

Mellanox Technologies, Ltd.  
Form 10-K  
February 16, 2018

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

Form 10-K

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the Fiscal Year Ended: December 31, 2017

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 Number 001-33299

MELLANOX TECHNOLOGIES, LTD.

(Exact name of registrant as specified in its charter)

Israel 98-0233400

(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification Number)

Mellanox Technologies, Ltd.

Beit Mellanox, Yokneam, Israel 20692

(Address of principal executive offices, including zip code)

+972-4-909-7200

(Registrant's telephone number, including area code)

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

Title of Each Class: \_\_\_\_\_ Name of Each Exchange on Which Registered:

Ordinary shares, nominal value NIS 0.0175 per share The NASDAQ Stock Market, Inc.

Securities registered pursuant to Section 12(g) of the Act: None

(Title of Class)

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

Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer,"

"accelerated filer" "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☐

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(Do not check if a  
smaller reporting company)

Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2). Yes ☐ No ☒

The aggregate market value of the registrant's ordinary shares, nominal value NIS 0.0175 per share, held by non-affiliates of the registrant on June 30, 2017, the last business day of the registrant's most recently completed second fiscal quarter, was approximately \$2.2 billion (based on the closing sales price of the registrant's ordinary shares on that date). Ordinary shares held by each director and executive officer of the registrant, as well as shares held by each holder of more than 10% of the ordinary shares known to the registrant, have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not a determination for other purposes. The total number of shares outstanding of the registrant's ordinary shares, nominal value NIS 0.0175 per share, as of February 9, 2018, was 51,781,340.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's Definitive Proxy Statement, to be filed with the Securities and Exchange Commission pursuant to Regulation 14A in connection with the 2018 Annual General Meeting of Shareholders of Mellanox Technologies, Ltd. (hereinafter referred to as the "Proxy Statement") are incorporated by reference in Part III of this report. Such Proxy Statement will be filed with the Securities and Exchange Commission not later than 120 days after the conclusion of the registrant's fiscal year ended December 31, 2017.

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## PART I

### SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report includes forward-looking statements. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends affecting the financial condition of our business. Forward-looking statements should not be read as a guarantee of future performance or results, and will not necessarily be accurate indications of the times at, or by which, such performance or results will be achieved.

Forward-looking statements are based on information available at the time those statements are made and/or management's good faith belief as of that time with respect to future events, and are subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed in or suggested by the forward-looking statements. Important factors that could cause such differences include, but are not limited to:

- the impact of worldwide economic conditions on us, our customers and our vendors;
- the impact of any acquisitions or investments in other companies;
- our ability to resume and maintain adequate revenue growth;
- market adoption of our Ethernet and InfiniBand solutions;
- our ability to accurately forecast customer demand;
- our dependence on a relatively small number of customers;
- competition and competitive factors;
- our ability to successfully introduce new products and enhance existing products;
- our dependence on third-party subcontractors;
- our ability to carefully manage the use of "open source" software in our products;
- a potential proxy contest for the election of directors at our annual meeting, which could distract our management, divert our resources and, the outcome of which may significantly impact the strategic direction of the Company and the Company's financial performance; and
- other risk factors included under "Risk Factors" in this report.

In addition, in this report, the words "believe," "may," "will," "estimate," "continue," "anticipate," "intend," "expect," "predict," "potential" and similar expressions, as they relate to us, our business and our management, are intended to identify forward-looking statements. In light of these risks and uncertainties, the forward-looking events and circumstances discussed in this report may not occur and actual results could differ materially from those anticipated or implied in the forward-looking statements.

You should not put undue reliance on any forward-looking statements. We assume no obligation to update forward-looking statements to reflect actual results, changes in assumptions or changes in other factors affecting forward-looking information, except to the extent required by applicable laws. If we update one or more forward-looking statements, no inference should be drawn that we will make additional updates with respect to those or other forward-looking statements.

When used in this report, "Mellanox," the "Company," "we," "our" or "us" refers to Mellanox Technologies, Ltd. and its consolidated subsidiaries unless the context requires otherwise.

## ITEM 1—BUSINESS

We are an integrated supplier of end-to-end high-performance interconnect products and solutions based on the Ethernet and InfiniBand standards. Our products facilitate efficient data transmission between servers, storage systems, communications infrastructure equipment and other embedded systems. We operate our business globally and offer products to customers at various levels of integration. The products we offer include integrated circuits ("ICs"), adapter cards, switch systems, multi-core and network processors, systems on a chip ("SOCs"), cables, modules, software, services and accessories. Together these products form a total end-to-end networking solution focused on computing, storage and communication applications used in multiple markets, including high-performance computing ("HPC"), cloud, Web 2.0, Big Data, machine learning, storage, telecommunications, financial services, and enterprise data centers ("EDC"). These solutions increase performance, application efficiency and improve return on investment. Through the successful development and implementation of multiple generations of our products, we have established significant expertise and competitive advantages.

As a leader in developing multiple generations of high-speed interconnect solutions, we have established strong relationships with our customers. Our products are incorporated in servers and associated networking solutions produced by the largest server vendors. We supply our products to leading storage and communications infrastructure equipment vendors, original design manufacturers ("ODMs"), distributors, and large end customers. Additionally, our products are used in embedded solutions.

We are one of the pioneers of InfiniBand, an industry-standard architecture for high-performance interconnects. We believe InfiniBand interconnect solutions deliver industry-leading performance, efficiency and scalability for clustered computing and storage systems that incorporate our products. In addition to supporting InfiniBand, our products also support industry-standard Ethernet transmission protocols providing unique product differentiation and connectivity flexibility. Our products serve as building blocks for creating reliable and scalable Ethernet and InfiniBand solutions with leading performance. We also believe that we are one of the major suppliers of 25, 50, and 100Gb/s Ethernet adapters, switches, and cables to the market, and the only end-to-end supplier of these products today. We are the leading provider of adapters at the 25, 40, 50, and 100Gb/s speeds, which helps to drive demand for our switch and cable products and provides us the opportunity to gain share in the Ethernet market as users upgrade from 1Gb/s or 10Gb/s directly to 25, 40, 50 or 100Gb/s.

On February 23, 2016, we completed our acquisition of EZchip Semiconductor, Ltd. ("EZchip"), for approximately \$782.2 million. The EZchip acquisition is a critical enabler of our strategy to become the leading broad-line supplier of intelligent interconnect solutions for the software-defined data centers. The addition of EZchip's products and expertise in security, deep packet inspection, video, and storage processing enhances our leadership position, and ability to deliver complete end-to-end, intelligent 10, 25, 40, 50, and 100Gb/s interconnect and processing solutions for advanced data center and edge platforms. The addition of multi-core and network processors allows us to offer our customers diverse and robust solutions to meet the growing demands of data-intensive applications used in high-performance computing, Web 2.0, cloud, secure data center, enterprise, telecom, database, financial services, and storage environments. The transaction closed on February 23, 2016 and was financed with cash on hand, and with \$280.0 million in term debt ("Term Debt").

We have been shipping our InfiniBand products since 2001 and our Ethernet products since 2007. During 2008, we introduced Virtual Protocol Interconnect, ("VPI"), into our ConnectX family of adapter ICs and cards. VPI provides the ability for an adapter to automatically sense whether a communications port is connected to Ethernet or InfiniBand. In 2015, we introduced the Spectrum family of 25, 50, and 100Gb/s Ethernet switches and the Switch-IB 2 smart InfiniBand switch.

In order to accelerate adoption of our high-performance interconnect solutions and our products, we work with leading vendors across related industries, including:

- processor and accelerator vendors such as AMD, ARM, IBM, Intel, Nvidia, Oracle, and Qualcomm;
- operating system vendors such as Microsoft and Red Hat; and
- software applications vendors such as Oracle, IBM and VMware.

We are a Steering Committee member of the InfiniBand Trade Association, ("IBTA"), and the OpenFabrics Alliance, ("OFA"), both of which are industry trade organizations that maintain and promote InfiniBand technology.

Additionally, OFA supports and promotes Ethernet solutions. We are a founding member of the 25 Gigabit Ethernet consortium. We are also a participating member of the Institute of Electrical and Electronic Engineers ("IEEE"), an organization that facilitates the advancement of the Ethernet standard, Ethernet Alliance and other industry organizations advancing various networking and storage related standards.

Our business headquarters are in Sunnyvale, California, and our engineering and manufacturing headquarters are in Yokneam, Israel. Our total assets as of December 31, 2017 and 2016 were approximately \$1,401.9 million and \$1,473.5 million, respectively. During the years ended December 31, 2017, 2016 and 2015, we generated approximately \$863.9 million,

\$857.5 million and \$658.1 million in revenues, respectively, and approximately \$(19.4) million, \$18.5 million and \$92.9 million in net income (loss), respectively.

We manage our business based on one reportable segment: the development, manufacturing, marketing and sales of interconnect products. Additional information required by this item is incorporated herein by reference to our consolidated financial statements and Note 13, "Geographic information and revenues by product group," of the Notes to Consolidated Financial Statements, included in Part IV, Item 15 of this report. The risks related to foreign operations and dependence on foreign operations are discussed under the section entitled "Risk Factors—Risks Related to Operations in Israel and Other Foreign Countries" under Part I, Item 1A of this report.

#### Industry Background

##### High-Performance Interconnect Market Overview and Trends

Computing and storage systems such as servers, supercomputers and storage arrays in today's data centers face a critical challenge of handling exponentially expanding volumes of transactions and data while delivering improved application performance, high scalability and reliability within economic and power constraints. High-performance interconnect solutions remove bottlenecks in communications between compute and storage resources through fast transfer of data, latency reduction, improved application processing by central processing unit ("CPU") utilization and efficient sharing of resources. The result is higher efficiency and better resource utilization, thereby delivering higher application performance with lower capital expenditures and operating expenses. Leading companies in HPC, cloud, Web 2.0, Big Data, machine learning, storage, telecommunications, financial services, and EDC utilize these technologies to develop distributed applications and services which are able to scale to serve millions of end customers.

Demand for computing power and data storage capacity continue to rise, fueled by the increasing reliance by enterprises on information technology ("IT") for everyday operations. Due to greater amounts of information to be processed, stored and retrieved, data centers rely on high-performance computing and high-capacity storage systems to optimize price/performance, minimize total cost of ownership, utilize power efficiently and simplify management. We believe that several IT trends impact the demand for interconnect solutions and the performance required from these solutions. These trends include:

- Transition to clustered computing and storage using connections among multiple standard components;
- Transition to multiple and multi-core processors in servers;
- Use of solid state Flash memory drives for data storage;
- Increasing deployments of software defined scale out storage;
- Enterprise data center infrastructure consolidation;
- Increasing deployments of mission critical, latency, or response time sensitive applications;
- Increasing deployments of converged and hyperconverged infrastructure;
- Increasing deployment of virtualized computing and virtualized networking resources to improve server utilization;
- Requirements by cloud providers to perform system provisioning, workload migrations and support multiple users' requests faster and more efficiently;
- Requirements by Web 2.0 data centers to increase their hardware utilization and to instantly scale up to large capacities;
- Big Data Analytics requirements for faster data access and processing to analyze increasingly large datasets and to provide real-time analysis; and
- Increasing deployment of artificial intelligence and machine learning applications that utilize massive amounts of data and compute resources and often require generating real-time results.

A number of semiconductor-based interconnect solutions have been developed to address different application requirements. These solutions include proprietary technologies as well as standard technologies, including Fibre Channel, Ethernet and InfiniBand, which was specifically created for high-performance computing, storage and embedded applications.

##### Challenges Addressed by High-Performance Interconnect

The trends described above indicate that high-performance interconnect solutions will play an increasingly important role in IT infrastructures and will drive strong growth in unit demand. Performance requirements for interconnect

solutions,

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however, continue to evolve and lead to high demand for solutions that are capable of resolving the following challenges to facilitate broad adoption:

**Performance limitations.** In clustered computing, cloud computing and storage environments, high bandwidth and low latency are key requirements to capture the full performance capabilities of a cluster. With the usage of multiple multi-core processors in server, storage and embedded systems, I/O bandwidth has not been able to keep pace with processor advances, creating performance bottlenecks. Fast data access has become a critical requirement to take advantage of the increased compute power of microprocessors. In addition, interconnect latency has become a limiting factor in a cluster's overall performance.

**Increasing complexity.** The increasing usage of clustered servers and storage systems as a critical IT tool has led to an increase in complexity of interconnect configurations. The number of configurations and connections has also proliferated in EDC, making systems increasingly complicated to manage and expensive to operate. Additionally, managing multiple software applications utilizing disparate interconnect infrastructures has become increasingly complex.

**Interconnect inefficiency.** The deployment of clustered computing and storage has created additional interconnect implementation challenges. As additional computing and storage systems, or nodes, are added to a cluster, the interconnect must be able to scale in order to provide the expected increase in cluster performance. Additionally, increased attention on data center energy efficiency is causing IT managers to look for ways to adopt more energy-efficient implementations.

**Limited reliability and stability of connections.** Most interconnect solutions are not designed to provide reliable connections when utilized in a large clustered environment, causing data transmission interruption. As more applications in EDCs share the same interconnect, advanced traffic management and application partitioning become necessary to maintain stability and reduce system down time. Such capabilities are not offered by most interconnect solutions.

**Poor price/performance economics.** In order to provide the required system bandwidth and efficiency, most high-performance interconnects are implemented with complex, multi-chip semiconductor solutions. These implementations have traditionally been extremely expensive.

In addition to Ethernet and InfiniBand, proprietary and other standards-based interconnect solutions, including Fibre Channel, are currently used in EDC, HPC and embedded markets. Performance and usage requirements, however, continue to evolve and are now challenging the capabilities of these interconnect solutions.

Proprietary interconnect solutions have been designed for use in supercomputer applications by supporting low latency and increased reliability. These solutions are only supported by a single vendor for product and software support, and there is no standard organization maintaining and facilitating improvements and changes to the technology. The number of supercomputers that use proprietary interconnect solutions has been declining largely due to the required use of proprietary software solutions, a lack of compatible storage systems and the availability of industry standards-based interconnects that offer superior price/performance.

Fibre Channel is an industry standard interconnect solution limited to storage applications. The majority of Fibre Channel deployments support 2, 4, 8 and 16Gb/s. Fibre Channel lacks a standard software interface, does not provide server cluster capabilities and remains more expensive relative to other standards-based interconnects. There have been industry efforts to support the Fibre Channel data transmission protocol over interconnect technologies including Ethernet (Fibre Channel over Ethernet) and InfiniBand (Fibre Channel over InfiniBand). The Fibre Channel market is declining as legacy storage area network moves to more modern Web 2.0 and cloud architectures based on converged, software defined, and scale out storage.

Ethernet is an industry-standard interconnect solution that was initially designed to enable basic connectivity between a local area network of computers or over a wide area network, where latency, connection reliability and performance limitations due to communication processing are non-critical. While Ethernet has a broad installed base at 1/10Gb/s and lower data rates, its overall efficiency, scalability and reliability have been less optimal than other interconnect solutions in high-performance computing, storage and communication applications. An increase to 25/40/50/100Gb/s bandwidth, a significant reduction in application latency and more efficient software solutions have improved Ethernet's capabilities to address specific high-performance applications that do not demand the highest performance

or scalability.

In the HPC, cloud, Web 2.0 and storage markets the predominant interconnects today are Ethernet and InfiniBand. In the EDC and embedded markets, the predominant interconnects today are Ethernet, Fibre Channel and InfiniBand. Based on our

knowledge of the industry, we believe there is significant demand for interconnect products that provide high bandwidth and better overall performance in these markets.

#### Advantages of InfiniBand

We believe that InfiniBand-based solutions have advantages compared to solutions based on alternative interconnect architectures. InfiniBand addresses the significant challenges within IT infrastructures by providing solutions for more demanding requirements of the high-performance interconnect market. More specifically, we believe that InfiniBand has the following advantages:

**Superior performance.** Compared to other interconnect technologies that were architected to have a heavy reliance on communication processing, InfiniBand was designed for implementation in an IC that relieves the CPU of communication processing functions. InfiniBand is able to provide superior bandwidth and latency relative to other existing interconnect technologies and has maintained this advantage with each successive generation of products. For example, our current InfiniBand adapters and switches provide bandwidth up to 100Gb/s, with end-to-end latency lower than a microsecond. In addition, InfiniBand fully leverages the I/O capabilities of PCI Express, a high-speed system bus interface standard.

The following table provides a bandwidth comparison of the various high-performance interconnect solutions:

	Proprietary	Fibre Channel	Ethernet	InfiniBand
Supported bandwidth of available solutions	2Gb/s - 100Gb/s	2Gb/s - 16Gb/s	1Gb/s - 100Gb/s	10Gb/s - 100Gb/s
Performance in terms of latency varies depending on system configurations and applications. According to independent benchmark reports, latency of InfiniBand solutions was less than half that of tested Ethernet solutions. Fibre Channel, which is used only as a storage interconnect, is typically not benchmarked on latency performance. HPC typically demands low latency interconnect solutions. In addition, there are increasing numbers of latency-sensitive applications in the cloud, Web 2.0, storage, machine learning and embedded markets, and, therefore, there is a trend towards using industry-standard Ethernet and InfiniBand solutions of 10Gb/s and faster, which are able to deliver lower latency than 1Gb/s Ethernet.				
<b>Reduced complexity.</b> While other interconnects require use of separate cables to connect servers, storage and communications infrastructure equipment, InfiniBand allows for the consolidation of multiple I/Os on a single cable or backplane interconnect, which is critical for blade servers and embedded systems. InfiniBand also consolidates the transmission of clustering, communications, storage and management data types over a single connection.				
<b>Highest interconnect efficiency.</b> InfiniBand was developed to provide efficient scalability of multiple systems. InfiniBand provides communication processing functions in hardware, relieving the CPU of this task, and enables the full resource utilization of each node added to the cluster.				
<b>Reliable and stable connections.</b> InfiniBand is one of the only industry standard high-performance interconnect solutions which provides reliable end-to-end data connections within the silicon hardware. In addition, InfiniBand facilitates the deployment of virtualization solutions, which allow multiple applications to run on the same interconnect with dedicated application partitions. As a result, multiple applications run concurrently over stable connections, thereby minimizing down time.				
<b>Superior price/performance economics.</b> In addition to providing superior performance and capabilities, standards-based InfiniBand solutions are generally available at a lower cost than other high-performance interconnects.				

#### Our InfiniBand Solutions

We provide comprehensive end-to-end 40/56/100Gb/s InfiniBand solutions, including switch and gateway ICs, adapter cards, switch, gateway and long-haul systems, cables, modules and software. We expect to introduce our 200Gb/s solutions in fiscal 2018. InfiniBand enables us to provide products that we believe offer superior performance and meet the needs of the most demanding applications, while also offering significant improvements in total cost of ownership compared to alternative interconnect technologies. As part of our comprehensive solution, we perform validation and interoperability testing from the physical interface to the applications software. Our expertise in performing validation and testing reduces time to market for our customers and improves the reliability of the fabric solution.

#### Our Ethernet Solutions

Advances in server virtualization, network storage and compute clusters have driven the need for faster network throughput to address application latency and availability problems in the Enterprise. To service this need, we provide a

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complete industry leading, end-to-end 10/25/40/50/100Gb/s Ethernet product portfolio for use in EDC, HPC, embedded environments, hyperscale, Web 2.0, and cloud data centers. Our portfolio of advanced Ethernet switch products supports the latest generation of Ethernet speeds and deliver wire speed forwarding for telco and data center environments. In addition, we provide a full range of Ethernet adapters at these speeds which incorporate the latest in Ethernet technology, including support for virtualization and RDMA over Converged Ethernet (RoCE). These solutions remove I/O bottlenecks in mainstream servers that limit application performance and support hardware-based I/O virtualization, providing dedicated adapter resources and guaranteed isolation and protection for virtual machines within the server.

#### VPI: Providing Connectivity to Ethernet and InfiniBand

Our VPI technology enables us to offer fabric-flexible products that concurrently support both Ethernet and InfiniBand with network ports having the ability to auto sense the type of switch to which it is connected and then take on the characteristics of that fabric. In addition, these products extend certain InfiniBand advantages to Ethernet fabrics, such as reduced complexity and superior price/performance, by utilizing existing, field-proven InfiniBand software solutions.

#### Our Strengths

We apply our strengths to enhance our position as a leading supplier of semiconductor-based, high-performance interconnect products. We consider our key strengths to include the following:

We have expertise in developing high-performance interconnect solutions. We were founded by a team with an extensive background in designing and marketing semiconductor solutions. Since our founding, we have been focused on high-performance interconnect and have successfully launched several generations of Ethernet and InfiniBand products. We believe we have developed strong competencies in integrating mixed-signal design and developing complex ICs. We also consider our software development capability as a key strength, and we believe that our software allows us to offer complete solutions. We have developed a significant portfolio of intellectual property ("IP"), and have 487 issued patents and pending design applications. We believe our experience, competencies and IP will enable us to remain a leading supplier of high-performance interconnect solutions.

We have expertise in developing high speed analog and optical components. We have unique design expertise and manufacturing capabilities required to build state of the art optical components, modules, and cable assemblies. We have developed significant know-how related to building advanced electrical and electro-optical components and sub-assemblies which combine electrical and optical components. In addition, we have design expertise to enable advanced transceiver chipsets for driving and receiving multimode optical signals and interfacing to low cost lasers and optical sensor technologies. We have developed significant manufacturing know how and automated assembly techniques to combine these optical and electrical components and build complete optical module and cables that are high performance, cost effective, high quality, and offer high reliability.

We believe we are the leading merchant supplier of InfiniBand ICs. We have gained in-depth knowledge of the InfiniBand standard through active participation in its development. We were first to market with InfiniBand products (in 2001) and InfiniBand products that support the standard PCI Express interface (in 2004), PCI Express 2.0 interface (in 2007) and PCI Express 3.0 (in 2011). We have sustained our leadership position through the introduction of several generations of products. Because of our market leadership, vendors have developed and continue to optimize their software products based on our semiconductor solutions. We believe that this places us in an advantageous position to benefit from continuing market adoption of our InfiniBand products.

■ We believe we are a leading merchant supplier of end to end Ethernet solutions and the leading merchant supplier of high performance Ethernet Adapters. We have gained significant expertise in Ethernet adapters and are the leading supplier of adapters with speeds of 25Gb/s and above with over 60% market share of adapters with speeds greater than 10Gb/s. We have developed significant expertise in Ethernet switches hardware and software and are gaining market share with our top of rack switch products and optical and copper cables and transceivers. Nine out of the top ten hyperscale, cloud and Web 2.0 data centers are using our products. Our engagement with these customers through several generations of designs has allowed us to understand the challenges faced by large scale deployments, and to develop features that solve these problems. We are the first to market with a complete end-to-end product portfolio of adapters, switches, and cables for the latest 25, 50, and 100Gb/s speeds of Ethernet. Our leading time to market,

customer engagements, advanced feature set, and rapid development cadence provides a significant competitive advantage over other vendors. We believe that this places us in an advantageous position to benefit from continuing market adoption of our Ethernet products.

We have a comprehensive set of technical capabilities to deliver innovative and reliable products. In addition to designing our ICs, we design standard and customized adapter card products, switch products, and optical cables and transceivers - providing us a deep understanding of the associated circuitry and component characteristics. We believe

this knowledge enables us to develop solutions that are innovative and can be efficiently implemented in target applications. We have devoted significant resources to develop our in-house test development capabilities, which enables us to rapidly finalize our mass production test programs, thus reducing time to market. We have synchronized our test platform with our outsourced testing provider and are able to conduct quality control tests with minimal disruption. We believe that because our capabilities extend from product definition, through IC design, and ultimately management of our high-volume manufacturing partners, we have better control over our production cycle and are able to improve the quality, availability and reliability of our products.

We have extensive relationships with our key original equipment manufacturers ("OEM") and hyperscale customers and many end users. Since our inception we have worked closely with major hyperscale customers and OEMs, including leading server, storage, communications infrastructure equipment and embedded systems vendors, to develop products that accelerate market adoption of our Ethernet and InfiniBand products. During this process, we have obtained valuable insight into the challenges and objectives of our customers, and gained visibility into their product development plans. We also have established end-user relationships with influential IT executives who allow us access to firsthand information about evolving market trends. We believe that our OEM customer and end-user relationships allow us to stay at the forefront of developments and improve our ability to provide compelling solutions to address their needs.

#### Our Strategy

Our goal is to be the leading supplier of end-to-end interconnect solutions for servers and storage that optimize data center performance for computing, storage and communications applications. To accomplish this goal, we intend to: Continue to develop leading, high-performance interconnect products. We will continue to expand our technical expertise and customer relationships to develop leading interconnect products. We are focused on extending our leadership position in high-performance interconnect technology and pursuing a product development plan that addresses emerging customer and end-user demands and industry standards. Our unified software strategy is to use a single software stack to support connectivity to Ethernet and InfiniBand with the same VPI enabled hardware adapter device.

Capture Ethernet market share with our adapter, switch, and cable products. We believe we are the market leader in Ethernet adapters with performance greater than 10Gb/s and the only provider of end-to-end solutions of adapters, switches, and cables at the latest 25, 40, 50, and 100Gb/s speeds. We plan to capture Ethernet market share as data centers transition from 10Gb/s to 25/40/50 or 100Gb/s. We believe we will be able to leverage our strength in the Ethernet adapter business to grow our Ethernet switch and cable business during the market transition to these advanced speeds.

Facilitate and increase the continued adoption of InfiniBand. We will facilitate and increase the continued adoption of InfiniBand in the high-performance interconnect marketplace by expanding our partnerships with key vendors that drive high-performance interconnect adoption, such as suppliers of processors, operating systems and other associated software. In conjunction with our OEM customers, we will expand our efforts to promote the benefits of InfiniBand and VPI directly to end users to increase demand for high-performance interconnect solutions.

Expand our presence with existing server OEM customers. We believe the leading server vendors are influential drivers of high-performance interconnect technologies to end users. We plan to continue working with and expanding our relationships with server OEMs to increase our presence in their current and future product platforms.

Broaden our customer base with storage, communications infrastructure and embedded systems OEMs. We believe there is a significant opportunity to expand our global customer base with storage, communications infrastructure and embedded systems OEMs. In storage solutions specifically, we believe our products are well suited to replace existing technologies such as Fibre Channel. We believe our adapter, SOC, and switch products are the basis of superior interconnect fabrics for unifying disparate storage interconnects, including back-end, clustering and front-end connections, primarily due to their ability to be a unified fabric and superior price/performance economics.

Leverage our fabless business model to deliver strong financial performance. We intend to continue operating as a fabless semiconductor company and consider outsourced manufacturing of our ICs, adapter cards, switches and cables to be a key element of our strategy. Our fabless business model offers flexibility to meet market demand and allows us to focus on delivering innovative solutions to our customers. We plan to continue to leverage the flexibility and

efficiency offered by our business.

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## Our Products

We provide complete solutions which are based on and meet the specifications of the Ethernet and InfiniBand standards. Our products include adapter ICs and cards (ConnectX®, Quantum, and Connect-IB™ product family) and switch ICs (InfiniScale®, SwitchX®, SwitchX®-2, Spectrum®, and Switch-IB™ product families) and systems, gateway ICs (BridgeX® product family) and gateway systems, long-haul systems (MetroX®), Bluefield family SOC multicore and SmartNIC processors, software, and LinkX® cables and transceivers. Our ConnectX® family of adapters and cards support both the Ethernet and InfiniBand interconnect standards. Our SwitchX® and SwitchX®-2 family of silicon and systems supports both Ethernet and InfiniBand, and includes gateways that support bridging from InfiniBand to Ethernet. Our Spectrum® switches support Ethernet standard and our Switch-IB switches support InfiniBand standard. Our long-haul systems expand the reach of InfiniBand and lossless Ethernet up to 80 kilometers. We have registered "Mellanox" and its logo, "Bluefield", "BridgeX", "Connect-IB", "ConnectX", "CoolBox", "CORE-Direct", "GPUDirect", "InfiniBridge", "InfiniHost", "InfiniScale", "Kotura" and its logo, "Mellanox Federal Systems", "Mellanox Hostdirect", "Mellanox Open Ethernet", "Mellanox Peerdirect", "Mellanox ScalableHPC", "Mellanox Technologies Connect. Accelerate. Outperform", "Mellanox Virtual Modular Switch", "MetroDX", "MetroX", "MLNX-OS", "Open Ethernet" logo, "PhyX", "SwitchX", "TestX", "The Generation of Open Ethernet" and its logo, "UFM", "Virtual Protocol Interconnect", "Quantum", "EZchip", "Tilera", and "Voltaire" and its logo as trademarks in the United States.

We have trademark applications pending to register in the United States "25G is the New 10G", "Accelio", "CloudX" logo, "CompustorX", "CYPUI", "FPGADirect", "HPC-X", "LinkX", "Mellanox Care", "Mellanox CloudX" and its logo, "Mellanox Multi-host", "Mellanox NEO", "Mellanox Opencloud" and its logo, "Mellanox OpenHPC", "Mellanox Socket Direct", "Mellanox Spectrum", "Mellanox StorageX", "Mellanox TuneX", "NVMEDirect", "One Switch. A world of options" slogan, "PlatformX", "PSiPHY", "SiPhy", "Spectrum", "StoreX", "STPU", "Switch-EN", "Switch-IB", "TuneX", "UCX", "UCX Unified Communication X" and "Unbreakable-Link".

We provide adapters to server, storage, communications infrastructure and embedded systems OEMs as ICs or standard card form factors with PCI Express interfaces. Adapter ICs or cards are incorporated into OEMs' server and storage systems to provide Ethernet and/or InfiniBand connectivity. All of our adapter products interoperate with standard programming interfaces and are compatible with previous generations, providing broad industry support. We support server operating systems including Linux, Windows, AIX, HP-UX, Solaris and VxWorks.

We provide our switch ICs and systems to server, storage, communications infrastructure and embedded systems OEMs to create switching equipment. To deploy an Ethernet or InfiniBand fabric, any number of server or storage systems that contain an adapter can be connected to a communications infrastructure system such as an Ethernet or InfiniBand switch. Our Spectrum Ethernet switch IC supports 10, 25, 40, 50, and 100Gb/s Ethernet throughput while Spectrum-2 is designed to support 200 and 400Gb/s Ethernet throughput. Our 8th generation InfiniBand switch IC (Switch-IB 2) supports up to 100Gb/s InfiniBand throughput. We have introduced switch systems that include 8-port, 12-port, 18-port, 36-port, 48-port, 64-port, 108-port, 216-port, 324-port and 648-port. Our family of multicore processors and the new Bluefield SOC device combine multiple processing cores together with advanced networking connectivity and accelerators for security, storage, and other intelligent networking applications.

Our products generally vary by the number and performance of Ethernet or InfiniBand ports, and the number of processor cores supported.

We also offer custom products that incorporate our ICs to select server and storage OEMs that meet their special system requirements. Through these custom product engagements we gain insight into the OEMs' technologies and product strategies.

We also provide our OEM customers software and tools that facilitate the use and management of our products. Our Linux, Windows, and VMware-based software enables applications to efficiently utilize the features of the interconnect. We have expertise in optimizing the performance of software that spans the entire range of upper layer protocols down through the lower level drivers that interface to our products. We provide a suite of software tools and a comprehensive management software solution, Unified Fabric Manager ("UFM"), Network Orchestration ("NEO"), and MLNX-OS, for managing, optimizing, testing and verifying the operation of Ethernet and InfiniBand switch fabrics. In addition, we provide a full suite of acceleration software (Messaging Accelerator ("VMA"), Fabric

Collective Accelerator ("FCA"), and Unstructured Data Accelerator ("UDA")) that further reduce latency, increase throughput, and offload CPU cycles, enhancing the performance of applications in multiple markets while eliminating the need for large investments in hardware infrastructure.

We provide an extensive selection of passive and active copper and optical cables and modules to enable Ethernet and InfiniBand connectivity at speeds up to 400Gb/s.

## Technology

We have technological core competencies in the design of high-performance interconnect ICs that enable us to provide a high level of integration, efficiency, flexibility and performance for our adapter and switch ICs. Our products integrate multiple complex components onto a single IC, including high-performance mixed-signal design, specialized communication processing functions and advanced interfaces.

### High-performance mixed-signal design

One of the key technology differentiators of our ICs is our mixed-signal data transmission SerDes technology. SerDes I/O directly drives the interconnect interface, which provides signaling and transmission of data over copper cables or fiber optic interfaces for longer distance connections. Additionally, we are able to integrate several of these high-performance SerDes onto a single, low-power IC, enabling us to provide the highest bandwidth, merchant switch ICs based on an industry-standard specification. We have developed a 26Gb/s SerDes I/O that is used in our ConnectX-4 adapter and Switch-IB and Spectrum switch silicon. Our 26Gb/s SerDes enables our ConnectX adapters to support 100Gb/s bandwidth (four 26Gb/s SerDes operating in parallel) in addition to providing a direct 10Gb/s connection to standard XFP and SFP+ fiber modules to provide long range Ethernet connectivity without the requirement of additional components, which saves power, cost and board space.

### Specialized communication processing and switching functions

We specialize in high-performance, low-latency design architectures that incorporate significant memory and logic areas requiring proficient synthesis and verification. Our adapter ICs are specifically designed to perform communication processing, effectively offloading this very intensive task from server and storage processors in a cost-effective manner. Our switch ICs are specifically designed to switch cluster interconnect data transmissions from one port to another with high bandwidth and low latency, and we have developed a packet switching engine and non-blocking crossbar switch fabric to address this.

We have developed a custom embedded Reduced Instruction Set Computer processor called InfiniRISC® that specializes in offloading network processing from the host server or storage system and adds flexibility, product differentiation and customization. We integrate a different number of these processors in a device depending on the application and feature targets of the particular product. Integration of these processors also shortens development cycles as additional features can be added by providing new programming packages after the ICs are manufactured, and even after they are deployed in the field.

### Advanced interfaces

In addition to Ethernet and InfiniBand interfaces, we also support other industry-standard, high-performance advanced interfaces such as PCI Express, which also utilize our mixed-signal SerDes I/O technology. PCI Express is a high-speed, chip-to-chip interface which provides a high-performance interface between the adapter and processor in server and storage systems. PCI Express and our high-performance interconnect interfaces are complementary technologies that facilitate optimal bandwidth for data transmissions along the entire connection starting from a processor of one system in the cluster to another processor in a different system.

### System hardware technology

In addition to silicon technology, we also provide system hardware technology that enables us to build high-density high-performance network adapters and switch systems. Our technology delivers end-to-end solutions that maximize data throughput through a given media at minimal hardware or power cost at very low Bit Error Rate.

### Software technology

In addition to hardware products, we develop and provide software stacks to expose standard I/O interfaces to the consumer applications on the host and to network management applications within the network. We also provide advanced interfaces and capabilities to enable application acceleration, efficient resource management and utilization in data centers, factoring cost, power and performance into the efficiency equation.

### Customers

HPC, cloud, Web 2.0 and embedded end-user markets for systems utilizing our products are mainly served by leading server, storage and communications infrastructure OEMs and ODMs. In addition, our customer base includes leading embedded systems OEMs that integrate computing, storage and communication functions that use high-performance interconnect solutions contained in a chassis which has been optimized for a particular environment.

Our products have broad adoption with multiple end customers across HPC, Web 2.0, cloud, EDC, financial services and storage markets; however, these markets are mainly served by leading server, storage, communications infrastructure and embedded system OEMs and ODMs. Therefore, we have derived a substantial portion of our revenues from a relatively small

number of OEM and ODM customers. In the years ended December 31, 2017, 2016 and 2015 sales to Hewlett Packard Enterprise ("HPE") accounted for 13%, 16% and 14%, respectively, of our total revenues. In the year ended December 31, 2017, sales to Dell Technologies ("Dell") accounted for 11% of our total revenues.

#### Backlog

Our sales are primarily made through standard purchase orders for delivery of products. Our manufacturing production is based on estimates and advance non-binding commitments from customers as to future purchases. We follow industry practice that allows customers to cancel, change or defer orders with limited advance notice prior to shipment. Given this practice, we do not believe that backlog is a reliable indicator of future revenue levels.

#### Sales and Marketing

We sell our products worldwide through multiple channels, including our direct sales force, our network of domestic and international sales representatives and independent distributors. We have strategically located marketing and sales personnel in the United States, Europe, China, Japan, India, Taiwan and Australia. Our sales directors focus their efforts on leading OEMs and target key decision makers. We are also in frequent communication with our customers' and partners' sales organizations to jointly promote our products and partner solutions into end-user markets. We have expanded our sales and business development teams to engage directly with end users promoting the benefits of our products which we believe creates additional demand for our customers' products that incorporate our products.

Our sales support organization is responsible for supporting our sales channels and managing the logistics from order entry to the delivery of products to our customers. In addition, our sales support organization is responsible for customer and revenue forecasts, customer agreements and program management for our large, multi-national customers.

To accelerate design and qualification of our products into our OEM customers' systems, and ultimately the deployment of our technology by our customers to end users, we have a field applications engineering ("FAE") team and a sales engineering team that provide direct technical assistance during the design-in process. In certain situations, our OEM customers will utilize our expertise to support their end-user customers jointly. Our technical support personnel have expertise in hardware and software, and have access to our development team to ensure proper technical expertise is provided to our OEM customers. Our FAE team provides OEM customers with design reviews of their systems in addition to technical training on the technology we have implemented in our products.

Our marketing team is responsible for creating and growing the brand of our company, product strategy and management, competitive analysis, marketing communications and raising the overall visibility of our company. The marketing team works closely with both the sales and research and development organizations to properly align development programs and product launches with market demands.

Our marketing team leads our efforts to promote our interconnect technology and our products to the entire industry by:

- assuming leadership roles within IBTA, OFA and other industry trade organizations;
- participating in tradeshow, press and analyst briefings, conference presentations and seminars for end-user education; and
- building and maintaining active partnerships with industry leaders whose products are important in driving Ethernet and InfiniBand adoption, including vendors of processors, operating systems and software applications.

#### Research and Development

Our research and development team is composed of experienced semiconductor designers, software developers and system designers. Our semiconductor design team has extensive experience in all phases of complex, high-volume design, including product definition and architecture specification, hardware code development, mixed-signal and analog design and verification. Our software team has extensive experience in development, verification, interoperability testing and performance optimization of software for use in computing and storage applications. Our systems design team has extensive experience in all phases of high-volume adapter card and custom switch designs including product definition and architectural specification, product design, design verification and transfer to production.

We design our products with careful attention to quality, reliability, cost and performance requirements. We utilize a methodology called Customer Owned Tooling ("COT"), where we control and manage a significant portion of timing,

layout design and verification in-house, before sending the semiconductor design to our third-party manufacturer. Although COT requires a significant up-front investment in tools and personnel, it provides us with greater control over the quality and reliability of our IC products, better product cost and superior time to market as opposed to relying on third-party verification services.

We choose first-tier technology vendors for our design tools and continue to maintain long-term relationships with our vendors to ensure timely support and updates. We also select a mainstream silicon manufacturing process only after it has proven its production worthiness. We verify that actual silicon characterization and performance measurements strongly correlate to models that were used to simulate the device while in design, and that our products meet frequency, power and thermal targets with good margins. Furthermore, we insert Design-for-Test circuitry into our IC products which increases product quality, provides expanded debugging capabilities and ultimately enhances system-level testing and characterization capabilities once the device is integrated into our customers' products. Frequent interaction between our silicon, software and systems design teams gives us a comprehensive view of the requirements necessary to deliver quality, high-performance products to our OEM customers. Our research and development expense was \$365.9 million in 2017, \$322.6 million in 2016 and \$252.2 million in 2015.

#### Manufacturing

We depend on third-party vendors to manufacture, package, assemble and production test our products as we do not own or operate facilities for semiconductor fabrication, packaging or production testing, or for board, cable or system assembly. By outsourcing manufacturing, we are able to avoid the high cost associated with owning and operating our own facilities while managing flexible capacity. This allows us to focus our efforts on the design and marketing of our products.

**Manufacturing and Testing.** We use Taiwan Semiconductor Manufacturing Company ("TSMC") for our CMOS process ICs and STMicroelectronics for our BiCMOS process ICs. We use Advanced Semiconductor Engineering ("ASE") and Amkor Technology Korea Inc. ("Amkor") to assemble, package and production test our IC products. We use Flextronics International Ltd. ("Flextronics") and Universal Scientific Industrial Co., Ltd. ("USI") to manufacture our standard and custom adapter card products and switch systems. In addition, we also use Comtel Electronics to manufacture some of our switch systems. We use several sub-contractors to manufacture our cables. We maintain close relationships with our suppliers, which improves the efficiency of our supply chain. We focus on mainstream processes, materials, packaging and testing platforms, and have a continuous technology assessment program in place to choose the appropriate technologies to use for future products. We provide all of our suppliers a 6-month rolling forecast, and generally receive their confirmation that they are able to accommodate our needs on a monthly basis. We have access to online production reports that provide up-to-date status information of our products as they flow through the manufacturing process. On a quarterly basis, we generally review lead-time, yield enhancements and pricing with all of our suppliers to obtain the optimal cost for our products.

**Quality Assurance.** We maintain an ongoing review of product manufacturing and testing processes. Our IC products are subjected to extensive testing to assess whether their performance exceeds the design specifications. We own Teradyne IC in-house testers providing immediate test data and the ability to generate characterization reports that are made available to our customers. Our adapter cards, switch system and cable products are subject to similar levels of testing and characterization, and are additionally tested for regulatory agency certifications such as Safety and EMC (radiation test) which are made available to our customers. We only use components on these products that are qualified to be on our approved vendor list.

#### Employees

As of December 31, 2017, we had 2,448 full-time employees and 275 part-time employees, including 1,819 full-time employees in research and development, 487 in sales and marketing, 311 in general and administrative and 106 in operations. 1,728 of our full-time employees and 264 of the part-time employees are located in Israel.

Certain provisions of the collective bargaining agreements between the Histadrut (General Federation of Labor in Israel) and the Coordination Bureau of Economic Organizations (including the Industrialists' Associations) are applicable to our employees in Israel by order of the Israeli Ministry of Economy and Industry, which extends such collective bargaining agreements to Israeli employers. These provisions primarily concern the length of the workweek, travel expended, and pension fund benefits for all employees. We generally provide our employees with benefits and working conditions above the required minimums.

We have never experienced any employment-related work stoppages and believe our relationship with our employees is good.

#### Intellectual Property

One of the key values and drivers for future growth of our high-performance interconnect IC, system hardware and software products is the IP we develop and use to improve them. We believe that the main value proposition of our high-performance interconnect products and success of our future growth will depend on our ability to protect our IP. We rely on a combination of patent, copyright, trademark, mask work, trade secret and other IP laws, both in the United States and internationally, as well as confidentiality, non-disclosure and inventions assignment agreements with our employees, customers,



partners, suppliers and consultants to protect and otherwise seek to control access to, and distribution of, our proprietary information and processes. In addition, we have developed technical knowledge, which, although not patented, we consider to be significant in enabling us to compete. The proprietary nature of such knowledge, however, may be difficult to protect and we may be exposed to competitors who independently develop the same or similar technology or gain access to our knowledge.

The semiconductor industry is characterized by frequent claims of infringement and litigation regarding patent and other IP rights. We, like other companies in the semiconductor industry, believe it is important to aggressively protect and pursue our IP rights. Accordingly, to protect our rights, we may file suit against parties whom we believe are infringing or misappropriating our IP rights. In addition, we may engage in litigation with parties that claim that we infringed their patents or misappropriated or misused their trade secrets. Such litigations could result in substantial cost and may divert management's attention away from day-to-day operations. We may not prevail in these lawsuits. If any party infringes or misappropriates our IP rights, this infringement or misappropriation could materially adversely affect our business and competitive position.

As of December 31, 2017, we had 410 issued patents and five registered designs in the United States, five issued patents in Israel and 72 issued patents and four registered designs in other countries. We had 250 patent applications and one design application pending in the United States, one patent application pending in Israel, and 60 patent applications pending in other countries, which cover aspects of the technology in our products. The term of any issued patent in the United States and Israel is 20 years from its priority date and if our applications are pending for a long time period, we may have a correspondingly shorter term for any patent that may be issued. In addition, the lives of acquired patents may also have a shorter term depending upon their acquisition date and the issue date of respective patent. Our present and future patents may provide only limited protection for our technology and may not be sufficient to provide competitive advantages to us. Furthermore, we cannot assure you that any patents will be issued to us as a result of our patent applications.

The risks associated with patents and intellectual property are more fully discussed under the section entitled "Risk Factors" under Part I, Item 1A of this report.

#### Competition

The markets in which we compete are highly competitive and are characterized by rapid technological change, evolving industry standards and new demands on features and performance of interconnect solutions. We compete primarily on the basis of:

- price/performance;
- time to market;
- features and capabilities;
- wide availability of complementary software solutions;
- reliability;
- power consumption and latency;
- customer and application support;
- product roadmap;
- intellectual property; and
- reputation.

We believe that we compete favorably with respect to each of these criteria. Many of our current and potential competitors, however, have longer operating histories, significantly greater resources, greater economies of scale, stronger name recognition and a larger base of customers than we do. This may allow them to respond more quickly to new or emerging technologies or changes in customer requirements. Many of our competitors also have significant influence in the semiconductor industry. They may be able to introduce new technologies or devote greater resources to the development, marketing and sales of their products than we can. Furthermore, in the event of a manufacturing capacity shortage, these competitors may be able to manufacture products when we are unable to do so.

We compete with other providers of semiconductor-based high-performance interconnect products based on InfiniBand, Ethernet, Fibre Channel and proprietary technologies. With respect to InfiniBand products, we compete with Intel Corporation's proprietary Omni-Path interconnects. The leading IC vendors that provide Ethernet and Fibre

Channel products to the market include Intel Corporation (“Intel”), Broadcom Limited ("Broadcom"), Marvell Technology Group, and Cavium. The leading Ethernet switch system vendors include Cisco Systems, Inc., Juniper Networks, Inc. and Arista Networks, Inc. In embedded

markets, we typically compete with interconnect technologies that are developed in-house by system OEM vendors and created for specific applications.

#### Acquisition

In February 2016, we completed the acquisition of EZchip, for approximately \$782.2 million. EZchip was a public company formed under the laws of the State of Israel specializing in network-processing semiconductors. The EZchip acquisition is a step in our strategy to become the leading broad-line supplier of intelligent interconnect solutions for the software-defined data centers. The addition of EZchip's products and expertise in security, deep packet inspection, video, and storage processing enhances our leadership position, and ability to deliver complete end-to-end, intelligent interconnect and processing solutions for advanced data center and edge platforms. The combined company has diverse and robust solutions to enable customers to meet the growing demands of data-intensive applications used in high-performance computing, Web 2.0, cloud, secure data center, enterprise, telecom, database, financial services, and storage environments.

Under the Agreement, EZchip became our wholly owned subsidiary. The acquisition closed on February 23, 2016. At the closing, we assumed each unvested option and restricted share units ("RSUs") of EZchip on the same terms and conditions as were applicable to such EZchip option or RSUs (including with respect to vesting), and converted it to an equivalent equity award to receive our ordinary shares appropriately adjusted to take into account the transaction consideration. All vested, in-the-money EZchip stock options and RSUs, after giving effect to any acceleration or vesting that occurs as a result of the transaction, were cashed out. Any vested out-of-the-money EZchip options were cancelled for no consideration. The acquisition and related transaction expenses were financed with cash on hand and with \$280.0 million in term debt. For additional information regarding the debt financing, see Note 15 to the consolidated financial statements. Acquisition-related expenses for the EZchip acquisition for the years ended December 31, 2017 and 2016 were \$0.3 million and \$8.3 million, respectively, and primarily consisted of investment banking, consulting, and other professional fees.

For further discussion of our acquisitions, see Note 3 to the consolidated financial statements.

#### Additional Information

We were incorporated under the laws of Israel in March 1999. Our ordinary shares began trading on The NASDAQ Global Market as of February 8, 2007 under the symbol "MLNX". Prior to February 8, 2007, our ordinary shares were not traded on any public exchange.

Our principal executive offices in the United States are located at 350 Oakmead Parkway, Suite 100, Sunnyvale, California 94085, and our principal executive offices in Israel are located at Beit Mellanox, Yokneam, Israel 20692. The majority of our assets are located in Israel. Our telephone number in Sunnyvale, California is (408) 970-3400, and our telephone number in Yokneam, Israel is +972-4-909-7200. Jacob Shulman, our Chief Financial Officer, is our agent for service of process in the United States, and is located at our principal executive offices in the United States. Our website address is [www.mellanox.com](http://www.mellanox.com). Information contained on our website is not a part of this report and the inclusion of our website address in this report is an inactive textual reference only.

#### Available Information

We file reports with the Securities and Exchange Commission ("SEC"), including annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any other filings required by the SEC. We post on the Investor Relations pages of our website, [ir.mellanox.com](http://ir.mellanox.com), links to our filings with the SEC, our Code of Business Conduct and Ethics, our Complaint and Investigation Procedures for Accounting, Internal Accounting Controls, Fraud or Auditing Matters and the charters of our Audit, Compensation, Technology and Nominating and Corporate Governance Committees of our board of directors and the charter of our Disclosure Committee. Our filings with the SEC, including our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any other filings required by the SEC, are posted on our website as soon as reasonably practical after they are electronically filed with, or furnished to, the SEC. You can also obtain copies of these documents, without charge to you, by writing to us at: Investor Relations, c/o Mellanox Technologies, Inc., 350 Oakmead Parkway, Suite 100, Sunnyvale, California 94085 or by emailing us at: [ir@mellanox.com](mailto:ir@mellanox.com). All these documents and filings are available free of charge. Please note that information contained on our website is not incorporated by reference in, or considered to be a part of, this report. Further, a copy of this report on Form 10-K is located at the SEC's Public Reference Room

at 100 F Street, NE, 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. The SEC maintains an Internet site that contains reports, proxy and information statements and other information regarding our filings at [www.sec.gov](http://www.sec.gov).

## ITEM 1A—RISK FACTORS

Investing in our ordinary shares involves a high degree of risk. You should carefully consider the following risk factors, in addition to the other information set forth in this report, before purchasing our ordinary shares. Each of these risk factors could harm our business, financial condition and results of operations, as well as decrease the value of an investment in our ordinary shares.

### Risks Related to Our Business

The semiconductor industry may be adversely impacted by worldwide economic uncertainties which may cause our revenues and profitability to decline.

We operate primarily in the semiconductor industry, which is cyclical and subject to rapid change and evolving industry standards. From time to time, the semiconductor industry has experienced significant downturns characterized by decreases in product demand and excess customer inventories. Economic volatility can cause extreme difficulties for our customers and vendors to accurately forecast and plan future business activities. This unpredictability could cause our customers to reduce spending on our products and services, which would delay and lengthen sales cycles. Furthermore, during challenging economic times our customers and vendors may face issues gaining timely access to sufficient credit, which could affect their ability to make timely payments to us. As a result, we may experience growth patterns that are different than the end demand for products, particularly during periods of high volatility.

We cannot predict the timing, strength or duration of any economic slowdown or recovery or the impact of such events on our customers, our vendors or us. The combination of our lengthy sales cycle coupled with challenging macroeconomic conditions could have a compound impact on our business. The impact of market volatility is not limited to revenue but may also affect our product gross margins and other financial metrics. Any downturn in the semiconductor industry may be severe and prolonged, and any failure of the industry to fully recover from downturns could seriously impact our revenue and harm our business, financial condition and results of operations.

Leverage incurred in connection with our acquisition of EZchip in February 2016 could adversely affect our ability to raise additional capital to fund our operations, limit our ability to react to changes in the economy or our industry, expose us to interest rate risk to the extent the interest rate on our variable rate debt increases and prevent us from meeting our obligations under the terms of the Term Debt.

As a result of the acquisition of EZchip and the related Term Debt, we have become leveraged. As of December 31, 2017, we had \$74.0 million outstanding principal under the Term Debt. Our indebtedness could have more important consequences, including:

- increasing our vulnerability to adverse general economic and industry conditions;
- requiring us to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness, thereby reducing the availability of our cash flow to fund working capital, capital expenditures, research and development efforts, the execution of our business strategy, acquisitions and other general corporate purposes;
- limiting our flexibility in planning for, or reacting to, changes in the economy and the semiconductor industry;
- placing us at a competitive disadvantage compared to our competitors with less indebtedness;
- exposing us to interest rate risk to the extent of our variable rate indebtedness; and
- making it more difficult to borrow additional funds in the future to fund growth, acquisitions, working capital, capital expenditures and other purposes.

The Term Debt requires payment of principal and accrued interest during the three years after the closing of the acquisition of EZchip. In addition, if we were to experience a change of control, this would trigger an event of default under the Term Debt, which would permit the lenders to immediately declare the loans due and payable in whole or in part. In either such event, we may not have sufficient available cash to repay such debt at the time it becomes due, or be able to refinance such debt on acceptable terms or at all. Any of the foregoing could materially and adversely affect our business, financial condition and results of operations.

Our Term Debt imposes certain restrictions on our business.

The Term Debt contains a number of covenants imposing certain restrictions on our business. These restrictions may affect our ability to operate our business and to take advantage of potential business opportunities as they arise. The restrictions placed on us include limitations on our ability to:



- incur additional indebtedness and issue preferred or redeemable shares;
- incur or create liens;
- consolidate, merge or transfer all or substantially all of our assets;
- make investments, acquisitions, loans or advances or guarantee indebtedness;
- engage in sale and lease back transactions;
- pay dividends or make other distributions;
- redeem or repurchase shares or make other restricted payments; and
- engage in transactions with affiliates.

The foregoing restrictions could limit our ability to plan for, or react to, changes in market conditions or our capital needs. We do not know whether we will be granted waivers under, or amendments to, the Term Debt if for any reason we are unable to meet these requirements, or whether we will be able to refinance our indebtedness on terms acceptable to us, or at all.

The breach of any of these covenants or restrictions could result in a default under the Term Debt. In addition, the Term Debt contains cross-default provisions that could result in an acceleration of amounts outstanding under the Term Debt if certain events of default occur under any of our material debt instruments. If we are unable to repay these amounts, lenders having secured obligations, including the lenders under the Term Debt, could proceed against the collateral securing that debt. Any of the foregoing would have a material adverse effect on our business, financial condition, and results of operations.

Servicing the debt incurred under the Term Debt will require a significant amount of cash, and we may not have sufficient cash flow from our business to pay our debt.

Our ability to make scheduled payments of the principal of, to pay interest on, and to refinance our debt, depends on our future performance, which is subject to economic, financial, competitive, and other factors beyond our control. Our business may not continue to generate cash flow from operations in the future sufficient to satisfy our obligations under the Term Debt and any future indebtedness we may incur and to make necessary capital expenditures. If we are unable to generate such cash flow, we may be required to adopt one or more alternatives, such as reducing or delaying investments or capital expenditures, selling assets, refinancing or obtaining additional equity capital on terms that may be onerous or highly dilutive. Our ability to refinance our outstanding indebtedness or future indebtedness will depend on the capital markets and our financial condition at such time. We may not be able to engage in any of these activities or engage in these activities on desirable terms, when needed, which could result in a default on our indebtedness. We may pursue acquisitions of other companies or new or complementary products, technologies and businesses, which could harm our operating results, may disrupt our business and could result in unanticipated accounting charges.

Our growth depends upon market growth, our ability to enhance our existing products, and our ability to introduce new products on a timely basis. We intend to continue to address the need to develop new products and enhance existing products through acquisitions of other companies, product lines, technologies, and personnel.

Acquisitions create additional material risk factors for our business that could cause our results to differ materially and adversely from our expected or projected results. Such risk factors include:

- difficulties in integrating the operations, systems, technologies, products, and personnel of the acquired companies, particularly companies with large and widespread operations and/or complex products;
- the diversion of management's attention from normal daily operations of the business and the challenges of managing larger and more widespread operations resulting from acquisitions;
- possible disruption to the continued expansion of our product lines;
- potential changes in our customer base and changes to the total available market for our products;
- reduced demand for our products;
- potential difficulties in completing projects associated with in-process research and development intangibles;
- the use of a substantial portion of our cash resources and incurrence of significant amounts of debt;
- significantly increase our interest expense, leverage and debt service requirements as a result of incurring debt;





the impact of any such acquisition on our financial results;  
internal controls may become more complex and may require significantly more resources to ensure they remain effective;  
negative customer reaction to any such acquisition; and  
assuming the liabilities of the acquired company.

Acquisitions present a number of other potential risks and challenges that could disrupt our business operations. For example, we may not be able to successfully negotiate or finance the acquisition on favorable terms. If an acquired company also has inventory that we assume, we will be required to write up the carrying value of that inventory to its fair value. When that inventory is sold, the gross margins for those products are reduced and our gross margins for that period are negatively affected. Furthermore, the purchase price of any acquired businesses may exceed the current fair values of the net tangible assets of such acquired businesses. As a result, we would be required to record material amounts of goodwill, acquired in-process research and development and other intangible assets, which could result in significant impairment and acquired in-process research and development charges and amortization expense in future periods. These charges, in addition to the results of operations of such acquired businesses and potential restructuring costs associated with an acquisition, could have a material adverse effect on our business, financial condition and results of operations. We cannot forecast the number, timing or size of future acquisitions, or the effect that any such acquisitions might have on our operating or financial results. Furthermore, potential acquisitions, whether or not consummated, will divert our management's attention and may require considerable cash outlays at the expense of our existing operations. In addition, to complete future acquisitions, we may issue equity securities, incur debt, assume contingent liabilities or have amortization expenses and write-downs of acquired assets, which could adversely affect our profitability.

We have made and may in the future pursue investments in other companies, which could harm our operating results. We have made, and could make in the future, investments in technology companies, including privately-held companies in the development stage. Many of these private equity investments are inherently risky because these businesses may never develop, and we may incur losses related to these investments. In addition, we have written down the carrying value of these investments in the past and may be required to write down the carrying value of these investments in the future to reflect other-than-temporary declines in their value, which could have a material adverse effect on our business, financial position and results of operations.

The adoption of InfiniBand is largely dependent on third-party vendors and end users and InfiniBand may not be adopted at prior rates or to the extent that we anticipate.

While the usage of InfiniBand has increased since its first specifications were completed in October 2000, continued adoption of InfiniBand is dependent on continued collaboration and cooperation among IT vendors. In addition, the end users that purchase IT products and services from vendors must find InfiniBand to be a compelling solution to their IT system requirements. We cannot control third-party participation in the development of InfiniBand as an industry standard technology. We rely on server, storage, communications infrastructure equipment and embedded systems vendors to incorporate and deploy InfiniBand ICs in their systems. InfiniBand may fail to effectively compete with other technologies, which may be adopted by vendors and their customers in place of InfiniBand. The adoption of InfiniBand is also affected by the general replacement cycle of IT equipment by end users, which is dependent on factors unrelated to InfiniBand. These factors may reduce the rate at which InfiniBand is incorporated by our current server vendor customers and impede its adoption in the storage, communications infrastructure and embedded systems markets, which in turn would harm our ability to sell our InfiniBand products.

We have limited visibility into customer and end-user demand for our products and generally have short inventory cycles, which introduce uncertainty into our revenue and production forecasts and business planning and could negatively impact our financial results.

Our sales are made on the basis of purchase orders rather than long-term purchase commitments. In addition, our customers may defer purchase orders. We place orders with the manufacturers of our products according to our estimates of customer demand. This process requires us to make multiple demand forecast assumptions with respect to both our customers' and end users' demands. It is more difficult for us to accurately forecast end-user demand because we do not sell our products directly to end users. In addition, the majority of our adapter card, switch system and cable

businesses are conducted on a short order fulfillment basis, introducing more uncertainty into our forecasts. Because of the lead time associated with fabrication of our semiconductors, forecasts of demand for our products must be made in advance of customer orders. In addition, we base business decisions regarding our growth on our forecasts for customer demand. As we grow, anticipating customer demand may become increasingly difficult. If we overestimate customer demand, we may purchase products from our manufacturers

that we may not be able to sell and may over-burden our operations. Conversely, if we underestimate customer demand or if sufficient manufacturing capacity were unavailable, we would forego revenue opportunities and could lose market share or damage our customer relationships.

In addition, the majority of our revenues are derived from customer orders received and fulfilled in the same quarterly period. If we overestimate customer demand, we could miss our quarterly revenue targets, which could have a material adverse effect on our financial results.

We depend on a small number of customers for a significant portion of our sales, and the loss of any one of these customers will adversely affect our revenues.

A small number of customers account for a significant portion of our revenues. Because the majority of servers, storage, communications infrastructure equipment and embedded systems are sold by a relatively small number of vendors, we expect that we will continue to depend on a small number of customers to account for a significant percentage of our revenues for the foreseeable future. Our customers, including our most significant customers, are not obligated by long-term contracts to purchase our products and may cancel orders with limited potential penalties. If any of our large customers reduces or cancels its purchases from us for any reason, it could have an adverse effect on our revenues and results of operations. See Part I, Item 1, "Business-Customers" for more information about our customers.

We face intense competition and may not be able to compete effectively, which could reduce our market share, net revenues and profit margin.

The markets in which we operate are extremely competitive and are characterized by rapid technological change, continuously evolving customer requirements and fluctuating average selling prices. We may not be able to compete successfully against current or potential competitors.

Some of our customers are also IC and switch suppliers and already have in-house expertise and internal development capabilities similar to ours. Licensing our technology and supporting such customers entails the transfer of intellectual property rights that may enable such customers to develop their own products and solutions to replace those we are currently providing to them. Consequently, these customers may become competitors to us. Further, each new design by a customer presents a competitive situation. In the past, we have lost design wins to divisions within our customers and this may occur again in the future. We cannot predict whether these customers will continue to compete with us, whether they will continue to be our customers or whether they will continue to buy products from us at the same volumes. Competition could increase pressure on us to lower our prices and could negatively affect our profit margins. Many of our current and potential competitors have longer operating histories, significantly greater resources, greater economies of scale, stronger name recognition and larger customer bases than we have. This may allow them to respond more quickly to new or emerging technologies or changes in customer requirements. In addition, these competitors may have greater credibility with our existing and potential customers. If we do not compete successfully, our market share, revenues and profit margin may decline, and, as a result, our business may be adversely affected. There has been a trend toward industry consolidation in our markets for several years, as companies attempt to improve the leverage of growing research and development costs, strengthen or hold their market positions in an evolving industry or are unable to continue operations. Companies that are strategic alliance partners in some areas of our business may acquire or form alliances with our competitors, thereby reducing their business with us. We believe that industry consolidation may result in stronger competitors that are better able to compete as sole-source vendors for customers. This could lead to more variability in our operating results and could have a material adverse effect on our business, financial condition and results of operations.

See Part I, Item 1, "Business-Competition" for more information about our competitors.

Winning business is subject to lengthy, competitive selection processes that often require us to incur significant expense, from which we may ultimately generate no revenues.

Our business is dependent on us winning competitive bid selection processes, known as "design wins," to develop semiconductors for use in our customers' products. These selection processes are typically lengthy and can require us to incur significant design and development expenditures and to dedicate scarce engineering resources in pursuit of a single customer opportunity. We may not win the competitive selection process and may never generate any revenue despite incurring such expenditures.

Furthermore, winning a product design does not guarantee sales to a customer. We may experience delays in generating revenue as a result of the lengthy development cycle typically required, or we may not realize as much revenue as anticipated. In addition, a delay or cancellation of a customer's plans could materially and adversely affect our financial results, as we may have incurred significant expense in the design process and generated little or no revenue. Customers could choose at any time

to stop using our products or may fail to successfully market and sell their products, which could reduce the demand for our products and cause us to hold excess inventory, thereby materially adversely affecting our business, financial condition and results of operations.

The timing of design wins is unpredictable and implementing production for a major design win, or multiple design wins occurring at or around the same time, may strain our resources and those of our contract manufacturers. In such instances, we may be forced to dedicate significant additional resources and incur additional, unanticipated costs and expenses, which may have a material adverse effect on our results of operations.

Finally, some customers will not purchase any products from us, other than limited numbers of evaluation units, until they qualify the products and/or the manufacturing line for the products. The qualification process can take significant time and resources and we may not always be able to satisfy the qualification requirements of these customers. Delays in qualification or failure to qualify our products may cause a customer to discontinue use of our products and result in a significant loss of revenue.

If we fail to develop new products or enhance our existing products to react to rapid technological change and market demands in a timely and cost-effective manner, our business will suffer.

We must develop new products or enhance our existing products with improved technologies to meet rapidly evolving customer requirements. We are currently engaged in the development process for our next generation of products in order to meet the demands of our customers who continually require higher performance and functionality at lower costs. The development process for these advancements is lengthy and will require us to accurately anticipate technological innovations and market trends. Developing and enhancing these products can be time-consuming, costly and complex. Our ability to fund product development and enhancements partially depends on our ability to generate revenues from our existing products.

We may be unable to successfully develop additional next generation products, new products or product enhancements. There is a risk that these developments or enhancements will be late, have technical problems, fail to meet customer or market specifications or otherwise be uncompetitive with other products using alternative technologies that offer comparable performance and functionality. Our next generation products or any new products or product enhancements may not be accepted in new or existing markets. Our business, financial condition and results of operations may be adversely affected if we fail to develop and introduce new products or product enhancements in a timely manner or on a cost-effective basis.

We rely on a limited number of subcontractors to manufacture, assemble, package and production test our products, and the failure of any of these third-party subcontractors to deliver products or otherwise perform as requested could damage our relationships with our customers, decrease our sales and limit our growth.

While we design and market our products and conduct test development in-house, we do not manufacture, assemble, package and production test the vast majority of our products, and we must rely on third-party subcontractors to perform these services. If these subcontractors do not provide us with high-quality products, services and production and production test capacity in a timely manner, or if one or more of these subcontractors terminates its relationship with us, we may be unable to obtain satisfactory replacements to fulfill customer orders on a timely basis, our relationships with our customers could suffer, our sales could decrease and our growth could be limited. In particular, there are significant challenges associated with moving our IC production from our existing manufacturer to another manufacturer with whom we do not have a pre-existing relationship.

In addition, the consolidation of foundry subcontractors, as well as the increasing capital intensity and complexity associated with fabrication in smaller process geometries has limited the diversity of our suppliers and increased our risk of a "single point of failure." Specifically, as we move to smaller geometries, we have become increasingly reliant on IC manufacturers. The lack of diversity of suppliers could also drive increased prices and adversely affect our results of operations, including our product gross margins.

We currently do not have long-term supply contracts with any of our third-party subcontractors. Therefore, they are not obligated to perform services or supply products to us for any specific period, in any specific quantities or at any specific price, except as may be provided in a particular purchase order. None of our third-party subcontractors has provided contractual assurances to us that adequate capacity will be available to us to meet future demand for our products. Our subcontractors may allocate capacity to the production of other companies' products while reducing

deliveries to us on short notice. Other customers that are larger and better financed than we are or that have long-term agreements with these subcontractors may cause these subcontractors to reallocate capacity to those customers, thereby decreasing the capacity available to us.

Other significant risks associated with relying on these third-party subcontractors include:

• reduced control over product cost, delivery schedules and product quality;

- potential price increases;
- inability to achieve sufficient production, increase production or test capacity and achieve acceptable yields on a timely basis;
- increased exposure to potential misappropriation of our intellectual property;
- shortages of materials used to manufacture products;
- capacity shortages;
- labor shortages or labor strikes;
- political instability in the regions where these subcontractors are located; and
- natural disasters impacting these subcontractors.

See Part I, Item 1, "Business-Manufacturing" for more information about our subcontractors.

If we fail to carefully manage the use of "open source" software in our products, we may be required to license key portions of our products on a royalty-free basis or expose key parts of source code.

Some portion of our software may be derived from "open source" software that is generally made available to the public by its authors and/or other third parties. Such open source software is often made available to us under licenses, such as the GNU General Public License, which impose certain obligations on us in the event we were to create and distribute derivative works of the open source software. These obligations may require us to make source code for the derivative works available to the public and/or license such derivative works under a particular type of license, rather than the forms of licenses customarily used to protect our intellectual property. In the event that we inadvertently use open source software without the correct license form or a copyright holder of any open source software were to successfully establish in court that we had not complied with the terms of a license for a particular work, we could be required to release the source code of that work to the public and/or stop distribution of that work.

The average selling prices of our products have decreased in the past and may do so in the future, which could harm our financial results.

The products we develop and sell are subject to declines in average selling prices. We have had to reduce our prices in the past and we may be required to reduce prices in the future. Reductions in our average selling prices to one customer could impact our average selling prices to other customers. If we are unable to reduce our associated manufacturing costs this reduction in average selling prices would cause our gross margin to decline. Our financial results will suffer if we are unable to offset any reductions in our average selling prices by increasing our sales volumes, reducing our costs or developing new or enhanced products with higher selling prices or gross margins. We expect gross margin to vary over time, and our recent level of product gross margin may not be sustainable. Our product gross margins vary from quarter to quarter, and our recent level of gross margins may not be sustainable and may be adversely affected in the future by numerous factors, including product mix shifts, product transitions, increased price competition in one or more of the markets in which we compete, increases in material or labor costs, excess product component or obsolescence charges from our contract manufacturers, warranty related issues, or the introduction of new products or entry into new markets with different pricing and cost structures.

Fluctuations in our revenues and operating results on a quarterly and annual basis could cause the market price of our ordinary shares to decline.

Our quarterly and annual revenues and operating results are difficult to predict and have fluctuated in the past, and may fluctuate in the future, from quarter to quarter and year to year. It is possible that our operating results in some quarters and years will be below market expectations. This would likely cause the market price of our ordinary shares to decline. Our quarterly and annual operating results are affected by a number of factors, many of which are outside of our control, including:

- unpredictable volume and timing of customer orders, which are not fixed by contract but vary on a purchase order basis;
- the loss of one or more of our customers, or a significant reduction or postponement of orders from our customers;
- our customers' sales outlooks, purchasing patterns and inventory levels based on end-user demands and general economic conditions;





- seasonal buying trends;
- the timing of new product announcements or introductions by us or by our competitors;
- our ability to successfully develop, introduce and sell new or enhanced products in a timely manner;
- changes in the relative sales mix of our products;
- decreases in the overall average selling prices of our products;
- changes in the cost of our finished goods; and
- the availability, pricing and timeliness of delivery of other components used in our customers' products.

We base our planned operating expenses in part on our expectations of future revenues, and a significant portion of our expenses is relatively fixed in the short-term. We have limited visibility into customer demand from which to predict future sales of our products. As a result, it may be difficult for us to forecast our future revenues and budget our operating expenses accordingly. Our operating results would be adversely affected to the extent customer orders are cancelled or rescheduled. If revenues for a particular quarter are lower than we expect, we may not be able to proportionately reduce our operating expenses.

We rely on our ecosystem partners to enhance and drive demand for our product offerings. Our inability to continue to develop or maintain such relationships in the future or our partners' inability to timely deliver technology or product offerings to the market may harm our revenues and ability to remain competitive.

We have developed relationships with third parties, which we refer to as ecosystem partners. Such partners provide their technology products, operating systems, tool support, reference designs and other elements necessary for the sale of our products into our markets. In addition, introduction of new products into the market by these partners may increase demand for our products. If we are unable to continue to develop or maintain these relationships, or if our ecosystem partners delay or fail to timely deliver their technology or products or other elements to the market, our revenues may be adversely impacted and we might not be able to enhance our customers' ability to commercialize their products in a timely manner and our ability to remain competitive may be harmed.

We rely primarily upon trade secret, patent, trademark and copyright laws and contractual restrictions to protect our proprietary rights, and, if these rights are not sufficiently protected, our ability to compete and generate revenues could suffer.

We seek to protect our proprietary manufacturing specifications, documentation and other written materials primarily under trade secret, patent, trademark and copyright laws. We also typically require employees and consultants with access to our proprietary information to execute confidentiality agreements. The steps taken by us to protect our proprietary information may not be adequate to prevent misappropriation of our technology. In addition, our proprietary rights may not be adequately protected because:

- people may not be deterred from misappropriating our technologies despite the existence of laws or contracts prohibiting it;
- policing unauthorized use of our intellectual property may be difficult, expensive and time-consuming, and we may be unable to determine the extent of any unauthorized use; and
- the laws of other countries in which we market our products, such as some countries in the Asia/Pacific region, may offer little or no protection for our proprietary technologies.

Reverse engineering, unauthorized copying or other misappropriation of our proprietary technologies could enable third parties to benefit from our technologies without paying us for doing so. Any inability to adequately protect our proprietary rights could harm our ability to compete, generate revenues and grow our business.

We may not obtain sufficient patent protection on the technology embodied in our products, which could harm our competitive position and increase our expenses.

Our success and ability to compete in the future may depend to a significant degree upon obtaining sufficient patent protection for our proprietary technology. Patents that we currently own do not cover all of the products that we presently sell as we have patent applications pending with respect to certain products, while we have not been able to obtain, or choose not to seek, patent protection for other products. Our patent applications may not result in issued patents, and even if they result in issued patents, the patents may not have claims of the scope we seek. Furthermore, any issued patents may be challenged,



invalidated or declared unenforceable. Whether or not these patents are issued, the applications may become publicly available and the proprietary information disclosed in the applications will become available to others. The lives of acquired patents may also be of a shorter term depending upon their acquisition dates and the issue dates. The term of any issued patent in the United States and Israel is typically 20 years from its filing date, and if our applications are pending for a long time period, we may have a correspondingly shorter term for any patent that may be issued. Our present and future patents may provide only limited protection for our technology and may not be sufficient to provide competitive advantages to us. For example, competitors could be successful in challenging any issued patents or, alternatively, could develop similar or more advantageous technologies on their own or design around our patents. Also, patent protection in certain foreign countries may not be available or may be limited in scope and any patents obtained may not be as readily enforceable as in the United States and Israel, making it difficult for us to effectively protect our intellectual property from misuse or infringement by other companies in these countries. Our inability to obtain and enforce our intellectual property rights in some countries may harm our business, financial condition and results of operations. In addition, given the costs of obtaining patent protection, we may choose not to protect certain innovations that later on turn out to be important. In such cases, our lack of intellectual property rights may have a material adverse impact on our business, financial condition and results of operations.

Intellectual property litigation, which is common in our industry, could be costly, harm our reputation, limit our ability to sell our products and divert the attention of management and technical personnel.

The semiconductor industry is characterized by frequent litigation regarding patent and other intellectual property rights. From time to time, we receive notices from competitors and other third parties that claim we have infringed upon, misappropriated or misused other parties' proprietary rights. We may also be required to indemnify some customers and strategic partners under our agreements if a third party alleges or if a court finds that our products or activities have infringed upon, misappropriated or misused another party's proprietary rights. We have received requests from certain customers and strategic partners to include increasingly broad indemnification provisions in our agreements with them. Additionally, our products may contain technology provided to us by other parties such as contractors, suppliers or customers. We may have little or no ability to determine in advance whether such technology infringes upon the intellectual property rights of a third party. Our contractors, suppliers and licensors may not be required to indemnify us in the event that a claim of infringement is asserted against us, or they may be required to indemnify us only up to a maximum amount, above which we would be responsible for any further costs or damages. Questions of infringement in the markets we serve involve highly technical and subjective analyses. We are involved in intellectual property litigation today and litigation may be necessary in the future to enforce any patents we may receive and other intellectual property rights, to protect our trade secrets, to determine the validity and scope of the proprietary rights of others or to defend against claims of infringement or invalidity, and we may not prevail in any such future litigation. Litigation, whether or not determined in our favor or settled, could be costly, could harm our reputation and could divert the efforts and attention of our management and technical personnel from normal business operations. In addition, adverse determinations in litigation could result in the loss of our proprietary rights, subject us to significant liabilities, and require us to seek licenses from third parties or prevent us from licensing our technology or selling our products, any of which could seriously harm our business.

In the normal course of business, we enter into agreements with terms and conditions that require us to indemnify the other party against third-party claims alleging that one of our products infringes or misappropriates intellectual property rights, as well as against certain claims relating to property damage, personal injury or acts or omissions relating to supplied products or technologies, or acts or omissions made by us or our agents or representatives. In addition, we are obligated pursuant to indemnification undertakings with our officers and directors to indemnify them to the fullest extent permitted by law and to indemnify venture capital funds that were affiliated with or represented by such officers or directors. If we receive demands for indemnification under these agreements and terms and conditions, they will likely be very expensive to settle or defend, and we may incur substantial legal fees in connection with any indemnity demands. Our indemnification obligations under these agreements and terms and conditions may be unlimited in duration and amount, and could have an adverse effect on our business, financial condition and results of operations.

We depend on key and highly skilled personnel to operate our business, and if we are unable to retain our current personnel and hire additional personnel, our ability to develop and successfully market our products could be harmed. Our business is particularly dependent on the interdisciplinary expertise of our personnel, and we believe our future success will depend in large part upon our ability to attract and retain highly skilled managerial, engineering, finance and sales and marketing personnel. The loss of any key employees or the inability to attract or retain qualified personnel could delay the development and introduction of, and harm our ability to sell our products and harm the market's perception of us. Competition for qualified engineers in the markets in which we operate is intense and accordingly, we may not be able to retain or hire all of the engineers required to meet our ongoing and future business needs. If we are unable to attract and retain the highly skilled professionals we need, we may have to forego projects for lack of resources or be unable to staff projects optimally. We believe

that our future success is highly dependent on the contributions of our president and CEO and other senior executives. We do not have long-term employment contracts with our president and CEO, CFO or any other key personnel, and their knowledge of our business and industry would be extremely difficult to replace.

In an effort to retain key employees, we may modify our compensation policies by, for example, increasing cash compensation to certain employees and/or modifying existing share options. These modifications of our compensation policies and the requirement to expense the fair value of share options and RSUs awarded to employees and officers may increase our operating expenses and result in the dilution of the holders of our ordinary shares. We cannot be certain that these and any other changes in our compensation policies will or would improve our ability to attract, retain and motivate employees. Our inability to attract and retain additional key employees and the increase in share-based compensation expense could each have an adverse effect on our business, financial condition and results of operations.

We may not be able to manage our future growth effectively, and we may need to incur significant expenditures to address the additional operational and control requirements of our growth.

We are experiencing a period of company growth and expansion. This expansion has placed, and any future expansion will continue to place, a significant strain on our management, personnel, systems and financial resources. We plan to hire additional employees to support an increase in research and development and strengthen our sales and marketing and general and administrative efforts. To successfully manage our growth, we believe we must effectively:

- manage and enhance our relationships with customers, distributors, suppliers, end users and other third parties;
- implement additional, and enhance existing, administrative, financial and operations systems, procedures and controls;

- address capacity shortages;

- expand and upgrade our technological capabilities;

- manage the challenges of having U.S., Israeli and other foreign operations; and

- hire, train, integrate and manage additional qualified engineers for research and development activities as well as additional personnel to strengthen our sales and marketing, financial and IT functions.

Managing our growth may require substantial managerial and financial resources and may increase our operating costs even though these efforts may not be successful. If we are unable to manage our growth effectively, we may not be able to take advantage of market opportunities, develop new products, satisfy customer requirements, execute our business plan or respond to competitive pressures, in which case our business, financial conditions and results of operations may be adversely affected.

We are subject to risks associated with our distributors' product inventories.

We sell many of our products to customers through distributors who maintain their own inventory of our products for sale to dealers and end customers. We allow limited price adjustments on sales to distributors. Price adjustments may be effected by way of credits for future product or by cash payments to the distributor, either in arrears or in advance, using estimates based on historical transactions. Currently we recognize revenues for sales to distributors upon sell through by the distributors, net of estimated allowances for price adjustments. Upon the adoption of the new revenue standards effective January 1, 2018, we will recognize revenue on sales to distributors upon shipment and transfer of control (known as "sell-in" revenue recognition), net of the estimated allowances for price adjustments. We have extended these programs to certain distributors in the United States, Asia and Europe and may extend them on a selective basis to some of our other distributors in these geographies. The reserves recognized for these programs are based on judgments and estimates, using historical experience rates, inventory levels in distribution, current trends and other factors, and there could be material differences between actual amounts and our estimates.

If our distributors are unable to sell an adequate amount of their inventory of our products in a given quarter to dealers and end customers or if they decide to decrease their inventories for any reason, such as adverse global economic conditions or a downturn in technology spending, our sales to these distributors and our revenues may decline. We also face the risk that our distributors may purchase, or for other reasons accumulate, inventory levels of our products in any particular quarter in excess of future anticipated sales to end customers. If such sales do not occur in the time frame anticipated by these distributors for any reason, these distributors may substantially decrease the amount of product they order from us in subsequent periods until their inventory levels realign with end-customer demand,

which would harm our business and could adversely affect our revenues in such subsequent periods. Our reserve estimates associated with products stocked by our distributors are based largely on reports that our distributors provide to us on a weekly or monthly basis. To date, we believe this resale and channel inventory data have been generally accurate. To the extent that these data are inaccurate or not received in a timely manner, we may not be able to make reserve estimates for future periods accurately or at all.

We do not always have a direct relationship with the end customers of our products sold through distributors. As a result, our products may be used in applications for which they were not necessarily designed or tested, and they may not perform as anticipated in such applications. In such event, failure of even a small number of parts could result in significant liabilities to us, damage our reputation and harm our business and results of operations.

Certain of our customers and suppliers require us to comply with their codes of conduct, which may include certain restrictions that may substantially increase our cost of doing business as well as have an adverse effect on our operating efficiencies, operating results and financial condition.

Certain of our customers and suppliers require us to agree to comply with the Electronic Industry Code of Conduct ("EICC") or their own codes of conduct, which may include detailed provisions on labor, human rights, health and safety, environment, corporate ethics and management systems. Certain of these provisions are not requirements under the laws of the countries in which we operate and may be burdensome to comply with on a regular basis. Moreover, new provisions may be added or material changes may be made to any these codes of conduct, and we may have to promptly implement such new provisions or changes, which may substantially further increase the cost of our business, be burdensome to implement and adversely affect our operational efficiencies and operating results. If we violate any such codes of conduct, we may lose further business with the customer or supplier and, in addition, we may be subject to fines from the customer or supplier. While we believe that we are currently in compliance with our customers and suppliers' codes of conduct, there can be no assurance that, from time to time, if any one of our customers and suppliers audits our compliance with such code of conduct, we would be found to be in full compliance. A loss of business from these customers or suppliers could have a material adverse effect on our business, financial condition and results of operations.

We may experience defects in our products, unforeseen delays, higher than expected expenses or lower than expected manufacturing yields of our products, which could result in increased customer warranty claims, delays of our product shipments and prevent us from recognizing the benefits of new technologies we develop.

Our products may contain defects and errors. Product defects and errors could result in additional development costs, diversion of technical resources, delayed product shipments, increased warranty-related returns, including wide-scale product recalls, warranty expenses and product liability claims against us which may not be fully covered by insurance. Our products are complex and our quality control tests and procedures may fail to detect any such defects or errors. Delivery of products with defects or reliability, quality or compatibility problems may damage our reputation and our ability to retain existing customers and attract new customers. As a result, defects in our products could have an adverse effect on our business, financial condition and results of operations.

In addition, our production of existing and development of new products can involve multiple iterations and unforeseen manufacturing difficulties, resulting in reduced manufacturing yields, delays and increased expenses. The evolving nature of our products requires us to modify our manufacturing specifications, which may result in delays in manufacturing output and product deliveries. We rely on a limited number of third parties to manufacture our products. Our ability to offer new products depends on our manufacturers' ability to implement our revised product specifications, which is costly, time-consuming and complex.

We have significant intangible assets and goodwill. Consequently, the future impairment of our intangible assets and goodwill, if any, may significantly impact our profitability.

Our intangible assets and goodwill are significant. As of December 31, 2017, we had recorded \$700.6 million of intangible assets, net and goodwill primarily related to our past acquisitions. Intangible assets and goodwill are subject to an impairment analysis whenever events or changes in circumstances indicate the carrying amount of the asset may not be recoverable. Additionally, goodwill and indefinite-lived assets are subject to an impairment test at least annually. The impairment of any goodwill and other intangible assets may have a negative impact on our consolidated results of operations.

Unanticipated changes in our tax provisions or adverse outcomes resulting from examination of our income tax returns could adversely affect our results of operations.

We are subject to income taxes in Israel, the United States and various foreign jurisdictions. Our effective income tax rate could be adversely affected by changes in tax laws or interpretations of those tax laws, by changes in the mix of earnings in countries with differing statutory tax rates, or by changes in the valuation of our deferred tax assets and

liabilities. The U.S. recently enacted significant tax reform, and certain provisions of the new law may adversely affect us. See Note 12 to the consolidated financial statements for more details about the U.S. tax reform and its effects.

Our effective income tax rates are also affected by intercompany transactions for sales, services, funding and other items. Given the increased global scope of our operations, and the complexity of global tax and transfer pricing rules and regulations, it has become increasingly difficult to estimate earnings within each tax jurisdiction. If actual earnings within a tax jurisdiction



differ materially from our estimates or new information is discovered in the course of our tax return preparation process, we may not achieve our expected effective tax rate. Additionally, our effective tax rate may be affected by the tax effects of acquisitions, restructuring activities, newly enacted tax legislation, share-based compensation and uncertain tax positions. Finally, we are subject to the examination of our income tax returns by the Internal Revenue Service and other tax authorities which may result in the assessment of additional income taxes. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. However, unanticipated outcomes from these examinations could have a material adverse effect on our business, financial condition and results of operations.

Changes to financial accounting standards may affect our results of operations and cause us to change our business practices.

We prepare our financial statements to conform to generally accepted accounting principles ("GAAP") in the United States. These accounting principles are subject to interpretation by the Financial Accounting Standards Board ("FASB"), the American Institute of Certified Public Accountants ("AICPA"), the SEC and various bodies formed to interpret and create appropriate accounting policies. A change in those policies can have a significant effect on our reported results and may affect our reporting of transactions completed before a change is announced. Changes to those rules or the questioning of current practices may adversely affect our reported financial results or the way we conduct our business.

We may be subject to disruptions or failures in information technology systems and network infrastructures, including theft, misuse of our electronic data or cyber-attacks that could have a material adverse effect on us.

We rely on the efficient and uninterrupted operation of complex information technology systems and network infrastructures to operate our business. We also hold large amounts of data in various data center facilities upon which our business depends. A disruption, infiltration or failure of our information technology systems or any of our data centers as a result of software or hardware malfunctions, system implementations or upgrades, computer viruses, third-party security breaches, attempts by others that try to gain unauthorized access through the Internet to our information technology systems, employee error, theft or misuse, malfeasance, power disruptions, natural disasters or accidents could cause breaches of data security, loss of intellectual property and critical data and the release and misappropriation of sensitive competitive information and partner, customer and employee personal data. These attempts may be the result of industrial or other espionage, or actions by hackers seeking to harm us, our products, or our end users. Any of these events could harm our competitive position, result in a loss of customer confidence, cause us to incur significant costs to remedy any damages and ultimately materially adversely affect our business, financial condition and results of operations.

While we have implemented a number of protective measures, including firewalls, antivirus, patches, log monitors, routine back-ups, system audits, routine password modifications and disaster recovery procedures, such measures may not be adequate or implemented properly to prevent or fully address the adverse effect of such events, and in some cases we may be unaware of an incident or its magnitude and effects.

In addition, our third-party subcontractors, including our foundries, test and assembly houses and distributors, have access to certain portions of our sensitive data. In the event that these subcontractors do not properly safeguard our data that they hold, security breaches and loss of our data could result. Any such loss of data by our third-party service providers, or theft, unauthorized use or publication of our trade secrets and other confidential business information as a result of such cyber threats, could adversely affect our competitive position and reduce marketplace acceptance of our products; the value of our investment in research and development and marketing could be reduced; and third parties may assert against us or our customers claims related to resulting losses of confidential or proprietary information or end-user data, or system reliability. Any such event could have a material adverse effect on our business, financial condition and results of operations.

Our business is subject to the risks of earthquakes, fires, floods and other natural catastrophic events.

Our U.S. corporate offices are located in the San Francisco Bay Area, a region known for seismic activity. A significant natural disaster, such as an earthquake, fire or flood or tsunami, could have a material adverse impact on our business, financial condition and results of operations. To the extent that such disruptions result in delays or cancellations of customer orders, or the deployment of our products, our business, financial condition and results of

operations would be adversely affected.

We must comply with a variety of existing and future laws and regulations that could impose substantial costs on us and may adversely affect our business.

We are subject to various state, federal and international laws and regulations governing the environment, including restricting the presence of certain substances in electronic products and making producers of those products financially responsible for the collection, treatment, recycling and disposal of those products. In addition, we are also subject to various industry requirements restricting the presence of certain substances in electronic products. Although our management systems

are designed to maintain compliance, we cannot assure you that we have been or will be at all times in complete compliance with such laws and regulations. If we violate or fail to comply with any of them, a range of consequences could result, including fines, import/export restrictions, sales limitations, criminal and civil liabilities or other sanctions.

We and our customers are also subject to various import and export laws and regulations. Government export regulations apply to the encryption or other features contained in some of our products. If we fail to continue to receive licenses or otherwise comply with these regulations, we may be unable to manufacture the affected products or ship these products to certain customers, or we may incur penalties or fines.

We are also subject to regulations concerning the supply of certain minerals coming from the conflict zones in and around the Democratic Republic of Congo ("DRC"). The Dodd-Frank Wall Street Reform and Consumer Protection Act includes disclosure requirements regarding the use of certain minerals mined from the DRC and adjoining countries and procedures regarding a manufacturer's efforts to identify sourcing of such conflict minerals. The implementation of these requirements could affect the sourcing and availability of minerals used in the manufacture of semiconductor devices.

As a result, this could limit the pool of suppliers who can provide us confirmation that the components and parts we source are considered DRC "conflict free," and we may not be able to confirm that we have obtained products or supplies that can be confirmed as DRC "conflict free" in sufficient quantities for our operations. Also, because our supply chain is complex, we may face reputational challenges with our customers, shareholders and other stakeholders if we are unable to sufficiently verify the origins for the minerals used in our products.

The costs of complying with these laws could adversely affect our current or future business. In addition, future regulations may become more stringent or costly and our compliance costs and potential liabilities could increase, which may harm our current or future business.

If we fail to maintain an effective system of internal controls, we may not be able to report accurately our financial results or prevent material fraud. As a result, current and potential shareholders could lose confidence in our financial reporting, which could harm our business and the trading price of our ordinary shares.

Effective internal controls are necessary for us to provide reliable financial reports and effectively prevent material fraud. We have in the past discovered, and may in the future discover, areas of our internal controls that need improvement. Section 404 of the Sarbanes-Oxley Act of 2002 requires our management to report on, and our independent registered public accounting firm to attest to, the effectiveness of our internal control structure and procedures for financial reporting. We have an ongoing program to perform the system and process evaluation and testing necessary to comply with these requirements. We have incurred, and expect to continue to incur significant expenses and to devote significant management resources to Section 404 compliance. Furthermore, as we grow our business or acquire businesses, our internal controls may become more complex and we may require significantly more resources to ensure they remain effective. Failure to implement required new or improved controls, or difficulties encountered in their implementation, either in our existing business or in businesses that we may acquire could harm our operating results or cause us to fail to meet our reporting obligations. In the event that our CEO, CFO or independent registered public accounting firm determine that our internal controls over financial reporting are not effective as defined under Section 404, investor perceptions of our company may be adversely affected and may cause a decline in the market price of our ordinary shares.

#### Risks Related to Operations in Israel and Other Foreign Countries

Regional instability in Israel may adversely affect business conditions and may disrupt our operations and negatively affect our revenues and profitability.

We have engineering facilities, corporate and sales support operations located in Israel. A significant number of our employees and a material amount of assets are located in Israel. Accordingly, political, economic and military conditions in Israel may directly affect our business. Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors, as well as incidents of civil unrest. These conflicts negatively affected business conditions in Israel. In addition, Israel and companies doing business with Israel have, in the past, been the subject of an economic boycott. In addition, there has been recent civil unrest in certain areas in the Middle East, including Egypt, Jordan, Iraq, Syria and Libya. Any future armed conflicts or political

instability in the region may negatively affect business conditions and adversely affect our results of operations. Parties with whom we do business have sometimes declined to travel to Israel during periods of heightened unrest or tension, forcing us to make alternative arrangements when necessary. In addition, the political and security situation in Israel may result in parties with whom we have agreements involving performance in Israel claiming that they are not obligated to perform their commitments under those agreements pursuant to force majeure provisions in the agreements.

The security and political conditions may have an impact on our business in the future. Hostilities involving Israel or the interruption or curtailment of trade between Israel and its present trading partners could adversely affect our operations and could make it more difficult for us to raise capital. Our Israeli operations are within range of Hezbollah or Hamas missiles and we or our immediate surroundings may sustain damages in a missile attack, which could adversely affect our operations.

In addition, our business insurance does not cover losses that may occur as a result of events associated with the security situation in the Middle East. Although the Israeli government currently covers the reinstatement value of direct damages that are caused by terrorist attacks or acts of war, we cannot assure you that this government coverage will be maintained. Any losses or damages incurred by us as a result of such events could have a material adverse effect on our business, financial condition and results of operations.

Our operations may be negatively affected by the obligations of our personnel to perform military service.

Generally, all non-exempt male adult citizens and permanent residents of Israel under the age of 45 (or older, for citizens with certain occupations), including some of our employees, are obligated to perform military reserve duty for Israel annually, and are subject to being called to active duty at any time under emergency circumstances. In the event of severe unrest or other conflict, individuals could be required to serve in the military for extended periods of time. In response to increases in terrorist activity, there have been periods of significant call-ups of military reservists, and some of our employees, including those in key positions, have been called upon in connection with armed conflicts. It is possible that there will be additional call-ups in the future. Our operations could be disrupted by the absence for a significant period of one or more of our officers, directors or key employees due to military service. Any such disruption could adversely affect our operations.

Our operations may be affected by labor unrest in Israel.

In the past, there have been several general strikes and work stoppages in Israel affecting all banks, airports and ports. These strikes had an adverse effect on the Israeli economy and on business, including our ability to deliver products to our customers and to receive raw materials from our suppliers in a timely manner. From time to time, the Israeli trade unions threaten strikes or work stoppages, which, if carried out, may have a material adverse effect on the Israeli economy and our business.

We are susceptible to additional risks from our international operations.

We derived 62%, 55% and 54% of our revenues in the years ended December 31, 2017, 2016 and 2015, respectively, from sales outside of the United States. As a result, we face additional risks from doing business internationally, including:

- reduced protection of intellectual property rights in some countries;
- difficulties in staffing and managing foreign operations;
- longer sales and payment cycles;
- greater difficulties in collecting accounts receivable;
- adverse economic conditions;
- seasonal reductions in business activity;
- potentially adverse tax consequences;
- laws and business practices favoring local competition;
- costs and difficulties of customizing products for foreign countries;
- compliance with a wide variety of complex foreign laws and treaties;
- compliance with the United States' Foreign Corrupt Practices Act and similar anti-bribery laws in other jurisdictions;
- compliance with export control and regulations;
- licenses, tariffs, other trade barriers, transit restrictions and other regulatory or contractual limitations on our ability to sell or develop our products in certain foreign markets;
- restrictive governmental actions, such as restrictions on the transfer or repatriation of funds and foreign investments;
- foreign currency exchange risks;

- fluctuations in freight rates and transportation disruptions;
- political and economic instability;
- variance and unexpected changes in local laws and regulations;
- natural disasters and public health emergencies; and
- trade and travel restrictions.

A significant legal risk associated with conducting business internationally is compliance with various and differing anti-corruption and anti-bribery laws and regulations of the countries in which we do business, including the U.S. Foreign Corrupt Practices Act, the U.K. Bribery Act and similar laws in China. In addition, the anti-corruption laws in various countries are constantly evolving and may, in some cases, conflict with each other. Our Code of Ethics and Business Conduct and other policies prohibit us and our employees from offering or giving anything of value to a government official for the purpose of obtaining or retaining business and from engaging in unethical business practices, including kick-backs to or from purely private parties. However, there can be no assurance that all of our employees or agents will refrain from acting in violation of such laws and our related anti-corruption policies and procedures. Any violations of these anti-corruption or trade control laws, or even allegations of such violations, can lead to an investigation, which could disrupt our operations, involve significant management distraction, and lead to significant costs and expenses, including legal fees. If we, or our employees or agents acting on our behalf, are found to have engaged in practices that violate these laws and regulations, we could suffer severe fines and penalties, profit disgorgement, injunctions on future conduct, securities litigation, and other consequences that may have a material adverse effect on our business, financial condition and results of operations. In addition, our reputation, sales activities or stock price could be adversely affected if we become the subject of any negative publicity related to actual or potential violations of anti-corruption, anti-bribery, or trade control laws and regulations.

Our principal research and development facilities are located in Israel, and our directors, executive officers and other key employees are located primarily in Israel and the United States. In addition, we engage sales representatives in various countries throughout the world to market and sell our products in those countries and surrounding regions. If we encounter any of the above risks in our international operations, we could experience slower than expected revenue growth and our business could be harmed.

It may be difficult to enforce a U.S. judgment against us, our officers and directors or to assert U.S. securities law claims in Israel.

We are incorporated in Israel. Two of our executive officers and four of our directors, one of whom is also an executive officer, are non-residents of the United States and are located in Israel, and a significant amount of our assets and the assets of these persons are located outside the United States. Therefore, it may be difficult to enforce a judgment obtained in the United States against us or any of the above persons in Israel.

In addition, it may be difficult for a shareholder to enforce civil liabilities under U.S. securities law claims in original actions instituted in Israel. Israeli courts may refuse to hear a claim based on a violation of U.S. securities laws because Israel is not the most appropriate forum to bring such a claim. If U.S. law is found to be applicable, the content of applicable U.S. law must be proved in an Israeli court as a fact, which can be a time-consuming and costly process. Certain matters of procedure will also be governed by Israeli law.

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

The Israeli Companies Law, 1999 (the “Companies Law”) generally requires that a merger be approved by the board of directors and by the general meeting of the shareholders. Upon the request of any creditor of a merging company, a court may delay or prevent the merger if it concludes that there is a reasonable concern that, as a result of the merger, the surviving company will be unable to satisfy its obligations. In addition, a merger may generally not be completed unless at least (i) 50 days have passed since the filing of the merger proposal with the Israeli Registrar of Companies and (ii) 30 days have passed since the merger was approved by the shareholders of each of the merging companies. Also, in certain circumstances, an acquisition of shares in a public company must be made by means of a tender offer if, as a result of the acquisition, the purchaser would hold 25% or more of the voting rights in the company (unless there is already a 25% or greater shareholder of the company) or more than 45% of the voting rights in the company (unless there is already a shareholder that holds more than 45% of the voting rights in the company). If, as a result of

an acquisition, the acquirer would hold more than 90% of a company's shares or voting rights, the acquisition must be made by means of a tender offer for all of the shares.

In addition, the Companies Law allows us to create and issue shares having rights different from those attached to our ordinary shares, including rights that may delay or prevent a takeover or otherwise prevent our shareholders from realizing a potential premium over the market value of their ordinary shares. The authorization of a new class of shares would require an amendment to our articles of association, which requires the prior approval of the holders of a majority of our shares at a general meeting.

These provisions could delay, prevent or impede an acquisition of us, even if such an acquisition would be considered beneficial by some of our shareholders.

Exchange rate fluctuations between the U.S. dollar and the NIS may negatively affect our earnings.

We derive all of our revenues in U.S. dollars. The U.S. dollar is our functional and reporting currency in all of our foreign locations. However, a significant portion of our liabilities, as well as our operating expenses, consisting principally of salaries and related personnel costs and facilities expenses, are denominated in NIS. This foreign currency exposure gives rise to market risk associated with exchange rate movements of the U.S. dollar against the NIS. To the extent that the value of the NIS increases against the U.S. dollar, our expenses on a U.S. dollar cost basis will increase. We cannot predict any future trends in the rate of appreciation of the NIS against the U.S. dollar. If the U.S. dollar cost of our salaries and related personnel costs and facilities expenses in Israel increases, our dollar-measured results of operations will be adversely affected. Our operations also could be adversely affected if we are unable to hedge against currency fluctuations in the future. Further, because all of our international revenues are denominated in U.S. dollars, a strengthening of the dollar versus other currencies could make our products less competitive in foreign markets and the collection of our receivables more difficult. To help manage this risk we have been engaged in foreign currency hedging activities, comprised of currency derivative instruments and natural hedges. Our cost in Israel in U.S. dollar terms will also increase if inflation in Israel exceeds the devaluation of the NIS against the U.S. dollar or if the timing of such devaluation lags behind inflation in Israel.

The results of the United Kingdom's referendum on withdrawal from the European Union may have a negative effect on global economic conditions, financial markets and our business.

The United Kingdom ("U.K.") held a referendum in June 2016 in which a majority of voters approved an exit from the European Union ("Brexit"). In March 2017, the U.K. began the process to exit the European Union. Negotiations are in progress to determine the future terms of the U.K.'s relationship with the European Union, including, among other things, the terms of trade between the U.K. and the European Union. The effects of Brexit will depend on any agreements the U.K. reaches to retain access to European Union markets either during a transitional period or more permanently. In addition, the exit of the U.K. from the European Union could lead to legal and regulatory uncertainty and potentially divergent treaties, laws and regulations as the U.K. determines which European Union treaties, laws and regulations to replace or replicate, including those governing manufacturing, labor, environmental, data protection/privacy, competition and other matters applicable to the semiconductor industry. The referendum has also given rise to calls for the governments of other European Union member states to consider withdrawal. These developments, or the perception that any of them could occur, may have a material adverse effect on global economic conditions and the stability of global financial markets, and may significantly reduce global market liquidity and restrict the ability of key market participants to operate in certain financial markets. Any of these factors could depress economic activity and restrict our access to capital, which could have a material adverse effect on our business, financial condition and results of operations and reduce the price of our ordinary shares.

The government tax benefits that we currently receive require us to meet several conditions and may be terminated or reduced in the future, which would increase our costs.

According to the Israeli Law for Encouragement of Capital Investments, 1959 ("The Law"), the Company's operations in Israel were granted "Approved Enterprise" status by the Investment Center in the Israeli Ministry of Economy and Industry (formerly, the Ministry of Industry Trade and Labor) and "Beneficiary Enterprise" status by the Israeli Income Tax Authority. The Company is eligible for tax benefits under the law with respect to its income derived from its Approved and Beneficiary Enterprises. The availability of these tax benefits is subject to certain requirements, including, among other things, making specified investments in fixed assets and equipment, financing a percentage of those investments with our capital contributions, complying with our marketing program which was submitted to the Investment Center, filing of certain reports with the Investment Center, limiting manufacturing outside of Israel and



complying with Israeli intellectual property laws. If we do not meet these requirements in the future, these tax benefits may be cancelled and we could be required to refund any tax benefits that we have already received plus interest and penalties thereon. The tax benefits that our current "Approved Enterprise" and "Beneficiary Enterprise" program receives may not be continued in the future at their current levels or at all. If these tax benefits were reduced or eliminated, the amount of taxes that we pay would likely increase, which could adversely affect our results of operations. Additionally, if we increase our activities outside of Israel, for example, by acquisitions, our increased activities may not be eligible for inclusion in Israeli tax benefit programs.

If we elect to distribute dividends out of exempt income derived from "Approved/Beneficiary Enterprise" income, we will be subject to tax on the gross amount distributed. The tax rate will be the rate which would have been applicable had we not been granted the beneficial status. This rate is generally between 10% and the corporate tax rate in Israel, depending on the percentage of our shares held by foreign shareholders. The dividend recipient is subject to withholding tax at the source at the reduced rate applicable to dividends from Approved Enterprises, which is 15% if the dividend is distributed during the tax exemption period (subject to the applicable double tax treaty) or within 12 years after the period. This 12-year limitation does not apply to foreign investment companies. The Law has defined certain actions that are deemed as dividend distributions and would trigger the recapture of tax benefits. The Israeli government grants that we received require us to meet several conditions and restrict our ability to manufacture and engineer products and transfer know-how outside of Israel and require us to satisfy specified conditions.

We have received grants from the Israeli National Authority for Technological Innovation, formerly known as the Office of the Chief Scientist of Israel's Ministry of Economy and Industry ("OCS") for the financing of a portion of our research and development expenditures in Israel. When know-how is developed using or in connection with OCS grants, we are subject to restrictions on the transfer of the know-how outside of Israel. Transfer of know-how outside of Israel requires pre-approval by the OCS which may at its sole discretion grant such approval and impose certain conditions, and is subject to the payment of a transfer fee calculated according to the formula provided in the R&D Law which takes into account, inter alia, the consideration for such know-how paid to us in the transaction in which the technology is transferred. In general, transfer fees are no less than the funding received plus interest less the royalties already paid for the transferred know-how and are not higher than six times the amount of the grants received by the company. In addition, any decrease of the percentage of manufacturing performed in Israel, as originally declared in the application to the OCS, requires us to obtain the approval of the OCS and may result in increased amounts to be paid to the OCS. These restrictions may impair our ability to enter into agreements for those products or technologies without the approval of the OCS. We cannot be certain that any approval of the OCS will be obtained on terms that are acceptable to us, or at all. Furthermore, in the event that we undertake a transaction involving the transfer to a non-Israeli entity of technology developed with OCS funding pursuant to a merger or similar transaction, the consideration available to our shareholders may be reduced by the amounts we are required to pay to the OCS. Any approval, if given, will generally be subject to additional financial obligations. If we fail to comply with the conditions imposed by the OCS, we may be required to refund any payments previously received, together with interest and penalties as well as tax benefits. Also, failure to meet the restrictions concerning transfer of know-how outside of Israel may trigger criminal liability.

Your rights and responsibilities as a shareholder will be governed by Israeli law and differ in some respects from the rights and responsibilities of shareholders under U.S. law.

We are incorporated under Israeli law. The rights and responsibilities of holders of our ordinary shares are governed by our amended and restated articles of association and by Israeli law. These rights and responsibilities differ in some respects from the rights and responsibilities of shareholders in typical U.S. corporations. In particular, a shareholder of an Israeli company has a duty to act in good faith toward the company and other shareholders and to refrain from abusing his, her or its power in the company, including, among other things, in voting at the general meeting of shareholders on certain matters.

#### Risks Related to Our Ordinary Shares

The price of our ordinary shares may continue to be volatile, and the value of an investment in our ordinary shares may decline.

During 2017, our shares traded as low as \$40.70 per share and as high as \$65.90 per share. Factors that could cause volatility in the market price of our ordinary shares include, but are not limited to:

- quarterly variations in our results of operations or those of our competitors;
- announcements by us, our competitors, our customers or rumors from sources other than our company related to acquisitions, new products, significant contracts, commercial relationships, capital commitments or changes in the competitive landscape;
- our ability to develop and market new and enhanced products on a timely basis;

• disruption to our operations;  
• geopolitical instability;  
• the emergence of new sales channels in which we are unable to compete effectively;  
• any major change in our board of directors or management;

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• changes in financial estimates, including our ability to meet our future revenue and operating profit or loss projections;

• changes in governmental regulations or in the status of our regulatory approvals;

• general economic conditions and slow or negative growth of related markets;

• anticompetitive practices of our competitors;

• commencement of, or our involvement in, litigation;

• whether our operating results meet our guidance or the expectations of investors or securities analysts;

• continuing international conflicts and acts of terrorism; and

• changes in accounting rules.

We may need to raise additional capital, which might not be available or which, if available, may be on terms that are not favorable to us.

We may need to raise additional funds, and we cannot be certain that we will be able to obtain additional financing on favorable terms, if at all. If we issue equity securities to raise additional funds, the ownership percentage of our shareholders would be diluted, and the new equity securities may have rights, preferences or privileges senior to those of existing holders of our ordinary shares. If we borrow money, we may incur significant interest charges, which could harm our profitability. Holders of debt may also have certain rights, preferences or privileges senior to those of existing holders of our ordinary shares. If we cannot raise needed funds on acceptable terms, we may not be able to develop or enhance our products, take advantage of future opportunities or respond to competitive pressures or unanticipated requirements, which could harm our business, financial condition and results of operations.

If we sell our ordinary shares in future financings, ordinary shareholders could experience immediate dilution and, as a result, the market price of our ordinary shares may decline.

We may from time to time issue additional ordinary shares at a discount from the current trading price of our ordinary shares. As a result, our ordinary shareholders would experience immediate dilution upon the purchase of any ordinary shares sold at such discount. In addition, as opportunities present themselves, we may enter into equity or debt financings or similar arrangements in the future, including the issuance of convertible debt securities, preferred shares or ordinary shares. If we issue ordinary shares or securities convertible into ordinary shares, holders of our ordinary shares could experience dilution.

The ownership of our ordinary shares may continue to be concentrated, and certain shareholders may have significant influence over the outcome of corporate actions requiring shareholder approval.

As of December 31, 2017, based on information filed with the SEC or reported to us, Starboard Value LP beneficially owned an aggregate of approximately 10.7% of our outstanding ordinary shares, Capital Research Global Investors beneficially owned an aggregate of approximately 5.9% of our outstanding ordinary shares, FMR, LLC beneficially owned an aggregate of approximately 5.5% of our outstanding ordinary shares, and DNB Asset Management AS owned an aggregate of approximately 5.4% of our outstanding ordinary shares. These shareholders and any other shareholders acquiring beneficial ownership of a significant amount of our outstanding ordinary shares may have significant influence over the outcome of corporate actions requiring shareholder approval, including the election of directors, any merger, consolidation or sale of all or substantially all of our assets or any other significant corporate transaction.

Our business could be negatively affected as a result of a proxy contest.

On January 17, 2018, Starboard Value and Opportunity Master Fund Ltd delivered a letter to us notifying us of its intention to nominate director candidates for election to our board of directors at our 2018 Annual General Meeting of Shareholders and solicit proxies from stockholders in support of its nominees. Responding to any proxy contest may be disruptive and costly for our business.

If securities or industry analysts do not publish research or reports about our business, if they adversely change their recommendations regarding our ordinary shares or if our operating results do not meet their expectations, the market price of our ordinary shares could decline.

The trading market for our ordinary shares could be influenced by the research and reports that industry or securities analysts publish about us or our business. If one or more of these analysts cease coverage of our company or fail to publish reports on us regularly, we could lose visibility in the financial markets, which in turn could cause the price of

our ordinary shares or trading volume in our ordinary shares to decline. Moreover, if one or more of the analysts who cover our company

downgrades our ordinary shares or if our operating results do not meet their expectations, the market price of our ordinary shares could decline.

Provisions of our articles of association could delay or prevent an acquisition of our company, even if the acquisition would be beneficial to our shareholders, and could make it more difficult for shareholders to change management. Provisions of our amended and restated articles of association may discourage, delay or prevent a merger, acquisition or other change in control that shareholders may consider favorable, including transactions in which shareholders might otherwise receive a premium for their shares. In addition, these provisions may frustrate or prevent any attempt by our shareholders to replace or remove our current management by making it more difficult to replace or remove our board of directors. These provisions include:

- no cumulative voting;

- a requirement for any merger involving the Company shall require the approval of the shareholders of at least a majority of the voting power of the Company;

- a requirement for the approval of at least 75% of the voting power represented at the general meeting of the shareholders for the removal of any director from office, and election of any director instead of the director so removed; and

- an advance notice requirement for shareholder proposals and nominations.

Furthermore, Israeli tax law treats some acquisitions, particularly share-for-share swaps between an Israeli company and a foreign company, less favorably than U.S. tax law. Under certain circumstances and subject to receiving a ruling from the Israeli Tax Authority, Israeli tax law generally provides that a shareholder who exchanges our shares for shares that are listed for trading on an Exchange in a foreign corporation is treated as if the shareholder has sold the shares. In such a case, the shareholder will generally be subject to Israeli taxation on any capital gains from the sale of shares (after two years, with respect to one half of the shares, and after four years, with respect to the balance of the shares, in each case unless the shareholder sells such shares at an earlier date), unless a relevant tax treaty between Israel and the country of the shareholder's residence exempts the shareholder from Israeli tax. For a further discussion of Israeli laws relating to mergers and acquisitions, please see "Risk Factors - Risks Related to Operations in Israel and Other Foreign Countries - Provisions of Israeli law may delay, prevent or make difficult an acquisition of our company, which could prevent a change of control and therefore depress the price of our shares." These provisions in our amended and restated articles of association and other provisions of Israeli law could limit the price that investors are willing to pay in the future for our ordinary shares.

We have never paid cash dividends on our share capital, and, while the Board regularly reviews our cash position and uses for cash, we do not anticipate paying any cash dividends in the foreseeable future.

We currently intend to retain all available funds and any future earnings to fund the development and growth of our business. As a result, capital appreciation, if any, of our ordinary shares will be your sole source of gain for the foreseeable future.

We may incur increased costs as a result of changes in laws and regulations relating to corporate governance matters. Changes in the laws and regulations affecting public companies, including Israeli laws, rules adopted by the SEC, the NASDAQ Stock Market, the FASB and the Public Company Accounting Oversight Board, may result in increased costs to us as we respond to their requirements. These laws and regulations could make it more difficult or more costly for us to obtain certain types of insurance, including director and officer liability insurance, and we may be forced to accept reduced policy limits and coverage or incur substantially higher costs to obtain the same or similar coverage. The impact of these requirements could also make it more difficult for us to attract and retain qualified persons to serve on our board of directors, our board committees or as executive officers. We cannot predict or estimate the amount or timing of additional costs we may incur to respond to these requirements.

#### ITEM 1B—UNRESOLVED STAFF COMMENTS

None.

#### ITEM 2—PROPERTIES

As of December 31, 2017, our major facilities consisted of:



	Israel	United States	Other	Total
Leased facilities (in thousands of square feet)	1,002	120	63	1,185

Our United States business headquarters are located in Sunnyvale, California, and our engineering headquarters are located in Yokneam, Israel. We believe that our existing facilities will be adequate to meet our current requirements and that suitable additional or substitute space will be available on acceptable terms to accommodate our foreseeable needs.

### ITEM 3—LEGAL PROCEEDINGS

See Note 9 to the consolidated financial statements for a full description of legal proceedings and related contingencies and their effects on our consolidated financial position, results of operations and cash flows.

We may, from time to time, become a party to various other legal proceedings arising in the ordinary course of business. We may also be indirectly affected by administrative or court proceedings or actions in which we are not involved, but which have general applicability to the semiconductor industry.

### ITEM 4—MINE SAFETY DISCLOSURES

Not applicable.

## PART II

### ITEM 5—MARKET FOR REGISTRANT'S ORDINARY SHARES, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

#### Market Information

Our ordinary shares began trading on The NASDAQ Global Market on February 8, 2007 under the symbol "MLNX". Prior to that date, our ordinary shares were not traded on any public exchange.

The following table summarizes the high and low sales prices for our ordinary shares as reported by The NASDAQ Global Select Market.

2017	High	Low
First quarter	\$52.80	\$40.70
Second quarter	\$52.65	\$41.55
Third quarter	\$47.95	\$42.05
Fourth quarter	\$65.90	\$42.25

2016	High	Low
First quarter	\$55.80	\$37.54
Second quarter	\$55.45	\$40.54
Third quarter	\$52.15	\$39.53
Fourth quarter	\$46.20	\$38.75

As of February 10, 2018, we had approximately 232 holders of record of our ordinary shares. This number does not include the number of persons whose shares are in nominee or in "street name" accounts through brokers.

#### Share Performance Graph

The graph below compares the five-year cumulative total shareholder return on our ordinary shares with the cumulative total return on The NASDAQ Composite Index and The Philadelphia Semiconductor Index. The period shown commences on December 31, 2012 and ends on December 31, 2017, the end date of our last fiscal year. The graph assumes an investment of \$100 on December 31, 2012, and the reinvestment of any dividends. No cash dividends have been declared or paid on our ordinary shares during such period. Shareholder returns over the indicated periods should not be considered indicative of future share prices or shareholder returns.



	12/31/2012 *	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017
Mellanox Technologies	100.00	67.31	71.96	70.97	68.88	108.96
NASDAQ Composite Index	100.00	138.32	156.85	165.84	178.28	228.63
Philadelphia Semiconductor Index	100.00	139.31	178.84	172.75	236.02	326.26

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\* \$100 invested on December 31, 2012 in shares or index-including reinvestment of dividends.

#### Dividends

We have not declared or paid any cash dividends on our ordinary shares in the past, and we do not anticipate declaring or paying cash dividends in the foreseeable future. The Companies Law also restricts our ability to declare dividends. We can only distribute dividends from profits (the "Profit Test") (as defined in the Companies Law) and only if there is no reasonable concern that the dividend distribution will prevent us from meeting our existing and foreseeable obligations as they come due (the "Insolvency Test"); provided that, with court approval, we may distribute dividends if we do not meet the Profit Test so long as we meet the Insolvency Test.

If we elect to distribute dividends out of income derived from "Approved Enterprise" operations, we will be subject to tax on the gross amount distributed. The tax rate will be the rate which would have been applicable had we not been granted the beneficial status. These dividend tax rules may also apply to our acquisitions outside Israel if they are made with cash from tax benefited income.

#### Securities Authorized for Issuance under Equity Compensation Plans

Our equity compensation plan information required by this item is incorporated by reference to the information in Part III, Item 12 of this report. For additional information on our share incentive plans and activity, see Note 10 to the consolidated financial statements.

#### Recent Sales of Unregistered Securities

None.

## ITEM 6—SELECTED FINANCIAL DATA

The following selected consolidated financial data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and related notes included elsewhere in this report. We derived the consolidated balance sheet data for the years ended December 31, 2015, 2014, and 2013 and our consolidated statements of operations data for the years ended December 31, 2014 and 2013, from our audited consolidated financial statements not included in this report. We derived the consolidated statements of operations data for each of the three years in the period ended December 31, 2017, as well the consolidated balance sheet data as of December 31, 2017 and 2016, from our audited consolidated financial statements included elsewhere in this report. Our historical results are not necessarily indicative of results to be expected in any future period.

	Year ended December 31,				
	2017	2016 (1)	2015	2014	2013
	(In thousands, except per share data)				
Consolidated Statement of Operations Data:					
Total revenues	\$863,893	\$857,498	\$658,140	\$463,649	\$390,436
Cost of revenues	300,450	301,986	189,209	148,672	134,282
Gross profit	563,443	555,512	468,931	314,977	256,154
Operating expenses:					
Research and development	365,878	322,620	252,175	208,877	169,382
Sales and marketing	150,457	133,780	97,438	76,860	70,544
General and administrative	52,170	68,522	44,212	36,431	37,046
Impairment of long-lived assets	12,019	—	—	—	—
Total operating expenses	580,524	524,922	393,825	322,168	276,972
Income (loss) from operations	(17,081 )	30,590	75,106	(7,191 )	(20,818 )
Interest expense	(7,937 )	(7,352 )	—	—	—
Other income (loss), net	3,115	1,090	(524 )	1,449	1,228
Interest and other, net	(4,822 )	(6,262 )	(524 )	1,449	1,228
Income (loss) before taxes on income	(21,903 )	24,328	74,582	(5,742 )	(19,590 )
Provision for (benefit from) taxes on income	(2,478 )	5,810	(18,312 )	18,267	3,752
Net income (loss)	\$(19,425 )	\$18,518	\$92,894	\$(24,009 )	\$(23,342 )
Net income (loss) per share — basic	\$(0.39 )	\$0.38	\$2.00	\$(0.54 )	\$(0.54 )
Net income (loss) per share — diluted	\$(0.39 )	\$0.37	\$1.94	\$(0.54 )	\$(0.54 )
Shares used in computing net income (loss) per share:					
Basic	50,310	48,145	46,365	44,831	43,421
Diluted	50,310	49,526	47,778	44,831	43,421

	December 31,				
	2017	2016 (1)	2015	2014 (2)	2013 (2)
	(In thousands)				
Consolidated Balance Sheet Data:					
Cash and cash equivalents	\$62,473	\$56,780	\$263,199	\$51,326	\$63,164
Short-term investments	211,281	271,661	247,314	334,038	263,528
Working capital	310,286	340,511	540,108	396,591	344,825
Long-term assets	895,015	920,427	376,144	348,982	363,939
Total assets	1,401,934	1,473,505	1,053,382	863,218	806,826
Current liabilities	196,633	212,567	137,130	117,645	98,062
Long-term liabilities	147,853	285,208	49,571	43,821	41,953
Total liabilities	344,486	497,775	186,701	161,466	140,015
Total shareholders' equity	\$1,057,448	\$975,730	\$866,681	\$701,752	\$666,811

(1) On February 23, 2016, we acquired EZchip. EZchip's results of operations and estimated fair value of assets acquired and liabilities assumed were included in our consolidated financial statements beginning February 23, 2016.

(2) In November 2015, the Financial Accounting Standards Board issued guidance requiring current deferred tax assets, current deferred tax liabilities and related current valuation allowances to be reclassified as non-current. As a result of adoption of this guidance, we made the following adjustments to selected consolidated financial data:

	Year ended	
	December 31,	
	2014	2013
	(in thousands)	
Working capital decrease	\$(2,271)	\$(7,336)
Long-term assets increase	2,271	7,336

## ITEM 7—MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion and analysis of our financial condition and results of operations in conjunction with the financial statements and the notes thereto included elsewhere in this report. The following discussion contains forward-looking statements that reflect our plans, estimates and beliefs. Our actual results could differ materially from those discussed in the forward-looking statements. Factors that could cause or contribute to these differences include those discussed below and elsewhere in this report, particularly in the section entitled "Risk Factors".

### Overview

#### General

We are a fabless semiconductor company that designs, manufactures (through subcontractors) and sells high-performance interconnect products and solutions primarily based on the Ethernet and InfiniBand standards. Our products facilitate efficient data transmission between servers, storage systems, communications infrastructure equipment and other embedded systems. We operate our business globally and offer products to customers at various levels of integration. The products we offer include ICs, adapter cards, switch systems, cables, modules, software, services and accessories. Together these products form a total end-to-end integrated networking solution focused on computing, storage and communication applications used in multiple markets, including HPC, cloud, Web 2.0, Big Data, machine learning, storage, telecommunications, financial services, and EDC. These solutions increase performance, application efficiency and improve return on investment. Through the successful development and implementation of multiple generations of our products, we have established significant expertise and competitive advantages.

As a leader in developing multiple generations of high-speed interconnect solutions, we have established strong relationships with our customers. Our products are incorporated in servers and associated networking solutions produced by the largest server vendors. We supply our products to leading storage and communications infrastructure equipment vendors. Additionally, our products are used in embedded solutions.

We are one of the pioneers of InfiniBand, an industry-standard architecture for high-performance interconnects. We believe InfiniBand interconnect solutions deliver industry-leading performance, efficiency and scalability for clustered computing and

storage systems that incorporate our products. In addition to supporting InfiniBand, our products also support industry-standard Ethernet transmission protocols providing unique product differentiation and connectivity flexibility. Our products serve as building blocks for creating reliable and scalable Ethernet and InfiniBand solutions with leading performance. We also believe that we are one of the early suppliers of 25/50/100Gb/s Ethernet adapters, switches, and cables to the market. This provides us with the opportunity to gain share in the Ethernet market as users upgrade from one or 10Gb/s directly to 25/40/50 or 100Gb/s.

Our revenues for the years ended December 31, 2017, 2016 and 2015 were \$863.9 million, \$857.5 million, and \$658.1 million, respectively. In order to increase our annual revenues, we must continue to achieve design wins over other Ethernet providers and providers of competing interconnect technologies. We consider a design win to occur when an original equipment manufacturer ("OEM"), or contract manufacturer notifies us that it has selected our products to be incorporated into a product or system under development. Because the life cycles for our customers' products can last for several years if these products have successful commercial introductions, we expect to continue to generate revenues over an extended period of time for each successful design win.

#### EZchip Acquisition

On February 23, 2016, we completed our acquisition of EZchip, a public company formed under the laws of the State of Israel, at which time EZchip became our wholly owned subsidiary. Under the terms of the Merger Agreement, the net cash purchase price of \$693.7 million consisted of a \$781.2 million cash payment for all outstanding common shares of EZchip at the price of \$25.50 per share, net of \$87.5 million of cash acquired. We also assumed 891,822 EZchip RSUs and converted them to 499,894 equivalent Mellanox RSU awards. The fair value of the converted RSUs was determined based on the per share value of the underlying Mellanox ordinary shares of \$46.40 per share as of the acquisition date. The 499,894 RSUs had a total aggregate value of \$23.2 million, of which \$1.0 million was recorded as a component of the purchase price for service rendered prior to the acquisition date and \$22.2 million will be recognized as share-based compensation expense over the remaining required service period of up to 2.25 years from the acquisition date.

In connection with the acquisition, we entered into a \$280.0 million variable interest rate Term Debt maturing February 21, 2019. For additional information on the Term Debt, see Note 15 to the consolidated financial statements. We accounted for the transaction using the acquisition method, which requires, among other things, that the assets acquired and liabilities assumed in a business combination be recognized at their respective fair values as of the acquisition date.

Acquisition-related expenses for the EZchip acquisition for the years ended December 31, 2017 and 2016 were \$0.3 million and \$8.3 million, respectively, and primarily consisted of investment banking, consulting, and other professional fees.

#### Amortization of Intangible Assets from Acquisitions

Intangible assets from acquisitions subject to amortization are comprised of trade names, customer relationships, backlog, and developed technology. In connection with the EZchip acquisition, we recognized \$254.5 million of finite-lived intangible assets subject to amortization over their useful lives of 1 to 9 years. Amortization of intangible assets, including acquired intangible assets, was \$61.3 million, \$59.2 million and \$10.1 million for the years ended December 31, 2017, 2016 and 2015, respectively. The increased amortization is primarily associated with the EZchip acquisition. For additional information about intangible assets from acquisitions, see Note 6 to the consolidated financial statements.

#### Patent Settlement

On March 7, 2016, we entered into a settlement and patent license agreement that resolved all litigation matters between Avago (now Broadcom), IPtronics, Inc., IPtronics A/S (now Mellanox Technologies Denmark Aps) and Mellanox. Under the settlement, both parties agreed not to sue each other for a period of 5 years. The settlement was deemed not contributory to our operations or products sold. As a result, we recorded a settlement expense in our operating expenses in the amount of \$5.1 million in our first quarter ended March 31, 2016.

#### Our Business

Revenues. We derive revenues from sales of our ICs, boards, switch systems, cables, modules, software, accessories and other product groups. Our products have broad adoption with multiple end customers across HPC, machine

learning, Web 2.0, cloud, EDC, financial services and storage markets; however, these markets are mainly served by leading server, storage and communications infrastructure OEMs. Therefore, we have derived a substantial portion of our revenues from a relatively small number of OEM customers. Sales to our top ten customers represented 56%, 55% and 57% of our total revenues for the years ended December 31, 2017, 2016 and 2015, respectively. Sales to customers representing 10% or more of revenues accounted for 24%, 16% and 14% of our total revenues for the years ended December 31, 2017, 2016 and 2015, respectively. The loss of one or more of our principal customers, the reduction or deferral of purchases, or changes in the mix of our products ordered by any one of these customers could cause our revenues to decline materially if we are unable to increase our revenues from other customers. Our customers, including our most significant customers, are not obligated by long-term contracts to purchase our products and may cancel orders with limited

potential penalties. If any of our large customers reduces or cancels its purchases from us for any reason, it could have an adverse effect on our revenues and results of operations.

**Cost of revenues and gross profit.** The cost of revenues consists primarily of the cost of silicon wafers purchased from our foundry supplier, costs associated with the assembly, packaging and production testing of our ICs, outside processing costs associated with the manufacture of our products, royalties due to third parties, warranty costs, excess and obsolete inventory costs, depreciation and amortization, and costs of personnel associated with production management, quality assurance and services. In addition, after we purchase wafers from our foundries, we also face yield risk related to manufacturing these wafers into semiconductor devices. Manufacturing yield is the percentage of acceptable product resulting from the manufacturing process, as identified when the product is tested as a finished IC. If our manufacturing yields decrease, our cost per unit increases, which could have a significant adverse impact on our cost of revenues. We do not have long-term pricing agreements with foundry suppliers and contract manufacturers. Accordingly, our costs are subject to price fluctuations based on the overall cyclical demand for semiconductors. We purchase our inventory pursuant to standard purchase orders. We estimate that lead times for delivery of our finished semiconductors from our foundry supplier and assembly, packaging and production testing subcontractor are approximately three to four months, lead times for delivery from our adapter card manufacturing subcontractor are approximately eight to ten weeks, lead times for delivery from our cable and transceiver manufacturing subcontractor are approximately ten to twelve weeks, and lead times for delivery from our switch systems manufacturing subcontractors are approximately twelve weeks. We build inventory based on forecasts of customer orders rather than the actual orders themselves.

We expect our cost of revenues as a percentage of sales to increase in the future as a result of a reduction in the average sale price of our products and a lower percentage of revenue deriving from sales of ICs and boards, which generally yield higher gross margins than sales of switches and cables. This trend will depend on overall customer demand for our products, our product mix, competitive product offerings and related pricing and our ability to reduce manufacturing costs.

#### **Operational expenses**

**Research and development expenses.** Our research and development expenses consist primarily of salaries, share-based compensation and associated costs for employees engaged in research and development, depreciation, amortization of intangibles, allocable facilities and administrative expenses and tape-out costs. Tape-out costs are expenses related to the manufacture of new ICs, including charges for mask sets, prototype wafers, mask set revisions and testing incurred before releasing new ICs into production.

**Sales and Marketing Expenses.** Sales and marketing expenses consist primarily of salaries, incentive compensation, share-based compensation and associated costs for employees engaged in sales and marketing, field applications engineering and sales engineering, advertising, trade shows and promotions, travel, amortization of intangibles, and allocable facilities and administrative expenses.

**General and Administrative Expenses.** General and administrative expenses consist primarily of salaries, share-based compensation and associated costs for employees engaged in finance, legal, human resources and administrative activities, professional service expenses for accounting, corporate legal fees and allocable facilities related expenses.

#### **Taxes on Income**

On December 22, 2017, the Tax Cuts and Jobs Acts was enacted into law. The new legislation contains several key tax provisions that will impact us. Changes include, but are not limited to, a corporate tax rate decrease from 35% to 21% effective for tax years beginning after December 31, 2017, a one-time repatriation tax on accumulated foreign earnings, a limitation on the tax deductibility of interest expense, an acceleration of business asset expensing, and a reduction in the amount of executive pay that could qualify as a tax deduction. The lower corporate income tax rate will require us to remeasure our U.S. deferred tax assets and liabilities as well as reassess the realizability of our deferred tax assets and liabilities. ASC 740 requires us to recognize the effect of the tax law changes in the period of enactment. However, the SEC staff has issued SAB 118 which will allow us to record provisional amounts during a measurement period.

We have concluded that a reasonable estimate could be developed for the effects of the tax reform. However, due to the short time frame between the enactment of the reform and the year end, its fundamental changes, the accounting

complexity, and the expected ongoing guidance and accounting interpretations over the next 12 months, we consider the accounting of the deferred tax remeasurement and other items to be incomplete. These effects have been included in the consolidated financial statements for the year ended December 31, 2017 as provisional amounts, which had no effect on the benefit from taxes on income due to the valuation allowance.

During the measurement period, we might need to reflect adjustments to the provisional amounts upon obtaining, preparing, or analyzing additional information about facts and circumstances that existed as of the enactment date that, if known, would have affected the income tax effects initially reported as provisional amounts.



The measurement period will end when we obtain, prepare, and analyze the information needed in order to complete the accounting requirements under ASC Topic 740 or on December 22, 2018, whichever is earlier. We expect to complete our analysis within the measurement period in accordance with SAB 118.

Our operations in Israel have been granted "Approved Enterprise" status by the Investment Center of the Israeli Ministry of Economy and Industry (formerly, the Ministry of Industry, Trade and Labor) and "Beneficiary Enterprise" status by the Israeli Income Tax Authority, which makes us eligible for tax benefits under the Israeli Law for Encouragement of Capital Investments, 1959. Under the terms of the Approved and Beneficiary Enterprise programs, income that is attributable to our operations in Yokneam, Israel is exempt from income tax commencing fiscal year 2011 through 2021. Income that is attributable to our operations in Tel Aviv, Israel is subject to a reduced income tax rate (generally between 10% and the current corporate tax rate, depending on the percentage of foreign investment in the Company) commencing fiscal year 2013 through 2021.

On January 4, 2016 the Israeli Government legislated a reduction in corporate income tax rates from 26.5% to 25.0%, effective in 2016. On December 29, 2016, the Israeli Government legislated a reduction in corporate income tax rates from 25.0% to 24.0% in 2017 and to 23.0% in 2018 and thereafter.

On June 14, 2017, the Israeli government legislated new regulations regarding the "Preferred Technological Enterprise" regime, under which a company that complies with the terms may be entitled to certain tax benefits. We expect that our operations in Israel will comply with the terms of the Preferred Technological Enterprise regime. Therefore, we may utilize the tax benefits under this regime after the end of the benefit period of our Approved and Beneficiary Enterprise statuses (i.e. from fiscal year 2022 onwards). Under the new legislation, the majority of our income from our operations in Yokneam, Israel, will be subject to a corporate rate of 7.5%, while the majority of the income from our operations in Tel-Aviv, Israel, will be subject to a corporate rate of 12%. As a result of the lower tax rates mentioned above, we recorded a decrease of approximately \$0.2 million in deferred tax assets and a corresponding increase in tax expense during the second quarter of 2017.

To prepare our consolidated financial statements, we estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual tax exposure together with assessing temporary differences resulting from the differing treatment of certain items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet.

#### Critical Accounting Policies and Estimates

Our consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States. The preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures. We evaluate our estimates and assumptions on an ongoing basis. Our estimates are based on historical experience and various other assumptions that we believe to be reasonable under the circumstances. Our actual results could differ from these estimates.

We believe that the assumptions and estimates associated with the following areas would have the greatest potential impact on our consolidated financial statements. Therefore, we consider these to be our critical accounting policies and estimates. For further information on all of our significant accounting policies, please see Note 1 to the consolidated financial statements.

#### Revenue recognition

We recognize revenue from the sales of products when all of the following criteria are met: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred; (3) the price is fixed or determinable; and (4) collection is reasonably assured. We use a binding purchase order or a signed agreement as evidence of an arrangement. Delivery occurs when goods are shipped and title and risk of loss transfer to the customer. Our standard arrangement with our customers typically includes freight-on-board shipping point, no right of return and no customer acceptance provisions. The revenues from fixed-price support or maintenance contracts, including extended warranty contracts and software post-contract customer support agreements, are recognized ratably over the contract period and the costs associated with these contracts are recognized as incurred. The customer's obligation to pay and the payment terms are set at the time of shipment and are not dependent on the subsequent resale of the product. The Company determines whether collectability is reasonably assured on a customer-by-customer basis. We determine whether collectability is

reasonably assured on a customer-by-customer basis. When assessing the probability of collection, we consider the number of years the customer has been in business and the history of our collections. Customers are subject to a credit review process that evaluates the customers' financial positions and ultimately their ability to pay. If it is determined at the outset of an arrangement that collection is not reasonably assured, no product is shipped and no revenue is recognized unless cash is received in advance.

We maintain inventory, or hub arrangements with certain customers. Pursuant to these arrangements, we deliver products to a customer or a designated third party warehouse based upon the customer's projected needs, but do not recognize product revenue unless and until the customer reports it has removed our product from the warehouse to be incorporated into its end products.

### Multiple Element Arrangements

For revenue arrangements that contain multiple deliverables, judgment is required to properly identify the accounting units of the transactions and to determine the manner in which revenue should be allocated among the accounting units. Moreover, judgment is used in interpreting the commercial terms and determining when all criteria of revenue recognition have been met for each deliverable in order for revenue recognition to occur in the appropriate accounting period. While changes in the allocation of the arrangement consideration between the units of accounting will not affect the amount of total revenue recognized for a particular sales arrangement, any material changes in these allocations could impact the timing of revenue recognition, which could affect our results of operations.

For multiple element arrangements that include a combination of hardware, services, such as post-contract customer support, and software, the arrangement consideration is first allocated among the accounting units before revenue recognition criteria are applied. The allocation is derived based on vendor specific objective evidence ("VSOE").

When VSOE or third party evidence is unavailable, we use management's best estimate of selling price.

### Distributor Revenue

A portion of our sales are made to distributors under agreements which contain price protection provisions. Currently, we recognize revenues from sales to distributors based on the sell-through method using inventory and point of sale information provided by the distributors, net of estimated allowances for price adjustments. Upon the adoption of the new revenue standards effective January 1, 2018, we will recognize revenues from sales to distributors upon shipment and transfer of control (known as "sell-in" revenue recognition), net of the estimated allowances for price adjustments.

### Short-term investments

We classify short-term investments as available-for-sale securities. We view our available-for-sale-portfolio as available for use in current operations. Available-for-sale securities are recorded at fair value, and we record temporary unrealized gains and losses as a separate component of accumulated other comprehensive income (loss). We regularly review our investment portfolio and charge unrealized losses against net income when a decline in fair value is determined to be other-than-temporary. We review several factors to determine whether a loss is other-than-temporary. These factors include but are not limited to: (1) the length of time a security is in an unrealized loss position, (2) the extent to which fair value is less than cost, (3) the financial condition and near term prospects of the issuer and (4) our intent and ability to hold the security for a period of time sufficient to allow for any anticipated recovery in fair value.

### Fair value of financial instruments

Our financial instruments consist of cash, cash equivalents, restricted cash, short-term investments and foreign currency derivative contracts. When there is no readily available market data, we may make fair value estimates, which may not necessarily represent the amounts that could be realized in a current or future sale of these assets.

### Derivatives

We enter into foreign currency forward and option contracts with financial institutions to protect against foreign exchange risks, mainly the exposure to changes in the exchange rate of the NIS against the U.S. dollar that are associated with forecasted future cash flows and existing assets and liabilities. We account for our derivative instruments as either assets or liabilities and carry them at fair value. The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and the resulting designation. For derivative instruments that hedge the exposure to variability in expected future cash flows that are designated as cash flow hedges, the effective portion of the gains or losses on the derivative instruments is reported as a component of accumulated other comprehensive income ("AOCI") in shareholders' equity and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The ineffective portion of the gains or losses on the derivative instruments, if any, is recognized in earnings in the current period. Our derivative instruments that hedge the exposure to variability in the fair value of assets or liabilities are not currently designated as hedges for financial reporting purposes, and thus the gains or losses on such derivative instruments are recognized in earnings in the current period.

### Inventory valuation

Inventory includes finished goods, work-in-process and raw materials. Inventory is stated at the lower of cost (principally standard cost which approximates actual cost on a first-in, first-out basis) or net realizable value. Reserves for potentially excess and obsolete inventory are made based on management's analysis of inventory levels, future

sales forecasts and market conditions. Once established, the original cost of our inventory less the related inventory reserve represents the new cost basis of such products.

#### Property and equipment

Property and equipment are stated at cost, net of accumulated depreciation. Depreciation and amortization is generally calculated using the straight-line method over the estimated useful lives of the related assets, which is three years for computer equipment and software, seven years for lab equipment, and seven years for office furniture and fixtures. Leasehold improvements and assets acquired under capital leases are amortized on a straight-line basis over the term of the lease, or the useful lives of the assets, whichever is shorter. Maintenance and repairs are charged to expense as incurred, and improvements are capitalized. When assets are retired or otherwise disposed of, the cost and accumulated depreciation or amortization are removed from the accounts and any resulting gain or loss is reflected in the results of operations in the period realized.

We capitalize certain costs incurred in connection with internal use of inventory items in our data centers and laboratories. Capitalized inventory costs are included in Property and equipment, net and amortized on a straight-line basis over the estimated useful life of the asset.

#### Business combinations

We account for business combinations using the acquisition method of accounting. We determine the recognition of intangible assets based on the following criteria: (i) the intangible asset arises from contractual or other rights; or (ii) the intangible asset is separable or divisible from the acquired entity and capable of being sold, transferred, licensed, returned or exchanged. We allocate the purchase price of business combinations to the tangible assets, liabilities and intangible assets acquired, including in-process research and development ("IPR&D"), based on their estimated fair values. The excess purchase price over those fair values is recorded as goodwill. The process of estimating the fair values requires significant estimates, especially with respect to intangible assets. Critical estimates in valuing certain intangible assets include, but are not limited to, future expected cash flows from customer contracts, customer lists and distribution agreements, acquired developed technologies, expected costs to develop IPR&D into commercially viable products, estimated cash flows from projects when completed and discount rates. We estimate fair value based upon assumptions that are believed to be reasonable, but which are inherently uncertain and unpredictable and, as a result, actual results may differ from estimates. Other estimates associated with the accounting for acquisitions may change as additional information becomes available regarding the assets acquired and liabilities assumed.

#### Goodwill and intangible assets

Goodwill represents the excess of the cost of acquired businesses over the fair market value of their identifiable net assets. We conduct a goodwill impairment qualitative assessment during the fourth quarter of each fiscal year or more frequently if facts and circumstances indicate that goodwill may be impaired. The goodwill impairment qualitative assessment requires us to perform an assessment to determine if it is more likely than not that the fair value of the business is less than its carrying amount. The qualitative assessment considers various factors, including the macroeconomic environment, industry and market specific conditions, market capitalization, stock price, financial performance, earnings multiples, budgeted-to-actual revenue performance from the prior year, gross margin and cash flow from operating activities and issues or events specific to the business. If adverse qualitative trends are identified that could negatively impact the fair value of the business, we perform a "two step" goodwill impairment test. "Step one" is the identification of potential impairment. This involves comparing the fair value of each reporting unit, which we have determined to be the entity itself, with its carrying amount including goodwill. If the fair value of a reporting unit exceeds its carrying amount, the goodwill of the reporting unit is considered not impaired and "Step two" of the impairment test is unnecessary. If the carrying amount of a reporting unit exceeds its fair value, "Step two" is performed and it involves comparing the carrying amount of goodwill to its implied fair value, which is determined to be the excess of the reporting unit's fair value over the fair value of its identifiable net assets other than goodwill. If the carrying amount of goodwill exceeds its implied fair value, an impairment exists and is recorded. As of December 31, 2017, our qualitative assessment of goodwill impairment indicated that goodwill was not impaired. Intangible assets represent acquired intangible assets including developed technology, customer relationships and IPR&D, as well as licensed technology. We amortize the finite lived intangible assets over their useful lives using a method that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used, or, if that pattern cannot be reliably determined, using a straight-line amortization method. We capitalize IPR&D

projects acquired as part of a business combination as intangible assets with indefinite lives. On completion of each project, IPR&D assets are reclassified to developed technology and amortized over their estimated useful lives. If any of the IPR&D projects are abandoned, we impair the related IPR&D asset.

Indefinite-lived intangible assets are tested for impairment annually or more frequently when indicators of impairment exist. We first assess qualitative factors to determine if it is more likely than not that an indefinite-lived intangible asset is impaired and whether it is necessary to perform a quantitative impairment test. The qualitative assessment considers various factors, including reductions in demand, the abandonment of IPR&D projects or significant economic slowdowns in the semiconductor industry and macroeconomic environment. If adverse qualitative trends are identified that could negatively impact the fair value of the asset, then quantitative impairment tests are performed to compare the carrying value of the asset to its undiscounted expected future cash flows. If this test indicates that there is impairment, the impaired asset is written down to fair value, which is typically calculated using: (i) quoted

market prices or (ii) discounted expected future cash flows utilizing an appropriate discount rate. Impairment is based on the excess of the carrying amount over the fair value of those assets. As of December 31, 2017, there were no indicators that impairment existed or assets were not recoverable. Intangible assets with finite lives are tested for impairment in accordance with our policy for long-lived assets.

#### Equity investments in privately-held companies

We account for these investments under the cost method, reduced by any impairment write-downs, because we do not have the ability to exercise significant influence over the operating and financial policies of these companies. To determine if an investment is recoverable, we monitor the investments and if facts and circumstances indicate the investment may be impaired, conduct an impairment test. The impairment test considers multiple factors including a review of the privately-held company's revenue and earnings trends relative to pre-defined milestones and overall business prospects, the general market conditions in its industry and other factors related to its ability to remain in business, such as liquidity and receipt of additional funding.

#### Impairment of long-lived assets

Long-lived assets include equipment and furniture and fixtures and finite-lived intangible assets. Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be fully recoverable. If the sum of the expected future cash flows (undiscounted and without interest charges) from the long-lived assets is less than the carrying amount of such assets, an impairment loss would be recognized, and the assets would be written down to their estimated fair values. We review for possible impairment on a regular basis.

While performing our review for impairment for the fourth quarter of 2017, we noted an impairment indicator associated with the potential sale or discontinuation of the 1550nm silicon photonics line of business. As a result, we recorded impairment charges totaling \$12.0 million in the fourth quarter of 2017, of which \$7.7 million were related to property and equipment and \$4.3 million were related to intangible assets. See Note 16 to the consolidated financial statements for more details about the impairment charges.

#### Warranty provision

We typically offer a limited warranty for our products for periods up to three years. We accrue for estimated returns of defective products at the time revenue is recognized based on historical activity. The determination of these accruals requires us to make estimates of the frequency and extent of warranty activity and estimated future costs to either replace or repair the products under warranty. If the actual warranty activity and/or repair and replacement costs differ significantly from these estimates, adjustments to record additional cost of revenues may be required in future periods.

#### Income taxes

To prepare our consolidated financial statements, we estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual tax exposure together with assessing temporary differences resulting from the differing treatment of certain items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are calculated using tax rates expected to be in effect during the period these temporary differences would reverse, and are included within our consolidated balance sheet.

We must also make judgments regarding the realizability of deferred tax assets. The carrying value of our net deferred tax assets is based on our belief that it is more likely than not that we will generate sufficient future taxable income in certain jurisdictions to realize these deferred tax assets. A valuation allowance has been established for deferred tax assets which we do not believe meet the "more likely than not" criteria. Our judgments regarding future taxable income may change due to changes in market conditions, changes in tax laws, tax planning strategies or other factors. If our assumptions and consequently our estimates change in the future, the valuation allowances we have established may be increased or decreased, resulting in a respective increase or decrease in income tax expense. Our effective tax rate is highly dependent upon the geographic distribution of our worldwide earnings or losses, the tax regulations and tax holidays in each geographic region, the availability of tax credits and carryforwards, and the effectiveness of our tax planning strategies.

We use a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with the guidance on judgments regarding the realizability of deferred taxes. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is more likely than not that the position will

be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. We consider many factors when evaluating and estimating our tax positions and tax benefits, which may require periodic adjustments and which may not accurately anticipate actual outcomes. We recognize potential accrued interest and penalties related to unrecognized tax benefits within the consolidated statements of income as income tax expense.



# Results of Operations

The following table sets forth our consolidated statements of operations as a percentage of revenues for the periods indicated:

	Year ended December 31,					
	2017	%	2016	%	2015	%
Total revenues	100	%	100	%	100	%
Cost of revenues	(35)	)	(35)	)	(29)	)
Gross profit	65		65		71	
Operating expenses:						
Research and development	42		38		38	
Sales and marketing	17		16		15	
General and administrative	6		7		7	
Impairment of long-lived assets	2		—		—	
Total operating expenses	67		61		60	
Income (loss) from operations	(2)	)	4		11	
Interest expense	(1)	)	(1)	)	—	
Other income (loss), net	—		—		—	
Interest and other, net	(1)	)	(1)	)	—	
Income (loss) before taxes on income	(3)	)	3		11	
Provision for (benefit from) taxes on income	(1)	)	1		(3)	)
Net income (loss)	(2)	)% 2	% 2		14	% 14

Comparison of the Year Ended December 31, 2017 to the Year Ended December 31, 2016 and the Year Ended December 31, 2016 to the Year Ended December 31, 2015

## Revenues.

The following tables represent our total revenues for the years ended December 31, 2017 and 2016 by product type and interconnect protocol:

	Year Ended December 31,					
	2017	% of Revenues	2016	% of Revenues		
	(In thousands)		(In thousands)			
ICs	\$161,216	18.7 %	\$170,641	19.9 %		
Boards	325,845	37.7 %	337,304	39.3 %		
Switch systems	222,836	25.8 %	204,083	23.8 %		
Cables, accessories and other	153,996	17.8 %	145,470	17.0 %		
Total Revenue	\$863,893	100.0 %	\$857,498	100.0 %		

	Year Ended December 31,					
	2017	% of Revenues	2016	% of Revenues		
	(In thousands)		(In thousands)			
InfiniBand:						
EDR	\$194,261	22.5 %	\$125,249	14.6 %		
FDR	181,465	21.0 %	302,093	35.2 %		
QDR/DDR/SDR	31,599	3.6 %	49,987	5.9 %		
Total	407,325	47.1 %	477,329	55.7 %		
Ethernet	401,005	46.4 %	317,241	37.0 %		
Other	55,563	6.5 %	62,928	7.3 %		

Total revenue    \$863,893   100.0   %   \$ 857,498   100.0   %

Revenues were \$863.9 million for the year ended December 31, 2017 compared to \$857.5 million for the year ended December 31, 2016, representing an increase of \$6.4 million, or approximately 0.7%. The year-over-year revenue increase in 2017 from 2016

was primarily attributable to increased demand for our 25, 50, and 100Gb/s Ethernet solutions. Revenues from our InfiniBand products decreased primarily due to declines in storage and embedded customers, driven by customer product transitions and customer M&A activity and lower average selling prices as a result of competition in the HPC market. Revenues from InfiniBand EDR products increased as customers continued transitioning from FDR and lower data rate products to the EDR product generation. Our 2017 revenues are not necessarily indicative of future results. The following tables represent our total revenues for the years ended December 31, 2016 and 2015 by product type and interconnect protocol:

	Year Ended December 31,					
	2016	% of	2015	% of		
	(In	Revenues	(In	Revenues		
	thousands)		thousands)			
ICs	\$170,641	19.9 %	\$92,214	14.0 %		
Boards	337,304	39.3 %	265,249	40.3 %		
Switch systems	204,083	23.8 %	179,977	27.3 %		
Cables, accessories and other	145,470	17.0 %	120,700	18.4 %		
Total Revenue	\$857,498	100.0 %	\$658,140	100.0 %		

	Year Ended December 31,					
	2016	% of	2015	% of		
	(In	Revenues	(In	Revenues		
	thousands)		thousands)			
InfiniBand:						
EDR	\$125,249	14.6 %	\$39,009	5.9 %		
FDR	302,093	35.2 %	347,760	52.8 %		
QDR/DDR/SDR	49,987	5.9 %	63,745	9.8 %		
Total	477,329	55.7 %	450,514	68.5 %		
Ethernet	317,241	37.0 %	155,221	23.6 %		
Other	62,928	7.3 %	52,405	7.9 %		
Total revenue	\$857,498	100.0 %	\$658,140	100.0 %		

Revenues were \$857.5 million for the year ended December 31, 2016 compared to \$658.1 million for the year ended December 31, 2015, representing an increase of \$199.4 million, or approximately 30.3%. The year-over-year Ethernet revenue increase in 2016 from 2015 was primarily attributable to increased demand for our adapters at 25Gb/s and above and incremental revenues from the EZchip acquisition derived from sales of ICs. Revenues from our InfiniBand products also increased primarily due to increased sales into HPC and cloud markets. Revenues from InfiniBand EDR products increased as customers continued transitioning from FDR and lower data rate products to the EDR product generation. The increase in other revenues was primarily due to higher revenue from support.

Gross Profit and Margin. Gross profit was \$563.4 million for the year ended December 31, 2017 compared to \$555.5 million for the year ended December 31, 2016, representing an increase of \$7.9 million, or approximately 1.4%. As a percentage of revenues, gross margin increased to 65.2% in the year ended December 31, 2017 from approximately 64.8% in the year ended December 31, 2016. The increase in gross margin was primarily due to a decrease in intangible asset amortization costs of \$5.6 million and inventory step-up amortization costs of \$8.3 million, both related to the EZchip acquisition, partially offset by the lower margins due to product mix. Gross margin for 2017 is not necessarily indicative of future results.

Gross profit was \$555.5 million for the year ended December 31, 2016 compared to \$468.9 million for the year ended December 31, 2015, representing an increase of \$86.6 million, or approximately 18.5%. As a percentage of revenues, gross margin decreased to 64.8% in the year ended December 31, 2016 from approximately 71.3% in the year ended December 31, 2015. The decrease in gross margin was primarily due to an increase in intangible asset amortization

costs of \$39.7 million and inventory step-up amortization costs of \$8.3 million, both related to the EZchip acquisition.

## Research and Development.

The following table presents details of our research and development expenses for the periods indicated:

	Year ended December 31,								
	2017	% of		2016	% of		2015	% of	
	(In	Revenues		(In	Revenues		(In	Revenues	
	thousands)			thousands)			thousands)		
Salaries and benefits	\$ 200,125	23.2	%	\$ 174,462	20.3	%	\$ 130,255	19.8	%
Share-based compensation	40,278	4.7	%	40,475	4.7	%	28,821	4.4	%
Development and tape-out costs	39,001	4.5	%	36,091	4.2	%	36,305	5.5	%
Other	86,474	10.0	%	71,592	8.4	%	56,794	8.6	%
Total Research and development	\$ 365,878	42.4	%	\$ 322,620	37.6	%	\$ 252,175	38.3	%

Research and development expenses were \$365.9 million for the year ended December 31, 2017 compared to \$322.6 million for the year ended December 31, 2016, representing an increase of \$43.3 million, or approximately 13.4%.

The increase in salaries and benefits expenses was primarily attributable to headcount additions and merit increases.

The increase in development and tape-out costs reflects continued investments in new products. The increase in other expenses was primarily due to higher depreciation expense and facilities costs.

Research and development expenses were \$322.6 million for the year ended December 31, 2016 compared to \$252.2 million for the year ended December 31, 2015, representing an increase of \$70.4 million, or approximately 27.9%.

The increase in salaries and benefits expenses was primarily attributable to headcount additions, including those associated with the EZchip acquisition, merit increases and higher accrued bonuses under our annual discretionary bonus award program. The increase in other expenses reflects higher outsourced services expenses, depreciation expense, and facilities costs.

Please refer to "Share-based Compensation Expense" below for a discussion of its impact on research and development expenses.

## Sales and Marketing.

The following table presents details of our sales and marketing expenses for the periods indicated:

	Year ended December 31,								
	2017	% of		2016	% of		2015	% of	
	(In	Revenues		(In	Revenues		(In	Revenues	
	thousands)			thousands)			thousands)		
Salaries and benefits	\$ 90,419	10.5	%	\$ 76,774	9.0	%	\$ 58,204	8.8	%
Share-based compensation	15,693	1.8	%	15,183	1.8	%	10,309	1.6	%
Trade shows and promotions	19,593	2.3	%	19,893	2.3	%	15,996	2.4	%
Other	24,752	2.8	%	21,930	2.5	%	12,929	2.0	%
Total Sales and marketing	\$ 150,457	17.4	%	\$ 133,780	15.6	%	\$ 97,438	14.8	%

Sales and marketing expenses were \$150.5 million for the year ended December 31, 2017 compared to \$133.8 million for the year ended December 31, 2016, representing an increase of \$16.7 million, or approximately 12.5%. The increase in salaries and benefits expenses was primarily related to headcount additions and merit increases. The increase in other expenses primarily reflects higher depreciation expense, amortization costs related to acquired intangible assets associated with the EZchip acquisition and facilities costs.

Sales and marketing expenses were \$133.8 million for the year ended December 31, 2016 compared to \$97.4 million for the year ended December 31, 2015, representing an increase of \$36.4 million, or approximately 37.3%. The increase in salaries and benefits was primarily attributable to headcount additions, including those associated with the EZchip acquisition, and merit increases. The increase in trade shows and promotions was due primarily to higher trade show exhibit costs and related travel costs. The increase in other expenses primarily reflects higher depreciation expense, amortization costs related to acquired intangible assets associated with the EZchip acquisition and facilities costs.

Please refer to "Share-based Compensation Expense" below for a discussion of its impact on sales and marketing expenses.

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## General and Administrative.

The following table presents details of our general and administrative expenses for the periods indicated:

	Year Ended December 31,											
	2017	% of Revenues			2016	% of Revenues			2015	% of Revenues		
	(In thousands)				(In thousands)				(In thousands)			
Salaries and benefits	\$21,476	2.5	%		\$ 20,976	2.4	%		\$ 16,050	2.4	%	
Share-based compensation	10,893	1.3	%		13,085	1.5	%		9,268	1.4	%	
Professional services	13,179	1.5	%		26,602	3.1	%		12,348	1.9	%	
Other	6,622	0.7	%		7,859	1.0	%		6,546	1.0	%	
Total General and administrative	\$52,170	6.0	%		\$ 68,522	8.0	%		\$ 44,212	6.7	%	

General and administrative expenses were \$52.2 million for the year ended December 31, 2017 compared to \$68.5 million for the year ended December 31, 2016, representing a decrease of \$16.3 million, or approximately 23.8%. The decrease in professional services expenses was primarily due to the fact that during 2016 we incurred \$8.3 million of investment banking, consulting and other professional fees related to the EZchip acquisition, and \$5.1 million of litigation settlement costs and legal fees.

General and administrative expenses were \$68.5 million for the year ended December 31, 2016 compared to \$44.2 million for the year ended December 31, 2015, representing an increase of \$24.3 million, or approximately 55.0%. The increase in salaries and benefits was primarily attributable to headcount additions, including those associated with the EZchip acquisition, merit increases and higher accrued bonuses under our annual discretionary bonus award program. The increase in professional services expenses was related to investment banking costs, consulting expenses and other professional fees related to the EZchip acquisition, litigation settlement costs and legal fees. The increase in other expenses was primarily related to higher depreciation and facilities costs.

Please refer to "Share-based Compensation Expense" below for a discussion of its impact on general and administrative expenses.

## Share-based Compensation Expense.

The following table presents details of our share-based compensation expense that is included in each functional line item in our consolidated statements of operations:

	Year ended December 31,		
	2017	2016	2015
	(in thousands)		
Cost of goods sold	\$2,000	\$2,375	\$2,366
Research and development	40,278	40,475	28,821
Sales and marketing	15,693	15,183	10,309
General and administrative	10,893	13,085	9,268
	\$68,864	\$71,118	\$50,764

Share-based compensation expenses were \$68.9 million for the year ended December 31, 2017, compared to \$71.1 million for the year ended December 31, 2016, representing a decrease of \$2.2 million, or approximately 3%. The decrease was primarily related to \$4.8 million of cash payments made during 2016 related to accelerated RSUs that were paid to individuals who were terminated on the closing date of the EZchip acquisition, partially offset by the additional expense due to new hires and focal grants.

Share-based compensation expenses were \$71.1 million for the year ended December 31, 2016, compared to \$50.8 million for the year ended December 31, 2015, representing an increase of \$20.3 million, or approximately 40%. The increase was primarily attributable to RSUs granted to existing employees during 2016 as part of our annual review process, RSUs assumed and granted to employees in conjunction with the acquisition of EZchip, RSUs granted to new hires, and expenses related to the acceleration of EZchip RSUs for employees terminated on the closing date.

Impairment of long-lived assets. While performing our review for impairment for the fourth quarter of 2017, we noted an impairment indicator associated with the potential sale or discontinuation of the 1550nm silicon photonics line of

business. As a result, we recorded impairment charges totaling \$12.0 million in the fourth quarter of 2017, of which \$7.7 million were related to property and equipment and \$4.3 million were related to intangible assets.



Interest and other, net. Interest and other, net was \$4.8 million for the year ended December 31, 2017 compared to \$6.3 million for the year ended December 31, 2016. The change was primarily attributable to a \$1.5 million increase in interest income and gains on short-term investments.

Interest and other, net was \$6.3 million for the year ended December 31, 2016 compared to \$0.5 million for the year ended December 31, 2015. The change was primarily attributable to \$7.4 million in interest expense associated with the Term Debt, a \$0.7 million increase in foreign exchange loss, and a \$0.8 million decrease in interest income and gains on short-term investments due to lower invested balances post EZchip acquisition, partially offset by a \$3.2 million impairment loss of investment in a privately-held company in the year ended December 31, 2015.

Provision for or Benefit from Taxes on Income. Our benefit from taxes on income was \$2.5 million for the year ended December 31, 2017 as compared to a provision for taxes on income of \$5.8 million for the year ended December 31, 2016. Our effective tax rate was 11.3% and 23.9% for 2017 and 2016, respectively. For the year ended December 31, 2017, the difference between the 11.3% effective tax rate and the 35% federal statutory rate resulted primarily from a decrease of \$15.7 million in deferred tax assets due to the effects of the recently enacted U.S. tax reform, partially offset by a \$10.4 million decrease in the valuation allowance primarily due to the same effects.

Our provision for taxes on income was \$5.8 million for the year ended December 31, 2016 as compared to a benefit from taxes on income of \$18.3 million for the year ended December 31, 2015. Our effective tax rate was 23.9% and (24.6)% for 2016 and 2015, respectively. For the year ended December 31, 2016, the difference between the 23.9% effective tax rate and the 35% federal statutory rate resulted primarily from the tax holiday in Israel and foreign earnings taxed at rates lower than the federal statutory rates which resulted in a reduction of approximately \$20.6 million, partially offset by the accrual of unrecognized tax benefits, interest and penalties associated with unrecognized tax positions in the amount of \$4.2 million, changes in valuation allowance in the amount of \$9.9 million mainly due to losses generated from subsidiaries without tax benefit and the reduction of deferred tax assets in the amount of \$2.7 million resulting from the reduction in the Israeli corporate income tax rates.

#### Liquidity and Capital Resources

On February 23, 2016, we completed the acquisition of EZchip and acquired its cash of approximately \$87.5 million and short term investments of \$108.9 million. We financed the acquisition purchase price of approximately \$782.2 million and related transaction expenses with cash on hand, and with \$280.0 million in term debt. The Term Debt agreement includes customary liquidity covenants and consists of a variable interest rate senior secured loan for the term of three years at an annualized variable interest rate based on, at our option, either (a) the London Interbank Offered Rate ("LIBOR") for Eurocurrency borrowing, or (b) an Alternate Base Rate ("ABR"), which is the highest of (i) the administrative agent's prime rate, (ii) one-half of 1.00% in excess of the overnight U.S. Federal Funds rate, and (iii) 1.00% in excess of the one-month LIBOR), plus in each case, an applicable margin. The Term Debt provides for an additional term loan borrowing under certain conditions. During the year ended December 31, 2017, we made principal payments of \$172.0 million, which included prepayments of \$146.5 million which were applied to future payment requirements. As of December 31, 2017, the outstanding principal amount of the Term Debt was \$74.0 million.

Historically, we have financed our operations through a combination of sales of equity securities and cash generated by operations. As of December 31, 2017, our principal source of liquidity consisted of cash and cash equivalents of \$62.5 million and short-term investments of \$211.3 million. After taking into consideration our forecasted operating expenses, including the restructuring charges as discussed in Note 17 to the consolidated financial statements, and capital expenditures to support our infrastructure and growth, we expect our current cash and cash equivalents, short-term investments, and our cash flows from operating activities will be sufficient to fund our operations and both our short-term and long-term liquidity requirements arising from interest and principal payments related to the Term Debt.

We are an Israeli company and as of December 31, 2017 our subsidiaries outside of Israel held approximately \$14.9 million in cash and cash equivalents and short term investments.

Our cash and cash equivalents, short-term investments, and working capital at December 31, 2017 and December 31, 2016 were as follows:

	Year ended	
	December 31,	
	2017	2016
	(in thousands)	
Cash and cash equivalents	\$62,473	\$56,780
Short-term investments	211,281	271,661
Total	\$273,754	\$328,441
Working capital	\$310,286	\$340,511

Our ratio of current assets to current liabilities was 2.6:1 at December 31, 2017 and 2016.

#### Operating Activities

Net cash provided by our operating activities amounted to \$161.3 million in the year ended December 31, 2017. Net cash provided by operating activities was attributable to net loss of \$19.4 million adjusted by net non-cash items of \$182.6 million, gain on short-term investments of \$3.5 million, and changes in assets and liabilities of \$1.6 million. Non-cash expenses consisted primarily of \$103.8 million of depreciation and amortization, \$68.9 million of share-based compensation, and \$12.0 million of impairment charges, partially offset by an increase in deferred income taxes of \$2.2 million. The \$1.6 million cash inflow from changes in assets and liabilities resulted from increases in accrued liabilities and other liabilities of \$15.2 million, primarily due to higher accrued salaries, benefits and severance liabilities, partially offset by, among other things, an increase in accounts receivable of \$12.2 million primarily due to the timing of sales.

Net cash provided by our operating activities amounted to \$196.1 million in the year ended December 31, 2016. Net cash provided by operating activities was attributable to net income of \$18.5 million adjusted by net non-cash items of \$163.1 million and changes in assets and liabilities of \$14.5 million (excluding the changes to assets and liabilities as a result of the EZchip acquisition). Non-cash expenses consisted primarily of \$66.3 million of share-based compensation, \$97.7 million of depreciation and amortization, and decreases in deferred income taxes of \$0.8 million, partially offset by a gain on investments of \$1.8 million. The \$14.5 million cash inflow from changes in assets and liabilities (excluding the changes to assets and liabilities as a result of the EZchip acquisition), resulted from decreases in inventories of \$8.3 million as a result of our effort to manage the inventory level, decreases in prepaid expenses and other assets of \$6.9 million, increases in accounts payable of \$13.3 million primarily due to the timing of payments, and increases in accrued and other liabilities of \$27.3 million primarily related to deferred revenue and salaries and benefits expenses, partially offset by an increase in accounts receivable of \$41.3 million primarily due to the timing of sales.

#### Investing Activities

Net cash provided by investing activities was \$2.0 million in the year ended December 31, 2017. Cash provided by investing activities was primarily attributable to net proceeds from sales, maturities and purchases of short-term investments of \$63.5 million, partially offset by \$41.4 million for purchases of property and equipment, \$15.0 million for purchases of investments in privately-held companies, \$2.8 million for purchases of intangible assets, \$1.3 million for purchases of severance-related insurance policies, and \$0.9 million of cash used for acquisitions.

Net cash used in investing activities was \$664.2 million in the year ended December 31, 2016. Cash used in investing activities was primarily attributable to \$693.7 million of net cash used to acquire EZchip, \$43.0 million for purchases of property and equipment, \$8.0 million for purchases of intangible assets, \$5.0 million for purchases of investments in privately-held companies, partially offset by net proceeds from sales, maturities and purchases of short-term investments of \$86.6 million.

#### Financing Activities

Net cash used in financing activities was \$149.6 million in the year ended December 31, 2017. Cash used in financing activities was primarily due to \$172.0 million of principal payments on the Term Debt and \$7.4 million of payments on intangible asset obligations, partially offset by \$29.7 million of proceeds from issuances of ordinary shares through our employee equity incentive plans.

Net cash provided by financing activities was \$261.6 million in the year ended December 31, 2016. Cash provided by financing activities was primarily due to \$280.0 million of proceeds from the Term Debt and \$22.6 million of proceeds from issuances of ordinary shares through employee equity incentive plans, partially offset by \$34.0 million of principal payments on the Term Debt and debt issuance costs of \$5.5 million.

#### Contractual Obligations

The following table summarizes our contractual obligations at December 31, 2017 and the effect those obligations are expected to have on our liquidity and cash flow in future periods:

## Contractual Obligations

	Total	Non-cancelable operating lease commitments	Purchase commitments	Term debt including interest
	(in thousands)			
2018	\$ 178,682	\$ 23,028	\$ 153,358	\$ 2,296
2019	95,220	18,453	2,447	74,320
2020	15,284	14,740	544	—
2021	13,492	12,950	542	—
2022	10,184	9,648	536	—
Thereafter	60,091	60,091	—	—
Total	\$ 372,953	\$ 138,910	\$ 157,427	\$ 76,616

For purposes of this table, purchase commitments are defined as agreements that are enforceable and legally binding and that specify all significant terms including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. Our purchase orders are based on our current manufacturing needs and are fulfilled by our vendors within relatively short time horizons. In addition, we have purchase orders that represent authorizations to purchase rather than binding agreements. We do not have significant agreements for the purchase of raw materials or other goods specifying minimum quantities or set prices that exceed our expected requirements.

## Other Commitments

## Operating lease

On May 3, 2016, we entered into a lease agreement for additional office space expected to be built in Yokneam, Israel. The lease term expires 10 years after lease inception with no options to extend the lease term. Our occupancy of the additional office space and our obligation under the lease agreement are contingent on the lessor's attainment of stated milestones in the lease agreement. As such, we cannot make a reliable estimate as to the timing of cash payments under the lease. At December 31, 2017, the estimated total future lease obligation is approximately \$30.7 million. Over a twelve month period the estimated rental expense is approximately \$3.1 million.

## Royalty-bearing grants

We are obliged to pay royalties to the Israeli National Authority for Technological Innovation or the OCS for research and development efforts partially funded through grants from the OCS and under approved plans in accordance with the Israeli Law for Encouragement of Research and Development in the Industry, 1984 (the "R&D Law"). Royalties are payable to the Israeli government at the rate of 4.5% on the revenues of the Company's products incorporating OCS funded know-hows, and up to the amount of the grants received. Our obligation to pay these royalties is contingent on actual sales of the products, at which time a liability is recorded. In the absence of such sales, we cannot make a reliable estimate as to the timing of cash settlement of the royalties. At December 31, 2017, we estimated a total future royalty obligation of approximately \$36.4 million, and if recognized, would increase the cost of revenues in our consolidated statement of operations.

## Unrecognized tax benefits

The contractual obligation table excludes our unrecognized tax benefit liabilities because we cannot make a reliable estimate of the timing of cash payments. As of December 31, 2017, our unrecognized tax benefits liabilities totaled \$45.2 million, out of which an amount of \$24.6 million would reduce our income tax expense and effective tax rate, if recognized.

## Recent accounting pronouncements

See Note 1 to the consolidated financial statements for a full description of recent accounting standards, including the respective dates of adoption and effects on our consolidated financial statements.

## Off-Balance Sheet Arrangements

As of December 31, 2017, we did not have any off-balance sheet arrangements.

## Impact of Currency Exchange Rates

Exchange rate fluctuations could have a material adverse effect on our business, financial condition and results of operations. Our most significant foreign currency exposure is the NIS. We do not enter into derivative transactions for speculative or trading purposes. We use foreign currency derivative contracts to hedge assets, liabilities and a significant portion of our operating expenses

denominated in NIS. Our derivative instruments are recorded at fair value in assets or liabilities. For the effective portion of derivatives designated as cash flow hedges, the gains or losses are recorded as a component of accumulated other comprehensive income and subsequently reclassified into operating expenses in the same period in which the hedged operating expenses are recognized. For the ineffective portion of derivatives designated as cash flow hedges, if any, as well as derivatives not designated as hedging instruments, the change in fair value is immediately recognized in other income (loss), net. See Note 7 to the consolidated financial statements.

#### ITEM 7A—QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

##### Interest rate fluctuation risk

As of December 31, 2017, the outstanding principal amount of the Term Debt was \$74.0 million. A hypothetical 1.0% increase in the applicable interest rate would increase the interest expense on our outstanding debt by \$0.7 million for the following 12 months.

Our investments consist of cash, money market funds, certificates of deposit, and interest bearing investments in government debt securities, commercial paper, corporate bonds, municipal bonds and foreign government bonds with an average maturity of 0.8 years. The primary objective of our investment activities is to preserve principal and ensure liquidity while maximizing income without significantly increasing risk. By policy, we limit the amount of our credit exposure through diversification and restricting our investments to highly rated securities. At the time of purchase, we do not invest more than 4% of the total investment portfolio in individual securities, except U.S. Treasury or agency securities. Highly rated long-term securities are defined as having a minimum Moody's, Standard & Poor's or Fitch rating of A2 or A, respectively. Highly rated short-term securities are defined as having a minimum Moody's, Standard & Poor's or Fitch rating of P-1, A-1 or F-1, respectively. We have not experienced any significant losses on our cash equivalents or short-term investments. We do not enter into investments for trading or speculative purposes. Our investments are exposed to market risk due to a fluctuation in interest rates, which may affect our interest income and the fair market value of our investments. An immediate 1% change in interest rates would have a \$1.4 million effect on the fair market value of our portfolio.

##### Foreign currency exchange risk

We derive all of our revenues in U.S. dollars. The U.S. dollar is our functional and reporting currency in all of our foreign locations. However, a significant portion of our liabilities and operating expenses, consisting principally of salaries and related personnel costs and facilities expenses, are denominated in NIS. This foreign currency exposure gives rise to market risk associated with exchange rate movements of the U.S. dollar against the NIS. Furthermore, we anticipate that a material portion of our expenses will continue to be denominated in NIS. To the extent the U.S. dollar weakens against the NIS, we will experience a negative impact on our net income.

To protect against foreign exchange risks associated with forecasted future cash flows and existing assets and liabilities, we have established a balance sheet and anticipated transaction risk management program. Currency derivative instruments and natural hedges are generally utilized in this hedging program. We do not enter into derivative instruments for trading or speculative purposes. We account for our derivative instruments as either assets or liabilities and carry them at fair value. The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and the resulting designation.

Our hedging program reduces, but does not eliminate the impact of currency exchange rate movements (see Part I, Item 1A, "Risk Factors"). If we were to experience a strengthening of NIS against USD of 10%, the impact on assets and liabilities denominated in NIS, after taking into account hedges and offsetting positions, would result in a loss before taxes of approximately \$0.1 million at December 31, 2017. There would also be an impact on future operating expenses denominated in NIS. For the month ending December 31, 2017, approximately \$20.5 million of our monthly expenses were denominated in NIS. As of December 31, 2017, we had derivative contracts designated as cash flow hedges in the notional amount of approximately 181.6 million NIS, or approximately \$52.4 million based upon the exchange rate on that day. In addition, as of December 31, 2017, we had derivative contracts hedging against NIS denominated assets and liabilities in the notional amount of approximately 163.0 million NIS, or approximately \$47.0 million based upon the exchange rate on that day.

Our derivatives expose us to credit risk to the extent that the counterparties may be unable to meet the terms of the agreement. We seek to mitigate such risk by limiting our counterparties to major financial institutions and by spreading the risk across a number of major financial institutions. However, failure of one or more of these financial institutions is possible and could result in incurred losses.

Inflation related risk

We believe that the rate of inflation in Israel has not had a material impact on our business to date. Our cost in Israel in U.S. dollar terms will increase if inflation in Israel exceeds the devaluation of the NIS against the U.S. dollar or if the timing of such devaluation lags behind inflation in Israel.

#### ITEM 8—FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The financial statements required by Item 8 are submitted as a separate section of this report and are incorporated by reference into this Item 8. See Item 15, "Exhibits and Financial Statement Schedules."

##### Summary Quarterly Data—Unaudited

	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1 (1)
	2017	2017	2017	2017	2016	2016	2016	2016
	(in thousands, except per share data)							
Total revenues	\$237,581	\$225,699	\$211,962	\$188,651	\$221,676	\$224,211	\$214,801	\$196,810
Cost of revenues	85,238	77,335	73,427	64,450	73,507	78,191	79,807	70,481
Gross profit	152,343	148,364	138,535	124,201	148,169	146,020	134,994	126,329
Operating expenses:								
Research and development	94,123	90,916	92,348	88,491	85,651	83,611	82,324	71,034
Sales and marketing	38,761	37,829	38,110	35,757	35,568	34,408	32,576	31,228
General and administrative	14,136	13,039	12,476	12,519	13,589	13,501	13,494	27,938
Impairment of long-lived assets	12,019	—	—	—	—	—	—	—
Total operating expenses	159,039	141,784	142,934	136,767	134,808	131,520	128,394	130,200
Income (loss) from operations	(6,696 )	6,580	(4,399 )	(12,566 )	13,361	14,500	6,600	(3,871 )
Interest expense	(1,932 )	(2,016 )	(1,996 )	(1,993 )	(1,944 )	(2,195 )	(2,215 )	(998 )
Other income (loss), net	649	956	827	683	108	606	315	61
Interest and other, net	(1,283 )	(1,060 )	(1,169 )	(1,310 )	(1,836 )	(1,589 )	(1,900 )	(937 )
Income (loss) before taxes on income	(7,979 )	5,520	(5,568 )	(13,876 )	11,525	12,911	4,700	(4,808 )
Provision for (benefit from) taxes on income	(5,386 )	2,117	2,423	(1,632 )	2,530	874	46	2,360
Net income (loss)	\$(2,593 )	\$3,403	\$(7,991 )	\$(12,244 )	\$8,995	\$12,037	\$4,654	\$(7,168 )
Net income (loss) per share — basic	\$(0.05 )	\$0.07	\$(0.16 )	\$(0.25 )	\$0.18	\$0.25	\$0.10	\$(0.15 )
Net income (loss) per share — diluted	\$(0.05 )	\$0.07	\$(0.16 )	\$(0.25 )	\$0.18	\$0.24	\$0.09	\$(0.15 )

(1) On February 23, 2016, we acquired EZchip. EZchip's results of operations have been included in our consolidated financial statements beginning February 23, 2016.

#### ITEM 9—CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

The information required by this Item 9 was previously reported in the company's Current Report on Form 8-K that was filed with the Securities and Exchange Commission on February 24, 2017.

#### ITEM 9A—CONTROLS AND PROCEDURES

##### Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934, as amended



(the "Exchange Act") is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our CEO (principal executive officer) and CFO (principal financial officer), as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by SEC Rule 13a-15(b), we carried out an evaluation, under the supervision and with the participation of our management, including our CEO and CFO, of the effectiveness of our disclosure controls and procedures as of December 31, 2017. Based on this evaluation, our CEO and CFO concluded that our disclosure controls and procedures were effective as of December 31, 2017 to provide the reasonable assurance described above.

#### Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the quarter ended December 31, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

#### Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) of the Exchange Act. Under the supervision and with the participation of our management, including the CEO and the CFO, we carried out an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2017 using the criteria established in "Internal Control-Integrated Framework" (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on that evaluation, our management concluded that our internal control over financial reporting was effective as of December 31, 2017.

Kost, Forer, Gabbay and Kasierer, a member of EY Global, our independent registered public accounting firm, audited our consolidated financial statements and has issued a report on the effectiveness of our internal control over financial reporting as of December 31, 2017, as stated in their report which appears under Item 8.

#### ITEM 9B—OTHER INFORMATION

None.

#### PART III

#### ITEM 10—DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Our written Code of Business Conduct and Ethics applies to all of our directors and employees, including our executive officers. The Code of Business Conduct and Ethics is available on our website at <http://www.mellanox.com>. Any changes to or waivers of the Code of Business Conduct and Ethics will be disclosed on the same website.

The other information required by this item will be contained in our definitive proxy statement to be filed with the SEC in connection with the Annual General Meeting of our Shareholders, or the Proxy Statement, which is expected to be filed no later than 120 days after the end of our fiscal year ended December 31, 2017, under the sections titled "Proposal - Election of Directors," "Security Ownership," and "Corporate Governance and Board of Director Matters" and is incorporated in this report by reference.

#### ITEM 11—EXECUTIVE COMPENSATION

The information required by this item will be set forth in the Proxy Statement under the sections titled “Compensation Discussion and Analysis,” “Executive Compensation Tables,” “Director Compensation in Fiscal Year 2017,” “Executive Officers” and “Corporate Governance and Board of Director Matters” and is incorporated in this report by reference.

#### ITEM 12—SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED SHAREHOLDER MATTERS

The information required by this item will be set forth in the Proxy Statement under the sections titled “Compensation Discussion and Analysis,” “Executive Compensation Tables,” “Security Ownership,” “Executive Officers” and “Corporate Governance and Board of Director Matters” and is incorporated in this report by reference.

#### ITEM 13—CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this item will be set forth in the Proxy Statement under the section titled “Corporate Governance and Board of Directors Matters” and is incorporated in this report by reference.

#### ITEM 14—PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this item will be set forth in the Proxy Statement under the section titled “Audit Matters” and is incorporated in this report by reference.

#### PART IV

#### ITEM 15—EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) Documents filed as part of this report.

1. Financial Statements. The following financial statements and report of the independent registered public accounting firm are included in Item 8:

	Page
<u>Report of Independent Registered Public Accounting Firm</u>	<u>57</u>
<u>Consolidated Balance Sheets</u>	<u>61</u>
<u>Consolidated Statements of Operations</u>	<u>62</u>
<u>Consolidated Statements of Comprehensive Income (Loss)</u>	<u>63</u>
<u>Consolidated Statements of Shareholders' Equity</u>	<u>64</u>
<u>Consolidated Statements of Cash Flows</u>	<u>65</u>
<u>Notes to Consolidated Financial Statements</u>	<u>66</u>

2. Financial Statement Schedules. The following financial statement schedules are filed as part of this report:

#### Schedule II—Consolidated Valuation and Qualifying Accounts

All other schedules have been omitted because they are not applicable or not required, or the information is included in the Consolidated Financial Statements or Notes thereto.

3. Exhibits. See Item 15(b) below. Each management contract or compensatory plan or arrangement required to be filed has been identified.

(b) Exhibits.

# INDEX TO EXHIBITS

Exhibit No.	Description of Exhibit
2.1	(1) <u>Agreement of Merger, dated as of September 30, 2015, among Mellanox Technologies, Ltd., Mondial Europe Sub Ltd. and EZchip Semiconductor Ltd.</u>
2.2	(2) <u>Amendment No. 1 to the Agreement of Merger, dated as of November 17, 2015, among Mellanox Technologies, Ltd., Mondial Europe Sub Ltd. and EZchip Semiconductor Ltd.</u>
3.1	(3) <u>Amended and Restated Articles of Association of Mellanox Technologies, Ltd. (as amended on May 9, 2016).</u>
10.1	(4) * <u>Mellanox Technologies, Ltd. Second Amended and Restated Global Share Incentive Plan (2006).</u>
10.2	(5) * <u>Mellanox Technologies, Ltd. Amended and Restated Employee Share Purchase Plan.</u>
10.3	(6) * <u>First Amendment to the Mellanox Technologies, Ltd. Amended and Restated Employee Share Purchase Plan.</u>
10.4	(7) * <u>Voltaire Ltd. 2007 Incentive Compensation Plan.</u>
10.5	(8) * <u>Voltaire Ltd. 2003 Section 102 Stock Option/Stock Purchase Plan.</u>
10.6	(9) * <u>Voltaire Ltd. 2001 Section 102 Stock Option/Stock Purchase Plan.</u>
10.7	(10) * <u>Voltaire Ltd. 2001 Stock Option Plan.</u>
10.8	(11) * <u>Kotura, Inc. Second Amended and Restated 2003 Stock Plan.</u>
10.9	(12) * <u>IPtronics, Inc. 2013 Restricted Stock Unit Plan.</u>
10.10	(13) * <u>Mellanox Technologies, Ltd., Global Share Incentive Assumption Plan (2010).</u>
10.11	(14) * <u>EZchip Semiconductor Ltd. 2003 Amended and Restated Equity Incentive Plan.</u>
10.12	(15) * <u>Amendment to EZchip Semiconductor Ltd. 2003 Amended and Restated Equity Incentive Plan, dated January 7, 2014.</u>
10.13	(16) * <u>EZchip Semiconductor Ltd. 2007 U.S. Equity Incentive Plan.</u>
10.14	(17) * <u>Amendment to EZchip Semiconductor Ltd. 2007 U.S. Equity Incentive Plan, dated September 10, 2013.</u>
10.15	(18) * <u>Amended and Restated EZchip Semiconductor Ltd. 2009 Equity Incentive Plan.</u>
10.16	(19) * <u>Form of Mellanox Technologies, Ltd. Executive Severance Benefits Agreement for U.S. Executives.</u>
10.17	(20) * <u>Form of Mellanox Technologies, Ltd. Executive Severance Benefits Agreement for Israel Executives.</u>
10.18	(21) <u>Lease Contract, dated March 1, 2011, by and between the Company, as tenant, and Sha'ar Yokneam, Registered Limited Partnership, as landlord (as translated from Hebrew).</u>
10.19	(22) <u>Lease Agreement, dated April 9, 2017, by and between the Company, as tenant, and Rubinstein Buildings Ltd., as landlord (as translated from Hebrew).</u>
10.20	† <u>Office Space Lease dated December 29, 2017 by and between Oakmead Parkway Properties Partnership, a California general partnership, as landlord, and Mellanox Technologies, Inc., as tenant.</u>
10.21	† <u>Form of Indemnification Undertaking made by and between Mellanox Technologies, Ltd. and each of its directors and executive officers.</u>
21.1	<u>List of Company Subsidiaries.</u>
23.1	<u>Consent of Kost, Forer, Gabbay and Kasierer, a member of EY Global, independent registered public accounting firm.</u>
23.2	<u>Consent of PricewaterhouseCoopers LLP, independent registered public accounting firm.</u>
24.1	<u>Power of Attorney (included on signature page to this annual report on Form 10-K).</u>
31.1	<u>Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>
31.2	<u>Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>
32.1	<u>Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
32.2	<u>Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document

101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

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- (1) Incorporated by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K (SEC File No. 001-33299) filed on September 30, 2015.
- (2) Incorporated by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K (SEC File No. 001-33299) filed on November 17, 2015.
- (3) Incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q (SEC File No. 001-33299) filed on July 29, 2016.
- (4) Incorporated by reference to Exhibit 3.2 to the Company's Quarterly Report on Form 10-Q (SEC File No. 001-33299) filed on May 5, 2017.
- (5) Incorporated by reference to Appendix A to the Company's Definitive Proxy Statement on Schedule 14A (SEC File No. 001-33299) filed on April 19, 2012.
- (6) Incorporated by reference to Exhibit 4.1 to the Company's Quarterly Report on Form 10-Q (SEC File No. 001-33299) filed on July 29, 2016.
- (7) Incorporated by reference to Exhibit 10.2 to the Company's Registration Statement on Form S-8 (File No. 333-172093) filed on February 7, 2011.
- (8) Incorporated by reference to Exhibit 10.3 to the Company's Registration Statement on Form S-8 (File No. 333-172093) filed on February 7, 2011.
- (9) Incorporated by reference to Exhibit 10.4 to the Company's Registration Statement on Form S-8 (File No. 333-172093) filed on February 7, 2011.
- (10) Incorporated by reference to Exhibit 10.5 to the Company's Registration Statement on Form S-8 (File No. 333-172093) filed on February 7, 2011.
- (11) Incorporated by reference to Exhibit 4.2 to the Company's Registration Statement on Form S-8 (File No. 333-190631) filed on August 15, 2013.
- (12) Incorporated by reference to Exhibit 4.2 to the Company's Registration Statement on Form S-8 (File No. 333-189720) filed on July 1, 2013.
- (13) Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K (SEC File No. 001-33299) filed on February 7, 2011.
- (14) Incorporated by reference to Exhibit 4.2 to the Company's Registration Statement on Form S-8 (SEC File No. 333-209808) filed on February 29, 2016.
- (15) Incorporated by reference to Exhibit 4.3 to the Company's Registration Statement on Form S-8 (SEC File No. 333-209808) filed on February 29, 2016.
- (16) Incorporated by reference to Exhibit 4.4 to the Company's Registration Statement on Form S-8 (SEC File No. 333-209808) filed on February 29, 2016.
- (17) Incorporated by reference to Exhibit 4.5 to the Company's Registration Statement on Form S-8 (SEC File No. 333-209808) filed on February 29, 2016.
- (18) Incorporated by reference to Exhibit 4.6 to the Company's Registration Statement on Form S-8 (SEC File No. 333-209808) filed on February 29, 2016.
- (19) Incorporated by reference to Exhibit 10.12 to Amendment No. 1 to the Company's Registration Statement on Form S-1 (SEC File No. 333-137659) filed on November 14, 2006.
- (20) Incorporated by reference to Exhibit 10.13 to Amendment No. 1 to the Company's Registration Statement on Form S-1 (SEC File No. 333-137659) filed on November 14, 2006.
- (21) Incorporated by reference to Exhibit 10.17 to the Company's Annual Report on Form 10-K (SEC File No. 001-33299) filed on March 7, 2011.
- (22) Incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q (SEC File No. 001-33299) filed on May 5, 2017.

\* Indicates management contract or compensatory plan, contract or arrangement.

† Filed herewith.



REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and the Board of Directors

Mellanox Technologies, Ltd.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheet of Mellanox Technologies Ltd. (the "Company") as of December 31, 2017 and the related consolidated statement of operations, comprehensive loss, shareholders' equity and cash flows for the year in the period ended December 31, 2017, and the related notes and the financial statement schedule listed in the Index at Item 15(a)(2) (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the consolidated financial position of the Company at December 31, 2017, and the consolidated result of its operations and its cash flows for the year in the period ended December 31, 2017, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated February 16, 2018 expressed an unqualified opinion thereon.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audit included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audit also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audit provides a reasonable basis for our opinion.

/s/ Kost, Forer, Gabbay and Kasierer  
KOST FORER GABBAY & KASIERER  
A Member of EY Global

We have served as the Company's auditor since 2017.  
Tel-Aviv, Israel  
February 16, 2018



## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and the Board of Directors

Mellanox Technologies, Ltd.

### Opinion on Internal Control over Financial Reporting

We have audited Mellanox Technologies Ltd. (the "Company") internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the "COSO criteria"). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheet of the Company as of December 31, 2017 and the related consolidated statement of operations, comprehensive loss, shareholders' equity and cash flows for the year in the period ended December 31, 2017 of the Company and our report dated February 16, 2018 expressed an unqualified opinion thereon.

### Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects.

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

### Definition and Limitations of Internal Control Over Financial Reporting

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

a material effect on the financial statements.

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

/s/ Kost, Forer, Gabbay and Kasierer  
KOST FORER GABBAY & KASIERER  
A Member of EY Global

Tel-Aviv, Israel  
February 16, 2018

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of Mellanox Technologies, Ltd.

In our opinion, the consolidated balance sheet as of December 31, 2016 and the related consolidated statements of operations, of comprehensive income (loss), of shareholders' equity and of cash flows for each of the two years in the period ended December 31, 2016 present fairly, in all material respects, the financial position of Mellanox Technologies, Ltd. and its subsidiaries as of December 31, 2016, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2016 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule for each of the two years in the period ended December 31, 2016 listed in the index appearing under Item 15(a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements, and on the financial statement schedule based on our audits. We conducted our audits of these financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 opinions.

/s/ PricewaterhouseCoopers LLP

San Jose, California  
February 17, 2017

MELLANOX TECHNOLOGIES, LTD.  
CONSOLIDATED BALANCE SHEETS

	December 31,	
	2017	2016
	(In thousands, except par value)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$62,473	\$56,780
Short-term investments	211,281	271,661
Accounts receivable, net	154,213	141,768
Inventories	64,657	65,523
Other current assets	14,295	17,346
Total current assets	506,919	553,078
Property and equipment, net	109,919	118,585
Severance assets	18,302	15,870
Intangible assets, net	228,195	278,031
Goodwill	472,437	471,228
Deferred taxes and other long-term assets	66,162	36,713
Total assets	\$1,401,934	\$1,473,505
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$59,090	\$59,533
Accrued liabilities	114,058	105,042
Deferred revenue	23,485	24,364
Current portion of term debt	—	23,628
Total current liabilities	196,633	212,567
Accrued severance	23,205	19,874
Deferred revenue	17,820	15,968
Term debt	72,761	218,786
Other long-term liabilities	34,067	30,580
Total liabilities	344,486	497,775
Commitments and Contingencies (Note 9)		
Shareholders' equity		
Ordinary shares: NIS 0.0175 par value, 200,000 shares authorized, 51,488 and 49,076 shares issued and outstanding at December 31, 2017 and 2016, respectively	221	209
Additional paid-in capital	873,979	774,605
Accumulated other comprehensive income (loss)	1,618	(928 )
Retained earnings	181,630	201,844
Total shareholders' equity	1,057,448	975,730
Total liabilities and shareholders' equity	\$1,401,934	\$1,473,505

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

MELLANOX TECHNOLOGIES, LTD.  
CONSOLIDATED STATEMENTS OF OPERATIONS

	Year ended December 31,		
	2017	2016	2015
	(In thousands, except per share data)		
Total revenues	\$863,893	\$857,498	\$658,140
Cost of revenues	300,450	301,986	189,209
Gross profit	563,443	555,512	468,931
Operating expenses:			
Research and development	365,878	322,620	252,175
Sales and marketing	150,457	133,780	97,438
General and administrative	52,170	68,522	44,212
Impairment of long-lived assets	12,019	—	—
Total operating expenses	580,524	524,922	393,825
Income (loss) from operations	(17,081 )	30,590	75,106
Interest expense	(7,937 )	(7,352 )	—
Other income (loss), net	3,115	1,090	(524 )
Interest and other, net	(4,822 )	(6,262 )	(524 )
Income (loss) before taxes on income	(21,903 )	24,328	74,582
Provision for (benefit from) taxes on income	(2,478 )	5,810	(18,312 )
Net income (loss)	\$(19,425 )	\$18,518	\$92,894
Net income (loss) per share — basic	\$(0.39 )	\$0.38	\$2.00
Net income (loss) per share — diluted	\$(0.39 )	\$0.37	\$1.94
Shares used in computing net income (loss) per share:			
Basic	50,310	48,145	46,365
Diluted	50,310	49,526	47,778

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

MELLANOX TECHNOLOGIES, LTD.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	Year ended December 31,		
	2017	2016	2015
	(In thousands)		
Net income (loss)	\$(19,425)	\$18,518	\$92,894
Other comprehensive income, net of tax:			
Change in unrealized gains/losses on available-for-sale securities, net	929	342	(204 )
Change in unrealized gains/losses on derivative contracts, net (net of tax effect of \$105, \$47, and \$97)	1,617	399	2,555
Other comprehensive income	2,546	741	2,351
Total comprehensive income (loss), net of tax	\$(16,879)	\$19,259	\$95,245

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

## MELLANOX TECHNOLOGIES, LTD.

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	Ordinary Shares		Additional	Accumulated	Other	Retained	Total
	Shares	Amount	Paid-in Capital	Comprehensive Income (Loss)	Earnings	Equity	Shareholders'
	(In thousands, except share data)						
Balance at December 31, 2014	45,487,764	\$ 192	\$ 615,148	\$ (4,020 )	\$ 90,432	\$ 701,752	
Net income	—	—	—	—	92,894	92,894	
Unrealized losses on available-for-sale securities, net of taxes	—	—	—	(204 )	—	(204 )	
Unrealized gain on derivative contracts, net of taxes	—	—	—	2,555	—	2,555	
Share-based compensation	—	—	50,764	—	—	50,764	
Issuances of shares through employee equity incentive plans	1,267,244	6	6,043	—	—	6,049	
Issuance of shares through employee share purchase plan	364,746	2	12,816	—	—	12,818	
Income tax benefit from share options exercised	—	—	53	—	—	53	
Balance at December 31, 2015	47,119,754	\$ 200	\$ 684,824	\$ (1,669 )	\$ 183,326	\$ 866,681	
Net income	—	—	—	—	18,518	18,518	
Unrealized gain on available-for-sale securities, net of taxes	—	—	—	342	—	342	
Unrealized gains on derivative contracts, net of taxes	—	—	—	399	—	399	
Share-based compensation	—	—	66,309	—	—	66,309	
Issuances of shares through employee equity incentive plans	1,463,884	7	5,083	—	—	5,090	
Issuance of shares through employee share purchase plan	491,968	2	17,463	—	—	17,465	
Income tax benefit from share options exercised	—	—	(46 )	—	—	(46 )	
Fair value of awards attributable to pre-acquisition services	—	—	972	—	—	972	
Balance at December 31, 2016	49,075,606	\$ 209	\$ 774,605	\$ (928 )	\$ 201,844	\$ 975,730	
Net loss	—	—	—	—	(19,425 )	(19,425 )	
Unrealized gains on available-for-sale securities, net of taxes	—	—	—	929	—	929	
Unrealized gains on derivative contracts, net of taxes	—	—	—	1,617	—	1,617	
Share-based compensation	—	—	68,864	—	—	68,864	
Issuances of shares through employee equity incentive plans	1,843,168	9	7,633	—	—	7,642	



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Issuance of shares through employee share purchase plan	568,876	3	22,088	—	—	22,091
Effect of adopting ASU 2016-09: Improvements to Employee Share-Based Payment Accounting	—	—	789	—	(789)	—
Balance at December 31, 2017	51,487,650	\$ 221	\$873,979	\$ 1,618	\$181,630	\$1,057,448

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

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MELLANOX TECHNOLOGIES, LTD.  
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year ended December 31,		
	2017	2016	2015
	(In thousands)		
Cash flows from operating activities:			
Net income (loss)	\$(19,425)	\$18,518	\$92,894
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	103,821	97,731	41,372
Deferred income taxes	(2,150)	809	(22,607)
Share-based compensation	68,864	66,309	50,764
Gains on short-term investments, net	(3,460)	(1,774)	(3,000)
Impairment charges	12,019	—	3,189
Changes in assets and liabilities, net of effect of acquisitions:			
Accounts receivable, net	(12,175)	(41,331)	(19,351)
Inventories	(887)	8,263	(24,735)
Prepaid expenses and other assets	(681)	6,948	(2,619)
Accounts payable	170	13,330	3,750
Accrued liabilities and other liabilities	15,216	27,261	30,884
Net cash provided by operating activities	161,312	196,064	150,541
Cash flows from investing activities:			
Purchase of severance-related insurance policies	(1,312)	(1,172)	(743)
Purchase of short-term investments	(188,745)	(300,858)	(219,459)
Proceeds from sales of short-term investments	193,082	237,764	179,700
Proceeds from maturities of short-term investments	59,129	149,725	129,279
Purchase of property and equipment	(41,376)	(42,976)	(48,601)
Purchase of intangible assets	(2,843)	(7,962)	(210)
Purchase of investments in privately-held companies	(15,021)	(4,982)	—
Acquisitions, net of cash acquired	(872)	(693,692)	—
Net cash provided by (used in) investing activities	2,042	(664,153)	39,966
Cash flows from financing activities:			
Proceeds from term debt	—	280,000	—
Principal payments on term debt	(172,000)	(34,000)	—
Term debt issuance costs	—	(5,521)	—
Principal payments on capital lease and intangible assets obligations	(7,369)	(1,364)	(1,105)
Proceeds from issuances of ordinary shares through employee equity incentive plans	29,733	22,555	18,867
Net cash provided by (used in) financing activities	(149,636)	261,670	17,762
Net increase (decrease) in cash, cash equivalents, and restricted cash	13,718	(206,419)	208,269
Cash, cash equivalents, and restricted cash at beginning of period	56,780	263,199	54,930
Cash, cash equivalents, and restricted cash at end of period	\$70,498	\$56,780	\$263,199
Supplemental disclosures of cash flow information			
Interest paid	\$5,384	\$5,335	\$27
Income taxes paid	\$1,218	\$835	\$1,114
Supplemental disclosure of non-cash investing and financing activities			
Intangible assets financed with debt	\$12,981	\$8,834	\$—
Unpaid property and equipment	\$3,962	\$5,425	\$2,228

Transfer from inventory to property and equipment	\$1,753	\$3,814	\$6,732
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The accompanying notes are an integral part of these consolidated financial statements.

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MELLANOX TECHNOLOGIES, LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1—THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Company

Mellanox Technologies, Ltd., an Israeli corporation (the "Company" or "Mellanox"), was incorporated and commenced operations in March 1999. Mellanox is a supplier of high-performance interconnect products for computing, storage and communications applications.

Principles of presentation

The consolidated financial statements include the Company's accounts as well as those of its wholly owned subsidiaries after the elimination of all intercompany balances and transactions.

On February 23, 2016, the Company completed its acquisition of EZchip Semiconductor, Ltd. ("EZchip"), a public company formed under the laws of the State of Israel and specializing in network-processing semiconductors. Upon the consummation of the acquisition, EZchip became a wholly owned subsidiary of the Company. The consolidated financial statements include the results of operations of EZchip commencing as of the acquisition date.

Certain prior year amounts have been reclassified to conform to the 2017 presentation.

Risks and uncertainties

The Company is subject to all of the risks inherent in a company which operates in the dynamic and competitive semiconductor industry. Significant changes in any of the following areas could have a material adverse impact on the Company's financial position and results of operations; unpredictable volume or timing of customer orders; ordered product mix; the sales outlook and purchasing patterns of the Company's customers based on consumer demands and general economic conditions; loss of one or more of the Company's customers; decreases in the average selling prices of products or increases in the average cost of finished goods; the availability, pricing and timeliness of delivery of components used in the Company's products; reliance on a limited number of subcontractors to manufacture, assemble, package and production test the Company's products; the Company's ability to successfully develop, introduce and sell new or enhanced products in a timely manner; product obsolescence and the Company's ability to manage product transitions; the timing of announcements or introductions of new products by the Company's competitors, and the Company's ability to successfully integrate acquired businesses.

Use of estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the dates of the financial statements and the reported amounts of net revenue and expenses in the reporting periods. The Company regularly evaluates estimates and assumptions related to revenue recognition, allowances for doubtful accounts, allowances for price adjustments, investment valuation, warranty reserves, inventory reserves, share-based compensation expense, long-term asset valuations, useful lives of property, equipment, and intangibles, accounting for business combinations, goodwill and purchased intangible asset valuation, investments in privately-held companies, accounting and fair value of financial instruments and derivatives, deferred income tax asset valuation, uncertain tax positions, litigation and other loss contingencies. These estimates and assumptions are based on current facts, historical experience and various other factors that the Company believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities and the recording of revenue, costs and expenses that are not readily apparent from other sources. The actual results that the Company experiences may differ materially and adversely from the Company's original estimates. To the extent there are material differences between the estimates and actual results, the Company's future results of operations will be affected.

## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Cash and cash equivalents

The Company considers all highly liquid investments with a maturity of three months or less from the date of purchase to be cash equivalents. Cash and cash equivalents consist of cash on deposit with banks and money market funds.

## Restricted cash

The Company maintains certain cash amounts that are restricted as to withdrawal or use over the long-term. The cash is securing bank guarantees primarily issued against long-term tenancy agreements. The long-term restricted cash balance of \$8.0 million was reported in other long-term assets on the balance sheet as of December 31, 2017, and was included in the ending balance of cash, cash equivalents and restricted cash in the statement of cash flows for the year ended December 31, 2017. There was no restricted cash as of December 31, 2016 and 2015. The following table provides a reconciliation of the cash and cash equivalents balances reported on the balance sheets and the cash, cash equivalents and restricted cash balances reported in the statements of cash flows:

	December 31,		
	2017	2016	2015
	(In thousands)		
Cash and cash equivalents, as reported on the balance sheets	\$62,473	\$56,780	\$263,199
Restricted cash in other long-term assets, as reported on the balance sheets	8,025	—	—
Cash, cash equivalents, and restricted cash, as reported in the statements of cash flows	\$70,498	\$56,780	\$263,199

## Short-term investments

The Company's short-term investments are classified as available-for-sale securities and are reported at fair value. Unrealized gains or losses are recorded in shareholders' equity and included in other comprehensive income ("OCI"). The Company views its available-for-sale portfolio as available for use in its current operations. Accordingly, the Company has classified all investments in available for sale securities with readily available markets as short-term, even though the stated maturity date may be one year or more beyond the current balance sheet date, because of the intent and ability to sell these securities prior to maturity to meet liquidity needs or as part of a risk management program. The Company regularly reviews its investment portfolio and charges unrealized losses against net income when a decline in fair value is determined to be other-than-temporary. The Company reviews several factors to determine whether a loss is other-than-temporary. These factors include but are not limited to: (1) the length of time a security is in an unrealized loss position, (2) the extent to which fair value is less than cost, (3) the financial condition and near term prospects of the issuer and (4) our intent and ability to hold the security for a period of time sufficient to allow for any anticipated recovery in fair value.

## Fair value of financial instruments

The Company's financial instruments consist of cash equivalents, restricted cash, short-term investments and foreign currency derivative contracts. The fair value of a financial instrument is the amount that would be received in an asset sale or paid to transfer a liability in an orderly transaction between unaffiliated market participants. When there is no readily available market data, fair value estimates may be made by the Company, which may not necessarily represent the amounts that could be realized in a current or future sale of these assets.

## Derivatives

The Company enters into foreign currency forward and option contracts with financial institutions to protect against foreign exchange risks, mainly the exposure to changes in the exchange rate of the NIS against the U.S. dollar that are associated with forecasted future cash flows and existing assets and liabilities. The Company's primary objective in entering into these arrangements is to reduce the volatility of earnings and cash flows associated with changes in foreign currency exchange rates. The program is not designated for trading or speculative purposes. The Company's derivative instruments expose the Company to credit risk to the extent that the counter-parties may be unable to meet the terms of the agreement. The Company seeks to mitigate such risk by limiting its counter-parties to major financial

institutions and by spreading the risk across a number of major financial institutions. In addition, the potential risk of loss with any one counter-party resulting from this type of credit risk is monitored on an ongoing basis.

## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company accounts for its derivative instruments as either assets or liabilities and carries them at fair value. The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and the resulting designation. For derivative instruments that hedge the exposure to variability in expected future cash flows that are designated as cash flow hedges, the effective portion of the unrealized gains or losses on the derivative instruments is reported as a component of accumulated other comprehensive income ("AOCI") in shareholders' equity and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The ineffective portion of the gains or losses on the derivative instruments, if any, is recognized in earnings in the current period. The derivative instruments that hedge the exposure to variability in the fair value of assets or liabilities are not currently designated as hedges for financial reporting purposes, and thus the gains or losses on such derivative instruments are recognized in earnings in the current period.

**Concentration of credit risk**

Financial instruments that potentially subject the Company to a concentration of credit risk consist of cash, cash equivalents, restricted cash, short-term investments and accounts receivable. Cash, cash equivalents, restricted cash and short-term investment balances are maintained with high quality financial institutions, the composition and maturities of which are regularly monitored by management. The Company's accounts receivable are derived from revenue earned from customers primarily located in North America, Europe and Asia. The Company performs ongoing credit evaluations of its customers' financial condition and, generally, requires no collateral from its customers. The Company maintains an allowance for doubtful accounts receivable based upon the expected collectability of accounts receivable. The Company reviews its allowance for doubtful accounts quarterly by assessing individual accounts receivable over a specific aging and amount, and all other balances based on historical collection experience and an economic risk assessment. If the Company determines that a specific customer is unable to meet its financial obligations to the Company, the Company provides an allowance for credit losses to reduce the receivable to the amount management reasonably believes will be collected.

The following table summarizes the revenues from customers (including original equipment manufacturers) in excess of 10% of the total revenues:

	Year Ended December 31,		
	2017	2016	2015
HPE	13 %	16 %	14 %
Dell	11 %	*	*

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\* Less than 10%

The following table summarizes accounts receivable balances in excess of 10% of total accounts receivable:

	December 31,		December 31,	
	2017		2016	
HPE	13 %		11 %	

**Inventory**

Inventory includes finished goods, work-in-process and raw materials. Inventory is stated at the lower of cost (principally standard cost which approximates actual cost on a first-in, first-out basis) or net realizable value. Reserves for potentially excess and obsolete inventory are made based on management's analysis of inventory levels, future sales forecasts and market conditions. Once established, the original cost of the Company's inventory less the related inventory reserve represents the new cost basis of such products.

**Property and equipment**

Property and equipment are stated at cost, net of accumulated depreciation. Depreciation is generally calculated using the straight-line method over the estimated useful lives of the related assets, which is three years for computer

equipment and software, seven years for lab equipment, and seven years for office furniture and fixtures. Leasehold improvements and assets acquired under capital leases are amortized on a straight-line basis over the term of the lease, or the useful lives of the assets, whichever is shorter. Maintenance and repairs are charged to expense as incurred, and improvements are capitalized. When



## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

assets are retired or otherwise disposed of, the cost and accumulated depreciation or amortization are removed from the accounts and any resulting gain or loss is reflected in the results of operations in the period realized. During the fourth quarter of 2017, the Company retired fully depreciated assets that were no longer in use. As a result, \$72.8 million of cost and accumulated depreciation was removed from the accounts. No gain or loss was recognized. The Company capitalizes certain costs incurred in connection with internal use of inventory items in the Company's data centers and laboratories. Capitalized inventory costs are included in Property and equipment, net and amortized on a straight-line basis over the estimated useful life of the asset.

**Business combinations**

The Company accounts for business combinations using the acquisition method of accounting. The Company determines the recognition of intangible assets based on the following criteria: (i) the intangible asset arises from contractual or other rights; or (ii) the intangible asset is separable or divisible from the acquired entity and capable of being sold, transferred, licensed, returned or exchanged. The Company allocates the purchase price of business combinations to the tangible assets, liabilities and intangible assets acquired, including in-process research and development ("IPR&D"), based on their estimated fair values. The excess purchase price over those fair values is recorded as goodwill. The process of estimating the fair values requires significant estimates, especially with respect to intangible assets. Critical estimates in valuing certain intangible assets include, but are not limited to, future expected cash flows from customer contracts, customer lists and distribution agreements, acquired developed technologies, expected costs to develop IPR&D into commercially viable products, estimated cash flows from projects when completed and discount rates. The Company estimates fair value based upon assumptions that are believed to be reasonable, but which are inherently uncertain and unpredictable and, as a result, actual results may differ from estimates.

**Goodwill and intangible assets**

Goodwill represents the excess of the cost of acquired businesses over the fair market value of their identifiable net assets. The Company conducts a goodwill impairment qualitative assessment during the fourth quarter of each fiscal year or more frequently if facts and circumstances indicate that goodwill may be impaired. The goodwill impairment qualitative assessment requires the Company to perform an assessment to determine if it is more likely than not that the fair value of the business is less than its carrying amount. The qualitative assessment considers various factors, including the macroeconomic environment, industry and market specific conditions, market capitalization, stock price, financial performance, earnings multiples, budgeted-to-actual revenue performance from prior year, gross margin and cash flow from operating activities and issues or events specific to the business. If adverse qualitative trends are identified that could negatively impact the fair value of the business, the Company performs a "two step" goodwill impairment test. "Step one" is the identification of potential impairment. This involves comparing the fair value of each reporting unit, which the Company has determined to be the entity itself, with its carrying amount including goodwill. If the fair value of a reporting unit exceeds its carrying amount, the goodwill of the reporting unit is considered not impaired and "Step two" of the impairment test is unnecessary. If the carrying amount of a reporting unit exceeds its fair value, "Step two" is performed. This involves comparing the carrying amount of goodwill to its implied fair value, which is determined to be the excess of the reporting unit's fair value over the fair value of its identifiable net assets other than goodwill. If the carrying amount of goodwill exceeds its implied fair value, an impairment exists and is recorded. As of December 31, 2017, the Company's qualitative assessment of goodwill impairment indicated that goodwill was not impaired.

Intangible assets represent acquired intangible assets including developed technology, customer relationships and IPR&D, as well as licensed technology. The Company amortizes its finite lived intangible assets over their useful lives using a method that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used, or, if that pattern cannot be reliably determined, using a straight-line amortization method. The Company capitalizes IPR&D projects acquired as part of a business combination as intangible assets with indefinite

lives. On completion of each project, IPR&D assets are reclassified to developed technology and amortized over their estimated useful lives. If any of the IPR&D projects are abandoned, the Company would impair the related IPR&D asset.

Indefinite-lived intangible assets are tested for impairment annually or more frequently when indicators of impairment exist. The Company first assesses qualitative factors to determine if it is more likely than not that an indefinite-lived intangible asset is impaired and whether it is necessary to perform a quantitative impairment test. The qualitative assessment considers various factors, including reductions in demand, the abandonment of IPR&D projects or significant economic slowdowns in the semiconductor industry and macroeconomic environment. If adverse qualitative trends are identified that could negatively impact the fair value of the asset, then quantitative impairment tests are performed to compare the carrying value of the asset to

MELLANOX TECHNOLOGIES, LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

its undiscounted expected future cash flows. If this test indicates that there is impairment, the impaired asset is written down to fair value, which is typically calculated using: (i) quoted market prices or (ii) discounted expected future cash flows utilizing an appropriate discount rate. Impairment is based on the excess of the carrying amount over the fair value of those assets. The Company performed an impairment test on the IPR&D during the fourth quarter of 2017 when the project reached technological feasibility and was transferred to developed technology, and concluded that the asset was not impaired. Intangible assets with finite lives are tested for impairment in accordance with our policy for long-lived assets.

Equity investments in privately-held companies

The Company has equity investments in privately-held companies. These investments are recorded at cost reduced by any impairment write-downs because the Company does not have the ability to exercise significant influence over the operating and financial policies of the company. The investments are included in other long-term assets on the accompanying balance sheets. The Company monitors the investments and if facts and circumstances indicate an investment may be impaired, then it conducts an impairment test of its investment. To determine if the investment is recoverable, it reviews the privately-held company's revenue and earnings trends relative to pre-defined milestones and overall business prospects, the general market conditions in its industry and other factors related to its ability to remain in business, such as liquidity and receipt of additional funding.

Impairment of long-lived assets

Long-lived assets include equipment and furniture and fixtures and finite-lived intangible assets. Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be fully recoverable. If the sum of the expected future cash flows (undiscounted and without interest charges) from the long-lived assets is less than the carrying amount of such assets, an impairment loss would be recognized, and the assets would be written down to their estimated fair values. The Company reviews for possible impairment on a regular basis.

While performing the review for impairment for the fourth quarter of 2017, the Company noted an impairment indicator associated with the potential sale or discontinuation of the 1550nm silicon photonics line of business. As a result, the Company recorded impairment charges totaling \$12.0 million in the fourth quarter of 2017, of which \$7.7 million were related to property and equipment and \$4.3 million were related to intangible assets. See Note 16 for more details about the impairment charges.

Revenue recognition

The Company recognizes revenue from the sales of products when all of the following criteria are met: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred; (3) the price is fixed or determinable; and (4) collection is reasonably assured. The Company uses a binding purchase order or a signed agreement as evidence of an arrangement. Delivery occurs when goods are shipped and title and risk of loss transfer to the customer. The Company's standard arrangement with its customers typically includes freight-on-board shipping point, no right of return and no customer acceptance provisions. The revenues from fixed-price support or maintenance contracts, including extended warranty contracts and software post-contract customer support agreements, are recognized ratably over the contract period and the costs associated with these contracts are recognized as incurred. The customer's obligation to pay and the payment terms are set at the time of shipment and are not dependent on the subsequent resale of the product. The Company determines whether collectability is reasonably assured on a customer-by-customer basis. When assessing the probability of collection, the Company considers the number of years the customer has been in business and the history of the Company's collections. Customers are subject to a credit review process that evaluates the customers' financial positions and ultimately their ability to pay. If it is determined at the outset of an arrangement that collection is not reasonably assured, no product is shipped and no revenue is recognized unless cash is received in advance.

The Company maintains inventory, or hub arrangements with certain customers. Pursuant to these arrangements the Company delivers products to a customer or a designated third party warehouse based upon the customer's projected needs, but does not recognize product revenue unless and until the customer reports it has removed the Company's product from the warehouse to be incorporated into its end products.

**Multiple Element Arrangements**

For revenue arrangements that contain multiple deliverables, judgment is required to properly identify the accounting units of the transactions and to determine the manner in which revenue should be allocated among the accounting units. Moreover, judgment is used in interpreting the commercial terms and determining when all criteria of revenue recognition have

## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

been met for each deliverable in order for revenue recognition to occur in the appropriate accounting period. While changes in the allocation of the arrangement consideration between the units of accounting will not affect the amount of total revenue recognized for a particular sales arrangement, any material changes in these allocations could impact the timing of revenue recognition, which could affect our results of operations.

For multiple element arrangements that include a combination of hardware, services, such as post-contract customer support, and software, the arrangement consideration is first allocated among the accounting units before revenue recognition criteria are applied. The allocation is derived based on vendor specific objective evidence ("VSOE"). When VSOE or third party evidence is unavailable, we use management's best estimate of selling price.

**Distributor Revenue**

A portion of the Company's sales are made to distributors under agreements which contain price protection provisions. Currently, the Company recognizes revenues from sales to distributors based on the sell-through method using inventory and point of sale information provided by the distributors, net of estimated allowances for price adjustments. Upon the adoption of the new revenue standards effective January 1, 2018, the Company will recognize revenues from sales to distributors upon shipment and transfer of control (known as "sell-in" revenue recognition), net of the estimated allowances for price adjustments.

**Deferred Revenue and Income**

The Company defers revenue and income when advance payments are received from customers before performance obligations have been completed and/or services have been performed.

**Shipping and Handling**

Costs incurred for shipping and handling expenses to customers are recorded as cost of revenues. To the extent these amounts are billed to the customer in a sales transaction, the Company records the shipping and handling fees as revenue.

**Product warranty**

The Company typically offers a limited warranty for its products for periods up to three years. The Company accrues for estimated returns of defective products at the time revenue is recognized based on historical activity. The determination of these accruals requires the Company to make estimates of the frequency and extent of warranty activity and estimated future costs to either replace or repair the products under warranty. If the actual warranty activity and/or repair and replacement costs differ significantly from these estimates, adjustments to record additional cost of revenues may be required in future periods. Changes in the Company's liability for product warranty were as follows:

	Year Ended	
	December 31,	
	2017	2016
	(In thousands)	
Balance, beginning of the period	\$1,474	\$1,641
Assumed warranty liability from acquisition	—	290
New warranties issued during the period	1,459	1,727
Reversal of warranty reserves	(565 )	(856 )
Settlements during the period	(1,479 )	(1,328 )
Balance, end of the period	889	1,474
Less: long-term portion of product warranty liability	(183 )	(211 )
Balance, end of the period	\$706	\$1,263

**Research and development**

Costs incurred in research and development are charged to operations as incurred. The Company expenses all costs for internally developed patents as incurred.



MELLANOX TECHNOLOGIES, LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Advertising

Costs related to advertising and promotion of products are charged to sales and marketing expense as incurred.

Advertising expense was approximately \$2.9 million, \$2.1 million and \$2.0 million for the years ended December 31, 2017, 2016 and 2015, respectively.

Share-based compensation

The Company accounts for share-based compensation expense based on the estimated fair value of the equity awards as of the grant dates. The fair value of restricted stock units ("RSUs"), is based on the closing market price of our ordinary shares on the date of grant. The Company estimates the fair value of share options and the Employee Share Purchase Plan ("ESPP") using the Black-Scholes option valuation model, which requires the input of subjective assumptions including the expected share price volatility and the calculation of expected term, as well as the fair value of the underlying ordinary share on the date of grant, among other inputs.

The Company bases its estimate of expected volatility on the historical volatility of the Company's shares. The Company did not grant share options in 2017, 2016, and 2015.

Share-based compensation expense is recognized on a straight-line basis over each recipient's requisite service period, which is generally the vesting period. Share-based compensation expense is recorded in full during the vesting period, and the effect of forfeitures will be recorded as they actually occur.

Comprehensive income (loss)

Accumulated other comprehensive income (loss), net of tax on the consolidated balance sheets at December 31, 2017 and 2016, represents the accumulated unrealized gains (losses) on available-for-sale securities, and the accumulated unrealized gains (losses) related to derivative instruments accounted for as cash flow hedges. The amount of income tax expense allocated to unrealized gains (losses) on available-for-sale securities and derivative instruments was immaterial at December 31, 2017 and 2016.

Foreign currency translation and remeasurement

The Company uses the U.S. dollar as its functional currency. Foreign currency assets and liabilities are remeasured into U.S. dollars at the end-of-period exchange rates except for non-monetary assets and liabilities, which are remeasured at historical exchange rates. The Company derives all revenues in U.S. dollars. Expenses are remeasured at the exchange rate in effect on the day the transaction occurred, except for those expenses related to non-monetary assets and liabilities, which are remeasured at historical exchange rates. Gains or losses from foreign currency transactions are included in the Consolidated Statements of Operations as part of "Other income (loss), net."

Net income (loss) per share

Basic net income (loss) per share is computed by dividing the net income (loss) by the weighted-average number of ordinary shares outstanding during the period. Diluted net income (loss) per share is computed by dividing the net income (loss) by the weighted-average number of ordinary shares outstanding during the period increased to include the number of additional shares that would have been outstanding if the potentially dilutive shares had been issued. Potentially dilutive shares include unvested RSUs, outstanding stock options, and shares to be purchased by employees under the Company's employee stock purchase plan. The dilutive effect of potentially dilutive shares is reflected in diluted net income (loss) per share by application of the treasury stock method.

## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table sets forth the computation of basic and diluted net income (loss) per share for the periods indicated:

	Year Ended December 31,		
	2017	2016	2015
	(In thousands, except per share data)		
Net income (loss)	\$(19,425)	\$18,518	\$92,894
Basic and diluted shares:			
Weighted average ordinary shares outstanding	50,310	48,145	46,365
Effect of dilutive shares	—	1,381	1,413
Shares used to compute diluted net income (loss) per share	50,310	49,526	47,778
Net income (loss) per share—basic	\$(0.39 )	\$0.38	\$2.00
Net income (loss) per share—diluted	\$(0.39 )	\$0.37	\$1.94

The Company excluded 4.5 million potentially dilutive share options and RSUs from the computation of diluted net loss per share for the year ended December 31, 2017, 0.5 million and 0.5 million potentially dilutive shares from the computation of diluted net income per share for the years ended December 31, 2016 and 2015, respectively, because including them would have had an anti-dilutive effect.

## Segment reporting

The Company has one reportable segment: the development, manufacturing, marketing and sales of interconnect products.

## Income taxes

To prepare the Company's consolidated financial statements, the Company estimates its income taxes in each of the jurisdictions in which it operates. This process involves estimating the Company's actual tax exposure together with assessing temporary differences resulting from the differing treatment of certain items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are calculated using tax rates expected to be in effect during the period these temporary differences would reverse, and are included within the Company's consolidated balance sheet.

The Company must also make judgments regarding the realizability of deferred tax assets. The carrying value of the Company's net deferred tax assets is based on its belief that it is more likely than not that the Company will generate sufficient future taxable income in certain jurisdictions to realize these deferred tax assets. A valuation allowance has been established for deferred tax assets which the Company does not believe meet the "more likely than not" criteria. The Company's judgments regarding future taxable income may change due to changes in market conditions, changes in tax laws, tax planning strategies or other factors. If the Company's assumptions and consequently its estimates change in the future, the valuation allowances it has established may be increased or decreased, resulting in a respective increase or decrease in income tax expense. The Company's effective tax rate is highly dependent upon the geographic distribution of its worldwide earnings or losses, the tax regulations and tax holidays in each geographic region, the availability of tax credits and carryforwards, and the effectiveness of its tax planning strategies.

The Company uses a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with the guidance on judgments regarding the realizability of deferred taxes. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. The Company considers many factors when evaluating and estimating its tax positions and tax benefits, which may require periodic adjustments and which may not accurately anticipate actual outcomes. The Company recognizes potential accrued interest and penalties related to unrecognized tax benefits within the



consolidated statements of income as income tax expense.

Adoption of new accounting principles

In March 2016, the Financial Accounting Standards Board ("FASB") issued ASU No. 2016-09, Compensation-Stock Compensation (Topic 718); Improvements to Employee Share-Based Payment Accounting. The Company adopted ASU No. 2016-09 during the quarter ended March 31, 2017. The standard requires, among other things, excess tax benefits to be

## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

recognized in the statement of operations as an income tax benefit as opposed to additional paid-in capital. This change was adopted prospectively and did not have a material effect on the Company's condensed consolidated financial statements. The standard also requires, among other things, excess tax benefits to be included in operating activities in the statement of cash flows as opposed to in financing activities. This change was adopted retrospectively and did not have a material effect on the Company's condensed consolidated financial statements.

The standard further requires excess tax benefits to be recognized when they arise, instead of when they actually reduce taxes payable under the prior guidance. This change was adopted using a modified retrospective method through a cumulative effect adjustment to retained earnings as of the beginning of the period of adoption. The impact of the adoption was to increase deferred tax assets by \$4.6 million, which in turn was offset by an increase in the valuation allowance in the same amount, resulting in no change in net deferred tax assets and retained earnings as of January 1, 2017.

The standard also establishes an alternative practical expedient for estimating the effects of forfeitures of an award by recognizing such effects in compensation cost when the forfeitures occur. Adoption of the alternative practical expedient was applied using a modified retrospective method through a cumulative effect adjustment to retained earnings as of the beginning of the period of adoption. The impact of the adoption was to reduce retained earnings and to increase additional paid-in capital by \$0.8 million as of January 1, 2017.

In November 2016, the FASB issued Accounting Standards Update No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash, which requires, among other things, an explanation of the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. The standard is effective for fiscal years beginning after December 15, 2017. We early adopted ASU 2016-18 retrospectively during the fourth quarter of 2017. The Company has long-term restricted cash in the amount of \$8.0 million as of December 31, 2017. This amount was reported in other long-term assets in the balance sheet as of December 31, 2017, and was included in the ending balance of cash, cash equivalents and restricted cash in the statement of cash flows for the year ended December 31, 2017. There was no restricted cash as of December 31, 2016 and 2015.

#### Recent accounting pronouncements

In August 2017, the FASB issued ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities, which expands the activities that qualify for hedge accounting and simplifies the rules for reporting hedging transactions. The standard is effective for the Company beginning January 1, 2019. Early adoption is permitted. The Company does not expect that the adoption of this standard will have a material impact on its consolidated financial statements and related disclosures.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). The standard requires lessees to recognize almost all leases on the balance sheet as a right-of-use asset and a lease liability and requires leases to be classified as either an operating or a finance type lease. The standard excludes leases of intangible assets or inventory. The standard becomes effective for the Company beginning January 1, 2019. Early adoption of the standard is allowed. The Company is currently evaluating the effect that the standard will have on its consolidated financial statements and related disclosures.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. ASU 2016-01 amends various aspects of the recognition, measurement, presentation, and disclosure of financial instruments, and is effective for the Company beginning January 1, 2018. One aspect that may have a material impact on the Company's consolidated financial statements relates to the measurement of its equity investments in privately-held companies whose fair values are not readily determinable. With the election to use the measurement alternative (as opposed to fair value), these equity investments will be measured at cost, less impairments, adjusted by observable price changes. The Company believes that the adoption of ASU 2016-01 may increase the volatility of its other income (expense), net, as a result of the

remeasurement of its equity investments in privately-held companies upon the occurrence of observable price changes and impairments.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). The standard will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective and may be applied retrospectively to each prior period presented, or applied using a modified retrospective method with the cumulative effect recognized in the beginning retained earnings during the period of initial application. Subsequently, the FASB has issued several additional ASUs related to ASU No. 2014-09, collectively they are referred to as the “new revenue standards,” which become effective for the Company beginning January 1, 2018. The Company expects to adopt the new revenue standards using

MELLANOX TECHNOLOGIES, LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

the modified retrospective method. Under the current guidance, the Company defers the recognition of revenue and the cost of revenue from distributor sales until the distributors report that they have sold the products to their customers (known as “sell-through” revenue recognition). Upon the adoption of the new revenue standards, the Company will recognize revenue on sales to distributors upon shipment and transfer of control (known as “sell-in” revenue recognition), net of the estimated allowances for price adjustments. The deferred “sell-through” revenue, net of the deferred cost of revenue, was approximately \$4.5 million as of December 31, 2017, which will be recognized and recorded as an increase to beginning retained earnings during the first quarter of 2018. The Company does not expect any other material effects on its consolidated financial statements.

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MELLANOX TECHNOLOGIES, LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## NOTE 2—BALANCE SHEET COMPONENTS:

	December 31, 2017	December 31, 2016
	(In thousands)	
Accounts receivable, net:		
Accounts receivable	\$ 154,845	\$ 142,400
Less: allowance for doubtful accounts	(632 )	(632 )
	\$ 154,213	\$ 141,768
Inventories:		
Raw materials	\$ 12,656	\$ 8,243
Work-in-process	22,769	26,118
Finished goods	29,232	31,162
	\$ 64,657	\$ 65,523
Other current assets:		
Prepaid expenses	\$ 7,518	\$ 9,053
Derivative contracts receivable	982	257
VAT receivable	2,259	6,093
Other	3,536	1,943
	\$ 14,295	\$ 17,346
Property and equipment, net:		
Computer, equipment, and software	\$ 164,707	\$ 214,719
Furniture and fixtures	3,198	5,210
Leasehold improvements	47,262	46,693
	215,167	266,622
Less: Accumulated depreciation and amortization	(105,248 )	(148,037 )
	\$ 109,919	\$ 118,585
Deferred taxes and other long-term assets:		
Equity investments in privately-held companies	\$ 29,255	\$ 12,720
Deferred taxes	24,563	22,413
Long-term restricted cash	8,025	—
Other assets	4,319	1,580
	\$ 66,162	\$ 36,713
Accrued liabilities:		
Payroll and related expenses	\$ 71,868	\$ 62,969
Accrued expenses	31,951	33,125
Derivative contracts payable	17	1,006
Product warranty liability	706	1,263
Other	9,516	6,679
	\$ 114,058	\$ 105,042
Other long-term liabilities:		
Income tax payable	\$ 24,425	\$ 24,184
Deferred rent	2,220	2,504
Other	7,422	3,892
	\$ 34,067	\$ 30,580



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MELLANOX TECHNOLOGIES, LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## NOTE 3—BUSINESS COMBINATION:

On February 23, 2016, the Company completed its acquisition of EZchip Semiconductor Ltd. ("EZchip"). Under the terms of the Agreement of Merger dated as of September 30, 2015 (as amended on November 17, 2015), by and among the Company, Mondial Europe Sub Ltd. and EZchip (the "Merger Agreement"), the total consideration was \$782.2 million, including \$1.0 million attributable to assumed RSUs. The net cash purchase price of \$693.7 million consisted of a \$781.2 million cash payment for all outstanding common shares of EZchip at the price of \$25.50 per share and net of \$87.5 million cash acquired. The Company also assumed 891,822 EZchip RSUs and converted them to 499,894 equivalent Company RSU awards. The fair value of the converted RSUs was determined based on the per share value of the underlying Mellanox ordinary shares of \$46.40 per share as of the acquisition date. The 499,894 RSUs had a total aggregate value of \$23.2 million, of which \$1.0 million was recorded as a component of the purchase price for service rendered prior to the acquisition date and \$22.2 million will be recognized as share-based compensation expense over the remaining required service period of up to 2.25 years from the acquisition date. In connection with the acquisition, the Company entered into a \$280.0 million variable interest rate Term Debt maturing February 21, 2019. See Note 15 for additional information.

The Company accounted for the transaction using the acquisition method, which requires, among other things, that the assets acquired and liabilities assumed in a business combination be recognized at their respective estimated fair values as of the acquisition date. The following summarizes consideration paid for EZchip at the acquisition date:

	(in thousands)
Consideration:	
Cash payment for all outstanding common shares of EZchip at \$25.50 per share	\$ 781,237
Fair value of awards attributable to pre-acquisition services	972
Total consideration:	782,209
Less: cash acquired	87,545
Fair value of total consideration transferred, net of cash acquired	\$ 694,664

The following summarizes the Company's allocation of the total purchase price, net of cash acquired for the EZchip acquisition after consultation with third party valuation specialists:

	(in thousands)
Short-term investments	\$ 108,862
Other current assets	34,114
Other long-term assets	9,638
Intangible assets	288,246
Goodwill	270,485
Total assets	711,345
Current liabilities	(10,253 )
Long-term liabilities	(6,428 )
Total liabilities	(16,681 )
Total purchase price allocation	\$ 694,664

Acquisition-related expenses for the EZchip acquisition for the year ended December 31, 2017 were \$0.3 million and primarily consisted of employee-related expenses. Acquisition-related expenses for the EZchip acquisition for the year ended December 31, 2016 were \$8.3 million and primarily consisted of investment banking, consulting, and other professional fees.





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## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Identifiable finite-lived intangible assets

	Fair value (in thousands)	Weighted Average Useful Life (in years)
Purchased intangible assets:		
Trade names	\$ 5,600	3
Customer relationships	56,400	9
Backlog	11,300	1
Developed technology	181,246	4 - 6
In-process research and development <sup>(1)</sup>	33,700	-
Total purchased intangible assets	\$ 288,246	

<sup>(1)</sup> IPR&D will not be amortized until the underlying products reach technological feasibility. Upon completion, each IPR&D project will be amortized over its useful life.

Trade name represents the fair values of brand and name recognition associated with the marketing of EZchip's products and services. The Company used the income approach and utilized a discount rate of 10.0% to determine the fair value of trade name assets.

Customer relationships represent the fair value of future projected revenues that will be derived from the sale of products to existing customers of EZchip. The Company used the comparative method ("with/without") of the income approach to determine the fair value of this intangible asset and utilized a discount rate of 10.0%.

Backlog represents the fair value of sales order backlog as of the valuation date. The Company used the income approach to determine the fair value of this intangible asset and utilized a discount rate of 8.0%.

Developed technology represents completed technology that has passed technological feasibility and/or is currently offered for sale to customers. The Company used the income approach to value the developed technology. Under the income approach, the expected future cash flows from each technology are estimated and discounted to their net present values at an appropriate risk-adjusted rate of return. Significant factors considered in the calculation of the rate of return are the weighted average cost of capital and the return on assets. The Company applied a discount rate of 9.0% to value the developed technology assets taking into consideration market rates of return on debt and equity capital and the risk associated with achieving forecasted revenues related to these assets.

The IPR&D intangible asset represents the value assigned to an acquired research and development project that, as of the acquisition date, had not established technological feasibility. The fair value of IPR&D was determined using a discount rate of 12.0%. This intangible asset will be capitalized on the balance sheet and evaluated periodically for impairment until the project is completed, at which time it will be transferred to developed technology and become subject to amortization over its useful life. IPR&D consists of one project related to the development of two network processors. The estimated remaining costs to complete the IPR&D project was \$22.3 million as of the acquisition date, which will be charged to operating expense in the condensed consolidated statements of operations as incurred. During the three months ended September 30, 2016, one component of the IPR&D project reached technological feasibility and \$4.2 million was transferred to developed technology. During the three months ended December 31, 2017, the remaining IPR&D project reached technological feasibility and \$29.5 million was transferred to developed technology. The total developed technology balance at December 31, 2017 will be amortized over seven years.

## Goodwill

Goodwill arising from the acquisition represents the value of the skilled assembled workforce and projected growth in overall revenues. The EZchip acquisition is a step in the Company's strategy to become a leading broad-line supplier of intelligent interconnect solutions for data centers. The addition of EZchip's products and expertise in network

processing is expected to enhance the Company's leadership position, and ability to deliver complete end-to-end, intelligent interconnect and processing solutions for advanced data center and edge platforms. The combined company has diverse and robust solutions to enable customers to meet the growing demands of data-intensive applications used in high-performance computing, Web 2.0, cloud, secure data center, enterprise, telecom, database, financial services, and storage environments. These significant factors

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## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

were the basis for the recognition of goodwill. Goodwill is not expected to be deductible for tax purposes. Goodwill will not be amortized but instead will be tested for impairment annually or more frequently if certain indicators are present.

## Supplemental pro forma data

The following unaudited pro forma data have been prepared as if the EZchip acquisition had occurred on January 1, 2015, and include adjustments for amortization of intangible assets acquired, the effect of purchase accounting adjustments including the step-up of inventory, share-based compensation expense, and interest on the Term Debt incurred to partially finance the acquisition. Pro forma results are not indicative of what would have occurred had the acquisition occurred as of January 1, 2015 or of results that may occur in the future.

	Year Ended December 31, 2016      2015 (in thousands, except per share amounts)	
Revenues	\$867,422	\$769,290
Net income	\$40,288	\$36,130
Net income per share — basic	\$0.82	\$0.77
Net income per share — diluted	\$0.80	\$0.74

Material non-recurring adjustments included in the unaudited pro forma net income for the year ended December 31, 2016 for the effect of purchase accounting adjustments include: a reduction of acquisition-related costs of \$15.3 million, composed of acquisition cost of \$8.3 million incurred by the Company and \$7.0 million incurred by EZchip; a reduction of amortization expense related to the acquired intangible assets and the step-up of inventory of \$13.0 million; and a reduction of the share-based compensation expense related to accelerated RSUs of \$4.8 million.

Material non-recurring adjustments included in the unaudited pro forma net income for the year ended December 31, 2015 for the effect of purchase accounting adjustments include: additional amortization expense related to the acquired intangible assets and the step-up of inventory of \$56.2 million; an increase of acquisition-related costs of \$15.3 million; and the interest expense of term debt, including the amortization of issuance costs, of \$7.6 million. The Company immediately integrated EZchip into its ongoing operations. As a result, it is impracticable to determine EZchip's effect on revenue and earnings in the consolidated statement of operations for the reporting period.

## NOTE 4—FAIR VALUE MEASUREMENTS:

## Fair value hierarchy:

The Company measures its cash equivalents, restricted cash, and marketable securities at fair value. The Company's cash equivalents are classified within Level 1. Cash equivalents are valued primarily using quoted market prices utilizing market observable inputs. The Company's restricted cash and investments in debt securities and certificates of deposits are classified within Level 2 as the market inputs to value these instruments consist of market yields, reported trades and broker/dealer quotes. In addition, foreign currency contracts are classified within Level 2 as the valuation inputs are based on quoted prices and market observable data of similar instruments. The Level 3 valuation inputs include the Company's best estimate of what market participants would use in pricing the asset or liability at the measurement date. The inputs are unobservable in the market and significant to the instrument's valuation. As of December 31, 2017 and December 31, 2016, the Company did not have any assets or liabilities valued based on Level 3 valuations.

## Financial Liabilities Measured at Fair Value on a Nonrecurring Basis:

As of December 31, 2017, the remaining principal of \$74.0 million on the Company's \$280.0 million Term Debt is classified as a Level 2 fair value measurement in the fair value hierarchy. The Company calculated a fair value amount of \$74.9 million at December 31, 2017 based on a discounted cash flow model using observable market inputs and taking into consideration variables such as interest rate changes, comparable instruments, and long-term credit ratings.

## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Financial Assets and Liabilities Measured at Fair Value on a Recurring Basis:

The following table represents the fair value hierarchy of the Company's financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2017.

	Level 1	Level 2	Total
	(in thousands)		
Money market funds	\$1,857	\$—	\$1,857
Certificates of deposit	—	58,003	58,003
U.S. Government and agency securities	—	43,872	43,872
Commercial paper	—	27,029	27,029
Corporate bonds	—	54,447	54,447
Municipal bonds	—	15,169	15,169
Foreign government bonds	—	12,761	12,761
	1,857	211,281	213,138
Long-term restricted cash	—	8,025	8,025
Derivative contracts	—	982	982
Total financial assets	\$1,857	\$220,288	\$222,145
Derivative contracts	\$—	\$17	\$17
Total financial liabilities	\$—	\$17	\$17

The following table represents the fair value hierarchy of the Company's financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2016.

	Level 1	Level 2	Total
	(in thousands)		
Money market funds	\$1,833	\$—	\$1,833
Certificates of deposit	—	78,643	78,643
U.S. Government and agency securities	—	56,347	56,347
Commercial paper	—	29,483	29,483
Corporate bonds	—	94,162	94,162
Municipal bonds	—	7,706	7,706
Foreign government bonds	—	5,320	5,320
	1,833	271,661	273,494
Derivative contracts	—	257	257
Total financial assets	\$1,833	\$271,918	\$273,751
Derivative contracts	\$—	\$1,006	\$1,006
Total financial liabilities	\$—	\$1,006	\$1,006

There were no transfers between Level 1 and Level 2 securities during the years ended December 31, 2017 and 2016.

## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## NOTE 5—INVESTMENTS:

Cash, cash equivalents and short-term investments:

At December 31, 2017 and 2016, the Company held cash, cash equivalents and short-term investments classified as available-for-sale securities as follows:

	December 31, 2017			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
	(in thousands)			
Cash	\$60,616	\$ —	\$ —	\$60,616
Money market funds	1,857	—	—	1,857
Certificates of deposit	58,039	—	(36 )	58,003
U.S. Government and agency securities	44,070	—	(198 )	43,872
Commercial paper	27,073	1	(45 )	27,029
Corporate bonds	54,673	—	(226 )	54,447
Municipal bonds	15,227	—	(58 )	15,169
Foreign government bonds	12,809	—	(48 )	12,761
Total	274,364	1	(611 )	273,754
Less amounts classified as cash and cash equivalents	(62,473 )	—	—	(62,473 )
Short-term investments	\$211,891	\$ 1	\$ (611 )	\$211,281

	December 31, 2016			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
	(in thousands)			
Cash	\$54,947	\$ —	\$ —	\$54,947
Money market funds	1,833	—	—	1,833
Certificates of deposit	78,643	—	—	78,643
U.S. Government and agency securities	56,431	2	(86 )	56,347
Commercial paper	29,486	—	(3 )	29,483
Corporate bonds	94,292	37	(167 )	94,162
Municipal bonds	7,718	—	(12 )	7,706
Foreign government bonds	5,327	—	(7 )	5,320
Total	328,677	39	(275 )	328,441
Less amounts classified as cash and cash equivalents	(56,780 )	—	—	(56,780 )
Short-term investments	\$271,897	\$ 39	\$ (275 )	\$271,661

Interest income and gains (losses) on short-term investments, net were \$3.7 million and \$2.2 million for the years ended December 31, 2017 and 2016, respectively. At December 31, 2017, gross unrealized losses on investments that were in a gross unrealized loss position for greater than 12 months were immaterial. These investments were not deemed to be other-than-temporarily impaired and the gross unrealized losses were recorded in OCI.

## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The contractual maturities of short-term investments at December 31, 2017 and 2016 were as follows:

	December 31, 2017		December 31, 2016	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
	(in thousands)			
Due in less than one year	\$ 148,232	\$ 147,921	\$ 157,270	\$ 157,163
Due in one to three years	63,659	63,360	114,627	114,498
	\$ 211,891	\$ 211,281	\$ 271,897	\$ 271,661

Equity investments in privately-held companies:

As of December 31, 2017 and 2016, the Company held a total of \$29.3 million and \$12.7 million in equity investments in privately-held companies, which were reported using the cost method. On April 27, 2015, the Company was informed that one of the privately-held companies intended to discontinue its operations. As a result, the Company concluded that its investment of \$3.2 million in this privately-held company was fully impaired and the impairment of this investment was other than temporary. The impairment loss was included in other loss, net, on the consolidated statements of operations for the year ended December 31, 2015. During the years ended December 31, 2017 and 2016, there was no impairment of equity investments in privately-held companies.

## NOTE 6—GOODWILL AND INTANGIBLE ASSETS:

The following table represents changes in the carrying amount of goodwill:

	(in thousands)
Carrying amount of goodwill at December 31, 2016	\$ 471,228
Acquisitions	1,209
Adjustments	—
Balance as of December 31, 2017	\$ 472,437

The carrying amounts of intangible assets as of December 31, 2017 were as follows:

	Gross Carrying Value	Accumulated Amortization	Net Carrying Value	Useful Life
	(in thousands)			(in years)
Licensed technology	\$40,407	\$ (16,478 )	\$ 23,929	1-8
Developed technology	279,543	(122,414 )	157,129	4-7
Customer relationships	69,776	(24,783 )	44,993	4-9
Trade names	5,600	(3,456 )	2,144	3
Total intangible assets	\$395,326	\$ (167,131 )	\$ 228,195	

## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The carrying amounts of intangible assets as of December 31, 2016 were as follows:

	Gross Carrying Value	Accumulated Amortization	Net Carrying Value	Useful Life
	(in thousands)			(in years)
Licensed technology	\$24,583	\$ (6,559 )	\$ 18,024	1-8
Developed technology	250,043	(75,591 )	174,452	4-7
Customer relationships	69,776	(17,731 )	52,045	4-9
Backlog	11,300	(11,300 )	—	1
Trade names	5,600	(1,590 )	4,010	3
Total finite-lived amortizable intangible assets	361,302	(112,771 )	248,531	
In-process research and development	29,500	—	29,500	-
Total intangible assets	\$390,802	\$ (112,771 )	\$ 278,031	

Amortization expense of intangible assets totaled approximately \$61.3 million, \$59.2 million and \$10.1 million for the years ended December 31, 2017, 2016 and 2015, respectively. An impairment charge of \$4.3 million was recorded in the fourth quarter of 2017 to write-off the intangible assets related to the 1550nm silicon photonics development activities. See Note 16 for more details about the impairment charge.

The estimated future amortization expense from amortizable intangible assets is as follows:

	(in thousands)
2018	\$ 66,718
2019	59,344
2020	47,311
2021	30,919
2022	10,355
Thereafter	13,548
Total	\$ 228,195

## NOTE 7—DERIVATIVES AND HEDGING ACTIVITIES:

## Fair Value of Derivative Contracts

The fair value of derivative contracts as of December 31, 2017 and 2016 was as follows:

	Other current assets	Other accrued liabilities	Other current assets	Other accrued liabilities
	December 31, 2017	December 31, 2016	December 31, 2017	December 31, 2016
	(in thousands)			
Derivatives designated as hedging instruments				
Currency forward and option contracts	\$980	\$ —	\$257	\$ 999
Derivatives not designated as hedging instruments				
Currency forward and option contracts	2	17	—	7
Total derivatives	\$982	\$ 17	\$257	\$ 1,006

The gross notional amounts of derivative contracts were NIS denominated. The notional amounts of outstanding derivative contracts in U.S. dollar at December 31, 2017 and 2016 were as follows:





## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	December 31, 2017	December 31, 2016
	(in thousands)	
Derivatives designated as hedging instruments		
Currency forward and option contracts	\$52,380	\$105,730
Derivatives not designated as hedging instruments		
Currency forward and option contracts	\$47,015	\$34,330
Effect of Derivatives Designated as Hedging Instruments on Accumulated Other Comprehensive Income (Loss)		
The following table represents the unrealized gains of derivatives designated as hedging instruments, net of tax effects, that were recorded in accumulated other comprehensive income (loss) as of December 31, 2017 and 2016, and their effect on OCI for the year ended December 31, 2017 (in thousands):		
December 31, 2016		\$(692)
Amount of gains recognized in OCI (effective portion)		8,651
Amount of gains reclassified from OCI to income (effective portion)		(7,034)
December 31, 2017		\$925
Foreign exchange contracts designated as hedging instruments primarily relate to operating expenses and the associated gains and losses are expected to be recorded in operating expenses when reclassified out of OCI. See Note 11 for the amounts recorded in each operating expense account. The Company expects to realize the accumulated OCI balance related to foreign exchange contracts within the next twelve months.		
Effect of Derivative Contracts on the Consolidated Statement of Operations		
The effect of derivative contracts on the consolidated statement of operations in the years ended December 31, 2017, 2016, and 2015 was as follows:		

	Derivatives designated as hedging instruments			Derivatives not designated as hedging instruments		
	Year Ended December 31,			Year Ended December 31,		
	2017	2016	2015	2017	2016	2015
	(in thousands)					
Operating income (expenses)	\$7,034	\$623	\$(3,630)	\$—	\$—	\$—
Other income	\$—	\$—	\$—	\$3,248	\$384	\$—

## NOTE 8—EMPLOYEE BENEFIT PLANS:

The Company has established a pretax savings plan under Section 401(k) of the Internal Revenue Code. The 401(k) Plan allows eligible employees in the United States to voluntarily contribute a portion of their pre-tax or after-tax salary, subject to a maximum limit specified in the Internal Revenue Code. The Company matches employee contributions of up to 4% of their annual base salaries. The total expenses for these contributions were \$2.2 million, \$1.9 million and \$1.2 million for the years ended December 31, 2017, 2016 and 2015, respectively.

Under Israeli law, the Company is required to make severance payments to certain of its retired or dismissed Israeli employees. For employees hired prior to January 1, 2007 the severance pay liability is calculated based on the last monthly salary of each employee multiplied by the number of years of such employee's employment and is presented in the Company's balance sheet in long-term liabilities, as if it was payable at each balance sheet date on an undiscounted basis. This liability is partially funded by the purchase of insurance policies or pension funds in the

name of the employees. The surrender value of the insurance policies or pension funds is presented in long-term assets.

## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The severance pay detail is as follows:

	December 31,	
	2017	2016
	(in thousands)	
Accrued severance liability	\$23,205	\$19,874
Severance assets	18,302	15,870
Unfunded portion	\$4,903	\$4,004

For other Israeli employees, the Company's contributions for severance pay replace its severance obligation. When the Company makes the monthly contribution equal to 8.3% of the employee's monthly salary to an insurance policy or pension fund, no additional calculations shall be conducted between the parties regarding the matter of severance pay and no additional payments will be made by the Company to the employee. Further, the related obligation and amounts deposited on behalf of the employee for such obligation are not stated on the balance sheet, as the Company is legally released from the obligation to employees once the deposit amounts have been paid.

Severance expenses for the years ended December 31, 2017, 2016 and 2015 were \$12.6 million, \$11.0 million and \$7.6 million, respectively.

In addition, the Company has established a pension contribution plan with respect to its employees in Israel. Under the plan, for the period from January 1 to June 30, 2016, the Company contributed up to 6.0% of employee monthly salary toward the plan. Effective July 1, 2016 the contribution percentage was increased to 6.25%, and was further increased to 6.5% effective January 1, 2017. Employees are entitled to amounts accumulated in the plan upon reaching retirement age, subject to any applicable law. Defined contribution pension plan expenses were \$10.4 million, \$8.0 million and \$5.7 million in the years ended December 31, 2017, 2016 and 2015, respectively.

## NOTE 9—COMMITMENTS AND CONTINGENCIES:

## Leases

The Company leases office space and motor vehicles under operating leases with various expiration dates through 2026. Expenses related to office space and motor vehicle leases were approximately \$21.3 million, \$18.9 million and \$14.3 million for the years ended December 31, 2017, 2016 and 2015, respectively. The terms of the facility leases provide for rental payments on a graduated scale. The Company recognizes rent expense on a straight-line basis over the lease period, and has accrued for rent expense incurred but not paid.

At December 31, 2017, future minimum payments under non-cancelable operating leases are as follows:

Year Ended December 31,	Operating Leases (in thousands)
2018	\$ 23,028
2019	18,453
2020	14,740
2021	12,950
2022	9,648
Thereafter	60,091
Total minimum lease payments	\$ 138,910

## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Purchase commitments

At December 31, 2017, the Company had the following non-cancelable purchase commitments:

Year Ended December 31,	Purchase Commitments (in thousands)
2018	\$ 153,358
2019	2,447
2020	544
2021	542
2022	536
Thereafter	—
Total purchase commitments	\$ 157,427

## Term Debt

See Note 15 for more information about the Term Debt.

## Other Commitments

## Operating lease

On May 3, 2016, the Company entered into a lease agreement for additional office space expected to be built in Yokneam, Israel. The Company is not involved in the construction, and will not be exposed to any risk during the construction period. The lease term expires 10 years after lease inception with no options to extend the lease term. The Company's occupancy of the additional office space and its obligation under the lease agreement are contingent on the lessor's attainment of stated milestones in the lease agreement. As such, the Company cannot make a reliable estimate as to the timing of cash payments under the lease. At December 31, 2017, the estimated total future lease obligation is approximately \$30.7 million. Over a twelve month period, the estimated rental expense will be approximately \$3.1 million.

## Royalty-bearing grants

We are obliged to pay royalties to the Israeli National Authority for Technological Innovation or the OCS for research and development efforts partially funded through grants from the OCS and under approved plans in accordance with the Israeli Law for Encouragement of Research and Development in the Industry, 1984 (the "R&D Law"). Royalties are payable to the Israeli government at the rate of 4.5% on the revenues of the Company's products incorporating OCS funded know-hows, and up to the amount of the grants received. The Company's obligation to pay these royalties is contingent on actual sales of the products, at which time a liability is recorded. In the absence of such sales, we cannot make a reliable estimate as to the timing of cash settlement of the royalties. At December 31, 2017, the Company estimated a total future royalty obligation of approximately \$36.4 million, and if recognized, would increase the Company's cost of revenues in its consolidated statement of operations.

## Unrecognized tax benefits

Due to the inherent uncertainty with respect to the timing of future cash outflows associated with the Company's unrecognized tax benefits, it is unable to reliably estimate the timing of cash settlement with the respective taxing authorities. As of December 31, 2017, the Company's unrecognized tax benefits totaled \$45.2 million, out of which an amount of \$24.6 million would reduce the Company's income tax expense and effective tax rate, if recognized.

## Contingencies

## Legal proceedings

The Company is involved in a variety of claims, suits, investigations and proceedings that arise from time to time in the ordinary course of its business, including actions with respect to contracts, intellectual property, taxation, employment, benefits, securities, personal injuries and other matters. The results of these proceedings in the ordinary

course of business are not expected to have a material adverse effect on the Company's condensed consolidated financial position or results of operations.

## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company records a liability when it believes that it is both probable that a liability will be incurred, and the amount of loss can be reasonably estimated. The Company evaluates, at least quarterly, developments in its legal matters that could affect the amount of liability that has been previously accrued and makes adjustments as appropriate. Significant judgment is required to determine both probability and the estimated amount of a loss or potential loss. The Company may be unable to reasonably estimate the reasonably possible loss or range of loss for a particular legal contingency for various reasons, including, among others: (i) if the damages sought are indeterminate; (ii) if proceedings are in the early stages; (iii) if there is uncertainty as to the outcome of pending proceedings (including motions and appeals); (iv) if there is uncertainty as to the likelihood of settlement and the outcome of any negotiations with respect thereto; (v) if there are significant factual issues to be determined or resolved; (vi) if the proceedings involve a large number of parties; (vii) if relevant law is unsettled or novel or untested legal theories are presented; or (viii) if the proceedings are taking place in jurisdictions where the laws are complex or unclear. In such instances, there is considerable uncertainty regarding the ultimate resolution of such matters, including a possible eventual loss, if any.

## NOTE 10—SHARE INCENTIVE PLANS:

## Stock option plans

During the 2016 annual shareholder meeting, the Company's shareholders approved the Mellanox Technologies, Ltd. Amended and Restated Global Share Incentive Plan (2006) (the "First Restated 2006 Plan"), which constitutes an amendment and restatement of the Mellanox Technologies, Ltd. Global Share Incentive Plan (2006) and its appendices (the "2006 Plan"). The Restated 2006 Plan became effective on March 14, 2016 ("Effective Date"). The approval of the First Restated 2006 Plan extended the term to February 2026.

The First Restated 2006 Plan reserves 750,000 ordinary shares for issuance under new equity awards and reduces to zero the shares available for issuance under all of the Company's other equity incentive plans in effect, including the Voltaire Ltd. 2007 Incentive Compensation Plan, the Voltaire Ltd. 2003 Section 102 Stock Option/Stock Purchase Plan, the Voltaire Ltd. 2001 Section 102 Stock Option/Stock Purchase Plan, the Voltaire Ltd. 2001 Stock Option Plan, the Kotura, Inc. Second Amended and Restated 2003 Stock Plan, the IPtronics, Inc. 2013 Restricted Stock Unit Plan, the Global Share Incentive Assumption Plan (2010), the EZchip Semiconductor Ltd. 2003 Amended and Restated Equity Incentive Plan, the EZchip Semiconductor Ltd. 2007 U.S. Equity Incentive Plan, and the Amended and Restated EZchip Semiconductor Ltd. 2009 Equity Incentive Plan (collectively, the "Prior Plans").

As of the Effective Date of the First Restated 2006 Plan, the Company ceased granting awards under the Prior Plans, and will grant new awards only from the First Restated 2006 Plan. Any shares subject to issued and outstanding awards under the Prior Plans that expire, are canceled or otherwise terminate after the Effective Date of the First Restated 2006 Plan will be added back to share reserves under the First Restated 2006 Plan. The share reserve of the 2006 Plan will no longer be available for issuance under the First Restated 2006 Plan. In addition, the First Restated 2006 Plan implements additional amendments to reflect compensation and governance best practices.

On April 25, 2017, the Company's shareholders approved the Mellanox Technologies, Ltd. Second Amended and Restated Global Share Incentive Plan (2006) (the "Second Restated 2006 Plan"), which constitutes a second amendment and restatement of the 2006 Plan, as amended and restated by the First Restated 2006 Plan. The Second Restated 2006 Plan became effective on February 14, 2017. The Second Restated 2006 Plan increases the ordinary shares reserved for issuance under the First Restated 2006 Plan by 1,640,000 shares to 2,390,000 shares plus any shares subject to issued and outstanding awards under the other equity incentive plans that existed prior to the First Restated 2006 Plan that expire, are cancelled or otherwise terminated after the effective date of the First Restated 2006 Plan. The Second Restated Plan also extends the term of the First Restated 2006 Plan to February 14, 2027. In addition, the Second Restated Plan implements additional amendments to reflect compensation and governance best practices.

Assumed EZchip restricted stock units

In connection with the acquisition of EZchip, the Company assumed 891,822 unvested EZchip RSUs and converted them into 499,894 Mellanox RSUs using an exchange ratio of 0.56. The aggregate value of the 499,894 Mellanox RSUs was \$23.2 million of which \$1.0 million related to service prior to the acquisition date and was included in the EZchip purchase price consideration. The remaining fair value of \$22.2 million represents post-acquisition share-based compensation expense that will



## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

be recognized over the requisite service period of approximately 2.25 years from the date of acquisition. The assumed RSUs retained all applicable terms and vesting periods.

## Share option activity

The following table summarizes the share option activity under all equity incentive plans:

	Options Outstanding Number of Shares	Weighted Average Exercise Price
Outstanding at December 31, 2015	2,028,595	\$ 30.81
Options exercised	(349,131 )	\$ 14.58
Options canceled	(44,979 )	\$ 84.57
Outstanding at December 31, 2016	1,634,485	\$ 32.79
Options exercised	(479,105 )	\$ 15.95
Options canceled	(45,319 )	\$ 74.59
Outstanding at December 31, 2017	1,110,061	\$ 38.35

There were no options granted in 2017, 2016 and 2015.

The total pretax intrinsic value of options exercised in 2017 was \$16.9 million. This intrinsic value represents the difference between the fair market value of the Company's ordinary shares on the date of exercise and the exercise price of each option. Based on the most recently available closing price of the Company's ordinary shares of \$64.70 prior to December 31, 2017, the total pretax intrinsic value of all outstanding options was \$35.5 million. The total pretax intrinsic value of exercisable options at December 31, 2017 was \$35.4 million.

The total pretax intrinsic value of options exercised in 2016 was \$11.1 million. Based on the most recently available closing price of the Company's ordinary shares of \$40.90 prior to December 31, 2016, the total pretax intrinsic value of all outstanding options was \$29.0 million. The total pretax intrinsic value of exercisable options at December 31, 2016 was \$28.9 million.

The weighted average remaining contractual life of options outstanding at December 31, 2017 was 3.0 years. There were 1,107,712 options exercisable at December 31, 2017 with a weighted average exercise price \$38.36 per share.

## Restricted share unit activity

The following table summarizes the restricted share unit activity under all equity incentive plans:

	Restricted Share Units Outstanding Number of Shares	Weighted Average Grant Date Fair Value
Non-vested restricted share units at December 31, 2015	2,205,083	\$ 44.39
Assumed restricted share units from the EZchip acquisition	499,894	\$ 46.40
Restricted share units granted	2,056,902	\$ 48.39
Restricted share units vested	(1,114,753 )	\$ 45.32
Restricted share units canceled	(322,607 )	\$ 46.26
Non-vested restricted share units at December 31, 2016	3,324,519	\$ 46.67
Restricted share units granted	1,844,350	\$ 49.88
Restricted share units vested	(1,364,063 )	\$ 46.25

Restricted share units canceled	(390,101 )	\$ 47.79
Non-vested restricted share units at December 31, 2017	3,414,705	\$ 48.45

## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The weighted average fair value of restricted share units granted was \$49.88, \$48.39 and \$45.98 for the years ended December 31, 2017, 2016 and 2015, respectively. The total intrinsic value of all outstanding restricted share units was \$220.9 million as of December 31, 2017.

## Employee stock purchase plan activity

The ESPP is designed to allow eligible employees to purchase the Company's ordinary shares, at semi-annual intervals, with their accumulated payroll deductions. A participant may contribute up to 15% of his or her base compensation through payroll deductions, and the accumulated deductions will be applied to the purchase of shares on the purchase date, which is the last trading day of the offering period. The purchase price per share will be equal to 85% of the fair market value per share on the start date of the offering period in which the participant is enrolled or, if lower, 85% of the fair market value per share on the purchase date. In May 2016 the shareholders approved an increase of 4,000,000 additional shares under the ESPP for a total of 6,585,712 shares reserved for issuance. No participant in the ESPP may be issued or transferred more than \$25,000 worth of ordinary shares pursuant to purchase rights under the ESPP per calendar year. During the years ended December 31, 2017, 2016 and 2015, 568,876, 491,968, and 364,746 shares, respectively, were issued under the ESPP at weighted average per share prices of \$38.83, \$35.50 and \$35.15, respectively.

## Shares reserved for future issuance

The Company had the following ordinary shares reserved for future issuance under its equity incentive plans as of December 31, 2017:

	Number of Shares
Share options outstanding	1,110,061
Restricted share units outstanding	3,414,705
Shares authorized for future issuance	757,786
ESPP shares available for future issuance	3,425,469
Total shares reserved for future issuance as of December 31, 2017	8,708,021

## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Share-based compensation

The Company accounts for share-based compensation expense for share option awards and ESPP based on the estimated fair value of the instruments as of the grant dates. There were no employee share options granted in 2017, 2016 and 2015. The following weighted average assumptions were used in the valuation of the ESPP for the years ended December 31, 2017, 2016 and 2015:

	Employee Share Purchase Plan		
	Year ended December 31,		
	2017	2016	2015
Dividend yield, %	—	—	—
Expected volatility	24.6 %	35.8 %	33.7 %
Risk free interest rate	1.20 %	0.45 %	0.10 %
Expected life, years	0.50	0.50	0.50

The following table summarizes the distribution of total share-based compensation expense in the Consolidated Statements of Operations:

	Year ended December 31,		
	2017	2016	2015
	(in thousands)		
Share-based compensation expense by caption:			
Cost of goods sold	\$2,000	\$2,375	\$2,366
Research and development	40,278	40,475	28,821
Sales and marketing	15,693	15,183	10,309
General and administrative	10,893	13,085	9,268
Total share-based compensation expense	\$68,864	\$71,118	\$50,764

## Share-based compensation expense by type of award:

Share options	\$115	\$2,711	\$6,680
ESPP	6,232	6,394	4,007
RSU	62,517	62,013	40,077
Total share-based compensation expense	\$68,864	\$71,118	\$50,764

Share-based compensation expense during the year ended December 31, 2016 included cash payments of \$4.8 million for the settlement of accelerated RSUs for individuals terminated on the Closing Date of the EZchip acquisition.

At December 31, 2017, there was \$142.2 million of total unrecognized share-based compensation costs related to non-vested share-based compensation arrangements. The costs are expected to be recognized over a weighted average period of approximately 2.7 years.

## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## NOTE 11—ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS):

The following table summarizes the changes in accumulated other comprehensive income (loss) for the years ended December 31, 2017 and 2016:

	Unrealized Gains (Losses) on Available-for-Sale Securities	Unrealized Gains (Losses) on Derivatives Designated as Hedging Instruments	Total
	(in thousands)		
Balance at December 31, 2016	\$(236)	\$ (692 )	\$(928 )
Other comprehensive income before reclassifications, net of taxes	918	8,651	9,569
Realized (gains)/losses reclassified from accumulated other comprehensive income	11	(7,034 )	(7,023 )
Net current-period other comprehensive income, net of taxes	929	1,617	2,546
Balance at December 31, 2017	\$693	\$ 925	\$1,618
Balance at December 31, 2015	\$(578)	\$ (1,091 )	\$(1,669)
Other comprehensive income/(loss) before reclassifications, net of taxes	(144 )	1,022	878
Realized (gains)/losses reclassified from accumulated other comprehensive income	486	(623 )	(137 )
Net current-period other comprehensive income, net of taxes	342	399	741
Balance at December 31, 2016	\$(236)	\$ (692 )	\$(928 )

The following table provides details about the realized (gains)/losses reclassified from accumulated other comprehensive income for the years ended December 31, 2017 and 2016:

	Realized (Gains)/Losses Reclassified from Accumulated Other Comprehensive Income Year ended December 31, 2017      2016 (in thousands)	Affected Line Item in the Statement of Operations
Realized (gains) on derivatives designated as hedging instruments	\$(7,034) \$(623)	Cost of revenues and Operating expenses:
	(347 ) (18 )	Cost of revenues
	(635 ) (36 )	General and administrative
	(628 ) (25 )	Sales and marketing
	(5,424 ) (544 )	Research and development
Realized losses on available-for-sale securities	11 486	Other income, net
Total reclassifications for the period	\$(7,023) \$(137)	Total



## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## NOTE 12—INCOME TAXES:

The components of income (loss) before taxes on income are as follows:

	Year ended December 31,		
	2017	2016	2015
	(in thousands)		
United States	\$(21,528)	\$(17,969)	\$(12,539)
Foreign	(375 )	42,297	87,121
Income (loss) before taxes on income	\$(21,903)	\$24,328	\$74,582

The components of the provision for (benefit from) income taxes are as follows:

	Year ended December 31,		
	2017	2016	2015
	(in thousands)		
Current:			
U.S. federal	\$(617 )	\$(1,333)	\$(1,578 )
State and local	632	220	284
Foreign	(261 )	6,161	5,737
Total current	(246 )	5,048	4,443
Deferred:			
Foreign	(2,232 )	762	(22,755 )
Total deferred	(2,232 )	762	(22,755 )
Provision for (benefit from) taxes on income	\$(2,478)	\$5,810	\$(18,312)

At December 31, 2017 and 2016, significant deferred tax assets and liabilities are as follows:

	December 31,	
	2017	2016
	(in thousands)	
Deferred tax assets:		
Net operating loss and credit carryforwards	\$42,820	\$75,350
Reserves and accruals	11,305	13,841
Depreciation and amortization	2,393	358
Other	6,645	7,128
Gross deferred tax assets	63,163	96,677
Valuation allowance	(31,648 )	(55,827 )
Total deferred tax assets	31,515	40,850
Intangible assets	(6,952 )	(18,437 )
Total deferred tax liabilities	(6,952 )	(18,437 )
Net deferred tax assets	\$24,563	\$22,413

## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company records net deferred tax assets to the extent it believes these assets will more likely than not be realized. As of each reporting date, management considers new evidence, both positive and negative, that could impact management's view with regards to the future realization of deferred tax assets for each jurisdiction. As of December 31, 2015, management determined that sufficient positive evidence existed to conclude that it was more likely than not that \$22.4 million of deferred tax assets of one of the Company's Israeli subsidiaries were realizable, and therefore, reduced the valuation allowance accordingly. After weighing all positive and negative evidence, including historical results and projections of future taxable income, the Company determined that it remained more likely than not that \$24.6 million and \$22.4 million of deferred tax assets would be realized as of December 31, 2017 and 2016, respectively. The Company continued to provide valuation allowances against a significant portion of the remaining deferred tax assets on the consolidated balance sheet as of December 31, 2017 due to uncertainty concerning realization of these deferred tax assets.

On December 22, 2017, the Tax Cuts and Jobs Acts was enacted into law. The new legislation contains several key tax provisions that will impact the Company. Changes include, but are not limited to, a corporate tax rate decrease from 35% to 21% effective for tax years beginning after December 31, 2017, a one-time repatriation tax on accumulated foreign earnings, a limitation on the tax deductibility of interest expense, an acceleration of business asset expensing, and a reduction in the amount of executive pay that could qualify as a tax deduction. The lower corporate income tax rate will require the Company to remeasure its U.S. deferred tax assets and liabilities as well as reassess the realizability of its deferred tax assets and liabilities. ASC 740 requires the Company to recognize the effect of the tax law changes in the period of enactment. However, the SEC staff has issued SAB 118 which will allow the Company to record provisional amounts during a measurement period.

The Company has concluded that a reasonable estimate could be developed for the effects of the tax reform. However, due to the short time frame between the enactment of the reform and the year end, its fundamental changes, the accounting complexity, and the expected ongoing guidance and accounting interpretations over the next 12 months, the Company considers the accounting of the deferred tax remeasurement and other items to be incomplete. These effects have been included in the consolidated financial statements for the year ended December 31, 2017 as provisional amounts, which had no effect on the benefit from taxes on income due to the valuation allowance.

During the measurement period, the Company might need to reflect adjustments to the provisional amounts upon obtaining, preparing, or analyzing additional information about facts and circumstances that existed as of the enactment date that, if known, would have affected the income tax effects initially reported as provisional amounts. The measurement period will end when the Company obtains, prepares, and analyzes the information needed in order to complete the accounting requirements under ASC Topic 740 or on December 22, 2018, whichever is earlier. The Company expects to complete its analysis within the measurement period in accordance with SAB 118.

On January 4, 2016, the Israeli Government legislated a reduction in corporate income tax rates from 26.5% to 25.0%, effective in 2016. Deferred tax assets and liabilities at December 31, 2015 were measured using the 26.5% tax rate. Deferred tax assets and liabilities as of January 1, 2016 were remeasured using the 25.0% tax rate. The change in the corporate income tax rate from 26.5% to 25.0% resulted in a reduction of approximately \$1.3 million to the Company's deferred tax assets and a corresponding increase in the Company's income tax expense during the first quarter of 2016. On December 29, 2016, the Israeli Government legislated a reduction in corporate income tax rates from 25.0% to 24.0% in 2017 and to 23.0% in 2018 and thereafter. This change in the corporate income tax rates from 25.0% to 24.0% and 23.0% resulted in a reduction of approximately \$1.4 million to the Company's deferred tax assets as of December 31, 2016, and a corresponding increase in the Company's income tax expense during the fourth quarter of 2016.

At December 31, 2017, the Company had net operating loss carryforwards ("NOLs") of approximately \$168.9 million in Israel, \$86.2 million in the United States ("U.S.") for federal tax purposes, \$37.2 million in the U.S. for state tax purposes and \$7.2 million in Denmark. The U.S. NOLs for federal tax purposes will expire from 2024 to 2027, and



the U.S. NOLs for state tax purposes will expire from 2018 to 2037. The non-U.S. NOLs have no expiration date. The Company has not provided for Israeli income and foreign withholding taxes on \$2.6 million of its non-Israeli subsidiaries' undistributed earnings as of December 31, 2017. The Company currently has no plans to repatriate those funds and intends to indefinitely reinvest them in its non-Israeli operations. The amount of the unrecognized deferred tax liability for temporary differences related to investments in non-Israeli subsidiaries that were essentially permanent in duration as of December 31, 2017 was less than \$1 million.

## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The reconciliation of the statutory federal income tax rate to the Company's effective tax rate is as follows:

	December 31,					
	2017	%	2016	%	2015	%
Tax at statutory rate	35.0	%	35.0	%	35.0	%
Tax at rates other than the statutory rate	(4.8)	)	(84.5)	)	(42.5)	)
Valuation allowance	47.3		40.8		(22.0)	
Net change in tax reserves	8.0		17.1		6.0	
Adjustment of deferred tax balances following changes in tax rates	(71.8)		10.9		—	
Other, net	(2.4)	)	4.6		(1.1)	)
Provision for (benefit from) taxes on income	11.3	%	23.9	%	(24.6)	%

The Company's operations in Israel were granted "Approved Enterprise" status by the Investment Center in the Israeli Ministry of Economy and Industry (formerly, the Ministry of Industry Trade and Labor) and "Beneficiary Enterprise" status from the Israeli Income Tax Authority, which makes the Company eligible for tax benefits under the Israeli Law for Encouragement of Capital Investments, 1959. Under the terms of the Approved and Beneficiary Enterprise programs, income that is attributable to the Company's operations in Yokneam, Israel, is exempt from income tax commencing fiscal year 2011 through 2021. Income that is attributable to the Company's operations in Tel Aviv, Israel is subject to a reduced income tax rate (generally between 10% and the current corporate tax rate, depending on the percentage of foreign investment in the Company) commencing fiscal year 2013 through 2021. The tax holiday has resulted in a cash tax savings of approximately \$11.6 million, \$37.3 million and \$33.0 million in 2017, 2016, and 2015, respectively, increasing diluted earnings per share by approximately \$0.23, \$0.75 and \$0.69 in the years ended December 31, 2017, 2016, and 2015, respectively.

The following summarizes the activity related to the Company's unrecognized tax benefits:

	December 31,		
	2017	2016	2015
	(in thousands)		
Gross unrecognized tax benefits, beginning of the period	\$41,460	\$25,382	\$18,037
Increases in tax positions for prior years	3,655	252	1,153
Decreases in tax positions for prior years	—	—	(131)
Increases in tax positions for current year	8,090	8,131	7,908
Increases in tax positions acquired or assumed in a business combination	—	8,990	—
Decreases due to lapses of statutes of limitations	(8,051)	(1,295)	(1,585)
Gross unrecognized tax benefits, end of the period	\$45,154	\$41,460	\$25,382

As of December 31, 2017, 2016 and 2015, the total amount of gross unrecognized tax benefits was \$45.2 million, \$41.5 million, and \$25.4 million, respectively. Of these amounts as of December 31, 2017, 2016 and 2015, \$24.6 million, \$23.4 million, and \$18.9 million, respectively, would reduce our income tax expense and effective tax rate, if recognized.

On June 14, 2017, the Israeli government legislated new regulations regarding the "Preferred Technological Enterprise" regime, under which a company that complies with the terms may be entitled to certain tax benefits. The Company expects that its operation in Israel will comply with the terms of the Preferred Technological Enterprise regime. Therefore, the Company may utilize the tax benefits under this regime after the end of the benefit period of its Approved and Beneficiary Enterprise statuses (i.e., from fiscal year 2022 onwards). Under the new legislation, the majority of the Company's income from its operations in Yokneam, Israel, will be subject to a corporate rate of 7.5%, while the majority of the income from its operations in Tel-Aviv, Israel, will be subject to a corporate rate of 12%. As a result of the lower tax rates mentioned above, the Company recorded a decrease of approximately \$0.2 million in

deferred tax assets and a corresponding increase in tax expense during the second quarter of 2017.

## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

It is the Company's policy to classify accrued interest and penalties as part of the accrued unrecognized tax benefits liability and record the expense in the provision for income taxes. As of December 31, 2017, 2016 and 2015, the amount of accrued interest and penalties related to unrecognized tax benefits totaled \$2.9 million, \$1.8 million, and \$1.2 million, respectively. For unrecognized tax benefits that existed at December 31, 2017, the Company does not anticipate any significant changes within the next twelve months.

As a multinational corporation, the Company conducts business in many countries and is subject to taxation in many jurisdictions. The taxation of the Company's business is subject to the application of multiple and sometimes conflicting tax laws and regulations as well as multinational tax conventions. The application of tax laws and regulations is subject to legal and factual interpretation, judgment and uncertainty. Tax laws themselves are subject to change as a result of changes in fiscal policy, changes in legislation and the evolution of regulations and court rulings. Consequently, taxing authorities may impose tax assessments or judgments against the Company that could materially impact its tax liability and/or its effective income tax rate. As of December 31, 2017, the 2014 through 2016 tax years are open and may be subject to potential examinations in the United States. The Company has net operating losses in the United States from prior tax periods beginning in 2003 which may be subject to examination upon utilization in future tax periods. As of December 31, 2017, the 2013 through 2016 tax years are open and may be subject to potential examinations in Denmark and Israel. As of December 31, 2017 the income tax returns of the Company and one of its subsidiaries in Israel are under examination by the Israeli Tax Authority for certain years from 2013 to 2015.

**NOTE 13—GEOGRAPHIC INFORMATION AND REVENUES BY PRODUCT GROUP:**

The Company operates in one reportable segment, the development, manufacturing, marketing and sales of interconnect products. The Company's chief operating decision maker is the chief executive officer. Since the Company operates in one segment, all financial segment information can be found in the accompanying Consolidated Financial Statements.

Revenues by geographic region are as follows:

	Year ended December 31,		
	2017	2016	2015
	(in thousands)		
United States	\$327,528	\$386,360	\$300,674
China	172,405	192,581	152,739
Europe	176,937	149,855	93,666
Other Americas	92,449	52,447	24,692
Other Asia	94,574	76,255	86,369
Total revenue	\$863,893	\$857,498	\$658,140

Revenues are attributed to countries based on the geographic location of the customers. Intercompany sales between geographic areas have been eliminated.

Property and equipment, net by geographic location are as follows:

	December 31,	
	2017	2016
	(in thousands)	
Israel	\$99,752	\$101,001
United States	7,017	14,246
Other	3,150	3,338
Total property and equipment, net	\$109,919	\$118,585

Property and equipment, net is attributed to the geographic location in which it is located.



## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Revenues by product type and interconnect protocol are as follows:

	Year ended December 31,		
	2017	2016	2015
	(in thousands)		
ICs	\$161,216	\$170,641	\$92,214
Boards	325,845	337,304	265,249
Switch systems	222,836	204,083	179,977
Cables, accessories and other	153,996	145,470	120,700
Total revenue	\$863,893	\$857,498	\$658,140

	Year ended December 31,		
	2017	2016	2015
	(in thousands)		
InfiniBand:			
EDR	\$194,261	\$125,249	\$39,009
FDR	181,465	302,093	347,760
QDR/DDR/SDR	31,599	49,987	63,745
Total	407,325	477,329	450,514
Ethernet	401,005	317,241	155,221
Other	55,563	62,928	52,405
Total revenue	\$863,893	\$857,498	\$658,140

## NOTE 14—OTHER INCOME (LOSS), NET:

Other income (loss), net, is summarized in the following table:

	Year ended December 31,		
	2017	2016	2015
	(in thousands)		
Interest income and gains (losses) on short-term investments, net	\$3,748	\$2,244	\$2,998
Foreign exchange loss, net	(596 )	(840 )	(186 )
Impairment of investment in a privately-held company	—	—	(3,189 )
Other	(37 )	(314 )	(147 )
Total other income (loss), net	\$3,115	\$1,090	\$(524 )

## NOTE 15—TERM DEBT:

In connection with the Company's acquisition of EZchip, on February 22, 2016, the Company and its wholly owned subsidiary, Mellanox Technologies, Inc., entered into a \$280.0 million variable interest rate Term Debt note maturing February 21, 2019. Debt issuance costs of \$5.5 million on the Term Debt are being amortized to interest expense at the effective interest rate over the contractual term of the Term Debt. The Term Debt provides for an additional term loan borrowing under certain conditions.

## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table presents the Term Debt at December 31, 2017:

	(in thousands)
Term Debt, principal amount	\$ 74,000
Less unamortized debt issuance costs	1,239
Term Debt, principal net of unamortized debt issuance costs	\$ 72,761
Effective interest rate	3.8 %

Principal on the Term Debt is paid in quarterly installments. Principal payments are made at a rate of (i) 2.50% of the original principal amount beginning on June 30, 2016 and ending on March 31, 2017, (ii) 3.75% of the original principal amount beginning on June 30, 2017 and ending on March 31, 2018 and (iii) 6.25% of the original principal amount beginning on June 30, 2018 and ending on December 31, 2018, with the balance due on February 21, 2019. During the year ended December 31, 2017, the Company made principal payments of \$172.0 million, including prepayments of \$146.5 million which were applied to future payment requirements. The Company is also required to make mandatory prepayments of loans under the Term Debt, subject to specified exceptions, with the proceeds of asset sales, debt issuances and specified other events.

At December 31, 2017, future scheduled principal payments on the Company's Term Debt are summarized as follows:

(in thousands)
2018\$ —
201974,000
\$ 74,000

The Term Debt bears interest through maturity at a variable rate based upon, at the Company's option, either (a) the LIBOR rate for Eurocurrency borrowing or (b) an Alternate Base Rate ("ABR"), which is the highest of (i) the administrative agent's prime rate, (ii) one-half of 1.00% in excess of the overnight U.S. Federal Funds rate, and (iii) 1.00% in excess of the one-month LIBOR), plus in each case, an applicable margin. The applicable margin for Eurocurrency loans ranges, based on the applicable total net leverage ratio, from 1.25% to 2.00% per annum and the applicable margin for ABR loans ranges, based on the applicable total net leverage ratio, from 0.25% to 1.00% per annum.

The Company's obligations under the Term Debt are guaranteed by all of its domestic and foreign subsidiaries, subject to certain agreed upon exceptions. The obligations under the Term Debt are also, subject to certain agreed upon exceptions, secured by a lien on substantially all of the Company's and certain of its subsidiaries tangible and intangible property, including 100% of the Company's and certain of its subsidiaries' equity interests in shares of its domestic and certain foreign subsidiaries.

The Term Debt contains a number of covenants and restrictions that among other things, and subject to certain agreed upon exceptions, require the Company and its subsidiaries to satisfy certain financial covenants and restricts the ability of the Company and its subsidiaries to incur liens, incur additional indebtedness, make loans and investments, engage in mergers and acquisitions, engage in asset sales, declare dividends or redeem or repurchase capital stock, prepay, redeem or purchase subordinated debt and amend or otherwise alter debt agreements, in each case, subject to certain agreed upon exceptions. A failure to comply with these covenants could permit the lenders under the Term Debt to declare all amounts borrowed under the Term Debt, together with accrued interest and fees, to be immediately due and payable. At December 31, 2017, the Company was in compliance with the covenants for the Term Debt.

## NOTE 16—IMPAIRMENT OF LONG-LIVED ASSETS:

While performing the review for impairment for the fourth quarter of 2017, the Company noted an impairment indicator associated with the potential sale or discontinuation of the 1550nm silicon photonics line of business. As a result, the Company recorded impairment charges totaling \$12.0 million in the fourth quarter of 2017, of which \$7.7

million were related to property and equipment and \$4.3 million were related to intangible assets.

The impairment charges were calculated based on the differences between the net book values of the related assets and their estimated fair values. The Company primarily used the market approach to determine the estimated fair values of the property and equipment. Under this approach we considered various factors, including secondary market comparables,



## MELLANOX TECHNOLOGIES, LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

replacement costs, age and condition of the assets and estimated selling costs. The impaired intangible assets represent obsolete technologies that were deemed to have no value, and therefore were fully written off.

## NOTE 17—SUBSEQUENT EVENT:

On January 9, 2018, the Company announced that it discontinued its 1550nm silicon photonics development activities. The discontinuation of the 1550nm silicon photonics development activities is expected to result in restructuring charges of approximately \$9.0 million to \$12.0 million primarily related to employee termination and severance costs, facility related costs and contract cancellation charges. The Company expects to recognize most of the restructuring charges in the first quarter of 2018.

SCHEDULE II—CONSOLIDATED VALUATION AND QUALIFYING ACCOUNTS  
MELLANOX TECHNOLOGIES, LTD.

Description:	Balance at Beginning of Year (in thousands)	Charged to Costs and Expenses	Deductions	Balance at End of Year
Year ended December 31, 2017				
Deducted from asset accounts:				
Allowance for doubtful accounts	\$632	\$ —	\$ —	\$632
Allowance for sales returns and adjustments	—	—	—	—
Income tax valuation allowance	55,827	—	(24,179 )	31,648
Total	\$56,459	\$ —	\$ (24,179 )	\$32,280
Year ended December 31, 2016				
Deducted from asset accounts:				
Allowance for doubtful accounts	\$621	\$ 11	\$ —	\$632
Allowance for sales returns and adjustments	—	—	—	—
Income tax valuation allowance	28,999	26,828	—	55,827
Total	\$29,620	\$ 26,839	\$ —	\$56,459
Year ended December 31, 2015				
Deducted from asset accounts:				
Allowance for doubtful accounts	\$672	\$ —	\$ (51 )	\$621
Allowance for sales returns and adjustments	—	—	—	—
Income tax valuation allowance	46,220	—	(17,221 )	28,999
Total	\$46,892	\$ —	\$ (17,272 )	\$29,620

## ITEM 16—FORM 10-K SUMMARY

Not applicable.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, Mellanox Technologies, Ltd. has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on February 16, 2018.

MELLANOX TECHNOLOGIES, LTD.

By: /s/ EYAL WALDMAN

Eyal Waldman

President and Chief Executive Officer

KNOW ALL MEN AND WOMEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Eyal Waldman and Jacob Shulman, and each of them, his or her attorneys-in-fact and agents, each with the power of substitution, for him or her in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith, with the U.S. Securities and Exchange Commission, hereby ratifying and confirming all that said attorneys-in-fact, or his or her or their substitute or substitutes, may do or cause to be done by virtue thereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Signature	Title	Date
/s/ EYAL WALDMAN Eyal Waldman	Chief Executive Officer and Director (principal executive officer)	February 16, 2018
/s/ JACOB SHULMAN Jacob Shulman	Chief Financial Officer (principal financial and accounting officer) and Authorized Representative in the United States	February 16, 2018
/s/ DOV BAHARAV Dov Baharav	Director	February 16, 2018
/s/ SHAI COHEN Shai Cohen	Director	February 16, 2018
/s/ GLENDA DORCHAK Glenda Dorchak	Director	February 16, 2018
/s/ IRWIN FEDERMAN Irwin Federman	Director	February 16, 2018
/s/ AMAL JOHNSON Amal Johnson	Director	February 16, 2018

/s/ DAVID PERLMUTTER      Director  
David Perlmutter

February 16,  
2018

/s/ THOMAS J. RIORDAN      Director  
Thomas J. Riordan

February 16,  
2018

/s/ C. THOMAS  
WEATHERFORD      Director  
C. Thomas Weatherford

February 16,  
2018