Israel Mezzanine Investors Fund and Israeli Infinity Venture Capital Fund since 1996. Mr. Butler is a director of Shellcase Ltd., Galil Medical Ltd., New York State Council of Humanities and A.R.T. New York. Mr. Butler served as chairman of Nitzanim, AVX/Kyocera Corporation from 1994 to 2001. Mr. Butler served as chief executive officer and chairman of AVX Corporation from 1974 to 1993 and as director of Kyocera Venture Capital from 1990 to 1994. Mr. Butler is on the board of governors of the Technion Institute in Haifa, Israel. In 1998, Mr. Butler received the Israeli Prime Ministerâ€™s award for his contribution to Israeli industry. In 2001, he received an Honoree Doctorate from the Technion Institute.

*Yaffa Krindel* has served as a director since November 2005. She is currently serving as a partner in the Herzlia, Israel office of STAR Ventures, a private venture capital partnership headquartered in Munich, Germany. Ms. Krindel joined Star Ventures in 1997 as the managing partner of Star Ventures in Israel. Before joining STAR Ventures, between 1992 and 1996, Ms. Krindel served as CFO and VP Finance of Lannet Data Communications Ltd., then a publicly traded company in NASDAQ (now part of Avaya Inc.), a data communication systems company for the enterprise market. From 1993 to 1997 she served as CFO of BreezeCOM Ltd. (now part of Alvarion Ltd.), a Point-to-Multipoint (PMP) Broadband Wireless Access company headquartered in Tel Aviv. Ms. Krindel currently serves on the boards of OrSense Ltd., Trivnet Inc., Negevtech Ltd., Siano Mobile Silicon Inc., Alfy Inc. and Broadlight Incorporated. Ms. Krindel has earned M.B.A. from Tel Aviv University and a B.A. in Economics and Japanese Studies from the Hebrew University in Jerusalem.

*David Schlachet* resigned as our chief executive officer and was appointed to our board of directors on May 14, 2007. Mr. Schlachet has served as our chief executive officer since November 2005. From July 2004 to November 2005, Mr. Schlachet served as our chief financial officer. From 2000 to June 2004, Mr. Schlachet served as Managing Partner of Biocom, a venture capital fund specializing in the life sciences area. From 1995 to 2000, Mr. Schlachet served as a senior

Vice President and Chief Financial Officer of Strauss Elite Holdings, a packaged food group. From June 1997 to June 2000 David Schlachet also served as an active chairman of Elite Industries, a chocolate and confectionary company which is a subsidiary of Strauss Elite Holdings, in addition to his position in Straus Elite Holdings. From 1990 to 1995, Mr. Schlachet served as Vice President of Finance and Administration of the Weizmann Institute of Science. Mr. Schlachet serves as a director for Nasdaq listed companies Pharmos Inc., LanOptics Ltd and Compugen Ltd.. In addition, Mr. Schlachet serves as a director for Tel-Aviv Stock Exchange listed companies Taya Investments Ltd. and Edgar Investments and Developments Ltd., as well as a director of several privately owned Israeli companies. Mr. Schlachet holds a B.Sc. degree in chemical engineering and an M.B.A. from the Tel-Aviv University.



*Dan Suesskind* has served as a director since November 2004. Mr. Suesskind has held numerous positions with Teva Pharmaceutical Industries Ltd. since 1976, including as a director, from 1981 until 2001, and chief financial officer since 1978. From 1970 until 1976, Mr. Suesskind was a consultant and securities analyst with I.C. International Consultants Ltd. Mr. Suesskind is a member of the Jerusalem Foundation, Investment Advisory Committee, Board of Trustees of Hebrew University, board member of First International Bank and a board member of Migdal Insurance Company Ltd. Mr. Suesskind received his B.A. in Economics and Political Science from the Hebrew University in 1965, a certificate in Business Administration from the Hebrew University in 1967, and an M.B.A. from the University of Massachusetts in 1969.

Our Chief Executive Officer and Chief Technology Officer serve at the discretion of our board of directors and hold office until his or her successor is elected or his or her earlier resignation or removal. Other executive officers, in their capacity as such, serves at the discretion of our Chief Executive Officer and holds office until his or her successor is elected or his or her earlier resignation or removal.

### *B. COMPENSATION*

The aggregate direct compensation we paid to our directors who are not officers for their services as directors as a group (five out of the six directors) for the year ended December 31, 2006 was approximately $288,410. This amount includes payment to our Chairman of the Board. Directors are reimbursed for expenses incurred in order to attend board or committee meetings.

The aggregate direct compensation we and our subsidiaries paid to the officers as a group for the year ended December 31, 2006 was approximately $1.1 million. This amount includes approximately $0.1 million which was set aside or accrued to provide for pension, retirement or similar benefits. This amount does not include expenses we incurred for other payments, including dues for professional and business associations, business travel and other expenses, and other benefits commonly reimbursed or paid by companies in Israel. We did not pay our officers who also serve as directors any separate compensation for their directorship during 2006, other than reimbursements for travel expenses.

As of May 31, 2007, there were outstanding options to purchase 603,751 ordinary shares granted to our directors and officers (eight persons), at exercise prices ranging from $0.01 to $27.73, 24,000 of these options shall expire in the year 2011, 4,000 of these option shall expire in the year 2012, and 575,751 of these options shall expire in the year 2013.

For a description of the plans pursuant to which such options were granted please see Item 6.E below.

### *C. BOARD PRACTICES*

**Board of Directors**

In general, the number of members of our board of directors will be determined from time to time by a vote of at least 75% of the ordinary shares present and entitled to vote, provided that there shall be no more than 7 and no fewer than three directors. Our board of directors consists of seven directors. Two of the directors, Dr. Anghel and Mr. Suesskind, are external directors under Israeli law and are independent for Nasdaq purposes. Other than external directors, who are subject to special election requirements under Israeli law, our directors are elected in three staggered classes by the vote of a majority of the ordinary shares present and entitled to vote. The directors of only one class are elected at each annual

meeting, so that the regular term of only one class of directors expires annually. At our annual general meeting to be held in 2007, the term of the third class, consisting of Dr. Eckhouse, will expire and the director elected at that meeting will be elected for a three-year term. The external directors will not be assigned a class. The general meeting of our shareholders may dismiss a director during his or her term of office only by a vote of at least 75% of the ordinary shares present and entitled to vote (except for external directors, who may be dismissed only in the manner prescribed in the Companies Law).

We have employment and consultancy agreements with our principal executive officers. These agreements contain salary, benefit, non-competition and other provisions that we believe to be customary in our industry. In addition, these agreements provide for up to six months of liquidation fees in certain events of termination of employment. Agreements with our directors (serving in that capacity) do not provide for benefits upon termination of service.



**External Directors**

We are subject to the Israeli Companies Law. Under the Companies Law, Israeli companies whose shares have been offered to the public in or outside of Israel are required to appoint at least two external directors to serve on their board of directors. Each committee of the board of directors entitled to exercise any powers of the board is required to include at least one external director. The audit committee must include all the external directors. Our external directors are Dr. Anghel and Mr. Suesskind.

A person may not serve as an external director if at the date of the personâ€™s appointment or within the prior two years the person, or his or her relatives, partners, employees or entities under the personâ€™s control, have or had any affiliation with us or any entity controlling, controlled by or under common control with us. Under the Companies Law, â€œaffiliationâ€ includes an employment relationship, a business or professional relationship maintained on a regular basis or control or service as an office holder, however, service as a director for a period of no more than three months during which we first offer our shares to the public is not considered a prohibited affiliation.

A person may not serve as an external director if that personâ€™s position or other business activities create, or may create, a conflict of interest with the personâ€™s service as an external director or may otherwise interfere with the personâ€™s ability to serve as an external director. If at the time any external director is appointed, all members of the board are the same gender, then the external director to be appointed must be of the other gender.

External directors are elected by a majority vote at a shareholdersâ€™ meeting, as long as either:

- the majority of shares voted for the election includes at least one-third of the shares of non-controlling shareholders voted at the meeting; or
- the total number of shares of non-controlling shareholders voted against the election of the external director does not exceed one percent of the aggregate voting rights of the company.

The Companies Law provides for an initial three-year term for an external director which may be extended for one additional three-year term. Election of external directors requires a special majority, as described above. External directors may be removed only by the same special majority required for their election or by a court, and then only if the external directors cease to meet the statutory qualifications for their appointment or if they violate their duty of loyalty to the company. In the event of a vacancy created by an external director, our board of directors is required under the Companies Law to call a shareholders meeting to appoint a new external director as soon as practicable.

External directors may be compensated only in accordance with regulations adopted under the Companies Law. The regulations provide three alternatives for cash compensation to external directors: a fixed amount determined by the regulations, an amount within a range set in the regulations, or an amount that is equal to the average compensation to other directors who are not controlling shareholders of the company or employees or service providers of the company or its affiliates. A company also may issue shares or options to an external director at the average amount granted to directors who are not controlling shareholders of the company or employees or service providers of the company or its affiliates. Cash compensation at the fixed amount determined by the regulations does not require shareholder approval.

Compensation determined in any other manner requires the approval of the companyâ€™s audit committee, board of directors and shareholders. Compensation of external directors must be determined prior to their consent to serve as an external director.



**Committees of the Board of Directors**

Our board of directors has established three standing committees, the audit committee, the compensation committee and the nominating and governance committee.

*Audit Committee.* Under the Companies Law, the board of directors of any public company must establish an audit committee. The audit committee must consist of at least three directors and must include all of the external directors. The audit committee may not include the chairman of the board, any director employed by the company or providing services to the company on an ongoing basis, a controlling shareholder or any of the controlling shareholderâ€™s relatives. In addition, under the listing requirements of the Nasdaq Global Market, we also are required to maintain an audit committee of at least three members, all of whom are independent directors under the Nasdaq Global Market listing requirements. The rules of the Nasdaq Global Market also require that at least one member of the audit committee be a financial expert.

Our audit committee, acting pursuant to a written charter, is comprised of Dr. Anghel, who has been designated as the audit committee financial expert, Mr. Suesskind and Ms. Yaffa Krindel. The audit committee meets the requirements of the Sarbanes-Oxley Act of 2002 and the rules and regulations thereunder.

The audit committee provides assistance to the board of directors in fulfilling its legal and fiduciary obligations in matters involving our accounting, auditing, financial reporting, internal control and legal compliance functions by approving the services performed by our independent accountants and reviewing their reports regarding our accounting practices and systems of internal accounting controls. The audit committee also oversees the audit efforts of our independent accountants and takes those actions as it deems necessary to satisfy itself that the accountants are independent of management. Under the Companies Law, the audit committee also is required to monitor deficiencies in the administration of the company, including by consulting with the internal auditor, and to review and approve related party transactions.

*Compensation Committee.* Our compensation committee, acting pursuant to a written charter, is comprised of Dr. Anghel, Ms. Yaffa Krindel and Mr. Butler. The composition and functions of the compensation committee meet the requirements of the Nasdaq Global Market rules, with which we comply voluntarily. The compensation committee makes recommendations to the board of directors regarding the issuance of employee share incentives under our share option and benefit plans and determines salaries and bonuses for our executive officers and incentive compensation for our other employees.

*Nominating and Governance Committee.* Our nominating and governance committee, acting pursuant to a written charter, is comprised of Dr. Anghel, Ms. Yaffa Krindel and Mr. Butler. The committee is responsible for making recommendations to the board of directors regarding candidates for directorships and the size and composition of the board. In addition, the committee is responsible for overseeing our corporate governance guidelines and reporting and making recommendations to the board concerning corporate governance matters. The composition and function of our nominating and governance committee meets the requirements of the rules of the Nasdaq Global Market, with which we comply voluntarily.

**Internal Auditor**

Under the Companies Law, the board of directors must also appoint an internal auditor nominated by the audit committee. Our internal auditor is Ezra Yehuda, C.P.A. The role of the internal auditor is to examine whether a companyâ€™s actions comply with the law and proper business procedure. The internal auditor may be an employee of the company employed specifically to perform internal audit functions but may not be an interested party or office holder, or a relative of any interested party or office holder, and may not be a member of the companyâ€™s independent accounting firm or its representative. The Companies Law defines an interested party as a holder of 5% or more of the shares or voting rights of a company, any person or entity that has the right to nominate or appoint at least one director or

the general manager of the company or any person who serves as a director or as the general manager of a company. Our internal auditor is not an employee of the Company, but the managing partner of an accounting firm which specializes in internal auditing.



### *D. EMPLOYEES*

The breakdown of our employees by department and geographic location is as follows:

| | As of December 31 | | |
|---|---|---|---|
| | **2004** | **2005** | **2006** |
| Management, administration and operations | 37 | 39 | 39 |
| Research and development | 23 | 24 | 40 |
| Selling and marketing | 56 | 83 | 195 |
| **Total** | **116** | **146** | **274** |
| | | | |
| Israel | 34 | 40 | 83 |
| North America | 72 | 94 | 175 |
| Asia-Pacific | 2 | 3 | 5 |
| Europe | 8 | 9 | 10 |
| Latin America | -- | -- | 1 |

The increase in the number of our employees during the year 2006 is associated with a previously announced effort to build the needed infrastructure necessary to support the rapid growth we have and anticipate to experience. Most of the increase is for Selling and Marketing personnel in North America and from Research and Development personnel in Israel.

Some provisions of the collective bargaining agreement between the Histadrut, which is the General Federation of Labor in Israel, and the Coordination Bureau of Economic Organizations, including the Industrialistâ€™s Association of Israel, apply to our Israeli employees by virtue of extension orders of the Israeli Ministry of Labor and Welfare. These provisions concern the length of the workday and the work-week, recuperation pay and commuting expenses. Furthermore, these provisions provide that the wages of most of our employees are adjusted automatically based on changes in Israelâ€™s Consumer Price Index. The amount and frequency of these adjustments are modified from time to time. In addition, Israeli law determines minimum wages for workers, minimum vacation pay, sick leave, insurance for work-related accidents, determination of severance pay and other conditions of employment. We have never experienced a work stoppage, and we believe our relations with our employees are good.

Israeli law generally requires the payment of severance pay by employers upon the retirement or death of an employee or termination of employment without cause. As of December 31, 2006, our accrued severance pay funds totaled $0.4 million. We fund our ongoing severance obligations by making monthly payments to insurance policies. Furthermore, Israeli employees and employers are required to pay predetermined sums to the National Insurance Institute, which is similar to the U.S. Social Security Administration. These amounts also include payments for national health insurance. The payments to the National Insurance Institute are approximately 16.0% of wages, up to a specified amount of which the employee contributes approximately 10.0% and the employer contributes approximately 6.0%.

### *E. SHARE OWNERSHIP*

The following table sets forth information regarding the beneficial ownership of our ordinary shares as of May 31, 2007 by our officers and directors:

Beneficial ownership of shares is determined in accordance with the rules of the SEC and generally includes any shares over which a person exercises sole or shared voting or investment power. Ordinary shares that are subject to warrants or stock options that are presently exercisable or exercisable within 60 days of the date of May 31, 2007 are deemed to be outstanding and beneficially owned by the person holding the stock options for the purpose of computing the

percentage ownership of that person, but are not treated as outstanding for the purpose of computing the percentage of any other person.



Except as indicated in the footnotes to this table, each shareholder in the table has sole voting and investment power for the shares shown as beneficially owned by them. Percentage ownership is based on 27,722,735 ordinary shares outstanding on May 31, 2007.

| | Number | Percent |
|---|---|---|
| **Executive Officers and Directors:** | | |
| Dr. Shimon Eckhouse(1) | 2,662,483 | 9.59% |
| Dr. Michael Kreindel (2) | 1,663,057 | 5.99% |
| Yaffa Krindel | * | *% |
| Marshall Butler | * | *% |
| Dan Suesskind | * | *% |
| Dr. Michael Anghel | * | *% |
| David Schlachet(3) | * | *% |
| David Seligman(3) | * | *% |
| Doron Gerstel | * | *% |
| Fabian Tenenbaum | | |
| All directors and executive officers as a group (9 persons) | 4,283,868 | 15.45% |

* equals less than 1%

(1) Includes 2,287,331 shares held by Starlight Capital Ltd and 341,816 shares held by European High-Tech Capital S.A., which are corporations wholly owned by foundations that were created for the benefit of members of Dr. Eckhouseâ€™s family. Dr. Eckhouse disclaims beneficial ownership of these shares. Includes 33,336 ordinary shares issuable upon exercise of options immediately exercisable or exercisable within 60 days of May 31, 2007.

(2) Includes 1,629,721 shares held by Cititrust Bahamas Ltd. as Trustee for TR-30777, for which Dr. Kreindel is the beneficiary. Includes 33,336 ordinary shares issuable upon exercise of options immediately exercisable or exercisable within 60 days of May 31, 2007.

(3) Mr. Schlachet resigned as our Chief Executive Officer on May 14, 2007, and Mr. Seligman resigned as our Chief Financial Officer on May 14, 2007.

**Employee Benefit Plans**

Prior to the adoption of the 2004 Plans, we maintained one equity incentive plan adopted in 2003, which served as an umbrella plan for all of our employees, directors, officers and other eligible persons worldwide. Prior to the 2003 Plan, we granted options according to individual agreements with the grantees, without adopting a specific plan.

As of December 31, 2006, we had 145,657 options outstanding, all of which were issued under the 2003 Plan or conformed to the terms of the 2003 Plan. On May 12, 2004, our board of directors cancelled the unallocated options under the 2003 Plan.

On July 12, 2004, our board of directors and shareholders adopted separate 2004 plans for Israel and for the United States, Canada and the rest of the world. On November 11, 2004, our shareholders approved the 2004 United States, Canada and Rest of World Plan. Under the 2004 Plans, as of December 31, 2006, we had 1,725,479 options and RSUâ€™s outstanding.

We adopted both the 2003 Plan and the 2004 Israel Plan under Section 102 of the Israeli Income Tax Ordinance.

Options granted to employees under the 2003 Plan generally vest over three to four years from the grant date. Any option not exercised within seven years of the grant date will expire unless extended by the board of directors. If we terminate the engagement with a grantee for cause, all of his or her vested and unvested options expire immediately. If we terminate the engagement with a grantee for any other reason or the grantee resigns, the grantee may exercise his or her vested options within six months of the date of termination. A grantee who terminates his or her engagement with us due to death or disability may exercise his or her options (or in case of death â€“ by the estate or the legal successor of the grantee) within 12 months of the date of death or disability. In case of retirement, the post-retirement period of exercise is set at the discretion of the board of directors or the compensation committee. Any expired or terminated options return to the plan and are automatically cancelled.



Under the 2003 Plan, we have granted to our directors, officers, employees and consultants and those of any of our subsidiaries, options to purchase our ordinary shares. Since May 12, 2004, all option grants to our Israeli employees have been issued under the 2004 Israel Plan and, unless we adopt a new plan, all such grants in the future will be issued under the 2004 Israel Plan. The 2004 Israel Plan also allows for beneficial tax treatment for options issued through a trustee. Based on Israeli law currently in effect and elections made by us, and provided that options granted or, upon their exercise, the underlying shares, issued under the plan are held by the trustee for at least two years following the end of the calendar year in which the options are granted, Israeli employees are (i) entitled to defer any taxable event with respect to the options until the underlying shares are sold, and (ii) subject to capital gains tax of 25% on the sale of the shares. We may not recognize expenses pertaining to the options for Israeli tax purposes.

Israeli tax law allows us to choose from among three alternative sets of tax treatment for our 2004 Israel Plan or future plans. In approving the 2004 Israel Plan, the board of directors selected the capital gains tax treatment described above.

Under the 2004 United States, Canada and Rest of World Plan, we may grant to our non-Israeli directors, officers, employees and consultants, options and other incentive awards to purchase our ordinary shares. These plans were adopted to allow favorable tax treatment for our United States and Canadian directors, officers, employees and consultants. Since May 12, 2004, all option grants to our non-Israeli employees have been issued under the 2004 United States, Canada and Rest of World Plan and, unless we adopt a new plan, all such grants in the future will be issued under the 2004 United States, Canada and Rest of World Plan.

Options granted under the 2004 Plans generally vest over a period of one to three years of employment. Any options that are cancelled or forfeited before expiration become available for future grants. The Company can also issue a variety of other equity incentives under the 2004 Plans, but no such other equity incentives were outstanding as of December 31, 2005. In addition to granting stock options during 2006, the Company started to routinely grant Restricted Stock Units (RSUs) under the 2004 Plans. RSUs usually vest over a period of employment of up to three years. Upon vesting, the RSU beneficiary is entitled to receive a share per one RSU for $0.01 per share. RSUs that are cancelled or forfeited become available for future grants.

Each of the 2004 Plans expires in 2014 and has an evergreen provision. The evergreen provision calls for the annual increase of shares reserved for issuance under the 2004 Plan by the lesser of 2,000,000 options or 3% of the share capital, provided however that the board of directors may, at its sole discretion, decrease, at any given year, the yearly incremental increase of options to whatever number it deems appropriate.

## ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

### *A. Major Shareholders*

The following table sets forth information, as of May 31, 2007, regarding the beneficial ownership of our ordinary shares by each person or entity that we know beneficially owns 5% or more of our outstanding ordinary shares.

Except as indicated in the footnotes to this table, each shareholder in the table has sole voting and investment power for the shares shown as beneficially owned by them. Percentage ownership is based on 27,722,735 ordinary shares

outstanding as of May 31, 2007.

| | Shares | Percentage |
|---|---|---|
| Starlight Capital Ltd.(1) | 2,287,331 | 8.25% |
| Dr. Michael Kreindel (2) | 1,663,057 | 5.99% |
| The Baupost Group, L.L.C. (3) | 1,500,000 | 5.52% |

(1) A corporation wholly owned by foundations that were created for the benefit of members of Dr. Eckhouseâ€™s family. Dr. Eckhouse disclaims beneficial ownership of these shares. Excludes 341,816 shares held by European High-Tech Capital S.A., which is also a corporation wholly owned by foundations that were created for the benefit of members of Dr. Eckhouseâ€™s family. Dr. Eckhouse disclaims beneficial ownership of these shares as well and 33,336 ordinary shares issuable upon exercise of options immediately exercisable or exercisable within 60 days of May 31, 2007 held by Dr. Eckhouse.



(2) Includes 1,629,721 shares held by Cititrust Bahamas Ltd. as Trustee for TR-30777, for which Dr. Kreindel is the beneficiary and 33,336 ordinary shares issuable upon exercise of options immediately exercisable or exercisable within 60 days of May 31, 2007 held by Dr. Kreindel.

(3) The information is solely based upon Schedule 13G filed with the Commission on February 13, 2007 by The Baupost Group, L.L.C. (Baupost), SAK Corporation and Seth A. Klarman. SAK Corporation is the Manager of Baupost. Seth A. Klarman, as the sole Director of SAK Corporation and a controlling person of Baupost, may be deemed to have beneficial ownership of the securities beneficially owned by Baupost. Securities reported on the Schedule 13G as being beneficially owned by Baupost include securities purchased on behalf of various investment limited partnerships.

To our knowledge, the only significant changes in the percentage ownership by our major shareholders during the past three years have been the dilution in their percentage ownership as a result of our initial public offering in 2004, sales by major shareholders in our underwritten secondary offering in March, 2005, the purchases and sale by FMR Corp. and Sprott Asset Management Inc. in the public market subsequent to our underwritten secondary offering, the purchases and sale by Veredus Asset Management LLC in the public market of our ordinary shares in the first quarter of 2006, the sale by Lintech International Inc., which is wholly owned by a trust that was created for the benefit of the issue of Beryl Levey, of its holdings in June 2005, the sale by Israel HealthCare Ventures LP, which is affiliated with our past director, Dr. Hadar Ron, of its holdings in June 2005, the sale by M.N.M.M. Holdings Ltd., which is controlled by our past director and former CEO Mr. Moshe Mizrahy, of its holdings in November 2005, and the sale by Cititrust Bahamas Ltd., which is a trust that was created for the benefit of our Chief Technology Officer and director, Dr. Michael Kreindel, of part of its holdings pursuant to 10b5-1 plans.

Our major shareholders have the same voting rights pursuant to their share ownership as our other shareholders.

To our knowledge, as of May 31, 2007, we had 8* stockholders of record who were registered with addresses in the United States. These United States holders were as of such date, the holders of record of approximately 84.52* of our outstanding shares.

* Includes the Depository Trust Company

***B. Related Party Transactions***

**Registration Rights**

Prior to our going public, we issued preferred shares to Starlight Capital Ltd., European High-Tech Capital S.A. and Marshall Butler. Starlight Capital Ltd. and European High-Tech Capital S.A. are controlled by foundations which have

been established for the benefit of family members of Dr. Shimon Eckhouse, our chairman of the board of directors. Dr. Eckhouse disclaims beneficial ownership of shares held by these companies. Marshall Butler is a member of our board of directors. All of these preferred shares were subject to registration rights, and all of these preferred shares were automatically converted to ordinary shares when we went public. As of May 31, 2007, we believe that these shareholders continue to hold a certain amount of ordinary shares issued upon conversion of our preferred shares subject to such registration rights. . Pursuant to these registration rights, in the event we propose to register any of our securities under the Securities Act, either for our own account or for the account of other security holders, these and other holders who may hold shares subject to registration rights are entitled to notice of such registration and are entitled to include their remaining ordinary shares subject to the registration rights in such registration, subject to certain marketing cutbacks and other limitations. The holders of at least 50% of the ordinary shares with registration rights will have the right to require us, on not more than one occasion, to file a registration statement on the appropriate form under the Securities Act in order to register the resale of their ordinary shares. We may, in certain circumstances, defer such registration and the underwriters have the right, subject to certain limitations, to limit the number of shares included in such registrations. Further, these holders may require us to register the resale of all or a portion of their shares on Form F-3, subject to conditions and limitations.



### *C. INTERESTS OF EXPERTS AND COUNSEL*

Not applicable.

## ITEM 8. FINANCIAL INFORMATION

### *A. Consolidated Statements and Other Financial Information*

Our audited consolidated financial statements for the year ended December 31, 2006 are included in this annual report under Item 18.

Legal Proceedings.

On July 29, 2004, Shaldot Metal Works Ltd. (â€œShaldotâ€□), a privately owned Israeli company, sued us and Dr. Eckhouse, in the District Court in Haifa, claiming that in 1999 Dr. Eckhouse had access to confidential material regarding an Israeli patent, which he allegedly used in violation of a confidentiality agreement in connection with forming Syneron. The complaint alleges that our products infringe Shaldotâ€™s Israeli patent. In its lawsuit Shaldot is suing us for $2.3 million (NIS 10 million) and has requested an injunction against us which will prohibit manufacturing, marketing and selling some or all of our products, which, if successful, could have a material adverse effect on our business in Israel. On October 10, 2004 we submitted our Statements of Defense to the Court, claiming that Shaldotâ€™s patent is invalid due to the existence of prior art, lack of novelty and no improvement over existing art in the field. Shaldotâ€™s patent is under review by the Israeli Patent Office, based on a request submitted to the Patent Office by a third party claiming that Shaldotâ€™s patent is invalid. Moreover, we claimed that even if the patent would have been valid, none of our devices infringe any of Shaldotâ€™s patents. The dispute was referred by the court to mediation and the parties attempted to resolve the dispute. The mediation process was not successful and was terminated by Shaldot. In January 2007, we learned that Shaldot had transferred all of its rights to the patent to a subsidiary, Qray Ltd. We submitted a motion to dismiss Shaldotâ€™s lawsuit, claiming that due to the transfer of rights, Shaldot no longer had standing to continue the proceedings. A hearing on our motion was held on February 19, 2007. At the hearing, the court ordered that Qray be added as an additional plaintiff to the lawsuit and that the parties submit revised statements of claims and defenses. On February 25, 2007, Shaldot submitted its revised statement of claims. On March 14, 2007, we submitted our revised statement of defense and also a revised statement of counterclaim. We are in the process of ongoing evidentiary hearings, with the next hearing scheduled to take place on June 18, 2007. We believe that Shaldotâ€™s lawsuit is without merit and we intend to defend ourselves vigorously. Therefore, we do not believe that this lawsuit will result in a loss to us and accordingly, no reserve was recorded in the financial statement with respect to this claim.

In September 2005 and further dates thereafter, nine plaintiffs filed complaints in which we and our subsidiary, Syneron Inc., are named as defendants along with other named defendants. Eight of the plaintiffs are African-American women who allege they sustained burn and/or other complications after hair removal or skin rejuvenation treatments were administered by one of our customers with one of our products. In addition to traditional product liability and negligence

theories, the complaint alleges theories of fraud, negligent misrepresentation, illegal sale of a dangerous prescriptive device and intentional race discrimination. We and our subsidiary have appeared in the litigation. A vigorous defense to all of the allegations is being funded and controlled by an insurance company that issued an insurance policy to our subsidiary and under which we are an additional insured through a controlling interest endorsement. The insurance company has reserved the right to deny coverage on some of the claims (product liability-intentional failure to warn, product liability-fraud, and intentional racial discrimination) which means there is a possibility that these claims would not be covered by the insurance policy. In addition, the complaint seeks recovery for punitive damages which the insurance company has advised us are not covered by the insurance policy. In May 2007 we appeared at a mediation in an attempt to resolve these claims. Following the mediation, we resolved the claims with most of the plaintiffs, and we are in the process of resolving the claims with the remaining plaintiffs. We anticipate that most of the settlement costs will be paid by the insurance company and we estimate that the portion of the settlement costs that will be paid by us will not be material and therefore no reserves have been made in our financial statements.



On November 10, 2005 a class action was filed against our subsidiary, Syneron Inc. The plaintiff seeks injunctive relief, statutory damages and attorneys fees and costs as a result of the alleged violations of the Telephone Consumer Protection Act (â€œTCPAâ€). Syneron Inc.â€˜s insurance carrier has accepted tender of defense of this litigation subject to a reservation of rights. Although there appears to be a likelihood that Syneron Inc. will have insurance coverage for this lawsuit and it is currently being provided a defense through its insurance carrier, there is the possibility that these TCPA claims against Syneron Inc. will not be covered by the insurance policy. Syneron Inc. has answered the Complaint and the parties have engaged in discovery relating to the appropriateness of proceeding with the action on behalf of a class, as well as discovery on the merits of the claim. On February 7, 2007, Syneron Inc. filed a motion to dismiss the action for lack of federal jurisdiction. All further discovery is stayed pending a ruling on this motion. Should this motion to dismiss be denied, Syneron Inc. plans vigorously to challenge class certification. We cannot predict the outcome of the claim, nor can we estimate the amount of damage, if we are held responsible. Accordingly no reserve was included in the financial statements with respect to this claim.

Please also see â€œItem 3.D Risk Factors â€“ Existing and Future third-party claims of infringement or other claims against us could require us to redesign our products, seek licenses, or engage in future costly intellectual property litigation, which could impact our future business and financial performanceâ€.

Policy on Dividend Distribution

We have never declared or paid cash dividends to our shareholders and we do not intend to pay cash dividends in the foreseeable future. We intend to reinvest any future earnings in developing and expanding our business. We have decided to reinvest the amount of tax-exempt income derived from out â€œApproved Enterpriseâ€ status and not to distribute that income as dividends.

### *B. SIGNIFICANT CHANGES*

Not applicable.



## ITEM 9. THE OFFER AND LISTING

### *A. OFFER AND LISTING DETAILS*

Our ordinary shares are quoted on the Nasdaq Global Market under the symbol â€œELOS.â€

The following table sets forth, for the periods indicated since August 5, 2004, when we were listed on the Nasdaq Global Market, the high and low sales prices of our ordinary shares as reported by the Global National Market.

| | PRICE PER ORDINARY SHARE (USD)(NASDAQ) | |
|---|---|---|
| | HIGH | LOW |
| During the last two years: | | |
| 2005 | $ 46.91 | $ 23.05 |
| 2006 | 32.72 | 17.81 |
| During the last nine quarters: | | |
| First quarter of 2005 | 34.31 | 23.05 |
| Second quarter of 2005 | 38.48 | 25.02 |
| Third quarter of 2005 | 44.13 | 33.21 |
| Forth quarter of 2005 | 46.91 | 30.56 |
| First quarter of 2006 | 32.72 | 25.40 |
| Second quarter of 2006 | 30.95 | 17.81 |
| Third quarter of 2006 | 25.22 | 18.00 |
| Forth quarter of 2006 | 28.40 | 22.34 |
| First quarter of 2007 | 28.12 | 24.21 |
| During the last six months: | | |
| December 2006 | 28.40 | 22.90 |
| January 2007 | 27.46 | 24.21 |
| February 2007 | 28.12 | 24.70 |
| March 2007 | 27.77 | 25.50 |
| April 2007 | 27.26 | 25.19 |
| May 2007 | 26.21 | 24.91 |

***B. PLAN OF DISTRIBUTION***

Not applicable.

***C. MARKETS***

Our ordinary shares are quoted on the Nasdaq Global Market under the symbol â€œELOS.â€

***D. SELLING SHAREHOLDERS***

Not applicable.

***E. DILUTION***

Not applicable.

***F. EXPENSES OF THE ISSUE***

Not applicable.



**ITEM 10. ADDITIONAL INFORMATION**

***A. SHARE CAPITAL***

Not applicable.

### *B. MEMORANDUM AND ARTICLES OF ASSOCIATION*

**Register Number and Purposes of the Company**

Our registration number with the Israeli Companies Registrar is 51-298651-4. Pursuant to Section 4 of our Articles of Association we may engage in any type of lawful business as may be determined by our board of directors from time to time.

**Dividend and Liquidation Rights**

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

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

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

**Voting, Shareholder Meetings and Resolutions**

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

Under the Companies Law, an annual general meeting of our shareholders should be held once every calendar year, but no later than 15 months from the date of the previous annual general meeting. The quorum required for a general meeting of shareholders consists of at least two shareholders present in person or by proxy holding at least 40.0% of the voting power. 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 number of shareholders present in person or by proxy.

Our board of directors may, in its discretion, convene additional meetings as â€œspecial general meetings.â€ In addition, the board must convene a special general meeting upon the demand of two of the directors, one fourth of the nominated directors, one or more shareholders having at least 5% of 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. The chairman of the board of directors presides at each of our general meetings. The chairman of the board of directors is not entitled to a vote at a general meeting in his capacity as chairman.



Most shareholdersâ€™ resolutions, including resolutions to:

- amend our articles of association (except for amendments relating to the election of directors and the powers, composition and size of the board of directors);
- make changes in our capital structure such as a reduction of capital, increase of capital or share split, merger

or consolidation;

- authorize a new class of shares, elect directors, other than external directors;
- appoint auditors; or
- approve transactions with certain office holders;

will be deemed adopted if approved by the holders of a majority of the voting power represented at a shareholdersâ€™ meeting, in person or by proxy, and voting on that resolution. In most cases these actions will not require the approval of a special majority.

**Ownership of Shares; Transfer of Shares; Notices**

Our articles of association and the laws of the State of Israel do not restrict the ownership or voting of ordinary shares by non-residents of Israel, except with respect to individuals and entities that are residents of countries in a state of war with Israel, and except with respect to entities which are controlled by residents of countries in a state of war with Israel.

Our fully paid ordinary shares are issued in registered form and are freely transferable under our articles of association.

Under the Companies Law, shareholdersâ€™ meetings require prior notice of at least 21 days.

Under the Companies Law, we are required to maintain a major shareholder register listing shareholders holding 5% or more of our outstanding ordinary shares.

**Modification of Class Rights**

The Companies Law provides that the rights of a particular class of shares may not be modified without the vote of a majority of the affected class.

**Election of Directors**

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

- the majority of shares voted for the election includes at least one-third of the shares of non-controlling shareholders voted at the meeting; or
- the total number of shares of non-controlling shareholders voted against the election of the external director does not exceed one percent of the aggregate voting rights in the company.

See â€œItem 6.C Board Practicesâ€ regarding our staggered board.

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

*Merger.* The Companies Law permits merger transactions with the approval of each partyâ€™s board of directors and shareholders. In accordance with the Companies Law, a merger may be approved at a shareholders meeting by a majority of the voting power represented at the meeting, in person or by proxy, and voting on that resolution. In determining whether the required majority has approved the merger, shares held by the other party to the merger, any person holding at least 25% of the outstanding voting shares or means of appointing the board of directors of the other party to the merger, or the relatives or companies controlled by these persons, are excluded from the vote.

Under the Companies Law, a merging company must inform its creditors of the proposed merger. Any creditor of a party to the merger may seek a court order blocking the merger, if there is a reasonable concern that the surviving company will not be able to satisfy all of the obligations of the parties to the merger. Moreover, a merger may not be completed until at least 30 days have passed from the time that the shareholders of each company approved the merger proposal and 50 days have passed from the time that a merger proposal was filed with the Israeli Registrar of Companies.

*Tender Offer.* The Companies Law requires a purchaser to conduct a tender offer in order to purchase shares in publicly held companies, if as a result of the purchase the purchaser would hold more than 25% of the voting rights of a company in which no other shareholder holds more than 25% of the voting rights, or the purchaser would hold more than 45% of the voting rights of a company in which no other shareholder holds more than 50% of the voting rights.

Under the Companies Law, a person may not purchase shares of a public company if, following the purchase of shares, the purchaser would hold more than 90% of the companyâ€™s shares or of any class of shares unless the purchaser makes a tender offer to purchase all of the target companyâ€™s shares or all the shares of the particular class, as applicable. If, as a result of the tender offer, the purchaser would hold more than 95% of the companyâ€™s shares or a particular class of shares, the ownership of the remaining shares will be transferred to the purchaser. However, if the purchaser is unable to purchase 95% or more of the companyâ€™s shares or class of shares, the purchaser may not own more than 90% of the shares or class of shares of the target company.

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

**Transfer Agent and Registrar**

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

**Listing**

Our ordinary shares are quoted on the Nasdaq Global Market under the symbol â€œELOSâ€□.

**Approval of Related Party Transactions under Israeli Law**

**Office Holders**

The Companies Law codifies the fiduciary duties that office holders owe to a company. An office holder is defined as any director, managing director, general manager, chief executive officer, executive vice president, vice president, other manager directly subordinate to the general manager or any other person assuming the responsibilities of any of these positions regardless of that personâ€™s title. Each person listed in the table under â€œManagement â€“ Executive Officers and Directorsâ€□ is an office holder under the Companies Law.



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

virtue of his or her position and all other relevant information pertaining to these actions.

*Compensation.* Under the Companies Law, all compensation arrangements for office holders who are not directors require approval of the board of directors, unless the articles of association provide otherwise. Our compensation committee is required to approve the compensation of all office holders. Arrangements regarding the compensation of directors require audit committee, board and shareholder approval.

*Disclosure of personal interest.* The Companies Law requires that an office holder promptly disclose to the company any personal interest that he or she may have and all related material information known to him or her, in connection with any existing or proposed transaction by the company. â€œPersonal interestâ€, as defined by the Companies Law, includes a personal interest of any person in an act or transaction of the company, including a personal interest of his relative or of a corporate body in which that person or a relative of that person is a 5% or greater shareholder, a holder of 5% or more of the voting rights, a director or general manager, or in which he or she has the right to appoint at least one director or the general manager. â€œPersonal interestâ€ does not apply to a personal interest stemming merely from the fact of that the office holder is also a shareholder in the company.

The office holder must make the disclosure of his personal interest no later than the first meeting of the companyâ€™s board of directors that discusses the particular transaction. This duty does not apply to the personal interest of a relative of the office holder in a transaction unless it is an â€œextraordinary transactionâ€. The Companies Law defines an extraordinary transaction as a transaction not in the ordinary course of business, not on market terms or that is likely to have a material impact on the companyâ€™s profitability, assets or liabilities, and defines a relative as a spouse, sibling, parent, grandparent, descendent, spouseâ€™s descendant and the spouse of any of the foregoing.

*Approvals.* The Companies Law provides that a transaction with an office holder or a transaction in which an office holder has a personal interest may not be approved if it is adverse to the companyâ€™s interest. In addition, such a transaction generally requires board approval, unless the transaction is an extraordinary transaction or the articles of association provide otherwise. If the transaction is an extraordinary transaction, or if it concerns exculpation, indemnification or insurance of an office holder, then in addition to any approval stipulated by the articles of association, approval of the companyâ€™s audit committee and the board of directors is required. Exculpation, indemnification, insurance or compensation of a director also would require shareholder approval. A director who has a personal interest in a matter that is considered at a meeting of the board of directors or the audit committee may not attend that meeting or vote on that matter, unless a majority of the board of directors or the audit committee also has a personal interest in the matter. If a majority of the board of directors or the audit committee has a personal interest in the transaction, shareholder approval also would be required.

**Shareholders**

The Companies Law imposes the same disclosure requirements, as described above, on a controlling shareholder of a public company that it imposes on an office holder. For these purposes, a controlling shareholder is any shareholder that has the ability to direct the companyâ€™s actions, including any shareholder holding 25% or more of the voting rights if no other shareholder owns more than 50% of the voting rights in the company. Two or more shareholders with a personal interest in the approval of the same transaction are deemed to be one shareholder.



Approval of the audit committee, the board of directors and our shareholders is required for:

- extraordinary transactions with a controlling shareholder or in which a controlling shareholder has a personal interest; and
- employment of a controlling shareholder.

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

- the majority must include at least one-third of the shares of the voting shareholders who have no personal

interest in the transaction; or

- the total shareholdings of those who have no personal interest in the transaction and who vote against the transaction must not represent more than 1% of the aggregate voting rights in the company.

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

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

A shareholder has a general duty to refrain from depriving any other shareholder of their rights as a shareholder. In addition, any controlling shareholder, any shareholder who knows that it possesses the power to determine the outcome of a shareholder vote and any shareholder who has the power to appoint or prevent the appointment of an office holder in the company is under a duty to act with fairness towards the company. The Companies Law does not describe the substance of this duty of fairness.

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

Our articles of association allow us to indemnify, exculpate and insure our office holders to the fullest extent permitted by the Companies Law, provided that procuring this insurance or providing this indemnification or exculpation is approved by the audit committee and the board of directors, as well as by the shareholders where the office holder is a director. Our articles of association also allow us to insure or indemnify any person who is not an office holder, including any employee, agent, consultant or contractor who is not an office holder.

Under the Companies Law, a company may indemnify an office holder in respect of some liabilities, either in advance of an event or following an event. If a company undertakes to indemnify an office holder in advance of an event, the indemnification must be limited to foreseeable types of events and reasonable amounts, as determined by the board of directors.

Under the Companies Law, a company may indemnify an office holder against any monetary liability incurred in his or her capacity as an office holder whether imposed on him or her in favor of another person pursuant to a judgment, a settlement or an arbitratorâ€™s award approved by a court. A company also can indemnify an office holder against reasonable litigation expenses including attorneysâ€™ fees, incurred by him or her in his or her capacity as an office holder, in proceedings instituted against him or her by the company, on its behalf or by a third-party, in connection with criminal proceedings in which the office holder was acquitted, or as a result of a conviction for a crime that does not require proof of criminal intent. The additional case in which a reimbursement of expenses is allowed according to the Companies Law is reasonable legal fees, including attorneys fees, incurred by an Office Holder in an investigatory proceeding or other proceeding filed by a governmental authority, which has terminated without the filing of criminal charges and without imposing a fine, or with imposing a fine in lieu of a criminal charge which does not require proof of criminal intent.



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

A company may exculpate an office holder for a breach of duty of care, but only in advance of that breach. A

company may not exculpate an office holder from a breach of duty of loyalty towards the company nor from a breach of duty of care with respect to a distribution.

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

Our audit committee, board of directors and shareholders have resolved to indemnify our directors and officers to the extent permitted by law and by our articles of association for liabilities not covered by insurance and that are of certain enumerated types of events, subject to an aggregate sum equal to 50.0% of the shareholders equity outstanding at the time a claim for indemnification is made.

### *C. MATERIAL CONTRACTS*

For a description of the material terms of our Patent License and Settlement Agreement with Lumenis Inc. and Lumenis Ltd., and of our Patent License and Settlement Agreement with Thermage, Inc., please see â€œItem 4.B Business Overview â€“ Intellectual Propertyâ€□.

For a short description of the material terms of our agreements with our manufacturers, please see â€œItem 4.B Business Overview â€“ Manufacturingâ€□.

Effective February 25, 2007, we entered into an exclusive Joint Development and Supply Framework Agreement with the Proctor & Gamble Company for the commercialization of patented and patent pending, ELOS based, home-use devices and compositions for the enhancement of skin appearance through the treatment of fine lines, wrinkles, age and sun spots and cellulite. Under the terms of the agreement we will lead the research, development and manufacturing of the devices, while Procter & Gamble will focus on the development of the compositions, marketing, and distribution of the devices. The agreement provides that Procter & Gamble will purchase the devices exclusively from us. The devices will be marketed under the Procter & Gamble family of skin care products and will be co-branded with our ELOS technology. The agreement contemplates further collaboration between Procter & Gamble that could lead to commercializing additional products in the future. Procter & Gamble may terminate the agreement in certain circumstances, including following the failure to successfully complete two milestones.

### *D. EXCHANGE CONTROLS*

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

### *E. TAXATION*

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



## ISRAELI TAXATION

The following is a summary of the material Israeli tax laws applicable to us, and some Israeli Government programs benefiting us. This section also contains a discussion of some Israeli tax consequences to persons owning our ordinary shares. This summary does not discuss all the acts of Israeli tax law that may be relevant to a particular investor in light of

his or her personal investment circumstances or to some types of investors subject to special treatment under Israeli law. Examples of this kind of investor include residents of Israel, traders in securities or persons that own, directly or indirectly, 10% or more of our outstanding voting capital, all of whom are subject to special tax regimes not covered in this discussion. Some parts of this discussion are based on new tax legislation which has not been subject to judicial or administrative interpretation. The discussion should not be construed as legal or professional tax advice and does not cover all possible tax considerations.

Potential investors are urged to consult their own tax advisors as to the Israeli or other tax consequences of the purchase, ownership and disposition of our ordinary shares, including, in particular, the effect of any foreign, state or local taxes.

**General Corporate Tax Structure in Israel**

Until December 31, 2003, the regular tax rate applicable to income of companies (which are not entitled to benefits due to investments in â€œapproved enterpriseâ€□, as described below) was 36%. In June 2004 and in July 2005, the â€œKnessetâ€□ (Israeli parliament) passed amendments to the Income Tax Ordinance (No. 140 and Temporary Provision), 2004 and (No. 147), 2005 respectively, which determine, among other things, that the corporate tax rate is to be gradually reduced to the following tax rates: 2004 â€“ 35%, 2005 â€“ 34%, 2006 â€“ 31%, 2007 â€“ 29%, 2008 â€“ 27%, 2009 â€“ 26% and 2010 and thereafter â€“ 25%.

However, the effective tax rate payable by a company that derives income from an approved enterprise, discussed further below, may be considerably less. See â€œâ€“Law for the Encouragement of Capital Investments, 1959.â€□

**Special Provisions Relating to Taxation under Inflationary Conditions**

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 described as follows:

- Where a companyâ€™s equity, as calculated under the Inflationary Adjustments Law, exceeds the depreciated cost of its Fixed Assets (as defined in the Inflationary Adjustments Law), a deduction from taxable income is permitted equal to the excess multiplied by the applicable annual rate of inflation. The maximum deduction permitted in any single tax year is 70% of taxable income, with the unused portion permitted to be carried forward, linked to the Israeli consumer price index. The unused portion that was carried forward may be deductible in full in the following year.

- Where a companyâ€™s depreciated cost of Fixed Assets exceeds its equity, then the excess multiplied by the applicable annual rate of inflation is added to taxable income. We refer to this additional amount as inflation supplement. The inflation supplement will only be added to the corporate income but not to other incomes, such as capital gain.

- Subject to specified limitations, depreciation deductions on Fixed Assets and losses carried forward are adjusted for inflation based on the change in the consumer price index.

The Minister of Finance may, with the approval of the Knesset Finance Committee, determine by decree, during a certain fiscal year (or until February 28th of the following year) in which the rate of increase of the Israeli consumer price index would not exceed or did not exceed, as applicable, 3.0%, that some or all of the provisions of the Inflationary Adjustments Law shall not apply with respect to such fiscal year, or that the rate of increase of the Israeli consumer price index relating to such fiscal year shall be deemed to be 0%, and to make the adjustments required to be made as a result of such determination.



**Tax Benefits under the Law for the Encouragement of Capital Investments, 1959**

***Tax benefits prior to the 2005 Amendment***

The Law for the Encouragement of Capital Investments, 1959, as amended (effective as of April 1, 2005) or the Investments Law, provides that a proposed capital investment in eligible facilities may, upon application to the Investment Center of the Ministry of Industry and Commerce of the State of Israel, be granted the status of an approved enterprise. The Investment Center bases its decision as to whether or not to approve an application, among other things, on the criteria set forth in the Investments Law and related regulations, the then prevailing policy of the Investment Center, and the specific objectives and financial criteria of the applicant. 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.

The Investments Law provides that a company investing in an approved enterprise is eligible for tax benefits (â€œtax benefitsâ€□) on taxable income derived from the operations under the approved enterprise programs. The tax benefits under the Investments Law also apply to income generated by a company from the grant of a usage right with respect to know-how developed pursuant to 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 ordinary course of business of the company investing in the approved enterprise. If a company has more than one approval or only a portion of its capital investments are approved, its effective tax rate is the result of a weighted average of the applicable rates. The tax benefits under the Investments Law are not, generally, available with respect to income derived from products manufactured outside of Israel. In addition, the tax benefits available to a company investing in an approved enterprise are contingent upon the fulfillment of conditions stipulated in the Investments Law and related 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, it would be required to refund the amount of tax benefits, plus a consumer price index linked adjustment and interest.

The Investments Law also provides that a company investing in an approved enterprise is entitled to accelerated depreciation on its property and equipment that are included in an approved enterprise program in the first five years of using the equipment.

The tax benefits call for taxable income of a company that has been granted the status of approved enterprise on a specific investment program to be 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, commencing with the year in which the approved enterprise first generates taxable income, and is limited to 12 years from commencement of production or 14 years from the date of approval, whichever is earlier (hereinafter â€œthe Time Limitâ€□).

Additionally, a company that has been granted the status of an approved enterprise on all or part of its operations may elect to receive a grant of money from the government or an alternative package of benefits under the Investments Law. Under the alternative package of benefits, a companyâ€™s undistributed income derived from the approved enterprise will be exempt from corporate tax (â€œtax exemptionâ€□) for a period of between two and ten years, starting from the first year the company derives taxable income under the approved enterprise program. The length of time of this exemption will depend on the geographic location of the approved enterprise within Israel. After this exemption lapses, the company will be eligible for the reduced tax rate discussed in the previous paragraph for the remainder of the benefit period. The Time Limit imposed on the tax benefit discussed above does not limit this exemption under the alternative package of benefits. If the exemption period extends beyond the Time Limit, the company will continue to enjoy the tax exemption until the end of the exemption period.

We have elected the alternative package of benefits. A company that has elected the alternative package of benefits and subsequently pays a dividend out of income derived from the approved enterprise during the tax exemption period will be subject to corporate tax on the amount which is determined by the distributed amount grossed up with the effective corporate tax rate which would have been applied had the company not elected the alternative package of benefits, which is generally 10%-25%, depending on the percentage of the companyâ€™s ordinary shares held by foreign shareholders. Dividends paid out of income derived from an approved enterprise (or out of dividends received from a company whose income is derived from an approved enterprise) are generally subject to withholding tax at the reduced rate of 15%, if the dividend is distributed during the tax exemption period or within twelve years thereafter. The company must withhold this tax.

A company that has an approved enterprise program is eligible for further tax benefits if it qualifies as a foreign investorsâ€™ company. A foreign investorsâ€™ company is a company where more than 25% of its share capital and combined share and loan capital is owned by non-Israeli residents. A company that qualifies as a foreign investorsâ€™ company and has an approved enterprise program is eligible for tax benefits for a ten-year benefit period. As specified above, depending on the geographic location of the approved enterprise within Israel, income derived from the approved enterprise program, if undistributed, may be exempt from tax for a period of between two to ten years, and will be subject to a reduced tax rate for the remainder of the benefit period. The tax rate for the remainder of the benefit period will be 25%, unless the level of foreign investment exceeds 49%, in which case the tax rate will be 20% if the foreign investment is more than 49% and less than 74%; 15% if more than 74% and less than 90%; and 10% if 90% or more.

Under the alternative package of benefits, dividends paid by a company are considered to be attributable to income received from the entire company and the companyâ€™s effective tax rate is the result of a weighted average of the various applicable tax rates, excluding any tax-exempt income. Under the Investments Law, a company that has elected the alternative package of benefits is not obliged to distribute retained profits, and may generally decide from which yearâ€™s profits to declare dividends. We currently intend to reinvest any income derived from our approved enterprise program and not to distribute such income as a dividend.

***Tax benefits under the 2005 Amendment***

A recent amendment to the Investments Law, which has been officially published and is effective as of April 1, 2005, has changed certain provisions of the Investments Law. The amendment includes revisions to the criteria for investments qualified to receive tax benefits as an approved enterprise. This amendment applies to new investment programs and investment programs commencing after 2004, and does not apply to investment programs approved prior to December 31, 2004. However, a company that was granted benefits according to section 51 of the Investments Law prior to the amendment would not be allowed to apply for benefits under the new amendment for a period of 3 years from the date of approval. This amendment simplifies the approval process for the approved enterprise. According to the amendment, only approved enterprises receiving cash grants require the approval of the Investment Center. The Investment Center will be entitled to approve such programs only until December 30, 2007.

The Amendment does not apply to benefits included in any certificate of approval that was granted before the amendment came into effect, which will remain subject to the provisions of the Investments Law as they were on the date of such approval.

Tax benefits are generally available, under this amendment, to production facilities (or other eligible facilities) if they derive more than 25% of their business income from export (a â€œBenefited Enterpriseâ€). In order to receive the tax benefits, the amendment states that a company must make an investment in the Benefited Enterprise exceeding a certain percentage or a minimum amount specified in the Investments 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 Benefited Enterprise (the â€œYear of Electionâ€). Where the company requests to have the tax benefits apply to an expansion of existing facilities, then only the expansion will be considered a Benefited Enterprise and the companyâ€™s effective tax rate will be the result of a weighted combination of the applicable rates. In this case, the minimum investment required in order to qualify as a Benefited Enterprise is required to exceed a certain percentage or a minimum amount of the companyâ€™s production assets before the expansion.

The duration of these tax benefits is limited to the earlier of 7 to 10 years from the Commencement Year or 12 years from the first day of the Year of Election. Commencement Year is defined as the later of the first tax year in which a company had derived income for tax purposes from the Benefited Enterprise, or the year of election which is the year in which a company requested to have the tax benefits apply to the Benefited Enterprise. The tax benefits granted to a Benefited Enterprise are determined, depending on the geographic location of the Benefited Enterprise within Israel, according to one of the following, which may be applicable to us:



- Similar to the currently available alternative package of benefits, exemption from corporate tax may be available on undistributed income for a period of two to ten years, depending on the geographic location of the Benefited Enterprise within Israel, and a reduced corporate tax rate of 10% to 25% for the remainder of the benefit period, depending on the level of foreign investment in each year. Benefits may be granted for a term of seven to ten years, depending on the level of foreign investment in the company. If the company pays a

dividend out of income derived from the Benefited Enterprise during the tax exemption period, such income will be subject to corporate tax at the applicable rate (10%-25%) with respect to the gross amount of the dividend that we may distribute. The company is required to withhold tax on such distribution at a rate of 15%; or

- A special tax option, which enables companies owning facilities in certain geographical locations in Israel to pay corporate tax at the rate of 11.5% on income of the Benefited Enterprise. The benefit period is ten years. Upon payment of dividends, the company is required to withhold tax on such dividend at a rate of 15% for Israeli residents and at a rate of 4% for foreign residents.

Generally, a company that is Abundant in Foreign Investment (owned by at least 74% foreign shareholders and has undertaken to invest a minimum sum of $20M in the Benefited Enterprise) is entitled to an extension of the benefit period by an additional five years, depending on the rate of its income that is derived in foreign currency.

The amendment changes the definition of â€œforeign investmentâ€ in the Investments Law so that the definition now requires a minimal investment of NIS 5 million by foreign investors. Furthermore, such definition now also includes the purchase of shares of a company from another shareholder, provided that the companyâ€™s outstanding and paid-up share capital exceeds NIS 5 million. Such changes to the aforementioned definition will take effect retroactively from 2003.

The amendment will apply to approved enterprise programs in which the year of election under the Investments Law is 2004 or later, unless such programs received approval from the Investment Center on or prior to December 31, 2004, in which case the amendment provides that terms and benefits included in any certificate of approval already granted will remain subject to the provisions of the Investments Law as it was on the date of such approval.

As a result of the amendment, tax-exempt income generated under the provisions of the Investments Law, as amended, will subject us to taxes upon distribution or liquidation and we may be required to record deferred tax liability with respect to such tax-exempt income.

Currently we have two approved programs under the Investments Law, which entitles us to some tax benefits. The first program under the Law before the amendment (â€œApproved Enterpriseâ€) and the second after the amendment (Benefited Enterpriseâ€). The above mentioned approved programs are subject to the alternative package of benefits, which allows for a ten years period of exemption of taxes for undistributed income.

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

We believe that we qualify as an â€œIndustrial Companyâ€ within the meaning of the Law for the Encouragement of Industry (Taxes), 1969, or the Industry Encouragement Law. The Industry Encouragement Law defines â€œIndustrial Companyâ€ as a company resident in Israel, of which 90% or more of its income in any tax year, other than of income from defense loans, capital gains, interest and dividends, is derived from an â€œIndustrial Enterpriseâ€ owned by it. An â€œIndustrial Enterpriseâ€ is defined as an enterprise whose major activity in a given tax year is industrial production activity.

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

- deduction of purchased of know-how and patents and/or right to use a patent over an eight-year period;
- accelerated depreciation rates on equipment and buildings;
- under specified conditions, an election to file consolidated tax returns with additional related Israeli Industrial Companies and an industrial holding company;



- expenses related to a public offering on recognized stock markets, are deductible in equal amounts over three years.

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

**Capital Gains Tax on Sales of Our Ordinary Shares**

Israeli law generally imposes a capital gains tax on the sale of any capital assets by residents of Israel, as defined for Israeli tax purposes, and on the sale of assets located in Israel, including shares in Israeli companies, by both residents and non-residents of Israel, unless a specific exemption is available or unless a tax treaty between Israel and the shareholderâ€™s country of residence provides otherwise. The law distinguishes between real gain and inflationary surplus. The inflationary surplus is a portion of the total capital gain which is equivalent to the increase of the relevant assetâ€™s purchase price which is attributable to the increase in the Israeli consumer price index or, in certain circumstances, a foreign currency exchange rate, between the date of purchase and the date of sale. The real gain is the excess of the total capital gain over the inflationary surplus.

Generally, until the 2006 tax year, capital gains tax was imposed on Israeli resident individuals at a rate of 15% on real gains derived on or after January 1, 2003, from the sale of shares in, among others, Israeli companies publicly traded on Nasdaq or on a recognized stock exchange or regulated market in a country that has a treaty for the prevention of double taxation with Israel. This tax rate was contingent upon the shareholder not claiming a deduction for financing expenses in connection with such shares (in which case the gain was generally be taxed at a rate of 25%), and did not apply to: (i) the sale of shares to a relative (as defined in the Israeli Income Tax Ordinance); (ii) the sale of shares by dealers in securities; (iii) the sale of shares by shareholders that report in accordance with the Inflationary Adjustments Law (that were taxed at corporate tax rates for corporations and at marginal tax rates for individuals); or (iv) the sale of shares by shareholders who acquired their shares prior to an initial public offering (who may be subject to a different tax arrangement).

As of January 1, 2006, the tax rate applicable to capital gains derived from the sale of shares, whether listed on a stock market or not, is 20% for Israeli individuals, unless such shareholder claims a deduction for financing expenses in connection with such shares, in which case the gain will generally be taxed at a rate of 25%. Additionally, if such shareholder is considered a â€œmaterial shareholderâ€ at any time during the 12-month period preceding such sale, i.e., such shareholder holds directly or indirectly, including with others, at least 10% of any means of control in the company, the tax rate shall be 25%. Israeli companies are subject to the Corporate Tax rate on capital gains derived from the sale of shares, unless such companies were not subject to the Adjustments Law (or certain regulations) at the time of publication of the aforementioned amendment to the Tax Ordinance that came into effect on January 1, 2006. In that case, the applicable tax rate is 25%. However, the foregoing tax rates do not apply to: (i) dealers in securities; and (ii) shareholders who acquired their shares prior to an initial public offering (that may be subject to a different tax arrangement).

The tax basis of shares acquired prior to January 1, 2003, will be determined in accordance with the average closing share price in the three trading days preceding January 1, 2003. However, a request may be made to the tax authorities to consider the actual adjusted cost of the shares as the tax basis if it is higher than such average price.

Non-Israeli residents are exempt from Israeli capital gains tax on any gains derived from the sale of shares of Israeli companies publicly traded on a recognized stock exchange or regulated market outside of Israel, provided however that such capital gains are not derived from a permanent establishment in Israel, such shareholders are not subject to the Adjustments Law, and such shareholders did not acquire their shares prior to an initial public offering. 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 some instances where our shareholders may be liable to Israeli tax on the sale of their ordinary shares, the payment of the consideration may be subject to the withholding of Israeli tax at the source.

Pursuant to the Convention Between the government of the United States of America and the government of Israel

with Respect to Taxes on Income, as amended (the â€œU.S.-Israel Tax Treatyâ€), the sale, exchange or disposition of ordinary shares by a person who holds the ordinary shares as a capital asset, qualifies as a resident of the United States within the meaning of the U.S.-Israel Tax Treaty and is entitled to claim the benefits afforded to such person by the U.S.-Israel Tax Treaty, generally, will not be subject to the Israeli capital gains tax. Such exemption will not apply if that Treaty U.S. Resident holds, directly or indirectly, shares representing 10% or more of our voting power during any part of the 12-month period preceding such sale, exchange or disposition, subject to certain conditions, or the capital gains from such sale, exchange or disposition can be allocated to a permanent establishment in Israel. In such case, the sale, exchange or disposition of ordinary shares would be subject to Israeli tax, to the extent applicable; however, under the U.S.-Israel Tax Treaty, such Treaty U.S. Resident would be permitted to claim a credit for such taxes against the U.S. federal income tax imposed with respect to such sale, exchange or disposition, subject to the limitations in U.S. laws applicable to foreign tax credits. The U.S.-Israel Tax Treaty does not relate to U.S. state or local taxes.

**Taxation of Non-Resident Holders of Shares**

Non-residents of Israel are subject to income tax on income accrued or derived from sources in Israel. Such sources of income include passive income such as dividends, royalties and interest, as well as non-passive income from services rendered in Israel. On distributions of dividends other than bonus shares, or stock dividends, income tax is withheld at the source at the following rates:

- for dividends distributed prior to January 1, 2006 - 25%;
- for dividends distributed on or after January 1, 2006 â€“ 20%, or 25% for a shareholder that is considered a â€œmaterial shareholderâ€ at any time during the 12-month period preceding such distribution, unless a different rate is provided in a treaty between Israel and the shareholderâ€™s country of residence.

Under the U.S.-Israel Tax Treaty, the maximum tax on dividends paid to a holder of ordinary shares who is a Treaty U.S. Resident is 25%. However, under the Investments Law, dividends generated by an approved enterprise (or Benefited Enterprise) are taxed at the rate of 15%. Furthermore, dividends not generated by an approved enterprise (or Benefited Enterprise) paid to a U.S. corporation holding at least 10% of our issued voting power during the part of the tax year which precedes the date of payment of the dividend and during the whole of its prior tax year, are generally taxed at a rate of 12.5%.

For information with respect to the applicability of Israeli capital gains taxes on the sale of ordinary shares by United States residents, see above â€œâ€“ Capital Gains Tax on Sales of Our Ordinary Shares.â€

**Foreign Exchange Regulations**

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



## UNITED STATES FEDERAL INCOME TAX CONSIDERATIONS

The following is a summary of the material U.S. federal income tax consequences of the ownership and disposition of ordinary shares. The following discussion is not exhaustive of all possible tax considerations. This summary is based upon the Internal Revenue Code of 1986, as amended (the â€œCodeâ€), regulations promulgated under the Code by the U.S. Treasury Department (including proposed and temporary regulations), rulings, current administrative interpretations and official pronouncements of the Internal Revenue Service (the â€œIRSâ€), and judicial decisions, all as currently in effect and all of which are subject to differing interpretations or to change, possibly with retroactive effect. Such change could materially and adversely affect the tax consequences described below. No assurance can be given that the IRS would not assert, or that a court would not sustain, a position contrary to any of the tax consequences described below.

This discussion does not address state, local, or foreign tax consequences of the ownership and disposition of ordinary shares. *See* â€œIsraeli Taxationâ€ above.

This summary is for general information only and does not address all aspects of the U.S. federal income taxation that may be important to a particular holder in light of its investment or tax circumstances or to holders subject to special tax rules, such as: banks; financial institutions; insurance companies; dealers in stocks, securities, or currencies; traders in securities that elect to use a mark-to-market method of accounting for their securities holdings; tax-exempt organizations; real estate investment trusts; regulated investment companies; qualified retirement plans, individual retirement accounts, and other tax-deferred accounts; expatriates of the United States; persons subject to the alternative minimum tax; persons holding ordinary shares as part of a straddle, hedge, conversion transaction, or other integrated transaction; persons who acquired ordinary shares pursuant to the exercise of any employee stock option or otherwise as compensation for services; persons actually or constructively holding 10% or more of our voting stock; and U.S. Holders (as defined below) whose functional currency is other than the U.S. dollar.

**This discussion is not a comprehensive description of all of the U.S. federal tax consequences that may be relevant with respect to the ownership and disposition of ordinary shares. We urge you to consult your own tax advisor regarding your particular circumstances and the U.S. federal income and estate tax consequences to you of owning and disposing of ordinary shares, as well as any tax consequences arising under the laws of any state, local, or foreign or other tax jurisdiction and the possible effects of changes in U.S. federal or other tax laws.**

This summary is directed solely to holders that hold their ordinary shares as capital assets within the meaning of Section 1221 of the Code, which generally means as property held for investment. For purposes of this discussion, the term â€œU.S. Holderâ€ means a beneficial owner of ordinary shares that is any of the following:

- a citizen or resident of the United States or someone treated as a U.S. citizen or resident for U.S. federal income tax purposes;
- a corporation (or other entity taxable as a corporation for U.S. federal income tax purposes) created or organized in or under the laws of the United States, any state thereof, or the District of Columbia;
- an estate, the income of which is subject to U.S. federal income taxation regardless of its source;
- a trust if a U.S. court can exercise primary supervision over the trust's administration and one or more U.S. persons are authorized to control all substantial decisions of the trust; or
- a trust in existence on August 20, 1996 that has a valid election in effect under applicable Treasury Regulations to be treated as a U.S. person.



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

If a partnership (including for this purpose any entity treated as a partnership for U.S. federal income tax purposes) is a beneficial owner of ordinary shares, the U.S. federal income tax treatment of a partner in the partnership will generally depend on the status of the partner and the activities of the partnership. A holder of ordinary shares that is a partnership and partners in such partnership should consult their own tax advisors about the U.S. federal income tax consequences of holding and disposing of ordinary shares.

**Distributions Paid on the Ordinary Shares**

We have never paid cash dividends and we do not intend to pay cash dividends in the foreseeable future. Subject to the discussion below under â€œPassive Foreign Investment Company Considerations,â€ a U.S. Holder generally will be required to include in gross income as ordinary dividend income the amount of any distributions paid on the ordinary

shares, including the amount of any Israeli taxes withheld, to the extent that those distributions are paid out of our current or accumulated earnings and profits as determined for U.S. federal income tax purposes. Subject to the discussion below under â€œPassive Foreign Investment Company Considerations,â€ distributions in excess of our earnings and profits will be applied against and will reduce (but not below zero) the U.S. Holderâ€™s tax basis in its ordinary shares and, to the extent they exceed that tax basis, will be treated as gain from a sale or exchange of those ordinary shares. Our dividends will not qualify for the dividends-received deduction applicable in some cases to U.S. corporations. Dividends paid in NIS, including the amount of any Israeli taxes withheld, will be includible in the income of a U.S. Holder in a U.S. dollar amount calculated by reference to the exchange rate in effect on the day they are received by the U.S. Holder. Any gain or loss resulting from currency exchange fluctuations during the period from the date the dividend is included in the income of the U.S. Holder to the date that payment is converted into U.S. dollars generally will be treated as ordinary income or loss.

For tax years beginning before January 1, 2011, a non-corporate U.S. Holderâ€™s â€œqualified dividend incomeâ€ is subject to tax at reduced rates not exceeding 15%. â€œQualified dividend incomeâ€ generally includes dividends paid by a foreign corporation if either:

- The stock of that corporation with respect to which the dividends are paid is readily tradable on an established securities market in the U.S., or

- That corporation is eligible for benefits of a comprehensive income tax treaty with the United States. which includes an information exchange program and is determined to be satisfactory by the U.S. Secretary of the Treasury. The Internal Revenue Service has determined that the U.S.-Israel Tax Treaty is satisfactory for this purpose.

In addition, under current law a U.S. Holder must generally hold his ordinary shares for more than 60 days during the 121 day period beginning 60 days prior to the ex-dividend date.

Dividends paid by a foreign corporation will not qualify for the reduced rates, however, if such corporation is treated, for the tax year in which the dividend is paid or the preceding tax year, as a â€œforeign investment companyâ€ or a â€œpassive foreign investment companyâ€ for U.S. federal income tax purposes. We do not believe that we will be classified as a â€œforeign investment companyâ€ or a â€œpassive foreign investment companyâ€ for U.S. federal income tax purposes for our current taxable year. However, see the discussion under â€œâ€“ Passive Foreign Investment Company Considerationsâ€ below.

Subject to the discussion below under â€œInformation Reporting and Back-up Withholding,â€ a Non-U.S. Holder generally will not be subject to U.S. federal income or withholding tax on dividends received on ordinary shares unless that income is effectively connected with the conduct by that Non-U.S. Holder of a trade or business in the United States.



**Foreign Tax Credit**

Any dividend income resulting from distributions we pay to a U.S. Holder with respect to the ordinary shares generally will be treated as foreign source income for U.S. foreign tax credit purposes, which may be relevant in calculating such holderâ€™s foreign tax credit limitation. Subject to certain conditions and limitations, Israeli tax withheld on dividends may be deducted from taxable income or credited against a U.S. Holderâ€™s U.S. federal income tax liability. The limitation on foreign taxes eligible for credit is calculated separately with respect to specific classes of income. For this purpose, dividends distributed with respect to the ordinary shares will generally constitute â€œpassive category incomeâ€ or, in the case of certain U.S. Holders, â€œgeneral category incomeâ€. The rules relating to the determination of foreign source income and the foreign tax credit are complex, and the availability of a foreign tax credit depends on numerous factors. Each prospective purchaser who would be a U.S. Holder should consult with its own tax advisor to determine whether its income with respect to the ordinary shares would be foreign source income and whether and to what extent that purchaser would be entitled to the credit.

**Disposition of Ordinary Shares**

Upon the sale or other disposition of ordinary shares, subject to the discussion below under â€œPassive Foreign Investment Company Considerations,â€ a U.S. Holder generally will recognize capital gain or loss equal to the difference between the amount realized on the disposition and the holderâ€™s adjusted tax basis in the ordinary shares. U.S. Holders should consult their own advisors with respect to the tax consequences of the receipt of a currency other than U.S. dollars upon such sale or other disposition.

In the event there is an Israeli income tax on gain from the disposition of ordinary shares, such tax should generally be the type of tax that is creditable for U.S. tax purposes; however, because it is likely that the source of any such gain would be a U.S. source, a U.S. foreign tax credit may not be available. U.S. Holders should consult their own tax advisors regarding the ability to claim such credit.

Gain or loss upon the disposition of the ordinary shares will be treated as long-term if, at the time of the sale or disposition, the ordinary shares were held for more than one year. For tax years beginning before January 1, 2011, long-term capital gains realized by non-corporate U.S. Holders are generally subject to a lower marginal U.S. federal income tax rate than ordinary income, other than qualified dividend income, as defined above. The deductibility of capital losses by a U.S. Holder is subject to limitations. In general, any gain or loss recognized by a U.S. Holder on the sale or other disposition of ordinary shares will be U.S. source income or loss for U.S. foreign tax credit purposes. U.S. Holders should consult their own tax advisors concerning the source of income for U.S. foreign tax credit purposes and the effect of the U.S.-Israel Tax Treaty on the source of income.

Subject to the discussion below under â€œInformation Reporting and Back-up Withholdingâ€, a Non-U.S. Holder generally will not be subject to U.S. federal income or withholding tax on any gain realized on the sale or exchange of ordinary shares unless:

- that gain is effectively connected with the conduct by the Non-U.S. Holder of a trade or business in the United States, or

- in the case of any gain realized by an individual Non-U.S. Holder, that holder is present in the United States for 183 days or more in the taxable year of the sale or exchange, and other conditions are met.

**Passive Foreign Investment Company Considerations**

Special U.S. federal income tax rules apply to U.S. Holders owning shares of a passive foreign investment company. A non-U.S. corporation will be considered a passive foreign investment company for any taxable year in which, after applying look-through rules, 75% or more of its gross income consists of specified types of passive income, or 50% or more of the average value of its assets consists of passive assets, which generally means assets that generate, or are held for the production of, passive income. Passive income may include amounts derived by reason of the temporary investment of funds. If we were classified as a passive foreign investment company, a U.S. Holder could be subject to increased tax liability upon the sale or other disposition of ordinary shares or upon the receipt of amounts treated as â€œexcess distributions.â€ Under these rules, the excess distribution and any gain would be allocated ratably over the U.S. Holderâ€™s holding period for the ordinary shares, and the amount allocated to the current taxable year and any taxable year prior to the first taxable year in which we were a passive foreign investment company would be taxed as ordinary income. The amount allocated to each of the other taxable years would be subject to tax at the highest marginal rate in effect for the applicable class of taxpayer for that year, and an interest charge for the deemed deferral benefit would be imposed on the resulting tax allocated to such other taxable years. The tax liability with respect to the amount allocated to years prior to the year of the disposition, or â€œexcess distribution,â€ cannot be offset by any net operating losses. In addition, holders of stock in a passive foreign investment company may not receive a â€œstep-upâ€ in basis on shares acquired from a decedent. U.S. Holders who hold ordinary shares during a period when we are a passive foreign investment company will be subject to the foregoing rules even if we cease to be a passive foreign investment company.



We believe that we are not a passive foreign investment company for U.S. federal income tax purposes, but we cannot be certain whether we will be treated as a passive foreign investment company for the current year or any future taxable year. Our belief that we will not be a passive foreign investment company for the current year is based on our estimate of the fair market value of our intangible assets, including goodwill, not reflected in our financial statements under U.S.

GAAP, and our projection of our income for the current year. If the IRS successfully challenged our valuation of our intangible assets, it could result in our classification as a passive foreign investment company. Moreover, because passive foreign investment company status is based on our income and assets for the entire taxable year, it is not possible to determine whether we will be a passive foreign investment company for the current taxable year until after the close of the year. In the future, in calculating the value of our intangible assets, we will value our total assets, in part, based on our total market value determined using the average of the selling price of our ordinary shares on the last trading day of each calendar quarter. We believe this valuation approach is reasonable. While we intend to manage our business so as to avoid passive foreign investment company status, to the extent consistent with our other business goals, we cannot predict whether our business plans will allow us to avoid passive foreign investment company status or whether our business plans will change in a manner that affects our passive foreign investment company status determination. In addition, because the market price of our ordinary shares is likely to fluctuate and the market price of the shares of technology companies has been especially volatile, and because that market price may affect the determination of whether we will be considered a passive foreign investment company, we cannot assure that we will not be considered a passive foreign investment company for any taxable year.

The passive foreign investment company rules described above will not apply to a U.S. Holder if the U.S. Holder makes an election to treat us as a qualified electing fund. However, a U.S Holder may make a qualified electing fund election only if we furnish the U.S. Holder with certain tax information. We currently do not provide this information, and we do not intend to take actions necessary to permit you to make a qualified electing fund election in the event we are determined to be a passive foreign investment company. As an alternative to making this election, a U.S. Holder of passive foreign investment company stock which is publicly traded may in certain circumstances avoid certain of the tax consequences generally applicable to holders of a passive foreign investment company by electing to mark the stock to market annually and recognizing as ordinary income or loss each year an amount equal to the difference as of the close of the taxable year between the fair market value of the passive foreign investment company stock and the U.S. Holderâ€™s adjusted tax basis in the passive foreign investment company stock. Losses would be allowed only to the extent of net mark-to-market gain previously included by the U.S. Holder under the election for prior taxable years. This election is available for so long as our ordinary shares constitute â€œmarketable stock,â€ which includes stock of a passive foreign investment company that is â€œregularly tradedâ€ on a â€œqualified exchange or other market.â€ Generally, a â€œqualified exchange or other marketâ€ includes a national market system established pursuant to Section 11A of the Securities Exchange Act of 1934. A class of stock that is traded on one or more qualified exchanges or other markets is â€œregularly tradedâ€ on an exchange or market for any calendar year during which that class of stock is traded, other than in de minimis quantities, on at least 15 days during each calendar quarter. We believe that the Nasdaq Global Market will constitute a qualified exchange or other market for this purpose. However, no assurances can be provided that our ordinary shares will continue to trade on the Nasdaq Global Market or that the shares will be regularly traded for this purpose.

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

**Information Reporting and Back-up Withholding**

Generally, information reporting requirements will apply to distributions on ordinary shares or proceeds on the disposition of ordinary shares paid within the United States (and, in certain cases, outside the United States) to U.S. Holders other than certain exempt recipients, such as corporations. Furthermore, backup withholding (currently at 28%) may apply to such amounts if the U.S. Holder fails to (i) provide a correct taxpayer identification number, (ii) report interest and dividends required to be shown on its U.S. federal income tax return, or (iii) make other appropriate certifications in the required manner. U.S. Holders who are required to establish their exempt status generally must provide such certification on IRS Form W-9.



Payments to Non-U.S. Holders of distributions on, or proceeds from the disposition of, ordinary shares are generally exempt from information reporting and backup withholding. However, a Non-U.S. Holder may be required to establish that exemption by providing certification of non-U.S. status on an appropriate IRS Form W-8.

Backup withholding is not an additional tax. Amounts withheld as backup withholding from a payment to you may be

credited against your U.S. federal income tax liability and you may obtain a refund of any excess amounts withheld by filing the appropriate claim for refund with the IRS and furnishing any required information in a timely manner.

### *F. DIVDENDS AND PAYING AGENTS*

Not applicable.

### *G. STATEMENT BY EXPERTS*

Not applicable.

### *H. DOCUMENTS ON DISPLAY*

A copy of each report submitted in accordance with applicable United States law is available for public review at our principal executive offices. In addition, our filings with the Securities and Exchange Commission may be inspected without charge at the SECâ€™s Public Reference Room at 100 F Street, N.E., Room 1580, Washington, D.C. 20549. Information on the operation of the Public Reference Room can be obtained by calling the SEC at 1-800-SEC-0330. Our SEC filings are also available to the public from the SECâ€™s website at www.sec.gov.

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



### *I. SUBSIDIARY INFORMATION*

Not applicable.

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

*Exchange Rate Risk*. A significant portion of our operations is conducted through operations in countries other than the United States and Israel. Revenues from our international operations which were recorded in U.S. dollars represented 73.8% of our total revenues for the year ended December 31, 2006. Substantially all of the remaining 26.2% were sales in Euros. Since we conduct our business in U.S. dollars, our main exposure, if any, results from changes in the exchange rate between the Euro and the U.S. dollar and NIS and U.S. dollar. Our functional currency is the U.S. dollar. Our policy is to reduce exposure to exchange rate fluctuations by having most of our assets and liabilities, as well as most of our revenues and expenditures, in U.S. dollars, or U.S. dollar linked. Therefore, we believe that the potential loss that would result from an increase or decrease in the exchange rate is immaterial to our business and net assets.

*Interest Rate Risk.* We do not have any outstanding loans and therefore, our exposure to market risk for changes in interest rate relates primarily to our investments in cash, marketable securities and bank deposits. The primary objective of our investment activities is to preserve principal while maximizing the interest income we receive from our investments, without increasing risk. We invest approximately 12% of our cash balances in bank deposits and the remainder primarily in securities issued by the United States, by non-U.S. governments and by high quality U.S and non U.S corporations featuring high credit rating of A and up. We do not use derivative financial instruments to limit exposure to interest rate risk. Our interest gains may decline in the future as a result of changes in the financial markets; however we believe any such potential loss would be immaterial to us.

## ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

Not applicable.

## PART II

**ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES**

Not applicable.

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

At the closing of our initial public offering, all of our outstanding preferred shares were converted into ordinary shares. Amendments to articles of incorporation (relating only to ordinary shares and allowing, for example, free transferability of shares) became effective upon the closing of our initial public offering. Since our initial public offering, no instruments defining the rights of our ordinary sharesâ€™ holders have been modified.

Pursuant to our initial public offering of our ordinary shares on August 11, 2004, we sold 5,000,000 ordinary shares at a per share price of $12. Our net aggregate proceeds (after underwriting discount and expenses) amounted to approximately $54 million. The amount of the underwriting discount paid by us in the initial public offering was approximately $4.2 million and the expenses of the offering, not including the underwriting discount, were approximately $2.0 million, consisting of, among other things, SEC registration fees, NASD filings fees, Nasdaq National Market listing fees, Israel stamp duty and legal and accounting fees. Payment of these expenses were not direct or indirect payments to our directors, officers, major shareholders or affiliates.

To date, the net proceeds of the offering were invested in term deposits in U.S. banks and have not been used. We still intend to use the proceeds in the manner set forth in our prospectus of August 5, 2004.

**ITEM 15T. CONTROLS AND PROCEDURES**

(a) Our management, including our chief executive officer and chief financial officer, has evaluated the effectiveness of our disclosure controls and procedures as of December 31, 2006. Based on such review, our chief executive officer and chief financial officer have concluded that we have in place effective controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934, as amended, is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure, and is recorded, processed, summarized and reported, within the time periods specified in the SECâ€™s rules and forms.



(b) Our management, under the supervision of our chief executive officer and chief financial officer, is responsible for establishing and maintaining adequate internal control over our financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) of the Securities Exchange Act of 1934, as amended. The Companyâ€™s internal control over financial reporting is defined as a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Internal control over financial reporting includes policies and procedures that:

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

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

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we evaluated the effectiveness of our internal control over financial reporting as of December 31, 2006 based on the framework for Internal Control-Integrated Framework set forth by The Committee of Sponsoring Organizations of the Treadway Commission Based on this evaluation, our management concluded that the Companyâ€™s internal controls over financial reporting were effective as of December 31, 2006.

This management report on internal control over financial reporting shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended or otherwise subject to the liabilities of that Section.

This annual report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting. Managementâ€™s report was not subject to attestation by our registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit us to provide only managementâ€™s report in this Annual report.

(c) There were no changes in our internal controls over financial reporting identified with the evaluation thereof that occurred during the period covered by this annual report that have materially affected, or are reasonable likely to materially affect our internal control over financial reporting.

**ITEM 16.**

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

Our Board of Directors has determined that Dr. Michael Anghel, who is an independent director (as defined under Rule 4200(a)(15) of the NASD market rules) and serves on our audit committee, qualifies as an â€œaudit committee financial expertâ€ as defined in Item 16A of Form 20-F.

**ITEM 16B. CODE OF ETHICS**

In 2004, we adopted a Code of Business Conduct and Ethics, which applies to the Companyâ€™s directors, officers and employees, including the Companyâ€™s Chief Executive Officer, Chief Financial Officer, principal accounting officer or controller, and persons performing similar functions. This Code has been posted on our website, www.syneron.com.



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

During the years 2005 and 2006, we paid the following fees for the professional services rendered by Ernst & Young, independent registered public accounting firm:

| | 2005 (in thousands) | 2006 (in thousands) |
|---|---|---|
| Audit Fees | 365 | 354 |
| Tax Fees | 38 | 55 |
| Audit Related Fees | 10 | 114 |
| **Total** | 413 | 523 |

Audit related services rendered by Ernst & Young during 2005 were in connection with our follow-on secondary offering. During 2006 audit related services were mostly in connection with review and supervision of our first year of complying with Section 404 of the Sarbanes-Oxley Act of 2002. Tax services rendered by our auditors were for tax

compliance and for tax consulting associated with international transfer pricing.

Our Audit Committee has adopted a policy for pre-approval of audit and non-audit services provided by the independent auditor. Under the policy, such services must require the specific pre-approval of the Audit Committee followed by ratification of the full Board of Directors. Any proposed services exceeding the Pre-approval amounts for all services to be provided by the independent auditor require an additional specific pre-approval by the Audit Committee.

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

Not applicable.

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

Not applicable.

**PART III**

**ITEM 17. FINANCIAL STATEMENTS**

Not applicable.



**ITEM 18. FINANCIAL STATEMENTS**

The following consolidated financial statements and related auditorsâ€™ report is filed as part of this annual report.


| | |
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| Consolidated Balance Sheets | F-3 |
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| Consolidated Statements of Changes in Shareholders' Equity | F-6 |
| Consolidated Statements of Cash Flows | F-8 |
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**ITEM 19. EXHIBITS**

The following exhibits are filed as part of this annual report on Form 20-F:

| | |
|---|---|
| 1.1 | Articles of Association of Registrant, as amended. |
| 2.1 | Form of Share Certificate (incorporated by reference to Exhibit 4.1 to our Registration Statement on Form F-1 filed July 14, 2004) |
| 4.1 | Turn-Key Manufacturing Agreement by and between R.F.L. Technologies Ltd. and A' to Z' Electronics Ltd. (incorporated by reference to Exhibit 10.1 to our Registration Statement on Form F-1/A filed August 3, 2004)^ |
| 4.2 | Turn-Key Manufacturing Agreement by and between Syneron Medical Ltd. and U.S.R. Electronics Systems (1987) Ltd. (incorporated by reference to Exhibit 10.2 to our Registration Statement on Form F-1/A filed August 3, 2004)^ |
| 4.3 | Turn-Key Manufacturing Agreement by and between Syneron Medical Ltd. and Fibernet Ltd. (incorporated by reference to Exhibit 10.3 to our Registration Statement on Form F-1/A filed August 3, 2004)^ |
| 4.4 | Patent License and Settlement Agreement dated March 4, 2004 by and between (a) Lumenis Inc. and |

| | |
|---|---|
| | Lumenis Ltd. and (b) Syneron Inc. and Syneron Medical Ltd. (incorporated by reference to Exhibit 10.4 to our Registration Statement on Form F-1/A filed August 3, 2004)^ |
| 4.5 | 2003 Stock Option Plan (incorporated by reference to Exhibit 10.5 to our Form F-1 filed July 14, 2004) |
| 4.6 | 2004 Israel Stock Option Plan (incorporated by reference to Exhibit 10.6 to our Registration Statement on Form F-1 filed July 14, 2004) |
| 4.7 | 2004 United States and Canada Stock Option Plan (incorporated by reference to Exhibit 10.7 to our Registration Statement on Form F-1 filed July 14, 2004) |
| 4.8 | Patent License and Settlement Agreement dated as of June 3, 2005 by and between Thermage, Inc. and Syneron Medical Ltd. (incorporated by reference to Exhibit 4.8 to our Annual Report on Form 20-F for the year ended December 31, 2004) |
| 4.9 | Joint Development and Supply Framework Agreement dated as of February 25, 2007 by and between The Procter & Gamble Company and Syneron Medical Ltd. ^ |



| | |
|---|---|
| 8.1 | List of Subsidiaries of the Registrant (incorporated by reference to Exhibit 21.1 to our Form F-1 filed July 14, 2004) |
| 12.1 | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer |
| 12.2 | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer |
| 13.1 | Section 1350 certifications of Periodic Financial Reports |
| 15.1 | Consent of Independent Registered Public Accounting Firm |

^ Portions of this exhibit have been omitted and filed separately with the secretary of the Securities and Exchange Commission pursuant to a confidential treatment request.



# SYNERON MEDICAL LIMITED AND ITS SUBSIDIARIES

**Consolidated**
**Financial Statements**

**As of December 31, 2006**

# SYNERON MEDICAL LIMITED AND ITS SUBSIDIARIES

**Consolidated**
**Financial Statements**
**As of December 31, 2006**

**U.S. dollars in thousands**

**C O N T E N T S**


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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**To the Board of directors and Shareholders of**

**SYNERON MEDICAL LTD.**

We have audited the accompanying consolidated balance sheets of Syneron Medical Ltd. (the â€œCompanyâ€) and its subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of income, changes in shareholdersâ€™ equity and cash flows for each of the three years in the period ended December 31, 2006. These consolidated financial statements are the responsibility of the Companyâ€™s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Companyâ€™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 Companyâ€™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 provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2006 and 2005, 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 U.S. generally accepted accounting principles.

As discussed in Note 2 to the consolidated financial statements, effective January 1, 2006 the Company adopted Statement of Financial Accounting Standards Board No. 123 (revised 2004) â€œShare-Based Paymentâ€□.

Haifa, Israel
June 12, 2007

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



**SYNERON MEDICAL LIMITED AND ITS SUBSIDIARIES**

CONSOLIDATED STATEMENTS OF INCOME

U.S. dollars in thousands, except per share data

| | | Year Ended December 31, | | |
|---|---|---|---|---|
| | **Note** | **2006** | **2005** | **2004** |
| Revenues | | $ 116,976 | $ 87,406 | $ 57,918 |
| Cost of revenues | | 17,921 | 11,428 | 6,914 |
| Gross profit | | 99,055 | 75,978 | 51,004 |
| Operating expenses | | | | |
| Research and development | | 8,515 | 5,030 | 3,078 |
| Selling and marketing | | 46,434 | 25,188 | 19,625 |
| General and administrative | | 9,455 | 3,534 | 2,725 |
| Other operating expenses | 1D,11C | - | 3,494 | - |
| Total operating expenses | | 64,404 | 37,246 | 25,428 |
| Operating income | | 34,651 | 38,732 | 25,576 |
| Financial income, net | 14 | 6,492 | 3,081 | 2,384 |
| Income before taxes on income | | 41,143 | 41,813 | 27,960 |
| Taxes on income | 13 | 1,489 | 750 | 620 |
| Net income | | $ 39,654 | $ 41,063 | $ 27,340 |
| Basic net earnings per share | | 1.46 | $ 1.65 | $ 1.45 |
| Diluted net earnings per share | | 1.44 | $ 1.48 | $ 1.14 |
| Weighted average number of shares used in per share calculations (in thousands): | | | | |
| Basic | | 27,202 | 24,888 | 18,917 |
| Diluted | | 27,601 | 27,664 | 24,083 |

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



**SYNERON MEDICAL LIMITED AND ITS SUBSIDIARIES**

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

| | Note | December 31 2006 | December 31 2005 |
|---|---|---|---|
| CURRENT ASSETS | | | |
| Cash and cash equivalents | | $ 16,036 | $ 13,070 |
| Short-term bank deposits | 3 | 5,000 | 3,500 |
| Available for sale marketable securities | 4 | 81,493 | 116,489 |
| Trade receivables (net of allowance for doubtful accounts of $1,582 and $222 as of December 31, 2006 and 2005, respectively) | | 38,478 | 20,384 |
| Other accounts receivable and prepaid expenses | 5 | 4,890 | 8,685 |
| Inventories | 6 | 7,084 | 3,434 |
| Total current assets | | 152,981 | 165,562 |
| Severance pay fund | | 368 | 249 |
| Long-term deposits and others | 7 | 1,105 | 1,103 |
| Long-term available for sale marketable securities | 4 | 68,147 | - |
| Long-term trade receivables | | - | 1,003 |
| Property and equipment, net | 8 | 1,513 | 1,189 |
| Intangible assets, net | 9 | 1,127 | 1,175 |
| Total long term assets | | 72,260 | 4,719 |
| Total assets | | $ 225,241 | $ 170,281 |

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



**SYNERON MEDICAL LIMITED AND ITS SUBSIDIARIES**

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands, except share and per share data

| | Note | December 31, 2006 | December 31, 2005 |
|---|---|---|---|
| CURRENT LIABILITIES | | | |

| | | | |
|---|---|---|---|
| Trade payables | | $ 6,452 | $ 2,112 |
| Other accounts payable and accrued expenses | 10 | 19,270 | 18,960 |
| Total current liabilities | | 25,722 | 21,072 |
| LONG-TERM LIABILITIES | | | |
| Deferred revenues | | 4,205 | 2,731 |
| Warranty Accruals | | 512 | 1,032 |
| Accrued severance pay | | 405 | 282 |
| Total long-term liabilities | | 5,122 | 4,045 |
| SHAREHOLDERS' EQUITY | | | |
| Ordinary shares of NIS 0.01 par value; Authorized - 100,000,000 ordinary shares; Issued and outstanding - 27,522,589 and 26,521,148 shares as of December 31, 2006 and 2005, respectively; | | 63 | 61 |
| Additional paid-in capital | | 78,663 | 70,254 |
| Treasury shares - 662,874 Ordinary shares | | (461) | (461) |
| Deferred stock based compensation | | - | (177) |
| Accumulated other comprehensive loss | | (1,197) | (2,188) |
| Retained earnings | | 117,329 | 77,675 |
| Total shareholders' equity | | 194,397 | 145,164 |
| Total liabilities and shareholders' equity | | $ 225,241 | $ 170,281 |

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



**SYNERON MEDICAL LIMITED AND ITS SUBSIDIARIES**

STATEMENTS OF CHANGES IN SHAREHOLDER'S EQUITY

U.S. dollars in thousands

| | Ordinary Shares | Additional Paid-in Capital | Accumulated Other Comprehensive Income (loss)* | Deferred Stock based Compensation | Treasury Shares | Retained Earnings | Total Shareholders' Equity | Total Comprehensive Income |
|---|---|---|---|---|---|---|---|---|
| **Balance as of January 1, 2006** | $ 61 | $70,254 | $ (2,188) | $ (177) | $(461) | $ 77,675 | $145,164 | |
| Exercise of stock options | 1 | 329 | - | - | - | - | 330 | |
| Issuance of shares as a result of exercise of restricted stock units (RSU) | 1 | 1 | | | | | 2 | |
| Reclassification of deferred stock based compensation to additional paid in capital due to adoption of FAS 123 (R) | - | (177) | - | 177 | - | - | - | |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Equity based compensation expenses | - | 8,256 | - | - | - | - | 8,256 | |
| Other comprehensive income: | | | | | | | | |
| Unrealized gain on available for sale securities | - | - | 913 | - | - | - | 913 | $ 913 |
| Reclassification to income statement for loss realized | - | - | 78 | - | - | - | 78 | 78 |
| Net income | - | - | - | - | - | 39,654 | 39,654 | 39,654 |
| Total comprehensive income | | | | | | | | $ 40,645 |
| **Balance as of December 31, 2006** | $ 63 | $78,663 | $ (1,197) | $ - | $(461) | $117,329 | $194,397 | |

* Accumulated other comprehensive loss on account of unrealized losses on available for sale marketable securities

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



**SYNERON MEDICAL LIMITED AND ITS SUBSIDIARIES**

STATEMENTS OF CHANGES IN SHAREHOLDER'S EQUITY

U.S. dollars in thousands

| | Ordinary Shares | Additional Paid-in Capital | Accumulated Other Comprehensive Income (loss)* | Deferred Stock based Compensation | Treasury Shares | Retained Earnings | Total Shareholders' Equity | Total Comprehensive Income |
|---|---|---|---|---|---|---|---|---|
| **Balance as of January 1, 2005** | $ 54 | $58,595 | $ (74) | $ (325) | $(461) | $36,612 | $ 94,401 | |
| Exercise of stock options | 7 | 11,659 | - | - | - | - | 11,666 | |
| Amortization of deferred stock based compensation | - | - | - | 148 | - | - | 148 | |
| Other comprehensive income: | | | | | | | | |
| Unrealized loss on available for sale securities | - | - | (1,206) | - | - | - | (1,206) | $ (1,206) |
| Reclassification to income statement for gain realized | - | - | (908) | - | - | - | (908) | (908) |
| Net income | - | - | - | - | - | 41,063 | 41,063 | 41,063 |
| Total comprehensive income | | | | | | | | $ 38,949 |
| **Balance as of December 31, 2005** | $ 61 | $70,254 | $ (2,188) | $ (177) | $(461) | $77,675 | $145,164 | |

* Accumulated other comprehensive loss on account of unrealized losses on available for sale marketable securities

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

**SYNERON MEDICAL LIMITED AND ITS SUBSIDIARIES**

STATEMENTS OF CHANGES IN SHAREHOLDER'S EQUITY

U.S. dollars in thousands

| | Share Capital | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Ordinary | Preferred A | Preferred B | Additional Paid-in Capital | Accumulated Other Comprehensive Income (loss)* | Deferred Stock based Compensation | Treasury Shares | Retained Earnings | Total Shareholders' Equity | Total Comprehensive Income |
| **Balance as of January 1, 2004** | $ 3 | $ 7 | $ 2 | $ 4,688 | $ 168 | $ (473) | $(226) | $ 9,272 | $13,441 | |
| Issuance of Ordinary shares, net of issuance costs of $6,299 | 39 | - | - | 53,663 | - | - | - | - | 53,702 | |
| Exercise of stock options | 3 | - | - | 95 | - | - | - | - | 98 | |
| Conversion of Preferred A and B Shares into Ordinary shares | 9 | (7) | (2) | - | - | - | - | - | - | |
| Issuance of Preferred A shares net of Issuance costs of $1 | - | - | - | 149 | - | - | - | - | 149 | |
| Repurchase of Preferred A shares from a shareholder | - | - | - | - | - | - | (235) | - | (235) | |
| Amortization of deferred stock based compensation | - | - | - | - | - | 148 | - | - | 148 | |
| Other comprehensive income: | | | | | | | | | | |
| Unrealized loss on available for sale securities | - | - | - | - | (432) | - | - | - | (432) | $ (432) |
| Reclassification to income statement for loss realized | - | - | - | - | 190 | - | - | - | 190 | $ 190 |
| Net income | - | - | - | - | - | - | - | 27,340 | 27,340 | 27,340 |
| Total comprehensive income | | | | | | | | | | $ 27,098 |
| **Balance as of December 31, 2004** | $ 54 | $ - | $ - | $58,595 | $ (74) | $ (325) | $(461) | $36,612 | $94,401 | |

* Accumulated other comprehensive loss on account of unrealized losses on available for sale marketable securities

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



**SYNERON MEDICAL LIMITED AND ITS SUBSIDIARIES**

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2006 | 2005 | 2004 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | | |

| | | | |
|---|---|---|---|
| Net income | $ 39,654 | $ 41,063 | $ 27,340 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation and amortization | 720 | 569 | 143 |
| Increase in accrued severance pay, net | 4 | 15 | 3 |
| Increase in short-term and long-term trade receivables | (17,091) | (11,397) | (4,049) |
| Decrease (increase) in other accounts receivables and prepaid expenses | 3,795 | (7,761) | (575) |
| Increase in inventories | (3,650) | (300) | (1,647) |
| Increase (decrease) in trade payables | 4,340 | 592 | (688) |
| Increase (decrease) in other account payables and accrued expenses | (403) | 7,542 | 389 |
| Increase (decrease) in long-term litigation settlement fee | - | - | (900) |
| Realized loss (gain) and changes in accrued interest from marketable securities | 52 | (908) | (396) |
| Equity based compensation | 8,256 | 148 | 148 |
| Increase in deferred revenues | 2,584 | 922 | 2,317 |
| Increase (decrease) in warranty accruals | (917) | 848 | 526 |
| Loss on sales of property and equipment | - | 12 | 3 |
| Net cash provided by operating activities | 37,344 | 31,345 | 22,614 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | |
| Maturity of (investment in) short-term deposits, net | (1,500) | 53,393 | (56,873) |
| Purchase of available-for-sale marketable securities | (82,207) | (98,880) | (17,759) |
| Proceeds from sale and redemption of available for sale marketable securities | 49,996 | 4,256 | 6,116 |
| Investment in long-term loans and others | (2) | (75) | (13) |
| Purchase of property and equipment | (747) | (645) | (484) |
| Purchase of intangible assets | (250) | (466) | (1,000) |
| Proceeds from sale of property and equipment | - | 8 | - |
| Net cash used in investing activities | (34,710) | (42,409) | (70,013) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | |
| Proceeds from issuance of ordinary and preferred shares, net | - | - | 53,851 |
| Exercise of stock options and RSUs | 332 | 11,666 | 98 |
| Repurchase of preferred A shares from shareholders | - | - | (235) |
| Net cash provided by financing activities | 332 | 11,666 | 53,714 |
| Increase in cash and cash equivalents | 2,966 | 602 | 6,315 |
| Cash and cash equivalents at the beginning of the year | 13,070 | 12,468 | 6,153 |
| Cash and cash equivalents at the end of the year | $ 16,036 | $ 13,070 | $ 12,468 |
| Cash paid during the period for: | | | |
| Income taxes | $ 9 | $ 12 | $ 3 |

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

**SYNERON MEDICAL LIMITED AND ITS SUBSIDIARIES**

Notes to the Consolidated Financial Statements

U.S. dollar in thousands, except share and per share data

**Note 1 â€“GENERAL**

A. Syneron Medical Ltd. (â€œthe Companyâ€□) commenced its operations in July 2000. The Company and its subsidiaries (together â€œthe Groupâ€□) are principally engaged in research, development, marketing and sales, directly to end-users and also to distributors of advanced equipment for the esthetic medical industry and systems for dermatologists, plastic surgeons and other qualified practitioners worldwide.

B. Syneron GmbH, a wholly-owned subsidiary in Germany, was established in August 2001, for the purpose of marketing and sales of the Companyâ€™s products in Europe. Syneron Inc. and Syneron Canada Corp., also wholly-owned subsidiaries, were established during 2002 for the purpose of marketing and sales of the Companyâ€™s products in North America. Syneron Medical (HK), also a wholly-owned subsidiary, was established in Hong Kong in June 2004 and became active promoting, marketing and serving as an agent of the Company in Asia and Australia in January 2007

C. During 2005 the Company invested in Light Instruments Ltd. (â€œLIâ€□), an Israeli development stage company engaged in the development of advanced dental laser devices. The Company invested $1,500, in two portions, in consideration for 51% of LI and exercised its right to increase the number of directors to three out of five members of LIâ€™s board of directors. As such, the company is consolidating LI since the third quarter of 2005.

According to the agreement the Company has an option to invest an additional $2,000, for a period of two years from the first investment and to increase its holding to 63% of the Ordinary Shares of LI. If during that period LI meets certain milestones, the Company will be obligated to invest the additional $2,000. According to the agreement, the two founders of LI have the option, for a period of two years, to sell their holdings (49%) to the Company for $5,000 in the Companyâ€™s share, after meeting certain milestones. As part of the investment agreement the Company will have the exclusive right to sell LI products in North America for 10 years following FDA approval. The initial value of the contingently puttable minority interests described above was immaterial to the Companyâ€™s financial statements. As of December 31, 2006 and 2005 it was not probable that the required conditions to enable the founders to sell their interest in LI to the Company would be met. Therefore, the aforementioned puttable minority interest rights did not have an effect on the Companyâ€™s financial statements.

The Company is the sole financing source of LI and it was granted preference in receiving its investment in case of LIâ€™s liquidation.

D. On August 11, 2004, the Company completed an initial public offering (â€œIPOâ€□ or â€œOfferingâ€□) in the US NASDAQ national market. Pursuant to the IPO, the Company issued 5 million Ordinary shares and received net proceeds of approximately $54 million (net of underwriting commissions and expenses of approximately $6 million). Trading in the Companyâ€™s Ordinary shares commenced on August 6, 2004. The underwriters were granted an option, exercisable within 30 days from the date of the IPO, to purchase up to 750,000 additional Ordinary shares at the public offering price of $12 per share less underwriting discounts. The option was solely for the purpose of covering any over-allotments in connection with the Offering. The underwriters did not exercise the option.

On March 8, 2005 a follow-on secondary offering was completed. In the offering the shareholders of the Company sold 7,937,809 ordinary shares, including 1,264,174 shares that were exercised by options holders. The consideration received by the Company for the stock options exercise was $1,588. As the offering was for the sale of shares by the Companyâ€™s shareholders, the total cost of the offering in the amount of $815 was expensed and included in other operating expenses.

**SYNERON MEDICAL LIMITED AND ITS SUBSIDIARIES**

Notes to the Consolidated Financial Statements

U.S. dollar in thousands, except share and per share data

**Note 2 â€“SIGNIFICANT ACCOUNTING POLICIES**

The consolidated financial statements are prepared in accordance with United States Generally Accepted Accounting Principles (â€œU.S. GAAPâ€).

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 Companyâ€™s consolidated revenues are generated mainly in U.S. dollars (â€œdollarsâ€). In addition, a substantial portion of the Groupâ€™s costs are incurred in dollars. The Companyâ€™s management believes that the dollar is the primary currency of the economic environment in which the Company and its subsidiaries operate. Thus, the dollar is the functional and reporting currency of the Company and its subsidiaries.

Transaction and balances in currencies other than the US dollars have been re-measured into dollars in accordance with the principles set forth in Statement of Financial Accounting Standard No. 52 â€œForeign Currency Translationâ€. All exchange gains and losses from re-measurement are reflected in the consolidated income statements in financial income or expenses.

C. PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its subsidiaries. Intercompany transactions and balances including profit from inter-company sales not yet realized outside the Group, have been eliminated upon consolidation.

D. RECLASSIFICATION

Certain amounts from prior years have been reclassified to conform to the current period presentation.

The reclassification had no effect on previously reported net loss, shareholdersâ€™ equity or cash flows.

E. CASH AND CASH EQUIVALENTS

Cash equivalents are short-term highly liquid investments that are readily convertible into cash with original maturities of less than three months at the date acquired.

F. SHORT-TERM DEPOSITS

Short-term bank deposits are deposits with maturities of more than three months but less than one year. The short-term deposits are presented at their cost. Accrued interest is included in other receivables

G. MARKETABLE SECURITIES

The Company accounts for investments in marketable securities in accordance with Statement of Financial Accounting Standard No. 115 â€œAccounting for Certain Investments in Debt and Equity Securitiesâ€.

Management determines the classification of investments in marketable securities with fixed maturities at the time of purchase and re-evaluates such designations as of each balance sheet date. In 2005 and 2006 investments in marketable securities were designated as available for sale securities. Accordingly, the securities are stated at fair value, with unrealized gains and losses reported in accumulated other comprehensive income, a separate component of shareholdersâ€™ equity. Realized gains and losses on sales of investments are included in the consolidated income statements. Interest and amortization of premium and discount on debt securities are recorded as financial income.





**Note 2 â€“SIGNIFICANT ACCOUNTING POLICIES (Continued)**

G. MARKETABLE SECURITIES (Continued)

Investments in corporate structured notes are classified as available for sale and accounted for under the provision of Emerging Issue Task Force No. 96-12, â€œRecognition of Interest Income and Balance Sheet Classification of Structured Notesâ€ (â€œEITF No. 96-12â€). Under EITF No. 96-12, the retrospective interest method is used for recognizing interest income.

H. INVENTORIES

Inventories are stated at the lower of cost or market value.

Cost is determined as follows:

Raw materials: first in, first out (â€œFIFOâ€) method.

Finished products: raw material as explained above, with the addition of the specific manufacturing costs.

I. PROPERTY AND EQUIPMENT, NET

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

| | % |
|---|---|
| Computers, software, manufacturing and laboratory equipment | 10-33 |
| Office furniture, equipment | 7-15 |

J. INTANGIBLE ASSET, NET

Intangible assets are stated at cost, net of accumulated amortization. The intangible assets are being amortized over their useful life using a method of straight line amortization. As per management opinion this method reflects best the pattern in which the economic benefits of the intangible assets are consumed or otherwise used up.

K. IMPAIRMENT OF LONG-LIVED ASSETS

The Companyâ€™s long-lived assets are reviewed for impairment in accordance with Statement of Financial Accounting Standards No. 144 â€œAccounting for the Impairment or Disposal of Long-Lived Assetsâ€ whenever events or changes in circumstances indicate that the carrying amount of an asset may not be

recoverable. Recoverability of an asset to be held and used is measured by a comparison of the carrying amount of the asset to the future undiscounted cash flows expected to be generated by the asset. If such asset is considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the asset exceeds its fair value. During 2004, 2005 and 2006, no impairments were recorded.





**Note 2 â€“SIGNIFICANT ACCOUNTING POLICIES (Continued)**

L. REVENUE RECOGNITION

The Company and its subsidiaries generate revenues mainly from product sales. The Company also generates revenues from services. The Company sells its products primarily through its subsidiaries to end users and distributors.

Revenues are recognized in accordance with Staff Accounting Bulletin No. 104 â€œRevenue Recognitionâ€ when delivery has occurred, persuasive evidence of an agreement exists, the fee is fixed and determinable, collectibility is probable and no further obligations exist. The Company does not grant a right of return to its products.

Other than from pricing terms which may differ due to the different volume of purchases between distributors and end-users, there are no material differences in the terms and arrangements involving direct and indirect customers.

All of the Companyâ€™s products sold through agreements with distributors are non-exchangeable, non-refundable, non-returnable and without any rights of price protection or stock rotation. Accordingly, the Company considers all the distributors as end-users.

Deferred revenue includes unearned amounts received in respect of service contracts and amounts received from customers but not yet recognized as revenues.

Revenue from product sales to end users in North America usually includes multiple elements within a single contract. The Companyâ€™s accounting policy complies with the requirements set forth in EITF 00-21, relating to the separation of multiple deliverables into individual accounting units with determinable fair values.

The Company considers the sale of a product and the service element in the agreement to be two separate accounting units of the arrangement and defers the fair value of the service element to the period in which it is earned. Fair value is determined based on the price charged by third parties on a stand alone basis for the service provided, and data available from which to estimate the volume of services provided during the term of the arrangement.

M. RESEARCH AND DEVELOPMENT COSTS

Research and development costs are charged to the income statement as incurred.

Notes to the Consolidated Financial Statements

U.S. dollar in thousands, except share and per share data

**Note 2 â€“SIGNIFICANT ACCOUNTING POLICIES (Continued)**

N. STOCK-BASED COMPENSATION

At December 31, 2006, the Company has 2 stock-based employee compensation plans, which are described more fully in Note 12. Prior to January 1, 2006, the Company accounted for those plans under the recognition and measurement provisions of APB Opinion No. 25, â€œAccounting for Stock Issued to Employeesâ€ (â€œOpinion 25â€), and related Interpretations, as permitted by FASB Statement No. 123, â€œAccounting for Stock-Based Compensationâ€ (â€œStatement 123â€). Under APB 25 compensation expense was measured based on the intrinsic value of the options granted at the grant date or other measurement date. Expenses in respect of stock-based employee compensation cost amounted to $148 in the Statement of Income for the years ended December 31, 2005 and 2004.

Effective January 1, 2006, the Company adopted the fair value recognition provisions of FASB Statement No. 123(R), â€œShare-Based Paymentâ€ (â€œStatement 123(R)â€), using the modified-prospective transition method. Under that transition method, compensation cost recognized during 2006 included: (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 provisions of Statement 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 Statement 123(R). Results for prior periods have not been restated.

As a result of adopting Statement 123(R) on January 1, 2006, the Companyâ€™s income before taxes on income and net income for the year ended December 31, 2006 was $ 8,108 lower than if it had continued to account for share-based compensation under Opinion 25. Basic and diluted earnings per share for the year ended December 31, 2006, were $ 0.30 and $ 0.29 lower, respectively, than if the Company had continued to account for share-based compensation under Opinion 25.

The following table illustrates the effect on net income and earnings per share for the years ended December 31, 2005 and 2004 if the Company had applied the fair value recognition provisions of Statement 123 to options granted under the Companyâ€™s stock option plans after the original effective date of SFAS 123. For purposes of this pro forma disclosure, the value of the options is estimated using the Black-Scholes options pricing model for options granted prior to January 1, 2005 and the Binomial model for options granted thereafter. The fair value of the options granted is amortized to expense over the optionsâ€™ vesting periods using the straight line method:





**Note 2 â€“SIGNIFICANT ACCOUNTING POLICIES (Continued)**

O. STOCK-BASED COMPENSATION (Continued)

| | Year ended December 31, | |
|---|---|---|
| | **2005** | **2004** |
| Net Income, as reported | $ 41,063 | $ 27,340 |

| | | |
|---|---|---|
| Add: Stock-based employee compensation expense included in reported net income | 148 | 148 |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards | (6,078) | (664) |
| Pro forma net income | $ 35,133 | $ 26,824 |
| Earnings per share | | |
| Basic - as reported | $ 1.65 | $ 1.45 |
| Basic - pro forma | $ 1.41 | $ 1.42 |
| Diluted - as reported | $ 1.48 | $ 1.14 |
| Diluted - pro forma | $ 1.27 | $ 1.11 |
| Weighted average number of shares used in per share calculations (in thousands): | | |
| Basic | 24,888 | 18,917 |
| Diluted | 27,532 | 24,083 |

The pro forma effects of estimated equity-based compensation expense on net income and earnings per share for the years ended December 31, 2005 and 2004 were estimated at the date of grant using the Black-Scholes options pricing model for options granted prior to January 1, 2005 and the Binomial model for options granted thereafter, based on the following assumptions (annualized percentages):

| | Year ended December 31, | |
|---|---|---|
| | 2005 | 2004 |
| Black-Scholes model | | |
| Volatility | | 80% |
| Risk-free interest rate | | 4.07% |
| Dividend yield | | 0% |
| Expected life (years) | | 3.4 years |
| Binomial model | | |
| Dividend yield | 0% | |
| Expected volatility | 65% | |
| Risk-free interest rate | 4.41% | |
| Early exercise multiple | 2 | |
| Expected life | 2.13 | |

As of December 31, 2006, the total unrecognized estimated compensation cost related to non-vested stock options granted prior to that date was $ 16,069. This cost is expected to be recognized over a weighted average period of 1.45 years. The Company recorded cash received from the exercise of stock options and RSU of $ 332.

U.S. dollar in thousands, except share and per share data

**Note 2 â€“SIGNIFICANT ACCOUNTING POLICIES (Continued)**

P. 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 net earning per share is computed based on the weighted average number of ordinary shares outstanding during each year, plus the dilutive effect of options considered to be outstanding during each year, in accordance with Statement of Financial Standard No. 128, â€œEarnings Per Shareâ€.

Q. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions are used by the Company in estimating fair values: The carrying amount reported in the consolidated balance sheet for cash and cash equivalents, short-term bank deposits, trade and other receivables, and trade and other payables approximate their fair values due to the short-term maturities of such instruments. Marketable securities are presented at fair value based on quoted market prices. The value of long-term bank deposits approximates fair value due to the variable interest rate on these deposits.

R. INCOME TAXES

The Company and its subsidiaries account for income taxes in accordance with Statement of Financial Accounting Standards No. 109, â€œAccounting for Income Taxesâ€(â€œSFAS No. 109â€). This statement prescribes the use of the liability method, whereby deferred tax assets and liability account balances are calculated for temporary differences between financial reporting and tax bases of assets and liabilities and for net operating loss carryforwords. The deferred tax assets and liabilities are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company and its subsidiaries provide a valuation allowance if necessary, to reduce deferred tax assets to their estimated realizable value.

S. SEVERANCE PAY

The Companyâ€™s liability for severance pay to its Israeli employees is calculated pursuant to Israeli 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 monthâ€™s salary for each year of employment or a portion thereof. The Companyâ€™s liability for all of its Israeli employees is covered by monthly deposits for insurance policies and by an accrual. The value of these policies is recorded as an asset in the Companyâ€™s balance sheet.

The deposited funds may be withdrawn only upon the fulfillment of the obligation pursuant to Israeli 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 accumulated up to balance sheet dates.

Severance expenses for the years ended December 31, 2006, 2005 and 2004 amounted to approximately $200, $106 and $100, respectively.

T. ADVERTISING EXPENSES

Advertising expenses are charged to the statements of income, as incurred. Advertising expenses for the years ended December 31, 2006, 2005 and 2004 were $2,019, $1,244 and $1,196, respectively.

Notes to the Consolidated Financial Statements

U.S. dollar in thousands, except share and per share data

**Note 2 â€“SIGNIFICANT ACCOUNTING POLICIES (Continued)**

U. CONCENTRATION OF CREDIT RISK

Financial instruments that potentially subject the Group to concentrations of credit risk consist principally of cash and cash equivalents, marketable securities, and trade receivables.

The majority of the Groupâ€™s cash and cash equivalents are invested in dollar instruments of major banks in Israel and in the United States. Management believes that the financial institutions that hold the Companyâ€™s investments are financially sound and, accordingly, minimal credit risk exists with respect to these investments

The Companyâ€™s trade receivables are derived from sales to large independent distributors located mainly in Western Europe, Asia Pacific region and to end-users in North America. The Company performs ongoing credit evaluations of its customers and to date has not experienced any material losses. An allowance for doubtful accounts is determined with respect to those specific amounts that the Company has determined to be doubtful of collection.

The Companyâ€™s marketable securities include investments in highly rated debentures of Israeli, U.S., Scotch and Austrian Corporations and Governmental Bonds. Based on the above and the fact that the portfolio is well diversified, management believes that low credit risk exists with respect to these marketable securities.

The Company and its subsidiaries have no significant off-balance sheet concentration of financial instruments subject to credit risk such as foreign exchange contracts, option contracts or other hedging arrangements.

The following table provides the detail of the change in the Company provision for doubtful debts for the years ended December 31, 2006 and 2005:

| | December 31, | |
|---|---|---|
| | 2006 | 2005 |
| Balance at the beginning of the year | $ 222 | $ 263 |
| Additions | 1,426 | 115 |
| Deductions | 66 | 156 |
| Balance at end of the year | $ 1,582 | $ 222 |





**Note 2 â€“SIGNIFICANT ACCOUNTING POLICIES (Continued)**

V. CONCENTRATION OF OPERANTIONAL RISK

The Company outsources the manufacturing of its products to four subcontractors located in Israel. These

subcontractors have limited manufacturing capacity that may be inadequate if customers place orders for unexpectedly large quantities of products. In addition, because The Companyâ€™s subcontractors are located in Israel, they on occasion may feel the impact of potential economic or political instability in the region. If the operations of one or more of these subcontractors were halted or limited, even temporarily, or if they were unable or unwilling to fulfill large orders, the Company could experience business interruption, increased costs, damage to the Companyâ€™s reputation and loss of customers. In addition, qualifying new subcontractors could take several months. Management believes that the above mentioned risk is mitigated by diversification of production where each product is manufactured by more than one subcontractor. In addition, most of the subcontractors are affiliated with international firms and if needed a temporary solution could be found by shifting manufacturing out of Israel.

Many of the components that comprise the Companyâ€™s products are currently manufactured by a limited number of suppliers. Although most of the components are obtained from at least three separate suppliers, the Company does not have the ability to manufacture these components. A supply interruption or an increase in demand beyond current suppliersâ€™capabilities could harm the Companyâ€™s ability to manufacture its products until it identifies and qualifies a new source of supply, which could take several months.

Any interruption in the supply of components or materials, or the Company inability to obtain substitute components or materials from alternate sources at acceptable prices in a timely manner, could impair the ability to meet the demand of the Companyâ€™s customers, which would have an adverse effect on the Companyâ€™s business.

W. WARRANTY

The Company generally provides a one year to three years standard warranty with its products, depending on the type of product and the country in which the Company does business. On sales to distributors, the Company provides a warranty on parts only. The Company records a provision for the estimated cost to repair or replace products under warranty at the time of sale. Factors that affect the Companyâ€™s warranty reserve include the number of units sold, historical and anticipated rates of warranty repairs and the cost per repair.

At December 31, 2006, short term and long term accrued warranty amounted to $931 and $512 respectively. At December 31, 2005, short term and long term accrued warranty amounted to $1,328 and $1,032, respectively.

X. COMPREHENSIVE INCOME

The Company reports comprehensive income in accordance with SFAS No. 130, â€œReporting Comprehensive Incomeâ€. This statement establishes standards for the reporting and display of comprehensive income and its components in a full set of general purpose financial statements. Comprehensive income generally represents all changes in stockholdersâ€™ equity during the period except those resulting from investments by, or distributions to, stockholders. The Company determined that their items of other comprehensive income relate to unrealized gains and losses on available for sale securities.





**Note 2 â€“SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Y. IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

1. In July 2006, the FASB issued FASB Interpretation No. 48 â€œAccounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109â€ (â€œFIN 48â€). 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 (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 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition.

FIN 48 is effective for the fiscal years beginning after December 15, 2006. The Company believes the adoption of FIN 48 will not have a material impact on its financial condition, results of operations and liquidity.

2. In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS No. 157). This Statement defines fair value, establishes a framework for measuring fair value and expands the required disclosure on fair value measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements and accordingly, does not require any new fair value measurement. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company is currently analyzing SFAS No. 157 and believes the adoption of SFAS No. 157 will not have a material impact on its financial condition, results of operations or liquidity.

3. In February, 2007, the FASB issued SFAS No. 159, â€œThe fair value of option for Financial Assets and Financial Liabilitiesâ€ (â€œSFAS No. 159â€). SFAS No. 159 permits entities to choose to measures many financial assets and financial liabilities at fair value. Unrealized gain and losses on items for which the fair value option has been elected are reported in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently assessing the impact of SFAS No. 159 on its consolidated financial position and results of operations.





**Note 3 â€“SHORT-TERM BANK DEPOSITS**

At December 31, 2006, short term deposits bear a 5.1% â€“ 5.17% annual interest rate.

At December 31, 2005 â€“ see Note 11D.

**Note 4 â€“AVAILABLE FOR SALE â€“ MARKETABLE SECURITIES**

| | December 31, 2006 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Market Value |
| **Equity securities** | 259 | 3 | - | 262 |
| **Available for sale - matures within one year:** | | | | |
| Government debentures - fixed interest rate | $ 64,605 | $ 184 | $ (92) | $ 64,697 |

| | | | | |
|---|---|---|---|---|
| Corporate debentures - fixed interest rate | 3,512 | 1 | (6) | 3,507 |
| | 68,117 | 185 | (98) | 68,204 |
| **Available for sale - matures after one year through three years:** | | | | |
| Government debentures - fixed interest rate | 50,057 | 47 | (345) | 49,759 |
| Corporate debentures - fixed interest rate | 12,853 | 18 | (197) | 12,674 |
| | 62,910 | 65 | (542) | 62,433 |
| **Available for sale - matures after three years through five years:** | | | | |
| Government debentures - fixed interest rate | 10,077 | - | (226) | 9,851 |
| Corporate debentures - fixed interest rate | 1,831 | - | (93) | 1,738 |
| | 11,908 | - | (319) | 11,589 |
| **Available for sale - matures after five years:** | | | | |
| Government debentures - fixed interest rate | 4,404 | - | (170) | 4,234 |
| Corporate debentures - fixed interest rate | 2,539 | - | (196) | 2,343 |
| Corporate structured notes - floating interest rate | 700 | - | (125) | 575 |
| | 7,643 | - | (491) | 7,152 |
| | $ 150,837 | $ 253 | $ (1,450) | 149,640 |
| Reclassification of certain securities to Long Term | | | | 68,147 |
| | | | | $ 81,493 |





**Note 4 â€“AVAILABLE FOR SALE â€“ MARKETABLE SECURITIES (Continued)**

| | December 31, 2005 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Market Value |
| **Equity securities** | 348 | 2 | - | 350 |

| | | | | |
|---|---|---|---|---|
| **Available for sale - matures within one year:** | | | | |
| Government debentures - fixed interest rate | $ 40,715 | $ 42 | $ (237) | $ 40,520 |
| Corporate debentures - fixed interest rate | 2,211 | - | (94) | 2,117 |
| | 42,926 | 42 | (331) | 42,637 |
| **Available for sale - matures after one year through three years:** | | | | |
| Government debentures - fixed interest rate | 58,921 | 55 | (1,205) | 57,771 |
| Corporate debentures - fixed interest rate | 508 | | (18) | 490 |
| | 59,429 | 55 | (1,223) | 58,261 |
| **Available for sale - matures after three years through five years:** | | | | |
| Government debentures - fixed interest rate | 2,459 | - | (103) | 2,356 |
| Corporate debentures - fixed interest rate | 3,238 | 8 | (99) | 3,147 |
| | 5,697 | 8 | (202) | 5,503 |
| **Available for sale - matures after five years:** | | | | |
| Government debentures - fixed interest rate | 4,404 | 5 | (139) | 4,270 |
| Corporate debentures - fixed interest rate | 3,932 | - | (214) | 3,718 |
| Corporate structured notes - floating interest rate | 1,941 | - | (191) | 1,750 |
| | 10,277 | 5 | (544) | 9,738 |
| | $ 118,677 | $ 112 | $ (2,300) | $ 116,489 |

For the year ended December 31, 2006, unrealized loses in the Companyâ€™s investments in available for sale securities instruments are mainly attributed to interest rate fluctuations. The contractual cash flows of these investments are either guaranteed by U.S. government or an agency of the U.S. government or were issued by highly rated corporations and other governments. As the Company has the ability to hold these investments until maturity, it is expected that these securities would not be settled at a price less than the amortized cost of the Companyâ€™s investments. Therefore, the securities were not considered to be other than temporarily impaired at December 31, 2006.



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U.S. dollar in thousands, except share and per share data

**Note 5 â€“OTHER ACCOUNTS RECEIVABLE AND PREPAID EXPENSES**

| | December 31, | |
|---|---|---|
| | **2006** | **2005** |

| | | |
|---|---|---|
| Government authorities | $ 1,836 | $ 869 |
| Prepaid expenses | 1,295 | 735 |
| Tax withholding Deposit * | 1,196 | 6,296 |
| Other receivables | 563 | 785 |
| | $ 4,890 | $ 8,685 |

* Employees optionâ€™s withholding tax, held in deposit until the time of remitting funds to tax authorities. See Note 10.

**Note 6 â€“INVENTORIES**

| | December 31, | |
|---|---|---|
| | **2006** | **2005** |
| Raw materials | $ 741 | $ 937 |
| Finished products | 6,343 | 2,497 |
| | $ 7,084 | $ 3,434 |

**Note 7 â€“LONG-TERM BANK DEPOSITS AND OTHERS**

| | December 31, | |
|---|---|---|
| | **2006** | **2005** |
| Structured note (1) | $ 1,000 | $ 1,000 |
| Others | 105 | 103 |
| | $ 1,105 | $ 1,103 |

(1) The structured note is redeemable by the Bank at the earlier of (a) the end of 10 years or (b) when the aggregate interest amount reaches 12% but not earlier than the end of 1.5 years. The interest rate in the first year is 10% and from the second year to maturity the interest rate will be 9.25% minus twice LIBOR for 6 months.

Due to increase in the interest rate and the LIBOR, the Company does not anticipate redeeming the structured note in the following year, as such the structured note was classified to long term bank deposits.





**Note 8 â€“PROPERTY AND EQUIPMENT, NET**

| | December 31, | |
|---|---|---|
| | 2006 | 2005 |
| Cost | | |
| Computers, software, manufacturing and laboratory equipment | $ 2,139 | $ 1,487 |
| Office furniture and equipment | 304 | 209 |
| **Total cost** | 2,443 | 1,696 |
| Accumulated depreciation | | |
| Computers, software, manufacturing and laboratory equipment | 824 | 450 |
| Office furniture and equipment | 106 | 57 |
| **Total accumulated depreciation** | 930 | 507 |
| **Depreciated cost** | $ 1,513 | $ 1,189 |

Depreciation expense for the years ended December 31, 2006, 2005 and 2004 were $422, $278 and $143, respectively.

**Note 9 â€“INTANGIBLE ASSETS, NET**

(1) In December 2004 the Company purchased a U.S. patent, in the amount of $1,000. Additional cost in the amount of $466, in connection with the purchase of the patent, was recorded in the beginning of 2005. The Company estimated the useful life of the patent at five years from the purchase date.

In 2006 the amortization expenses related to the patent were $293. The annual amortization expense relating to the patent as of December 31, 2006 for each of the three years in the period ending December 31, 2009 is estimated to be approximately $293.

(2) In November 2006 the Company purchased a U.S. patent, in the amount of $250. The Company estimated the useful life of the patent at five years from the purchase date.

In 2006 the amortization expenses related to the patent were $4. The annual amortization expenses relating to the patent as of December 31, 2006 for each of the five years in the period ending December 31, 2011 is estimated to be approximately $50.





**Note 10 â€“OTHER ACCOUNTS PAYABLE AND ACCRUED EXPENSES**

| | December 31, | |
|---|---|---|
| | 2006 | 2005 |

| | | |
|---|---|---|
| Deferred revenues | $ 5,358 | $ 4,248 |
| Warranty accruals | 931 | 1,328 |
| Accrued expenses | 3,468 | 1,693 |
| Accrued commission | 3,653 | 1,970 |
| Employees and related expenses | 1,360 | 1,282 |
| Tax authorities | 3,116 | 1,499 |
| Tax Withholding * | 1,196 | 6,296 |
| Other payables | 188 | 644 |
| | $ 19,270 | $ 18,960 |

* See note 5

**Note 11 â€“COMMITMENTS AND CONTINGENCIES**

A. ROYALTY

In June 2004 the Company has entered into an agreement effective from December 1, 2003, for using know-how of a third party, in which the Company is obligated to pay royalties, at a rate of 4-5%, on sales of certain products to its distributors and subsidiaries.

Expenses in respect of royalties amounted to $1,311, $370 and $79 for the years ended December 31, 2006, 2005 and 2004 respectively, and were recorded as part of cost of revenues.

B. LEASES

The Company operates from leased facilities in Canada, United States, Germany and Israel leased for periods expiring in years 2006 through 2011.

The future minimum lease commitments of the Group under various non-cancelable operating lease agreements in respect of premises and motor vehicles, that are in effect as of December 31, ? 2006, are as follows:

| Year ended December 31, | |
|---|---|
| 2007 | $ 664 |
| 2008 | 493 |
| 2009 | 493 |
| 2010 | 493 |
| 2011 | 137 |
| | $ 2,280 |

Rent expenses amounted to $546, $336 and $347 for the years ended December 31 2006, 2005 and 2004, respectively.

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U.S. dollar in thousands, except share and per share data

**Note 11 â€“COMMITMENTS AND CONTINGENCIES (Continued)**

C. LEGAL CLAIMS

1. On July 23, 2004, Thermage, Inc. sued the Company in the United States District Court in the Northern District of California, for patent infringement, seeking an injunction against infringing their patent rights and unspecified damages.

   In June 2005, the Company reached an agreement with Thermage which settled patent-related claims of the parties against each other. This settlement did not include an admission of liability. Under this agreement each party grants the other a non-exclusive paid-up license under the patents in suit and related patents. Total legal fees in connection with the lawsuit and the settlement and settlement costs in connection with the settlement with Thermage amounted to $2.7 million and were recorded as part of other operating expenses.

   The license granted to Thermage excludes the right to utilize the ELOS technology and the license granted to the Company excludes the right to utilize Thermageâ€™s monopolar RF and capacitive electrical coupling. The agreement includes a consent, of the parties, not to sue each other on current or future devices.

2. On July 29, 2004, Shaldot Metal Works Ltd. (â€œShaldotâ€□), a privately owned Israeli company, sued the Company and Dr. Eckhouse (the chairman of the board of directors of the Company), in the District Court in Haifa, claiming that in 1999 Dr. Eckhouse had access to confidential material regarding an Israeli patent, which he allegedly used in violation of a confidentiality agreement in connection with forming Syneron. The complaint alleges that the Companyâ€™s products infringe Shaldotâ€™s Israeli patent. In its lawsuit Shaldot is suing the Company for $2.3 million (NIS 10 million) and has requested an injunction against the Company which will prohibit manufacturing, marketing and selling some or all of the Companyâ€™s products, which, if successful, could have a material adverse effect on the Companyâ€™s business in Israel. On October 10, 2004 the Company submitted its Statements of Defense to the Court, claiming that Shaldotâ€™s patent is invalid due to the existence of prior art, lack of novelty and no improvement over existing art in the field. Shaldotâ€™s patent is under review by the Israeli Patent Office, based on a request submitted to the Patent Office by a third party claiming that Shaldotâ€™s patent is invalid. Moreover, the Company claimed that even if the patent would have been valid, none of the Companyâ€™s devices infringe any of Shaldotâ€™s patents. The dispute was referred by the court to mediation and the parties attempted to resolve the dispute. The mediation process was not successful and was terminated by Shaldot. In January 2007, the Company learned that Shaldot had transferred all of its rights to the patent to a subsidiary, Qray Ltd. The Company submitted a motion to dismiss Shaldotâ€™s lawsuit, claiming that due to the transfer of rights, Shaldot no longer had standing to continue the proceedings. A hearing on the Companyâ€™s motion was held on February 19, 2007. At the hearing, the court ordered that Qray be added as an additional plaintiff to the lawsuit and that the parties submit revised statements of claims and defenses. On February 25, 2007, Shaldot submitted its revised statement of claims. On March 14, 2007, The Company submitted its revised statement of defense and also a revised statement of counterclaim. The lawsuit is in the process of ongoing evidentiary hearings with the next hearing scheduled to take place on June 18, 2007.

C. LEGAL CLAIMS (Continued)

The Company believes that Shaldotâ€™s lawsuit is without merit, and the Company intends to defend itself vigorously. Therefore, the Company does not believe that this lawsuit will result in a loss to the Company and accordingly, no accrual was recorded in the financial statement with respect to this claim.

3. In September 2005 and further dates thereafter, nine plaintiffs filed complaints in which the Company and its subsidiary, Syneron Inc., are named as defendants along with other named defendants. Eight of the plaintiffs are African-American women who allege they sustained burn and/or other complications after hair removal or skin rejuvenation treatments were administered by one of the Companyâ€™s customers with one of its products. In addition to traditional product liability and negligence theories, the complaint alleges theories of fraud, negligent misrepresentation, illegal sale of a dangerous prescriptive device and intentional race discrimination. The Company and its subsidiary have appeared in the court hearings. A vigorous defense to all of the allegations is being funded and controlled by an insurance company that issued an insurance policy to the Companyâ€™s subsidiary and under which the Company is also additionally insured through a controlling interest endorsement. The insurance company has reserved the right to deny coverage on some of the claims (product liability-intentional failure to warn, product liability-fraud, and intentional racial discrimination) which means there is a possibility that these claims would not be covered by the insurance policy. In addition, the complaint seeks recovery for punitive damages which the insurance company has advised the Company that it is not covered by the insurance policy.

   Following mediation the Company has resolved the claims with most of the plaintiffs and the Company is in the process of finalizing the mediation process with the rest of the plaintiffs. Most of the settlement costs will be paid by the insurance company and the Company estimates that the portion of the settlement that will be paid by the Company will not be material; therefore no provision has been made in the financial statements in respect of this claim.

4. On November 10, 2005 a class action was filed against one of the Companyâ€™s subsidiaries, Syneron Inc. The plaintiff seeks injunctive relief, statutory damages and attorneys fees and costs as a result of the alleged violations of the Telephone Consumer Protection Act (â€œTCPAâ€). Syneron Inc.â€˜s insurance carrier has accepted tender of defense of this litigation subject to a reservation of rights. Although there appears to be a likelihood that Syneron Inc. will have insurance coverage for this lawsuit and it is currently being provided a defense through its insurance carrier, there is the possibility that these TCPA claims against Syneron Inc. will not be covered by the insurance policy. Syneron Inc. has answered the Complaint and the parties have engaged in discovery relating to the appropriateness of proceeding with the action on behalf of a class, as well as discovery on the merits of the claim. On February 7, 2007, Syneron Inc. filed a motion to dismiss the action for lack of federal jurisdiction. All further discovery is stayed pending a ruling on this motion. Should this motion to dismiss be denied, Syneron Inc. plans vigorously to challenge class certification.





**Note 11 â€“COMMITMENTS AND CONTINGENCIES (Continued)**

C. LEGAL CLAIMS (Continued)

The Company cannot predict the outcome of the claim, nor can it estimate the amount of damage or the range of such an amount, if it is held responsible. Accordingly no accrual was included in the financial statements with respect to this claim.

5. From time to time, the Company may become involved in litigation relating to claims arising in the ordinary course of business. Management does not believe the final disposition of these matters will have a material adverse effect on the financial position, results of operations or cash flows of the Company.

D. GUARANTEE

In July 2005 the Company signed a Bank Guarantee agreement with a commercial bank as a guarantee of a loan to a customer of Syneron Inc. The amount of the guarantee amounted to $3.5 million.

The guarantee was in the form of a deposit Syneron has deposited in the lending bank bearing annual interest of 6.75%. The terms of the interest for the deposit were favorable to the Company.

As a first degree collateral a major shareholder of this customer gave a personal guarantee to the bank.

On February 1, 2006 the bank released the assignment on the deposit used as collateral for the loan granted to the customer. The guarantee was then made null and void.

The Company follows the provisions of FASB Interpretation No. 45. However, it did not recognize a liability for the guarantee as of December 31, 2005 since the risk of execution of the Companyâ€™s guarantee as of that date was insignificant and any fair value would be immaterial.

**Note 12 â€“SHAREHOLDERSâ€™ EQUITY**

A. SHARE CAPITAL

1. On July 12, 2004, the board of directors and shareholders approved an increase in the authorized ordinary shares to 100,000,000 NIS 0.01 par value each, and a 3.4 for 1 stock split of all outstanding ordinary shares. All ordinary share and per share amounts as well as the outstanding stock options included in the financial statements, for periods prior to the stock split, have been retroactively restated to reflect the stock split. Prior to this action the Company had 4,007,801 preferred shares authorized and 5,992,199 ordinary shares authorized. Upon closing of the Offering (See Note 1D.), each outstanding preferred share was converted into 3.4 ordinary shares.

2. Ordinary shares confer upon their holders voting rights, the right to receive dividends and the right to share in equity upon liquidation of the Company.





**Note 12 â€“SHAREHOLDERSâ€™ EQUITY (Continued)**

A. SHARE CAPITAL (Continued)

3. During 2005 3,232,328 stock options were exercised into ordinary shares, in consideration of $11,666, including options exercised in the secondary offering (see Note 1D.)

4. During 2006 1,001,543 stock options and RSU were exercised into ordinary shares, in consideration of $332.

5. Certain of our officers, directors and major shareholders hold ordinary shares have the right to require the Company, on not more than one occasion, to file a registration statement on the appropriate form

under the Securities Act in order to register the resale of their ordinary shares.

B. STOCK OPTION PLAN

In 2001, the Companyâ€™s board of directors approved the grant of options to employees, consultants and directors of the Company, and reserved 2,614,158 ordinary shares for issuance pursuant to such grant of stock options. All options granted prior to 2003 were granted pursuant to specific option agreements rather than under a stock option plan. In 2003, the shareholders of the Company approved a stock option plan and an increase in the number of ordinary shares reserved for option issuances to up to 5,440,000 shares.

The exercise price of the options granted in 2001-2003 was equal to or was below the fair market value of the Companyâ€™s shares at the date of grant. Options granted generally vested over a period of two to four years, and will expire between 2008 and 2010. Any option which is cancelled or forfeited before expiration becomes available for future grants.

In May 2004, the Company decided to cancel the remaining un-allocated 279,783 options under the 2003 option pool. Upon expiry of any allocated options, such options and any ordinary shares previously reserved in the option pool for such options shall be automatically cancelled.

In 2004, the Company adopted the 2004 Israel Stock Option Plan (for Israeli residents) and the 2004 Incentive Stock Option Plan (for United States, Canada and the rest of the world) (collectively â€œthe 2004 Plansâ€□). The number of options approved under the 2004 Plans was 2,000,000 options, increasing annually according to the evergreen provision included in each of the 2004 Plans. The evergreen provision calls for the annual increase by the lesser of 2,000,000 options or 3% of the share capital, provided however that the Board of Directors may at its sole discretion decrease, at any given year, the increase of the number of options to what ever number it seems fit.

As of December 31, 2006 there were 2,768,607 options available for future grant.

Under the Companyâ€™s 2004 equity incentive plans (the â€œ2004 Plansâ€□), options are granted to employees, officers directors and consultants at an exercise price equal to at least the fair market value at the date of grant and are granted for periods not to exceed seven years. Options granted under the 2004 Plans generally vest over a period of one to three years of employment. Any options that are cancelled or forfeited before expiration become available for future grants. The Company can also issue a variety of other equity incentives under the 2004 Plans, but no such other equity incentives were outstanding as of December 31, 2005. In addition to granting stock options during 2006, the Company started to routinely grant Restricted Stock Units (RSUs) under the 2004 Plans. RSUs usually vest over a period of employment of up to three years. Upon vesting, the RSU beneficiary is entitled to receive a share per one RSU for no consideration ($0.01 per share). RSUs that are cancelled or forfeited become available for future grants.





**Note 12 â€“SHAREHOLDERSâ€™ EQUITY (Continued)**

B. STOCK OPTION PLAN (Continued)

The following is a summary of activities relating to the Companyâ€™s stock options and RSUs granted to employee among the Companyâ€™s various plans:

| | Year ended December 31, | | |
|---|---|---|---|
| | **2006** | **2005** | **2004** |

| | Amount of options | Weighted average exercise price | Amount of options | Weighted average exercise price | Amount of options | Weighted average exercise price |
|---|---|---|---|---|---|---|
| Options outstanding at beginning of year | 1,591,065 | $ 9.80 | 3,900,807 | $ 3.01 | 3,281,122 | $ 0.08 |
| Changes during the year: | | | | | | |
| Granted | 1,160,202 | $ 21.98 | 520,504 | $ 29.99 | 664,000 | $ 17.33 |
| Exercised | (956,478) | $ 0.35 | (2,801,381) | $ 4.13 | (44,030) | $ 0.07 |
| Forfeited and cancelled | (32,638) | $ 23.08 | (28,865) | $ 12.06 | (285) | $ 0.07 |
| Options outstanding at end of year | 1,762,151 | $ 21.87 | 1,591,065 | $ 9.80 | 3,900,807 | $ 3.01 |
| Options exercisable at end of year | 737,008 | $ 20.49 | 1,079,668 | $ 3.61 | 1,902,879 | $ 0.07 |

The intrinsic value of options and RSU exercised by employees during the years ended on December 31, 2006, 2005 and 2004 was $26,164, $78,228 and $1,213 respectively.

As of December 31, 2006, the total unrecognized estimated compensation cost related to non-vested stock options granted prior to that date was $ 16,069 which is expected to be recognized over a weighted average period of 1.45 years.

The information regarding the options and RSUs outstanding as of December 31, 2006, is as follows:

| | Outstanding | Weighted average remaining contractual life (years) | Aggregate intrinsic value (*) | Weighted average exercise price | Exercisable | Weighted average remaining contractual life (years) | Aggregate intrinsic value (*) | Weighted average exercise price |
|---|---|---|---|---|---|---|---|---|
| RSU | 130,927 | 6.50 | 3,530 | $ 0.01 | 23,497 | 6.50 | 637 | $ 0.01 |
| Options | 1,631,224 | 5.75 | 6,517 | $ 23.58 | 713,511 | 5.06 | 4,560 | $ 21.17 |
| | 1,762,151 | 5.80 | 10,047 | $ 21.87 | 737,008 | 5.11 | 5,197 | $ 20.49 |

| | Vested or expected to vest | Weighted average remaining contractual life (years) | Aggregate intrinsic value (*) | Weighted average exercise price |
|---|---|---|---|---|
| RSU | 130,927 | 6.50 | 3,551 | $ 0.01 |
| Options | 1,605,504 | 6.27 | 6,364 | $ 23.62 |
| | 1,736,431 | 6.30 | 9,915 | $ 21.76 |

(*) Calculation of aggregate intrinsic value is based on the share price of the Companyâ€™s common stock as of December 29, 2006 ($ 27.13 per share).

**Note 12 â€“SHAREHOLDERSâ€™ EQUITY (Continued)**

B. STOCK OPTION PLAN (Continued)

The following table summarizes information relating to RSUs granted to employee, as well as changes to such awards during 2006:

| | Year Ended December 31, 2006 | |
|---|---|---|
| | Number | Weighted average grant date fair value |
| Outstanding at the beginning of the year | - | - |
| Granted | 177,035 | $ 24.90 |
| Exercised | 41,824 | 26.21 |
| Forfeited | 4,284 | 27.71 |
| Outstanding as of December 31, 2006 | 130,927 | $ 24.70 |

The Companyâ€™s outstanding options and RSUs to consultants as of December 31, 2006 are as follows:

| | Issuance date | Options for Ordinary Shares | Exercise Price per Share | Options Exercisable | Exercisable Through |
|---|---|---|---|---|---|
| Options | October 20, 2003 | 45,065 | $ 0.07 | 45,065 | October 20, 2010 |
| RSU | May 8, 2006 | 49,040 | $ 0.01 | 4,460 | May 8, 2013 |
| RSU | November 2, 2006 | 14,880 | $ 0.01 | - | November 2, 2013 |
| | | 108,985 | | 49,525 | |

The weighted average fair values of options granted (including those granted to non-employees but excluding RSUs) during the years ended December 31, 2006, 2005 and 2004 were:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2006 | 2005 | 2004 |
| Weighted average exercise prices | $ 25.99 | $ 29.99 | $ 17.33 |
| Weighted average fair value on grant date | $ 12.24 | $ 8.12 | $ 10.59 |

**Note 12 â€“SHAREHOLDERSâ€™ EQUITY (Continued)**

B. STOCK OPTION PLAN (Continued)

The weighted-average estimated fair value of employee stock options granted during the 12 months ended December 31, 2006, was calculated using the binomial model with the following weighted-average assumptions (annualized percentages):

| | Year ended December 31, 2006 |
|---|---|
| Volatility | 65% |
| Risk-free interest rate | 4.36%-5.09% |
| Dividend yield | 0% |
| Post-vest cancellation rate *) | 0-5% |
| Suboptimal exercise factor **) | 2-3 |
| Expected life | 3.17-5.65 |

*) The post-vest cancellation rate was calculated on a monthly basis and is presented here on an annual basis.

**) The ratio of the stock price to strike price at the time of exercise of the option.

The Company used volatility data of comparable companiesâ€™ with similar characteristics to the Company, i.e. profitability, for calculating volatility in accordance with SFAS 123(R). The computation of historical volatility was derived from the comparable companiesâ€™ historical volatility for similar contractual terms. As a result of the above-mentioned calculations, the weighted-average volatility used for the 12 months ended December 31, 2006 was 65 %.

The risk-free interest rate assumption is based on observed interest rates appropriate for the term of the Companyâ€™s employee stock options. Weighted average interest rate used for the 12 months ended December 31, 2006 was 4.68 %.

The Company is required to assume a dividend yield as an input in the binomial model. The dividend yield assumption is based on the Companyâ€™s historical and expectation of future dividend payouts and may be subject to substantial change in the future. The dividend yield used for the twelve months ended December 31, 2006 was 0%.

The expected life of employee stock options represents the weighted-average period the stock options are expected to remain outstanding and is a derived output of the binomial model. The expected life of employee stock options is impacted by all of the underlying assumptions used in the Companyâ€™s model. The binomial model assumes that employeesâ€™ exercise behavior is a function of the optionâ€™s remaining contractual life and the extent to which the option is in-the-money (i.e., the average stock price during the period is above the strike price of the stock option). The binomial model estimates the probability of exercise as a function of these two variables based on the history of exercises and factors in also the post vesting termination rate of employees, as termination triggers the truncation of employee awards shortly thereafter. The expected life for options granted during the 12 months ended December 31, 2006 derived from the binomial model was a weighted average of 4.07 years.

As equity-based compensation expense recognized in the consolidated statement of income is based on awards

ultimately expected to vest, it should be reduced for estimated forfeitures. Statement 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.



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**Note 12 â€“SHAREHOLDERSâ€™ EQUITY (Continued)**

B. STOCK OPTION PLAN (Continued)

Pre-vesting forfeitures were estimated, in 2006 to be approximately 5.71%, for the full term of the award on a weighted average basis, based on historical experience.

The Companyâ€™s aggregate compensation cost for the 12 months ended December 31, 2006 totaled $ 8,256 thousand.

The total equity-based compensation expense related to all of the Companyâ€™s equity-based awards, recognized for 12 months ended December 31, 2006, was comprised as follows:

| | Year ended December 31, |
|---|---|
| | 2006 |
| Cost of goods sold | $ 267 |
| Research and development | 644 |
| Sales and Marketing | 5,054 |
| General and administrative | 2,291 |
| Total equity-based compensation expense before taxes | $ 8,256 |

A summary of the status of the Companyâ€™s nonvested RSU granted to employees as of December 31, 2006, and changes during the year ended December 31, 2006, is presented below:

| Nonvested shares | Shares | Weighted average grant date fair value |
|---|---|---|
| | (In thousands) | $ |
| Non-vested at January 1, 2006 | - | - |
| Granted | 177,035 | 24.90 |
| Vested | (67,925) | 25.94 |
| Forfeited | (4,284) | 27.71 |
| Non-vested at December 31, 2006 | 104,826 | 24.11 |

C. DIVIDENDS

The Company has never paid cash dividends to shareholders. The Company intends to retain future earnings for use in its business and does not anticipate paying cash dividends on its shares in the foreseeable future. Any future dividend policy will be determined by the Board of Directors and will be based upon conditions then existing, including results of operations, financial condition, current and anticipated cash needs, contractual restrictions and other conditions as the Board of Directors may deem relevant. In the event that cash dividends are declared in the future, such dividends will be paid in U.S. dollars subject to any statutory limitations.



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**Note 13 â€“INCOME TAXES**

A. ISRAELI TAXATION

**1. Corporate Tax Rate**

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 in 2010 and thereafter â€“ 25%.

**2. Measurement of taxable income under Israelâ€™s Income Tax (Inflationary Adjustments) Law, 1985:**

Results for tax purposes for the Company are measured and reflected in accordance with the change in the Israeli Consumer Price Index (â€œCPIâ€). As explained above in Note 2B, the consolidated financial statements are presented in U.S. dollars. The differences between the change in the Israeli CPI and in the NIS/US. dollar exchange rate cause a difference between taxable income and the income before taxes reflected in the consolidated financial statements.

In accordance with paragraph 9(f) of SFAS No. 109, the Company has not provided deferred income taxes on the above difference between the reporting currency and the tax basis of assets and liabilities.

**3. Tax benefits under Israelâ€™s Law for the Encouragement of Industry (Taxes), 1969:**

The Company is â€œIndustrial Companyâ€, as defined by the Law for the Encouragement of Industry (Taxes), 1969, and as such, the Company is entitled to certain tax benefits, mainly amortization of costs relating to know-how and patents over eight years, accelerated depreciation and the right to deduct public issuance expenses for tax purposes.

**4. Tax Benefits Under the Law for the Encouragement of Capital Investments, 1959 (the â€œLawâ€):**

The Investment Law empowers the Israeli Investment Center to grant Approved Enterprise status to capital investments in production facilities that meet certain relevant criteria (â€œApproved Enterpriseâ€) specified by the law and the regulations specified thereafter. The tax benefits derived from any Approved Enterprise relate only to taxable income attributable to the specific program of investment to which the status was granted.

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**Note 13 â€“INCOME TAXES (Continued)**

A. ISRAELI TAXATION (Continued)

On April 1, 2005, an amendment to the Investment Law came into effect (â€œthe Amendmentâ€) 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 Beneficiating Enterprise, such as provisions generally requiring that at least 25% of the Beneficiating Enterpriseâ€™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 no longer require Investment Center approval in order to qualify for tax benefits.

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 Companyâ€™s existing Approved Enterprise will generally not be subject to the provisions of the Amendment. As a result of the amendment, tax-exempt income generated under the provisions of the new law, as part of a new Beneficiating enterprise, will subject the Company to taxes upon distribution or liquidation.

The Company has been granted the status of â€œApproved Enterprisesâ€, under the Law, for an investments program for the period ending in 2004, and the status of â€Beneficiating Enterpriseâ€ according to the Amendment to the Law, for investments in 2005 (â€œProgramsâ€).

In accordance with the Law and the Amendment, Syneron Medical Ltd. has chosen to enjoy an â€œAlternative benefits programâ€ status. Accordingly, Syneron Medical Ltdâ€™s income attributed to the Programs is tax exempt from taxes on income derived there from for a period of ten years starting in the year in which the Company first generates taxable income.

Out of the Companyâ€™s retained earnings as of December 31, 2006 approximately $116 million are tax-exempt earnings attributable to its Approved Enterprise programs and $40 million are tax-exempt earnings attributable to its Beneficiating Enterprise program. The tax-exempt income attributable to the Approved and Beneficiating Enterprise cannot be distributed to shareholders without subjecting the Company to taxes. If these retained tax-exempt profits are distributed, the Company would be taxed at the reduced corporate tax rate applicable to such profits (currently â€“ 25% According to the implementation of the Law effectively 33%). According to the Amendment, tax-exempt income generated under the Beneficiating Enterprise status will be taxed upon dividend distribution or complete liquidation, whereas tax exempt income generated under the Approved Enterprise status will be taxed only upon dividend distribution (and not upon complete liquidation, where the tax liability will be incurred by the shareholders). As of December 31, 2006, if the income attributed to the Approved Enterprise were distributed as dividend, the Company would incur a tax liability of approximately $ 38 million. If income attributed to the Beneficiating Enterprise were distributed as dividend, including upon liquidation, the Company would incur a tax liability in the amount of $ 13 million.

These amounts will be recorded as an income tax expense in the period in which the Company declares the dividend.



**SYNERON MEDICAL LIMITED AND ITS SUBSIDIARIES**

Notes to the Consolidated Financial Statements

U.S. dollar in thousands, except share and per share data

**Note 13 â€“INCOME TAXES (Continued)**

A. ISRAELI TAXATION (Continued)

The Companyâ€™s board of directors has determined that it will 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 Companyâ€™s Approved and Beneficiating Enterprise programs as the undistributed tax exempt income is essentially permanent in duration.

The entitlement to the above benefits is conditional upon the Companyâ€™s fulfilling the conditions stipulated by the Law, regulations published there under and the certificates of approval for the specific investments in approved enterprises.

Should Syneron Ltd. fail to meet such requirements in the future, income attributable to its 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 program. The Companyâ€™s management believes that the Company is meeting the aforementioned conditions.

Income from sources other than the â€œApproved Enterpriseâ€ is subject to tax at regular Israeli corporate tax rate of 31%.

B. NON-ISRAELI SUBSIDIARIES

Non-Israeli subsidiaries are taxed based on tax laws in their countries of residence.

C. DEFERRED INCOME TAXES

Deferred income 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 Companyâ€™s deferred tax assets and liabilities are as follows:

| | December 31, | |
|---|---|---|
| | **2006** | **2005** |
| Deferred tax assets, net | | |
| Net operating loss carryforward of subsidiaries | $ 17,542 | $ 15,209 |
| FAS 123R- compensation costs | 1,170 | - |
| Deferred tax asset from available for sale marketable securities | 371 | 744 |
| Temporary differences | 1,097 | 1,494 |
| Total deferred tax asset before valuation allowance | 20,180 | 17,447 |
| Valuation allowance | (20,180) | (17,447) |
| Net deferred tax liabilities | $ - | $ - |

Notes to the Consolidated Financial Statements

U.S. dollar in thousands, except share and per share data

**Note 13 â€“INCOME TAXES (Continued)**

C. DEFERRED INCOME TAXES (Continued)

In assessing the realization of deferred tax assets, management considers whether it is more likely than not that the deferred tax assets will not be realized. The ultimate realization of the deferred tax assets is dependent upon the generation of future taxable income during the periods in which temporary differences are deductible and net operating losses are utilized.

The Israeli subsidiaries have available carryfoward tax loss of $1,928 to offset against future tax profits for an indefinite period.

The Canadian subsidiary estimated total available carryforward tax losses of $764 to offset against future tax profits for an indefinite period.

The Companyâ€™s subsidiary in the United States has estimated total available carryforward tax losses of $47,353 to offset against future tax profits for periods of 15-20 years expiring between 2017-2022.

Management currently believes that since the aforementioned subsidiaries have a history of losses it is more likely than not that the deferred tax regarding the loss carryforward and other temporary differences will not be realized in the foreseeable future.

Utilization of U.S. loss carryforwards may be subject to substantial annual limitation due to the â€œchange in ownershipâ€ provisions of the Internal Revenue Code of 1986 and similar state provisions. The annual limitations may result in the expiration of losses before utilization.

D. INCOME BEFORE TAXES ON INCOME

| | Year Ended December 31, | | |
|---|---|---|---|
| | **2006** | **2005** | **2004** |
| Domestic | $ 46,671 | $ 40,446 | $ 30,719 |
| Foreign | (5,528) | 1,367 | (2,759) |
| | $ 41,143 | $ 41,813 | $ 27,960 |

E. TAXES ON INCOME

| | Year Ended December 31, | | |
|---|---|---|---|
| | **2006** | **2005** | **2004** |
| Domestic (current taxes) | $ 1,417 | $ 750 | $ 620 |
| Foreign (current taxes) | 72 | - | - |
| | $ 1,489 | $ 750 | $ 620 |

**SYNERON MEDICAL LIMITED AND ITS SUBSIDIARIES**

Notes to the Consolidated Financial Statements

U.S. dollar in thousands, except share and per share data

**Note 13 â€“INCOME TAXES (Continued)**

F. 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 income statements, is as follows:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2006 | 2005 | 2004 |
| Income before taxes, as reported in the consolidated statements of income | $ 41,143 | $ 41,813 | $ 27,960 |
| Statutory tax rate | 31% | 34% | 35% |
| Theoretical tax expenses (benefits) on the above amount at the Israeli Statutory tax rate | 12,754 | 14,216 | 9,786 |
| Decrease in taxes resulting from "Approved Enterprise" benefits (1) | (14,368) | (12,864) | (9,951) |
| Difference in basis of measurement for tax purpose | (1,769) | (240) | 522 |
| Change in valuation allowance, net | 3,124 | (533) | 260 |
| Non-deductible stock based compensation | 1,684 | - | - |
| Non-deductible expenses | 134 | 68 | 3 |
| Others | (70) | 103 | - |
| Actual tax expense | 1,489 | 750 | 620 |
| (1) Per share amounts (basic) of the tax benefit resulting from the exemption | (0.59) | (0.53) | (0.50) |
| Per share amounts (diluted) of the tax benefit Resulting from the exemption | $ (0.58) | $ (0.47) | $ (0.39) |



**SYNERON MEDICAL LIMITED AND ITS SUBSIDIARIES**

Notes to the Consolidated Financial Statements

U.S. dollar in thousands, except share and per share data

**Note 14 â€“FINANCIAL INCOME, NET**

| | Year Ended December 31, |
|---|---|

| | 2006 | 2005 | 2004 |
|---|---|---|---|
| Income: | | | |
| Interest on cash equivalents | $ 472 | $ 377 | $ 27 |
| Gain and interest on available for sale marketable securities | 5,111 | 2,332 | 2,002 |
| Interest on short-term deposits and structured note | 333 | 1,011 | 483 |
| Foreign currency translation adjustments | 1,025 | (507) | (69) |
| Expenses: | | | |
| Interest on short-term credit and bank commissions | (127) | (85) | (59) |
| Loss on available for sale marketable securities | (322) | (47) | - |
| | $ 6,492 | $ 3,081 | $ 2,384 |

**Note 15 â€“MAJOR CUSTOMERS AND GEOGRAPHIC INFORMATION**

The Company applies Statement of Financial Accounting Standard No. 131 â€œDisclosures About Segments of an Enterprise and Related Informationâ€□, (â€œSFAS No. 131â€□). The Company operates in one reportable segment (see Note 1 for a brief description of the Companyâ€™s business). The total revenues are attributed to geographic areas based on the location of the end customer.

The following presents total revenues for the years ended and long-lived assets as of December 31, 2006, 2005 and 2004:

| | 2006 | | 2005 | | 2004 | |
|---|---|---|---|---|---|---|
| | Total Revenue | Long lived assets | Total Revenue | Long lived assets | Total Revenue | Long lived assets |
| North America | $ 66,582 | $ 348 | $ 54,406 | $ 298 | $ 32,550 | $ 176 |
| Europe | 30,662 | 35 | 13,984 | 39 | 9,915 | 40 |
| Asia Pacific | 16,289 | - | 16,609 | - | 14,327 | - |
| Israel | 700 | 2,257 | 1,730 | 2,027 | 625 | 1,626 |
| Others | 2,743 | - | 677 | - | 501 | - |
| | $ 116,976 | 2,640 | $ 87,406 | $ 2,364 | $ 57,918 | $ 1,842 |

Major customerâ€™s data as a percentage of total revenues:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2006 | 2005 | 2004 |
| Customer A | -* | -* | 10% |

* Less than 10%

U.S. dollar in thousands, except share and per share data

**Note 16 â€“EARNINGS PER SHARE**

The following table sets forth the computation of basic and diluted net earnings per share:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2006 | 2005 | 2004 |
| **Numerator:** | | | |
| Net income | $ 39,654 | $ 41,063 | $ 27,340 |
| **Denominator:** | | | |
| Weighted-average number of shares outstanding used in computing basic net earnings per share | 27,201,932 | 24,888,273 | 18,916,911 |
| Dilutive effect: stock options and RSUs | 398,786 | 2,775,589 | 5,166,076 |
| Total weighted-average number of share used-in Computing diluted net earnings per share | 27,600,718 | 27,663,862 | 24,082,987 |
| Basic net earning per share | 1.46 | 1.65 | 1.45 |
| Diluted net earning per share | 1.44 | 1.48 | 1.14 |

Anti-dilutive securities
The following outstanding options (prior to the application of the treasury shares method) were excluded from the computation of diluted net earnings per ordinary share for the periods presented because including them would have had an anti-dilutive effect.

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2006 | 2005 | 2004 |
| Options to purchase ordinary shares | 1,197,831 | - | 1,733 |



**SIGNATURES**

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

SYNERON MEDICAL LTD.

By: */s/ Doron Gerstel*
â€”â€”â€”

**EXHIBIT INDEX**

| | |
|---|---|
| 1.1 | Articles of Association of Registrant, as amended. |
| 2.1 | Form of Share Certificate (incorporated by reference to Exhibit 4.1 to our Registration Statement on Form F-1 filed July 14, 2004) |
| 4.1 | Turn-Key Manufacturing Agreement by and between R.F.L. Technologies Ltd. and A' to Z' Electronics Ltd. (incorporated by reference to Exhibit 10.1 to our Registration Statement on Form F-1/A filed August 3, 2004)^ |
| 4.2 | Turn-Key Manufacturing Agreement by and between Syneron Medical Ltd. and U.S.R. Electronics Systems (1987) Ltd. (incorporated by reference to Exhibit 10.2 to our Registration Statement on Form F-1/A filed August 3, 2004)^ |
| 4.3 | Turn-Key Manufacturing Agreement by and between Syneron Medical Ltd. and Fibernet Ltd. (incorporated by reference to Exhibit 10.3 to our Registration Statement on Form F-1/A filed August 3, 2004)^ |
| 4.4 | Patent License and Settlement Agreement dated March 4, 2004 by and between (a) Lumenis Inc. and Lumenis Ltd. and (b) Syneron Inc. and Syneron Medical Ltd. (incorporated by reference to Exhibit 10.4 to our Registration Statement on Form F-1/A filed August 3, 2004)^ |
| 4.5 | 2003 Stock Option Plan (incorporated by reference to Exhibit 10.5 to our Form F-1 filed July 14, 2004) |
| 4.6 | 2004 Israel Stock Option Plan (incorporated by reference to Exhibit 10.6 to our Registration Statement on Form F-1 filed July 14, 2004) |
| 4.7 | 2004 United States and Canada Stock Option Plan (incorporated by reference to Exhibit 10.7 to our Registration Statement on Form F-1 filed July 14, 2004) |
| 4.8 | Patent License and Settlement Agreement dated as of June 3, 2005 by and between Thermage, Inc. and Syneron Medical Ltd. (incorporated by reference to Exhibit 4.8 to our Annual Report on Form 20-F for the year ended December 31, 2004) |
| 4.9 | Joint Development and Supply Framework Agreement dated as of February 25, 2007 by and between The Procter & Gamble Company and Syneron Medical Ltd. ^ |
| 8.1 | List of Subsidiaries of the Registrant (incorporated by reference to Exhibit 21.1 to our Form F-1 filed July 14, 2004) |
| 12.1 | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer |
| 12.2 | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer |
| 13.1 | Section 1350 certifications of Periodic Financial Reports |
| 15.1 | Consent of Independent Registered Public Accounting Firm |

^ Portions of this exhibit have been omitted and filed separately with the secretary of the Securities and Exchange Commission pursuant to a confidential treatment request