SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 20-F

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

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005
COMMISSION FILE NO. 005-60609

Compugen Ltd.

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

Israel

(Jurisdiction of incorporation or organization)

72 Pinchas Rosen Street, Tel Aviv, 69512 Israel

(Address of principal executive offices)

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

None

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

Ordinary Shares, par value New Israeli Shekels 0.01 per share

(Title of Class)

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

None

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

27,846,420 Ordinary Shares

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

Yes [x] No [ ]

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

Item 17 [ ] Item 18 [x]

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This annual report on Form 20-F includes "forward-looking" statements within the meaning of Section 21E of the Securities Exchange Act of 1934. These statements include words such as "may", "expect", "believe", and "intend", and describe opinions about future events. We have based these forward-looking statements on information available to us on the date hereof, and on our current intentions, beliefs, expectations and projections about future events. We assume no obligation to update any such forward-looking statements. These forward-looking statements are not guarantees of future performance and are subject to risks, uncertainties and assumptions that could cause our actual results to differ materially from our expectations or projections. Factors that could cause our actual results to differ materially from those projected in the forward-looking statements include the risk factors set forth under "Item 3. Key Information. Risk Factors", the information about us set forth under "Item 4. Information about the Company", and information related to our financial condition under "Item 5. Operating and Financial Review and Prospects."

Compugen Ltd. is referred to in this annual report as "we", "our", "our company" or "us".

We have prepared our consolidated financial statements in United States dollars and in accordance with accounting principles generally accepted in the United States. All references herein to "dollars" or "$" are to United States dollars, and all references to "Shekels" or "NIS" are to New Israeli Shekels.

PART I.

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

Selected Financial Data

	Year ended December 31				
	2001*	**2002***	**2003***	**2004***	**2005**
	($ in thousands, except share and per share data)				
Consolidated Statements of Operations Data					
Revenues	$ 10,366	$ 9,262	$ 6,776	$ 2,630	$ 646
Total operating expenses **	29,385	24,306	20,992	18,207	15,524
Operating loss	(19,019)	(15,044)	(14,216)	(15,577)	(14,878)
Financial income, net	3,875	2,789	2,112	1,417	682
Net loss available to ordinary shares	(15,144)	(12,204)	(11,442)	(13,722)	(13,978)
Basic and diluted net loss per ordinary share	$ (0.58)	$ (0.47)	$ (0.43)	$ (0.50)	$ (0.50)
Weighted average number of ordinary shares used in computing basic and diluted net loss per share	26,005,784	26,103,343	26,409,180	27,473,341	27,774,535
Consolidated Balance Sheet Data					
Cash and cash equivalents, short-term bank deposits, marketable securities and cash held in favor of consortium partners	$32,347	$48,402	$16,707	$20,574	{ $31,821
Long-term investments in marketable securities and bank deposits	46,148	18,940	43,803	27,854	4,983
Total assets	87,289	77,257	67,526	55,353	42,106
Accumulated deficit	(68,388)	(80,592)	(92,034)	(105,756)	(119,734)
Total shareholders' equity	80,062	68,881	59,808	49,566	36,248

(*) Reclassified - previously, we presented governmental and other grants as a component of our revenues and grants, based on the single step income statement presentation approach. These amounts have been reclassified for all periods presented and are now shown as a deduction from research and development expenses.

(**) Includes deferred stock compensation – see Note 11 of our 2005 consolidated financial statements.

For additional financial information, please see “Item 5. Operating and Financial Review and Prospects - Results of Operations”.

Risk Factors

Many factors could affect our financial condition, cash flows and results of operations. We are subject to various risks resulting from changing economic, political, social, industry, business and financial conditions. The principal risks are described below.

Factors Related to our Financial Results and Financing Needs

We have a history of losses, we expect to incur future losses and we may never achieve or sustain profitability.

We incurred net losses of approximately $11.4 million in 2003, $13.7 million in 2004 and $14 million in 2005. As of December 31, 2005, we had an accumulated deficit of approximately $94.8 million (not including approximately $24.9 million in accumulated deficit attributable to the conversion of preferred shares upon the closing of our initial public offering). We expect to continue to incur net losses in the future due in part to the costs and expenses associated with our research and development activities. We cannot assure you that we will ever achieve profitability. Even if we do achieve profitability, we may not be able to sustain or increase profitability.

We may be required to allocate substantial additional funds in the future to our discovery and development activities, and we may never be able to achieve profitability.

We discover and carry out early stage development of therapeutic and diagnostic product candidates. Product candidates are molecules that we discover and identify as having a potential therapeutic or diagnostic application. In 2005, we allocated a substantial portion of our cash and other resources to our discovery and development activities and we intend to continue to do so. To date, these activities have generated only negligible revenues. These activities may never generate significant revenues and we may never achieve profitability.

In December 2005, we underwent a re-organization in order to focus our resources on our research and development and on our commercialization goals. Nevertheless, we do not anticipate that we will achieve profitability in the near future. We expect that we will need additional funds to continue financing our discovery and development and commercialization activities. If we are unable to obtain the required additional financing, whether internally or from third parties, on commercially reasonable terms, we may have to curtail or cease our discovery and development activities, and our business will likely be materially harmed.

If we are unable to raise additional capital in the future, we may need to curtail or cease operations, and if we raise additional capital, our existing shareholders are likely to experience dilution of their shareholdings.

As of December 31, 2005, we had cash and cash equivalents, short-term marketable securities and cash held in favor of consortium partners of approximately $32 million, and long-term marketable securities of approximately $5 million. Based on our current projections and following our re-organization in December 2005, we anticipate that our existing cash and cash equivalents, and short-term and long-term marketable securities will be sufficient to support our operations for at least the next two years. We expect that we will need to raise additional capital within the next two years.

However, we cannot assure you that we would be able to raise sufficient additional capital on favorable terms, if at all. If we raise additional capital by issuing equity securities, we expect that our shareholders will experience dilution of their shareholdings. In December 2005, as part of a re-organization that we underwent, we curtailed certain of our activities that we determined not to directly support the achievement

of our current corporate goals. If we fail to raise sufficient funds, we will likely have to further curtail or cease activities, which would materially harm our business and financial results.

If we are unable to continue to successfully apply for research and development grants, our financial results may be materially harmed.

We receive research and development grants from the Office of the Chief Scientist of the Israeli Ministry of Industry, Trade and Labor, from the Israel-U.S. Bi-national Industrial Research and Development Foundation and from the European Community, under the European Union's 6th Framework Program. Our entitlement to receive these grants is dependent on, among other things, our compliance with the various grants' respective terms and conditions. In addition, the total value of grants that the Office of the Chief Scientist makes available generally, and to each individual grantee, had gradually decreased in recent years.

If we do not comply with these terms and conditions or if we do not succeed in obtaining these grants in the future, or if we will be able to obtain only a reduced amount of grants, our business and financial results may be materially harmed, and we may have to restrict or cease operations.

If our wholly-owned subsidiary, Keddem Bioscience Ltd., will not be able to raise capital in the next few months, it may have to cease operations, in which case all of our investments made in Keddem Bioscience's business to date will be lost and our financial results may be harmed.

In 2004, we turned our chemistry division, which was engaged in small-molecule drug discovery, into a wholly-owned subsidiary, Keddem Bioscience Ltd. The transaction was effected by us transferring to Keddem Bioscience all of our assets and liabilities that were dedicated to the operation of our chemistry division. In connection with this transaction, we agreed to loan to Keddem Bioscience $1,572,000. In November 2005, our board of directors also agreed to assign to Keddem Bioscience what was at the time our entitlement to receive (and which we since received) from the Investment Center of the Israeli Ministry of Industry, Trade and Labor, an amount of approximately $400,000, on account of our investment in the expansion of, what was at the time, our computational chemistry facilities and the building of a chemistry laboratory for drug discovery. Pursuant to our board of directors' decision, Keddem Bioscience received the amount of approximately $400,000. We currently seek to raise third party funding for Keddem Bioscience. The continuation of Keddem Bioscience's operations depends on raising additional capital in order to continue its operations. Keddem Bioscience's external auditors have raised substantial doubts on Keddem Bioscience's ability to continue as a going concern.

If Keddem Bioscience fails to raise additional capital in the next few months, it will likely need to cease its operations. If so, our investments in Keddem Bioscience will be lost, and this is likely to harm our financial results.

The revision of SFAS No. 123, which will require us to record employee stock-based compensation expense in connection with equity share based compensation, may significantly increase our financial losses.

On December 16, 2004, the Financial Accounting Standards Board (FASB) issued Statement No. 123 (revised 2004), entitled "Share-Based Payment", relating to accounting for stock-based compensation. SFAS No. 123 previously permitted stock-based payments to employees to be recognized based on their fair values, and following the revision, as of January 1, 2006, this permissive standard became a mandatory requirement. SFAS No. 123 also revised, among other parameters, the measuring of fair value, classifying an award as equity or as a liability and attributing compensation cost to reporting periods. Stock-based compensation is a tool at our disposal by which we are able to encourage our employees to achieve success and remain in our employ.

As a result of the revisions to SFAS No. 123, commencing in 2006, we will be required to record an expense in relation to stock-based compensation that we provide to our employees, and this expense may increase commensurate with, among other parameters, an increase in our share price and number of options

granted. As a result of the provision of such compensation, our financial results could be materially harmed. If we seek to limit this harm, our ability to continue to provide to our employees stock-based compensation may be curtailed, which could hurt our ability to recruit or retain employees, and as a result our business may be materially harmed.

Factors Related to our Discovery and Development Activities and to the Commercialization of our Discoveries

Our approach of incorporating ideas and methods from mathematics, computer science and physics into biology, chemistry and medicine for the purpose of discovery and development of novel therapeutic and diagnostic product candidates, is itself novel and has not yet been fully proven or validated. If this approach does not prove to be successful our business will be significantly harmed.

We incorporate ideas and methods from mathematics, computer science and physics into biology, chemistry and medicine. We attempt to discover novel potential therapeutic molecules, including proteins and peptides, and diagnostics biomarkers on the basis of which our collaborators and licensees may be able to develop novel drugs and diagnostic products. By using this approach, we have already predicted discoveries *in-silico*, which means prediction by computers. We have also initially validated the suitability for diagnostic and therapeutic application of some of the diagnostic and therapeutic product candidates respectively that we discovered *in-silico*. However, our approach has not yet been proven or validated beyond that initial validation.

If our approach is ultimately proven to be ineffective for making discoveries or if we may fail to make further discoveries, our business may be materially harmed. If our potential customers or collaborators will not accept that our approach provides value to them, or if we are not able to find any biological activity for the therapeutic product candidates that we discover, we may fail to commercialize discoveries that we make, and, as a result, our business will likely be significantly harmed.

We may never make discoveries that will be suitable for development into therapeutic or diagnostic products, and if we do not, our business may be significantly harmed and we may cease operations.

Even if our approach to discovering therapeutic and diagnostic product candidates by incorporating ideas and methods from mathematics, computer science and physics into biology, chemistry and medicine proves to be effective, our discoveries may be proven to be unsuitable for the development into revenue-producing products by our collaborators and licensees.

One criterion that we applied in the past when choosing a potential therapeutic product candidate is that such candidate must have been a variant of a gene from which a known protein is derived. In focusing on such variants, we hope to benefit from the availability of biological and medical information that relate to the biology and use of the known protein. However, to date, it has not been proven that such a variant is likely to have pharmacological characteristics or uses that are similar to or advantageous over the known protein to which it relates. Another example of a criterion that we apply when choosing one type of potential diagnostic product candidates is that such candidates must be secreted into the blood stream. However, mere presence of a candidate molecule in blood does not necessarily ensure that it will have all the characteristics necessary for it to function as an effective diagnostic marker.

If our approach to discovering diagnostic and therapeutic product candidates proves to be ineffective, we may fail to discover therapeutic and diagnostic product candidates that are suitable for development into revenue-producing products by our collaborators and licensees, and as a result our business will likely fail or we will likely never become profitable.

There are risks that are inherent in the development and commercialization of therapeutic and diagnostic products, and if these risks materialize, our business and financial results may be materially harmed.

We face a number of risks of failure that are inherent in the process of developing and commercializing

therapeutic and diagnostic products. These risks include, among other risks, the possibility that:

- our therapeutic product candidates will be found to be pharmacologically ineffective or toxic or to have other detrimental side effects;
- our diagnostic product candidates will prove to be ineffective in distinguishing between healthy and disease samples or in providing information relating to a patient's response to a drug;
- our collaborators will fail to receive applicable regulatory approvals;
- our collaborators will fail to manufacture these products on a large scale in a cost effective manner;
- our collaborators will fail to develop and market products based on our discoveries prior to the successful marketing of competing products;
- the development, marketing or sale of our product candidates will fail because they may infringe third party intellectual property rights; and/or
- the development, marketing or sale of our product candidates will fail because of our inability or failure to protect or maintain our own intellectual property rights.

Therefore, even if we are able to continue to discover new therapeutic or diagnostic product candidates, our collaborators or licensees may not be able to develop new products based on our discoveries. If any of these risks materialize our business and financial results may be materially harmed.

We have limited experience in, and limited resources for, the discovery and development of therapeutic and diagnostic product candidates, and if we fail to acquire the appropriate experience, our business may be materially harmed.

Our experience in the discovery and development of therapeutic and diagnostic product candidates is limited. Although we believe that we have already acquired and are continuing to acquire experience and expertise in the discovery and in certain aspects of the development of therapeutic and diagnostic product candidates, in order to successfully develop and commercialize therapeutic and diagnostic product candidates, we must further improve our internal expertise, capabilities and facilities. We may not be able to engage all of the experts that we need in order to do so.

If we fail to acquire all of the required experience and expertise in the discovery and development of therapeutic and diagnostic product candidates, we may be unsuccessful in our discovery and development activities, and as a result our business may be materially harmed.

The biotechnology and pharmaceutical industries are highly competitive, and we may be unable to compete effectively.

The biotechnology and pharmaceutical industries are highly competitive. Numerous entities in the United States and elsewhere compete with our efforts to discover, validate and commercialize therapeutic and diagnostic products or product candidates. Our competitors include pharmaceutical, biotechnology and diagnostic companies, academic and research institutions and governmental and other publicly funded agencies. We face, and expect to continue to face, competition from these entities to the extent that they develop products that have a function similar or identical to the function of our therapeutic and diagnostic product candidates. We also face, and expect to continue to face, competition from entities that seek to develop technologies that enable the discovery of novel therapeutic and diagnostic product candidates.

Many of our competitors benefit from greater market recognition, and have substantially greater financial, technical, human, research and development, and marketing resources than we do. Since we are a small company with limited human resources, we are not able to work with a large number of collaborators in parallel. Our competitors may discover and develop product candidates or market and sell products based on their discoveries, in advance of us or of our collaborators or licensees. They may also obtain patents and other intellectual property rights before us and thereby prevent us from pursuing the development and commercialization of our discoveries. For information about the specific competitors with whom we

compete, see “Competition” under “Item 4. Information on the Company.”

If we are unable to compete successfully against existing or potential competitors, our financial results and business may be materially harmed.

The trend towards consolidation in the pharmaceutical and biotechnology industries may adversely affect us.

There is a trend towards consolidation in the pharmaceutical and biotechnology industries. This consolidation trend may result in the remaining companies having greater financial resources and technological capabilities, thus intensifying competition in the industries. This trend may also result in fewer potential collaborators or licensees for our therapeutic and diagnostic product candidates. Also, if a consolidating company is already doing business with our competitors, we may lose existing licensees or collaborators as a result of such consolidation.

This trend may adversely affect our ability to enter into agreements for the development and commercialization of our product candidates, and as a result may harm our business.

We depend significantly on our collaborators and licensees for the development and commercialization of our therapeutic and diagnostic product candidates, and if we are unable to enter into additional agreements with collaborators and licensees in the future, our business will likely be materially harmed.

Our strategy for the development and commercialization of therapeutic and diagnostic product candidates depends on the formation of collaborations or licensing relationships with third parties that have complementary capabilities. We depend significantly on our collaborators and licensees to carry out and/or finance product development and commercialization of our therapeutic and diagnostic product candidates. Potential collaborators and licensees include pharmaceutical, biotechnology and diagnostic companies.

To date, we have granted a small amount of licenses for the development and commercialization of our product candidates. Over approximately the past one and a half years, we entered into three license collaboration agreements for the development and commercialization of a multiple number of diagnostic products.

Even though we have entered and intend to continue to enter into license and collaboration agreements for the development and commercialization of our discoveries, we cannot assure you that any of these agreements will result in the successful development or commercialization of any products based on our discoveries. Further, we cannot assure you that we will succeed in entering into any other agreements with third party collaborators or licensees for the development and commercialization of our therapeutic and diagnostic product candidates. If we are unable to enter into new collaborations or license agreements, our business will likely be materially harmed.

We may not be able to find additional collaborators or licensees that will agree to in-license our discoveries at an early stage, and if we do not find these collaborators or licensees, our business will likely be materially harmed.

Our strategy for the development and commercialization of therapeutic and diagnostic product candidates is based on our discovery and early stage development of those product candidates. We consider early stage development in the case of diagnostic product candidates to be a stage at which their existence in nature is validated. This stage may also involve us demonstrating that the product candidate is differentially expressed in different physiological conditions, but in any case with no clinical proof. We consider early stage development in the case of a therapeutic product candidate, to be a stage at which we show biological activity of that candidate. We ordinarily carry out certain such validation work ourselves, and we ordinarily seek to rely on our collaborators and licensees to carry out further product development.

Pharmaceutical and diagnostic companies may be reluctant or refuse to in-license our therapeutic and diagnostic product candidates at these early stages of discovery or development. Even if additional potential collaborators or licensees agree to in-license our discoveries at an early stage, such additional collaborators or licensees may not agree to do so on terms that we would consider commercially desirable.

If we are unable to out-license our discoveries at an early stage, we may need to develop our discoveries ourselves until we attain a more mature stage of development. Such development activities may require us to expend substantial additional financial and other resources. If we are unable to commit these required additional resources, we may have to curtail or cease our discovery and development activities, and as a result our business will likely be materially harmed.

Our dependence on licensing and collaboration agreements with third parties presents a number of risks, and if one or more of these risks materialize, our business may be materially harmed.

The risks that we face in connection with our existing collaborations, licenses and other business alliances as well as those that we may enter into the future include, among other things, the following:

- we may be unable to comply or fully comply with our obligations under license or collaboration agreements into which we enter, and as a result, we may not generate royalties from such agreements, and our ability to enter into additional agreements may be harmed;
- our collaborators may have significant discretion in electing whether to pursue any of the planned activities and the manner in which this will be done;
- we may not be able to control our collaborators' or licensees' willingness to pursue development of our product candidates, or the amount of resources that our collaborators will devote to the collaboration;
- changes in a collaborator's or a licensee's business strategy may negatively affect its willingness or ability to complete its obligations under its arrangement with us;
- our rights in any intellectual property or products that may result from our collaborations may depend on additional investment of money that we may not be able nor willing to make;
- prospective collaborators may pursue alternative products or technologies, by internally developing them or by preferring those of our competitors;
- disagreements between us and our collaborators may lead to delays in, or termination of, the collaboration; and
- our collaborators may fail to develop or commercialize successfully any products based on product candidates to which they have obtained rights from us.

If any of these risks materialize, our business, financial condition and results of operations may be materially harmed.

Factors Related to our Discovery Engines and Related Technologies

The success of our business largely depends on our ability to continue to develop and enhance our discovery engines and related technologies, and if we fail to continue to develop and enhance them, our business will likely be materially harmed.

Our discovery engines are proprietary computational platforms that are designed to identify therapeutic and diagnostic product candidates in a specific therapeutic and diagnostic area of interest. By using our discovery engines and related technologies, we intend to constantly feed our pipeline of discoveries with novel therapeutic and diagnostic product candidates. Our success as a genomic-based discovery company largely depends on our ability to continue to develop and enhance our discovery engines and related technologies.

The pharmaceutical and biotechnology industries are characterized by continuous technological changes. We may not be able to make the necessary developments and enhancements to our discovery

engines and related technologies in order to compete successfully within these industries.

This competition is intensified by the public and free availability of human and other organisms' genomic sequence data, as a result of the US Federal Government funded Human Genome Project and other projects engaged in the study of genes. Since we use these data to improve and enhance our discovery engines, the publication of these data may render our discovery engines and related technologies less valuable or even obsolete. Although we believe that our discovery engines provide us with discovery capabilities, this competition is also intensified by the availability to our competitors of software that performs some functions that are performed by our discovery engines.

If we fail to continue to develop and enhance our discovery engines and related technologies, our business will likely be materially harmed.

We rely on access to public and commercial databases to feed our discovery engines, and if we are denied access to these databases for any reason, our operations and business may be harmed.

In carrying out our discovery and development of therapeutic and diagnostic product candidates, we rely on our ability to access and use public and commercially available databases. If we are denied access to these databases, or if we are granted access to such databases on terms, which are not commercially reasonable, our business and our results of operation may be harmed.

Factors Related to our Operations

The licensing cycle for our commercial offerings is complex and lengthy and as a result, we may expend substantial funds and management resources with no assurance of success.

We are required to negotiate agreements containing terms unique to each licensee and collaborator and which suit each licensee's or collaborator's specific discovery, development and business strategies. The accommodation of these requirements mandates a thorough consideration of both the scientific and business aspects of each transaction. As a result, the process of preparing and negotiating our licensing and other agreements is complex and may take 12 months or longer. These business development and related commercial activities require the input and efforts of our key management personnel.

As a result we expend and believe that we will need to continue to expend substantial funds and management effort with no assurance of successfully entering into agreements with potential collaborators and licensees.

We may be unable to hire or retain key personnel or sufficiently qualified employees, in which case our business may be harmed.

Our business is highly dependent upon the continued services of our senior management and key scientific and technical personnel. While members of our senior management have entered into employment or consulting agreements and non-competition and non-disclosure agreements, we cannot assure you that these key personnel and others will not leave us or compete with us, which could harm our business activities and operations. Within our geographic location, it is difficult to find suitable and highly qualified personnel in certain aspects of our industry.

Furthermore, we do not carry key person life insurance on any member of our senior management.

Our business may be harmed if we are unable to retain our key personnel, or to attract, integrate or retain other highly qualified personnel in the future.

Revenues that we generate from commercialization of our technologies or discoveries may be limited because of Israeli governmental grants that we receive.

The development of some of our technologies and of the discoveries that we make have been and may

in the future be partially funded by governmental grants that we receive from the Office of the Chief Scientist of the Israeli Ministry of Industry, Trade and Labor. According to Israeli law, certain restrictions and obligations may be imposed on us in relation to the development and commercialization of discoveries that are financed by these grants. These obligations and restrictions may be imposed if we were to seek to manufacture outside of Israel or transfer our know-how within or outside of Israel.

We believe that these obligations and restrictions do not apply to us for a number of reasons, including our strategy not to transfer, as opposed to license, the know-how subsisting in our technologies and discoveries. We also believe that these restrictions do not apply to the sale or to the export of product candidates that we develop by using or based on our Office of the Chief Scientist-funded technologies or discoveries. In addition, due to certain changes to the applicable Israeli law that came into force in June 2005, these obligations and restrictions, have been ameliorated.

Nevertheless, if the Office of the Chief Scientist of the Israel Ministry of Industry, Trade and Labor adopts a view contrary to our own or if restrictive statutory changes are legislated in the future, our ability to commercialize some of our technologies or discoveries may be limited.

We may be unable to safeguard the integrity, security and confidentiality of our data or third parties' data, and if we are unable to do so, our business may be harmed.

We rely heavily on the use and manipulation of large amounts of data and on the secure and continuous use of our internal computers, communication networks and software and hardware systems. We have implemented and maintain physical and software security measures to preserve and protect our computers, communication, and hardware and software systems as well as our data and third parties' data. These measures are intended to safeguard against loss, corruption and misappropriation caused by system failures or unauthorized access. We have also entered into confidentiality agreements with our employees, consultants, customers and collaborators who may have access to such confidential or proprietary information.

However, these methods may not protect us against fire, storm, flood, power loss, earthquakes, telecommunications failures, physical or software break-ins or similar events. In addition, these measures may not be sufficient to prevent unauthorized access, use or publication of such proprietary data. A party who is able to circumvent our security measures could misappropriate or destroy proprietary information or cause interruptions in our operations. In addition, a party who obtains unauthorized access to our proprietary data or breaches a confidentiality agreement with us could publish or transfer large portions or all of our proprietary data. Such publication of proprietary data could materially harm our intellectual property position, thereby seriously harming our financial condition. These security problems, if significant, could harm our operations and even cause our business to cease.

We may be subject to claims related to hazardous chemicals and biological materials that we use, and these claims may harm our business.

Our research and development activities in some cases involve the controlled use of biological and chemical materials, a small amount of which could be considered to be hazardous. To our knowledge, our work is performed substantially in accordance with all applicable environmental regulations. However, we cannot eliminate the risk of accidental contamination or discharge of any of these materials. If hazardous biological or chemical materials in our possession were to be improperly used, this could result in harm to persons or property and we could be subject to both civil damages and criminal penalties. In such event, our liability may exceed our insurance coverage.

The clinical development and marketing of products based on our discoveries are subject to governmental regulation and the receipt of regulatory approvals, and if we or our collaborators or licensees fail to receive such approvals, our business may be materially harmed.

The clinical development and marketing of therapeutic and diagnostic products based on our discoveries requires obtaining regulatory approvals to such effect. The process of obtaining regulatory

approvals for therapeutic or diagnostic products based on our discoveries in the United States and in other countries can be lengthy and complex. Changes in legislation and in guidelines and policies made pursuant to such legislation could increase the complexity and the length of the process of obtaining such regulatory approvals. Even if and once we or our collaborators or licensees obtain regulatory approval for products based on our discoveries, these products may be subject to continuous regulatory review. Products based on our discoveries that are found to be unsuitable for human consumption, for example due to the causation of unwanted side effects, may result in the withdrawal of such products from the market.

Neither we, nor our licensees or collaborators, have yet applied for or received any regulatory approvals for any therapeutic or diagnostic products based on our discoveries. Such approvals are also required for conducting clinical trials of products based on our discoveries. We rely on our collaborators and licensees to advance regulatory approval processes. However, we cannot be certain that we or our collaborators or licensees will be able to obtain such approvals for any product or product candidate that we may develop.

If we or our collaborators or licensees fail to obtain required regulatory approvals, our collaborators or licensees may be prevented from marketing therapeutic or diagnostic products based on our discoveries. This will in turn reduce our chances of receiving payment from our collaborators and as a result, our business may be materially harmed.

Factors Related to Intellectual Property

We may not be able to protect our non-patented proprietary data, technologies or discoveries, and this may materially harm our business.

We rely heavily on our proprietary know-how and trade secrets that we develop and that are not protectable or protected by patents. We employ a number of measures to ensure that our know-how and trade secrets will not be disclosed outside our organization, and to the extent that they may be, we make extensive use of confidentiality agreements. We believe that principal aspects of our know-how and trade secrets relating to our technology are complex and, as a result, difficult to copy or reproduce. Nevertheless, the protective measures that we employ may not provide adequate protection for our trade secrets and know-how. Our business collaborators, employees, advisors and consultants may disclose our proprietary know-how or trade secrets in violation of their obligations to us. We may not be able to meaningfully protect our rights in our proprietary know-how or trade secrets against such unauthorized disclosure and any consequent unauthorized publication.

If we are not able to adequately protect our proprietary know-how and trade secrets, competitors may be able to develop technologies and resulting discoveries and inventions that are the same or similar to our own discoveries and inventions. This could erode our competitive advantage and materially harm our business.

We may not be able to obtain or maintain patent protection for our inventions that relate to genes and gene-based products, and if we fail to do so, our business will likely be materially harmed.

The success of our business depends, to a large extent, on our ability to obtain and maintain patents that cover our therapeutic and diagnostic product candidates. We have applied for patents covering our therapeutic and diagnostic product candidates as well as aspects of some of our technologies. We have a total of seven patents, of which six are US patents and one is an Australian patent. We plan to continue to apply for patents as we deem appropriate, but we cannot assure you that our patent applications will be accepted, or that they will be accepted to the extent that we seek.

The process of obtaining patents for inventions that cover our genes and gene-based products is uncertain for a number of reasons, including but not limited to:

- the patenting of genes and gene-based inventions involves complex legal issues, many of which have not yet been settled;
- legislative and judicial changes, or changes in the examination guidelines of governmental patent

offices may negatively affect our ability to obtain genes and gene-based patents;

- in view of the finite number of human genes, we face intense competition from other biotechnology and pharmaceutical companies who have already sought patent protection relating to gene and gene-based discoveries that we may intend to develop and commercialize;
- part of our discovery efforts are aimed at discovering novel variants of gene-based therapeutic products that belong to third parties and, as such, those third parties may have already acquired intellectual property rights that precede and prevent us from obtaining patent protection for our variants;
- publication of large amounts of genomic data by non-commercial and commercial entities may hinder our ability to obtain sufficiently broad patent claims for our inventions;
- even if we succeed in obtaining patent protection, such protection may not be sufficient to prevent third parties from using our patented inventions; and
- even if we succeed in obtaining patent protection, our patents could be partially or wholly invalidated.

If we do not succeed in obtaining patent protection for our inventions to the fullest extent for which we seek protection, our business and financial results will likely be materially harmed.

The existence of third party intellectual property rights may prevent us from developing our discoveries or require us to expend financial and other resources to be able to continue to do so.

In selecting a therapeutic or diagnostic product candidate for development, we take into account, among other considerations, the existence of third party intellectual property rights that may hinder our right to develop and commercialize that product candidate. The human genomic pool is finite. To our knowledge, third parties, including our competitors, have been filing wide patent applications covering an increasing portion of the human genomic pool and the proteins expressed therefrom.

As a result of the existence of such third party intellectual property rights, we may be required to:

- forgo the research, development and commercialization of therapeutic and diagnostic products candidates that we discover, notwithstanding their promising scientific and commercial merits;
- invest substantial management and financial resources to either challenge or in-license such third party intellectual property, and we cannot assure you that we will succeed in doing so on commercially reasonable terms, if at all.

We do not always have available to us, in a timely manner, information of the existence of third party intellectual property rights related to our own discoveries. The content of US and other patent applications remain unavailable to the public for a period of 18 months from their filing date. In some instances, the content of US patent applications remain unavailable to the public until the patents are issued. As a result, we can never be certain that development projects that we commence will be free of third party intellectual property rights. If we become aware of the existence of third party intellectual property rights only after we have commenced a particular development project, we may have to forgo such project after having invested in it substantial resources.

We may infringe third party rights and may become involved in litigation, which may materially harm our business.

Our business philosophy is to respect the intellectual property rights of third parties. Nevertheless, if a third party accuses us of infringing its intellectual property rights or if a third party commences litigation against us for the infringement of patent or other intellectual property rights, we may incur significant costs in defending such action, whether or not we ultimately prevail. Typically, patent litigation in the pharmaceutical and biotechnology industry is expensive. Costs that we incur in defending third party infringement actions would also include diversion of management's and technical personnel's time. In addition, parties making claims against us may be able to obtain injunctive or other equitable relief that could prevent us from further developing our discoveries or commercializing our products. In the event of a

successful claim of infringement against us, we may be required to pay damages and obtain one or more licenses from the prevailing third party. If we are not able to obtain these licenses at a reasonable cost, if at all, we could encounter delays in product introductions and loss of substantial resources while we attempt to develop alternative products. Defense of any lawsuit or failure to obtain any of these licenses could prevent us or our partners from commercializing available products and could cause us to incur substantial expenditures.

Factors Related to our Ordinary Shares

Holders of our ordinary shares who are United States residents may be required to pay additional income taxes.

There is a significant risk that we will be classified as a Passive Foreign Investment Company, or PFIC. Our treatment as a PFIC could result in a reduction in the after-tax return to the holders of our ordinary shares and may cause a reduction in the value of these shares. For US Federal income tax purposes, we will be classified as a PFIC for any taxable year in which either: (i) 75% or more of our gross income is passive income, or (ii) at least 50% of the average value of all of our assets for the taxable year produce or are held for the production of passive income. For this purpose, passive income includes dividends, interest, royalties, rents, annuities and the excess of gains over losses from the disposition of assets that produce passive income. If we were determined to be a PFIC for US Federal income tax purposes, highly complex rules would apply to US taxpayers owning our ordinary shares. Accordingly, **YOU ARE URGED TO CONSULT YOUR TAX ADVISORS REGARDING THE APPLICATION OF THESE RULES**.

As a result of our substantial cash position and the relatively lower price of our stock in recent years, there is a risk that we will be classified as a PFIC under the asset test described in the preceding paragraph. There can be no assurance that we will not be classified as a PFIC in the future, because the determination of whether we are a PFIC is based upon the composition of our income and assets from time to time, and such determination cannot be made with certainty until the end of a calendar year.

United States residents should carefully read "Taxation, United States Federal Income Tax Consequences" under "Item 10. Additional Information" for a more complete discussion of the US Federal income tax risks related to owning and disposing of our ordinary shares.

Our business is difficult to evaluate because we have a limited history of operations and because we operate in industries that are constantly evolving, and this may result in our shares trading at a discount or in our share price being volatile.

Since our incorporation in 1993, our research focus, the products that we developed and our business model had continually evolved. Whereas in the past we used our intellectual property, scientific know-how and computational capabilities to develop, market and sell to third parties life science software products and services, we now use these capabilities to discover therapeutic and diagnostic product candidates.

In addition, since 1998, part of our business has involved the discovery and development of therapeutic and diagnostic product candidates. Therapeutic products are typically developed over a period of approximately 9-12 years and the development period for diagnostic products is typically four to six years. For these reasons, we have a history of operations in which we believe there is insufficient information to identify a historical pattern.

Even if we could discern an historical pattern for our operations, the continuously evolving nature of the biotechnology and pharmaceutical industries in general and our business in particular would make it very difficult to identify any meaningful information. Therefore, it would also be difficult to make any projections about the future of our operations.

These difficulties may result in our ordinary shares trading at a discount or the market price of our shares to be volatile.

Our share price has been volatile and we believe that it is likely to continue to be volatile.

The market price of our ordinary shares has been highly volatile and we believe that it is likely to continue to be volatile. This is due to the risks and uncertainties described in this annual report, as well as other factors, including:

- general economic conditions, including those that specifically relate to life science-related industries;
- actual or anticipated fluctuations in our operating results;
- changes in expectations as to our future financial performance or changes in financial estimates by the investment community;
- technological innovations by us or by our competitors;
- investors' perceptions or changes in market valuation of biotechnology companies in general;
- relatively low volumes at which our shares have been traded at in the past and at which they may continue to trade; and
- the operating and share price performance of comparable companies.

In addition, the market prices of equity securities of companies that have a significant presence in Israel may also be affected by the changing security situation in the Middle East and particularly in Israel. As a result, these companies may experience difficulties in raising additional financing required to effectively operate and grow their businesses. Such failure and the volatility of the securities market in general, and our share price in particular, may affect our ability to raise additional financing in the future. Market and industry fluctuations may adversely affect the trading price of our ordinary shares, regardless of our actual operating performance.

Our share price may decline if our operating results fluctuate and/or if we fail to meet the expectations of the investment community.

Our quarterly operating results have fluctuated in the past and we believe that they will do so in the future. These fluctuations may cause our share price to fluctuate significantly. If our operating results fail to meet the expectations of the investment community, this may cause fluctuations in our share price. These results should not be relied upon as indications of future performance, and comparisons of quarterly results of operations may not be any meaningful indication of our progress in the long term.

Our operating results may fluctuate as a result of, among other things:

- our rate of success and timing of entering into transactions for the commercialization of our therapeutic and/or diagnostic product candidates;
- a decrease in the financial resources available to our customers, collaborators or licensees;
- the timing of the release of products by our competitors;
- inflation/deflation in Israel or changes in the conversion rate between New Israeli Shekel and other currencies;
- the outcome and length of conflicts in the Middle East;
- the time within which our collaborators may develop our therapeutic and/or diagnostic product candidates into revenue-producing products;
- our ability to secure research and development grants.

Provisions of Israeli law may delay, prevent or affect a potential acquisition of all or a significant portion of our shares or assets and therefore depress the price of our stock.

Israeli corporate law regulates acquisitions of shares through tender offers. It requires special approvals for transactions involving significant shareholders and regulates other matters that may be relevant to these types of transactions. The provisions of Israeli law may delay or prevent an acquisition, or make it less

desirable to a potential acquirer and therefore depress the price of our shares. For information about these limitations, see "Anti-Takeover Provisions under Israeli Law" Under "Item 10. Additional Information." Further, Israeli tax considerations may make potential transactions undesirable to us or to some of our shareholders.

Risks Relating to Operations in Israel

Conditions in the Middle East and in Israel may harm our operations.

Our principal offices and research and development facilities are located in Israel. Political, economic and military conditions in Israel directly affect our operations. Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors, as well as incidents of civil unrest, military conflicts and terrorist actions. Since September 2000, there have been periods of time during which Israel experienced heightened levels of violence with varying levels of severity. This state of hostility has caused security and economic problems for Israel. To date, we do not believe that the political and security situation has had a material adverse impact on our business but we cannot give you any assurance that this will continue to be the case. However, if there were to be emergency conditions, some of our key employees may be called to active duty for extended periods of time and could adversely affect our operations. Any hostilities involving Israel or the interruption or curtailment of trade between Israel and its present trading partners could also adversely affect our operations and could make it more difficult for us to raise capital.

Our 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 could have a material adverse effect on our business. Any armed conflicts or political instability in the region would likely negatively affect business conditions and could harm our results of operations.

Our results of operations may be adversely affected by inflation and/or by a devaluation of the Dollar against the New Israel Shekel.

We hold most of our cash, cash equivalents and marketable securities in US dollars but incur a significant portion of our expenses, principally salaries and related personnel expenses, in New Israel Shekels. As a result, we are exposed to the risk that the US dollar will be devalued against the New Israel Shekel. In addition, we are exposed to the risk that the rate of inflation in Israel will exceed the rate of devaluation of the New Israel Shekel in relation to the dollar or that the timing of any devaluation may lag behind inflation in Israel. However, since a significant portion of our expenses are the cost of our salaries, which we pay in New Israel Shekel, we believe that this risk is not significant. If the US dollar cost of our operations in Israel increases, our dollar-measured results of operations will be adversely affected. Our operations could also be adversely affected if we will be unable in the future to guard against devaluation of the Dollar against the New Israel. To date, our business has not been materially adversely affected by changes in the Israeli rate of inflation or by a decrease in the US dollar - New Israeli Shekel exchange rate.

We may not continue to receive research and development grants and may not continue to be entitled to certain tax benefits.

We currently receive 3 different types of research and development grants and are entitled to certain grants and tax benefits under Israeli government programs. We receive funds in support of some of our research and development programs from the Office of Chief Scientist of the Israel Ministry of Industry, Trade and Labor, from the Israel-U.S. Bi-national Industrial Research and Development Foundation and from the European Community, under the European Union's 6th Framework Program.

In addition, our subsidiary Keddem Bioscience, is currently entitled to certain grants and tax benefits under Israeli government programs and receives funds in support of some of its research and development programs from the Office of Chief Scientist of the Israel Ministry of Industry, Trade and Labor.

To maintain our eligibility to receive these funds, we must file periodic reports and pay royalties with respect to some of the grants that we received.

We intend to submit requests for additional research and development funds from the Office of Chief Scientist, from the European Community as well as from other funds that offer financial grants in support of our research and development programs. However, we cannot assure you that we will continue to receive such funds at the same rate, if at all. In 2005 we received an aggregate of $2.3 million funds in support of some of our research and development programs. For more information, see "Item 5. Operating and Financial Review and Prospects; Research and Development, Patents and Licenses; Research and Development Programs."

The tax benefits that we are entitled to receive are a function of the "Approved Enterprise" status of our existing facilities in Israel. For more information, see "Item 5. Operating and Financial Review and Prospects; Operating Results; Governmental Economic, Fiscal, Monetary or Political Policies that Materially Affected or Could Materially Affect our Operations". To date we have not received any such tax benefits because we have not yet generated any taxable income. To maintain our eligibility for these tax benefits, we must continue to meet certain conditions, including making specified investments in fixed assets and financing a percentage of investments with share capital.

The termination or reduction of the funding that we receive, could have a material adverse effect on our business, financial condition and results of operations.

If we cease to become entitled to these tax benefits, we may be required to pay increased taxes on the taxable income that we may generate in the future from funded technology.

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

Service of process upon us, since we are incorporated in Israel, and upon our directors and officers and our Israeli auditors, almost all of whom reside outside the United States, may be difficult to obtain within the United States. In addition, because substantially all of our assets and almost all of our directors and officers are located outside the United States, any judgment obtained in the United States against us or any of our directors and officers may not be collectible within the United States.

ITEM 4. INFORMATION ON THE COMPANY

History and Development of the Company

Our legal and commercial name is Compugen Ltd. We were established as a corporation under the laws of the State of Israel in 1993, and we operate under the laws of the State of Israel. Our principal offices are located at 72 Pinchas Rosen Street, Tel Aviv 69512, Israel, and our telephone number is +972-3-765-8585. The principal offices of Compugen USA, Inc. (formerly known as Compugen, Inc.), our wholly-owned US subsidiary, are located at 560 S. Winchester Blvd., Suite 500, San Jose, California 95128, and its telephone number is (408) 236-7336. Our primary Internet address is www.cgen.com. None of the information on our websites is incorporated by reference into this annual report.

We initially developed a computer hardware system and software applications to accelerate homology searches of biological sequences. This system and those applications were commercialized under the name "Bioccelerator" since 1994. In 2003, we sold the Bioccelerator product line. For more information regarding the sale of our Bioccelerator product line, see Note 3 of our 2005 Consolidated Financial Statements. The divestment of our Bioccelerator product line, was part of an evolution that we underwent. Whereas in the past we used our intellectual property, scientific know-how and computational capabilities to develop, market and sell to third parties life science software products and services, we now use these capabilities to discover therapeutic and diagnostic product candidates. For more information about our evolution, see in this Item 4 "Business Overview."

In 1997, we incorporated our wholly-owned US subsidiary, Compugen USA, Inc. We conduct most of our business development and marketing operations from the US.

Since 1997, we directed a significant portion of our activities to the development of computational biology platforms and technologies that allow molecular biologists to obtain significantly more valuable information from genomic and related databases. The technologies that we developed solve quantitative and qualitative problems inherent in the analysis of genomic and expressed sequence data. Our first major technology platform was our LEADS computational biology platform, which among other functions, analyses and rearranges - also known as clustering and assembly - genomic and expressed sequence data. With the use of our computational platforms, we have been able to discover novel genes and gene-based products, including novel transcripts and proteins. Throughout the years, we licensed use of this technology to a number of pharmaceutical and biotechnology companies, including Pfizer, Inc., Novartis Pharma A.G. and Abbott Laboratories.

In 1998, we established our biology laboratory, the initial purpose of which was to validate our computationally generated predictions. Subsequently, we recognized that there is vast potential in discovering and developing novel therapeutic and diagnostic product candidates, rather than merely validating our computational capabilities and technologies.

In August 2000, we sold 5,000,000 of our ordinary shares in the initial public offering of our shares on the Nasdaq National Market at $10.00 per share. In September 2000, we sold an additional 750,000 ordinary shares upon the exercise by our underwriters of their over-allotment option. In January 2002, we listed our shares for trading on the Tel Aviv Stock Exchange (TASE).

Between the years 2000 and 2004 we pursued a number of commercial activities, including the marketing and sale of computational tools, by applying our intellectual property, scientific know-how and computational technologies to the development of solutions for addressing challenges in the fields of functional genomics, which is the study of gene expression and gene function. We no longer seek to sell computational tools, for the same reason that we divested the Bioccelerator product line, which is to use our intellectual property, scientific know-how and computational capabilities in-house, to discover and carry out the initial development of novel therapeutic and diagnostic product candidates.

Commencing in 2000, we designed probes, which are short nucleotide sequences designed to be

uniquely representative of much larger corresponding genes. Probes that we designed can be used for gene expression experiment and served as the basis for our Oligolibraries products. In 2001, we entered into a joint license and marketing agreement with Sigma-Genosys for the development, marketing and production of these products. This agreement terminated on December 31, 2004, following which, we no longer market our Oligolibraries products.

In 2001, we launched product named "Genecarta", a user-friendly database application that allows scientists in the field of genomics, functional genomics and proteomics to easily use the results of analyses performed with our LEADS computational biology platform. We no longer market the Genecarta product.

In 1999, we established a division focusing on agricultural biotechnology and plant genomics. On January 1, 2002, we transferred the business of this division to what was at the time a majority-owned subsidiary, Evogene Ltd. For more information about this transaction and our holdings in Evogene, see Item 7, "Major Shareholders and Related Party Transactions; Related Party Transactions; Evogene Ltd."

In 2000, we launched our Z3 software product, and in 2003 our Z4000 software product, both of which use advanced computational techniques to carry out pattern recognition analyses and image processing to analyze the results of certain protein separation experiments. We no longer market the Z software products.

In 1999, we established a chemistry division to carry out a research program in which we integrated the disciplines of organic chemistry with physics and advanced computational technologies for the development of a method to substantially increase the predictability and success rates of small molecule drug discovery. This transaction by which we created our wholly-owned subsidiary Keddem Bioscience was part of our continuing efforts to focus on the enhancement of our discovery engines and the discovery and development of novel therapeutic proteins and diagnostic biomarkers. On August 1, 2004 we turned our chemistry division into a wholly owned subsidiary by transferring all of our assets and liabilities that were dedicated to the operation of our chemistry division into Keddem Bioscience.

Since 2002, we have been focusing on the discovery of novel therapeutic proteins (these are proteins that are themselves drugs and that are usually administered by injection) and diagnostic biomarker (which indicate the presence or absence of a physiological condition, such as a disease) product candidates through the use of the intellectual property, scientific know-how and computational biology capabilities that we had developed. During 2003 and 2004 we expanded our biology laboratory by, among other things, expanding its floor space and adding new functions and equipment. We also recruited experts for the purpose of strengthening our protein expression, production, purification and analysis capabilities. We seek to generate revenue from commercializing the novel therapeutic protein and diagnostic biomarker candidates that we discover, by pursuing commercial relationships with potential collaborators and licensees, including leading diagnostic, biotechnology and pharmaceutical companies. We intend for these revenues to be in the form of milestone and royalty payments.

In December 2005, we underwent a re-organization. Part of this re-organization comprised the establishment of three research and development units in order to continue to focus on the discovery, validation and commercialization of our therapeutic and diagnostic biomarker product candidates. Our recently formed three research and development units consist of a therapeutics unit, a diagnostic biomarkers unit, and a research and discovery unit. This re-organization included a reduction of approximately twenty five percent in the number of our employees across the company. We currently continue to operate under a single reporting segment and our three research and development units are not measured separately by our company's management.

Business Overview

We are a biotechnology discovery company focused on therapeutic and diagnostic product candidates. The Company's powerful predictive models and discovery engines enable the discovery of numerous potential therapeutics and diagnostic biomarkers. This capability results from the Company's pioneering and on-going incorporation of ideas and methods from mathematics, computer science, and physics into biology, chemistry and medicine. To date, our discovery efforts have focused mainly on cancer,

cardiovascular and immune-related diseases. Product development is pursued both in-house and through collaborative arrangements. The Company's primary business goal is to out-license therapeutic and diagnostic product candidates for commercialization by leading companies under milestone and revenue sharing agreements.

We have three principal research and development units comprising a therapeutics unit, a diagnostic biomarkers unit and a research and discovery unit. These units are serviced and supported by our other units, which include finance, legal and business development units.

Therapeutics Unit

The therapeutics unit selects and validates therapeutic protein product candidates that we discover in-house with the use of our predictive discovery engines. This unit is responsible for carrying out *in-vitro* and *in-vivo* experimental validation of selected potential therapeutic protein candidates. *In-vitro* and *in-vivo* experiments are experiments outside the living body, in an artificial environment and experiments in a living body respectively. This validation is done internally and by outsourcing to third party laboratories and includes protein production, purification and analysis, and *in-vitro* and *in-vivo* bioassays.

We use the capabilities of our LEADS computational platform and discovery engines and related technologies to discover proteins that we believe are potential therapeutic product candidates. Once we identify therapeutic product candidates *in-silico*, we select candidate molecules for validation in a biology laboratory. The molecules that we select for validation and further development, are those molecules that we believe are most likely to succeed, based on a set of criteria that we continually develop and use in our discovery process. One criterion for our selection of proteins is that they are predicted to be novel and are found not to be covered by third party patents. Another criterion, that we applied to splice variants, is that the selected splice variant should be closely related to an already marketed drug, drug target or to one that is in advanced stages of development. In focusing on the discovery of such proteins, we seek to benefit from the availability of relevant biological and medical information that relate to our novel splice variant.

The first biology laboratory activity that we carry out on the selected molecules is either to validate their existence in nature at the RNA level and/or to synthesize them. The validation at the RNA level is achieved by biology laboratory techniques such as quantitative RT-PCR, which is a method for isolating and amplifying desired RNA sequences. Synthesis of these molecules is achieved by either chemical synthesis in the case of short peptides, or by genetic engineering techniques in the case of longer proteins.

We are currently pursuing *in-vitro* and *in-vivo* experiments to assess the activity of a large number of our therapeutic protein product candidates. We expect to complete this assessment in 2006. Our ability to seek partners for development and commercialization for our therapeutic protein candidates will depend on those proteins' suitability to become therapeutic proteins and on our ability to generate experimental data in support of that suitability.

Diagnostics Unit

The diagnostics unit selects and prioritizes diagnostic product candidates that we discover in-house with the use of our predictive discovery engines. This unit is responsible for carrying out initial validation of the potential diagnostic candidates that it selects.

Similarly to the use of our discovery engines and related technologies to discover therapeutic product candidates, we also use discovery engines and related technologies to discover proteins that we believe are potential diagnostic biomarker product candidates. We first identify diagnostic product candidates *in-silico* and then select for validation at the RNA level those molecules that we believe are most likely to succeed, based on a set of criteria that we developed.

There are three principal selection criteria that we apply to select for validation and further development diagnostic product candidates that we identify *in-silico*. These are:

- Novelty and freedom to operate - we select molecules that are predicted to be novel and found not to be covered by third party patents.
- Differentiation between disease and healthy conditions – we select molecules that are predicted to be present in different quantities in diseased and healthy human tissues respectively.
- Biological characteristics – we select molecules that have biological features, which make them suitable for diagnostic detection. For example, in the case of immunoassay-based diagnostic biomarkers, we select molecules that are predicted to be secreted into the blood stream and therefore possibly detectable in blood.

We believe that in 2004 and 2005, we have demonstrated our ability to discover biomarker candidates, primarily for various cancers and cardiovascular diseases, that are of interest for further development and commercialization by leading companies in the field of immunoassay diagnostics. Our discovery engines together with our related technologies have already formed the basis for a broad discovery-based collaboration with Diagnostic Product Corporation, Ortho-Clinical Diagnostics, a Johnson & Johnson company, and with Biosite, all for the development and commercialization of immunoassay diagnostic products based on the output of our diagnostic discovery engines. For more information about these transactions, see the Section entitled "Our Selected Customers and Collaborators" in this Item 4.

We expect that during 2006 and 2007, together with our licensees and partners, we will validate and develop products based on the first wave of discoveries from our immunoassay based diagnostic discovery engines. We also intend to continue our discovery activities, which are currently targeted at cancer and cardiovascular diseases, and we have already commenced to extend our efforts to other disease areas.

Our development activities with respect to nucleic acid based diagnostics, which rely on slightly modified versions of our immunoassay discovery engines, are approximately one year behind our immunoassay based diagnostic development activities. We intend to begin entering into agreements for the commercialization of our nucleic acid based diagnostic product candidates in the second half of 2006.

Research and Discovery Unit

Our research and discovery unit has generated our discoveries of therapeutic protein and diagnostic product candidates (although this was done before it was formally reorganized as such). These discoveries have all been made *in-silico*. We intend for this unit to continue to generate discoveries of therapeutic and diagnostic product candidates as well as create additional discovery engines and other platforms and technologies that will enable us to add to and improve upon our predictive biology capabilities.

Our ability to discover therapeutic protein and diagnostic product candidates is enabled by the computational platforms, discovery engines and related technologies that we have developed and continue to develop. These platforms include our LEADS computational biology platform, and our discovery engines, including our therapeutic protein discovery engine and our diagnostic biomarkers discovery engines.

We have begun an analysis in order to select new projects for the development of new platforms and technologies. We intend to continue to develop platforms and technologies that will enable us to discover categories of therapeutic and diagnostic product candidates that we had not discovered to date. It is our current intention that after proof of concept is successfully achieved for these new platforms and technologies, their further development and the commercialization of therapeutic or diagnostic product candidates that we discover with these new platforms and technologies will be the subject of a major collaboration with a pharmaceutical or biotechnology partner.

Our Enabling Technologies

Our LEADS Computational Biology Platform

Our LEADS computational biology platform analyzes genomic and expressed sequence data to enable

rapid discovery of genes, transcripts, and proteins, including their splice variants, and information about their potential respective functions. Our LEADS computational biology platform models a wide variety of complex biological phenomena and provides a comprehensive research infrastructure, facilitating the discovery of therapeutic and diagnostic product candidates and other biological products. This technology and expertise has enabled us to efficiently and effectively extract valuable information from genomic, proteomic and related databases.

Discovery Engines

Our discovery engines are proprietary computational platforms that extend the capabilities of our LEADS platform by incorporating sophisticated search and analysis algorithms. Our discovery engines are designed to enable our researchers to identify proteins and transcripts that are suitable for the development of therapeutic and diagnostic product candidates. We use our discovery engines and related technologies in our internal therapeutic and diagnostics discovery efforts. By using these engines and related technologies, we intend to constantly feed our pipeline of discoveries with novel therapeutic and diagnostic product candidates.

Although to date, we have used our discovery engines to discover therapeutic protein and diagnostic product candidates, our approach to discovering novel product candidates may be equally useful for the discovery and selection of potential targets for small molecules, antibodies and other types of gene products with clinical value, such as DNA polymorphisms, which are changes in the DNA nucleotide base pair sequence.

Therapeutic Protein Discovery Engines - Our therapeutic protein discovery engines are designed to identify proteins for which there is substantial evidence indicating a therapeutic utility. One such engine is designed to identify novel splice variants of known proteins. This engine also enables the selection of proteins based on their predicted biological properties such as the existence of a signal peptide, which is a biological signal on the protein directing it to be secreted out of the cell into the blood stream. The input into our therapeutic protein discovery engines is analyzed by proprietary software and automated processes. Its output is thereafter manually analyzed by our scientists and consulting experts to evaluate each molecule's potential to be a therapeutic product candidate.

Diagnostic Biomarker Discovery Engines - Another example of our discovery engines is our series of diagnostic biomarker discovery engines. These engines are designated to identify novel transcripts and splice variants of genes, and proteins, that are differentially expressed in specific tissues or pathological conditions, and which may therefore serve as biomarkers for diagnosis. Genes, transcripts and proteins that are involved in various diseases may be differentially expressed in such conditions. Our approach to identify such genes, transcripts and proteins is to search *in-silico* for, among other things, patterns of differential expression, and then to attempt to verify these predictions by experimental methods in our biology laboratory. In addition, we seek to discover splice variants of proteins with a known diagnostic utility since these splice variants may themselves have a diagnostic utility.

Our diagnostic biomarker discovery engines consist of disease driven biomarker engines and application driven biomarker engines. The disease driven biomarker engines identify transcripts and proteins that are expressed differently in disease situations, compared to the expression levels of such transcripts and proteins in normal physiological conditions. The diseases that these engines target are various cancers, autoimmune diseases and heart related diseases. The application driven biomarker engines identify transcripts and proteins that are characterized by selected features or their suitability for certain diagnostic applications. These categories of biomarkers are secreted forms of known biomarkers that can be found in serum, biomarkers that are membrane-bound which are suitable for *in-vivo* imaging applications and biomarkers that can be used at the nucleic acid level, primarily in the field of cancer.

Our Approach to Research and Discovery

By incorporating ideas and methods from mathematics, computer science and physics into biology, chemistry and medicine, we attempt to discover novel potential therapeutic and diagnostic product

candidates. Over approximately the past decade, we have been developing technologies, including our discovery engines, which enable researchers to identify genes, transcripts, and proteins that can be the basis for the development of therapeutic and diagnostic products of interest. Our multidisciplinary discovery process combines sophisticated mathematical modeling with experimental "wet" biological validation in an iterative process that is designed to investigate biological phenomena and discover potentially valuable drug targets, therapeutic proteins and diagnostic biomarkers. We believe that our approach to drug and diagnostic discovery makes it possible for us to further discover novel therapeutic and diagnostic product candidates.

Our discovery cycle relies on an iterative process of predictive modeling followed by hypothesis-driven experimentation, yielding discoveries, which in turn, facilitates the improvement of the predictive models, thereby increasing the probability of making additional discoveries in the future. This process nurtures the continuing improvement and enhancement of our discovery engines and related technologies.

We believe that the mathematical modeling of significant biological phenomena will lead us to better research capabilities and to more efficient and effective discovery of potential therapeutic and diagnostic product candidates.

We believe that the understanding of one biological phenomenon that is derived from an understanding of other biological phenomena is made possible as life sciences transform and mature from largely observational to more predictive. We believe that a deeper understanding of biological phenomena is useful for drug discovery. Our belief is supported by discoveries of novel genes and gene-based therapeutic and diagnostic product candidates that we have already made and that have resulted from our modeling of biological phenomena. Below are four examples of biological phenomena that we have modeled:

- *Alternative Splicing* - alternative splicing is a biological phenomenon whereby a single gene may give multiple different transcripts that could be translated into more than one protein. Since 1997, by applying our proprietary LEADS computational biology platform to the analysis of publicly available genomic information, we discovered that the phenomenon of alternative splicing occurs in at least 50% of human genes. Previously, scientists believed that alternative splicing occurred in only a very small number of genes. By having identified the wide-spread nature of the alternative splicing phenomenon and having developed the computational technologies to identify it, we are able to discover unknown proteins that are encoded by known genes.

- *Antisense* - antisense is a biological phenomenon of the existence of two genes that are located on opposite strands of DNA and, therefore, have complementary nucleic acid sequences. In 2002, by applying our proprietary LEADS computational biology platform to the analysis of publicly available genomic information, we discovered that the phenomenon of naturally occurring antisense in the human genome was significantly more common than previously believed. We identified hundreds of antisense pairs of genes and published our findings in the April 2003 issue of Nature Biotechnology, Volume 21, No. 4.

- *RNA Editing* - RNA editing is a biological phenomenon in which small nucleotide changes occur in RNA after its transcription from DNA. Although it has been known that RNA editing is an essential factor for mammalian development and although recent evidence has suggested that it may be a fairly common phenomenon, very few RNA editing sites had been actually discovered and it was generally believed to be impossible to systematically discover such sites with current experimental and computational procedures and tools. We developed and proved systematic identification of adenosine to inosine (A to I) RNA editing sites in the human transcriptome, and increased the number of known A to I RNA editing sites from approximately 100 to 12,723. Our discovery was published in the August 2004 issue of Nature Biotechnology, Volume 22, No. 8.

- Processed Pseudogenes - processed pseudogenes are naturally occurring copies of genes that were created through reverse transcription of mature spliced mRNAs and then reinserted into the genome at a new location. These genomic sequences are generally considered "junk DNA". However, through analysis of thousands of such human pseudogenes with an *in-silico* predictive methodology, we were able to predict the existence of hundreds of novel transcript variants, a selected subset of which were then experimentally validated in our biology laboratories. Our

discovery was published in the January 2006 edition of the Proceedings of the National Academy of Sciences (USA).

Background – Pharmaceutical and Biotechnological Research and Development

Biological Processes - The characteristics of all living organisms are determined by DNA, a molecule found in virtually every living cell. DNA is comprised of pairs of four types of small chemical units, each called a nucleotide. DNA contains genes, which are comprised of thousands of nucleotides. The Human Genome Project, an international research program designed to construct detailed genetic maps of the human genome (that is, all of the genetic information contained in the human genes), demonstrated that the human genome consists of a total of approximately 3 billion nucleotides. These nucleotides are arranged in up to 25,000 genes.

Cells carry out a major part of their biological functions by means of proteins. The production of proteins is encoded by DNA through a process known as gene expression. Therefore, by identifying a gene, it is possible to identify a protein or proteins that are expressed from that gene. The first stage of gene expression is transcription, which involves the matching of the DNA nucleotides in a gene with the nucleotides of a related molecule called messenger RNA, or mRNA. mRNA then instructs the cell to produce a protein by a process known as translation. Proteins are the molecules that regulate or perform most of the physiological functions of the body.

Diagnostic Biomarkers - A major aspect of the pharmaceutical and biotechnological research and development process is the identification of diseases and other physiological conditions. In the case of certain types of cancers, such as breast cancer, early detection can be critical to their treatment and even cure. The early detection of certain types of cancers is currently an unmet medical need. The levels of presence or absence of proteins or other molecules, may give information about the presence or absence of a disease or a particular stage of a disease or other physiological condition. A molecule that provides this information is known as a "diagnostic biomarker". For example, the presence or abnormal increased presence of a certain protein in blood may indicate a cancerous condition. In order to develop a diagnostic biomarker, it is first necessary to identify a correlation between, on the one hand, the presence or levels of presence of a molecule and, on the other hand, a disease or other physiological condition. Once such a correlation is identified, it is then necessary to develop a method for identifying the changes in levels of the diagnostic biomarker. The task of developing a method that will be easy to perform, that is sensitive, that has a high predictive value, that is safe, reliable, inexpensive, and that covers an attractive market segment, is a challenge that the diagnostics, pharmaceutical and biotechnological industries face.

Therapeutic Proteins - In some cases, the protein itself may be a drug. A familiar example of such a drug is insulin, which is a protein. This category of proteins is referred to as therapeutic proteins, because use or administration of the protein itself may have the effect of preventing, treating or curing a disease. Therapeutic proteins are usually administered by injection.

Drug Targets – In other cases, a protein may be a target to which a drug binds, and is known as a drug target. By increasing or decreasing the amount of a target protein or by activating or inhibiting its activity, a disease may be prevented, treated or cured.

Our Products and Commercial Offerings

Our therapeutic and diagnostic product candidates, that we offer for out-licensing, exclusively comprise our own discoveries, which are enabled by our proprietary discovery engines and internal experimental validation. We believe that our unique approach to drug discovery makes it possible for us to identify additional novel therapeutic and diagnostic product candidates.

Our most commercially advanced product area is immunoassay diagnostics, and we have signed agreements for the development and commercialization of a series of these products with three leading diagnostic companies. For more information about these transactions, see "Our Selected Customers and Collaborators." We expect to enter into nucleic acid development and commercialization agreements in the

second half of 2006.

For our therapeutic product candidates, we expect to reach the stage of seeking partners for development and commercialization of our therapeutic product candidates once we will have generated experimental data in support of their suitability to becoming therapeutic product candidates.

We intend to generate revenue from commercializing our pipelines of therapeutic protein and diagnostic biomarker product candidates through commercial relationships with potential collaborators and licensees, including leading biotechnology, diagnostic and pharmaceutical companies. We intend to receive payments upon the successful completion of predetermined development stages, and royalties from the sale of therapeutic and diagnostic products based on our discoveries.

We offer to our prospective collaborators a license to develop and commercialize therapeutic and diagnostic product candidates that we discover through use of our discovery engines. We are able to offer such candidates that are within a given area of interest to them. By collaborating with us, our prospective collaborators, primarily pharmaceutical, diagnostic and biotechnology companies, would be able to gain access to the advantages offered by use of our proprietary discovery engines and multidisciplinary team of experts. Ultimately, these collaborations are intended to yield novel putative genes and gene-based products, including transcripts and proteins, to enable our collaborators and licensees to develop and commercialize therapeutic and diagnostic products based on our discoveries.

Our Selected Customers and Collaborators

We intend to continue to focus on licensing-out our novel therapeutic and diagnostic product candidates, which we discovered and continue to discover internally, to pharmaceutical, biotechnology and diagnostics companies, with the aim that they will develop and commercialize our discoveries into therapeutic or diagnostic products. In these commercial arrangements we seek to receive payments upon the successful completion of certain predetermined developmental stages and milestones, and royalties from the sales of the drugs and/or diagnostics applications, which will be based on our discoveries.

In June 2005, we announced our entry into a collaboration with Ortho-Clinical Diagnostics, Inc. ("OCD"), for the development and commercialization of immunoassay based diagnostic products that are based on the output of our diagnostic discovery engines. The terms of this agreement allow OCD to select up to nine diagnostic biomarkers and then we will collaborate on the initial clinical validation of the selected biomarkers. Under the agreement, successfully validated biomarkers will be developed into products and commercialized by OCD, and we will receive milestone payments and license fees for each commercialized biomarker, in addition to revenue-based royalties. We applied together with OCD for a grant from the Israel-U.S. Bi-national Industrial Research and Development Foundation for contribution to our research and development expenditures under our joint collaborative project. For more information about this grant, see "Item 5. Operating and Financial Review and Prospects; Research and Development, Patents and Licenses."

In June 2005, we also announced our entry into a collaboration with Biosite Incorporated ("Biosite"), for the development and commercialization of immunoassay based diagnostic products based on the output of our diagnostic discovery engines. Under the terms of this agreement, we granted to Biosite an exclusive license in the diagnostic field to use certain of our targets for immunoassay based diagnostic applications. In return for this grant, we are entitled to receive milestone payments and royalties from the sales of each diagnostic product emerging from the collaboration.

In April 2005, we announced a joint pilot research project with Novartis in the field of systems biology. Under the agreement, we were required to generate information about biological interaction networks through the development of a proprietary platform for research and analysis of microarray and other biological data. Novartis obtained sole rights to the specific results of the project, and we retained all rights to the research and discovery systems developed through the collaboration.

In August 2004, we entered into a broad pipeline discovery-based collaboration with Diagnostic Product Corporation, for the development and commercialization of diagnostic products based on the output of our diagnostic discovery engines, with an anticipated focus on cancer and cardiovascular disease. The terms of this agreement allow Diagnostic Product Corporation to develop and commercialize immunoassay and nucleic-acid based diagnostic products that are based on candidate biomarkers that we already discovered, as well as additional candidates that may arise out of the collaboration. We are entitled to receive milestone payments and royalties from the sales of each diagnostic product emerging from the collaboration.

Our Strategy

We seek to generate revenues from our collaborators and licensees commercializing therapeutic and diagnostic products that are based on our discoveries and which is enabled by the use of the intellectual property, scientific know-how and computational biology capabilities that we had developed and continue to develop. We believe that we can commercialize discoveries that result from our in-house discovery programs or that result from collaboration discovery projects aimed at a given area of interest to our collaborators and/or their profile of requirements. We intend to focus on licensing-out our product candidates to diagnostics, biotechnology and pharmaceutical companies, and we intend that they will further develop and commercialize those product candidates into revenue generating therapeutic and diagnostic products. We intend to receive from these commercial arrangements payments upon the successful completion of certain predetermined development stages and milestones, and royalties from the sales of the drugs or diagnostics products, which will be based on our discoveries.

To date, we have commenced to implement this strategy by entering into a collaboration and license agreement with each of Diagnostic Products Corporation, Ortho-Clinical Diagnostics, and Biosite, for the development and commercialization of novel diagnostic products.

Subsidiaries

Keddem Bioscience Ltd.

In 1999, we formed a chemistry division that focused on substantially increasing the predictability and success rates of small molecule drug discovery. On August 1, 2004, we turned our chemistry division into a wholly-owned subsidiary, Keddem Bioscience. For more information on Keddem Bioscience, see Item 7. “Major Shareholders and Related Party Transactions; Related Party Transactions. Keddem Bioscience Ltd.”.

Keddem Bioscience is a drug discovery company that aims to improve the success rate for the discovery of new drug products by developing and applying a technology platform that consistently enables the design of small molecules which can potentially modulate a given protein target. Keddem's method does not rely on protein structure information or high-throughput screening of very large compound libraries.

Identifying a lead chemical for a potential target is a long, arduous and expensive undertaking, considered by many to be the principal bottleneck in small molecule drug discovery. Common methods for finding such small molecules, typically involving high-throughput screening of drug like compounds, have low success rates and often fail to find any candidate compound for a given target.

Keddem Bioscience’s approach is based on the proposed creation of a comprehensive, yet relatively small set of approximately 70,000 carefully designed molecules and a set of algorithms. Keddem Bioscience intends to synthesize this set of molecules and then use it in a screening process, in which the activity of drug targets will be tested against the screening library molecules. Keddem Bioscience’s ability to implement its intention to synthesize a set of approximately 70,000 molecules will depend on the availability to it of all the necessary resources, including funding. The design of Keddem’s set of molecules is aimed at obtaining information that, when analyzed by its proprietary algorithms, will provide accurate and comprehensive three-dimensional information about a drug target’s active site. Keddem believes that this information can then be used to design a variety of potent inhibitors satisfying desired drug-like

properties. Keddem's approach is unique in that it is designed to generate information relating to a protein's active sites, sufficient to enable the design of small molecules drug candidates. It does not seek to discover among its screening set lead molecules, which are molecules that react with protein targets and that may be optimized to generate a therapeutic effect.

The continuation of Keddem Bioscience's operations depends on raising additional capital in order to continue its operations. Keddem Bioscience's external auditors have raised substantial doubts on Keddem Bioscience's ability to continue as a going concern.

Evogene Ltd.

In 1999, we formed a division focusing on agricultural biotechnology and plant genomics. On January 1, 2002, we turned the business of this division into a majority-owned subsidiary, Evogene Ltd. As of December 31, 2005, we held approximately 84.7% of Evogene's issued and outstanding share capital, but only 23.36% of Evogene's share capital, on a fully-diluted basis. Following our grant of irrevocable proxies to certain investors in Evogene, those investors were empowered to vote, in a manner determined in their discretion, with approximately 50% of our holdings in Evogene, as existed at the date of grant of such proxy. As a result, in 2005, we had the power to vote 34.89% of Evogene's share capital. For more information on our holdings in Evogene, see Item 7. "Major Shareholders and Related Party Transactions; Related Party Transactions; Evogene Ltd."

In February 2006, Evogene completed a financing round with certain investors, under which, among other things, it received $7 million dollars and those of its investors who until that date were creditors of Evogene under various convertible loan agreements, converted their loans into shares. The round of investment included $2 million dollars that Evogene received in January 2005 by way of a convertible bridge loan. We did not participate in the investment in Evogene under this most recent financing round. As a result, as of February 16, 2006, we own approximately 14.76% of Evogene's issued and outstanding capital.

Evogene is a crop genetics company, focused on the development of improved traits in commercially important plants through gene discovery, genome remodeling and advanced classical breeding techniques. Evogene's current product development efforts are focused on enhanced fiber in cotton, abiotic stress tolerance and nitrogen use efficiency in various crops, and a unique plant platform for the production of therapeutic proteins. For more information, see below "Organizational Structure" in this Item 4 and Item 7. "Major Shareholders and Related Party Transactions; Related Party Transactions; Evogene Ltd."

Sales, Marketing and Business Development

Since our incorporation in 1993, we devoted most of our capital and human resources to research and development of our technologies, discoveries, products and services. Since 2003 we moved away from commercializing our software tools and software products and began concentrating our efforts on our in-house discovery activities and commercializing those discoveries. In connection with this shift in strategy, we reduced the number of our marketing, sales and business development staff from 19 employees in 2002 to five employees by the end of 2005.

The approximate geographical breakdown of our revenues for the year ended December 31, 2005 was 65% in North America, 34% in Europe and less than one percent in other countries. The approximate geographical breakdown of our revenues for the year ended December 31, 2004 was 40% in North America, 48% in Europe, 10% in the Far East and 2% in other countries. The approximate geographical breakdown of our revenues for the year ended December 31, 2003 was 66% in North America, 31% in Europe, 1% in the Far East and 2% in other countries.

In the US, we have business development presence in San Jose, California and in Rockville, Maryland.

Seasonality; Raw Materials

Seasonality does not affect our main business; our business generally does not fluctuate based solely on the time of year.

We use a large range of raw materials in our research. Our research and discovery unit uses bioinformatics databases such as databases of ESTs, which are short nucleotide sequences that code for the expression of partial mRNA, gene expression databases, including from microarrays, protein interaction pathway databases and databases that match drugs with their respective targets. Our therapeutic unit uses a large range of biological reagents such as cell growth media, enzymes, antibodies and chromatographic resins. Our diagnostic unit also uses biological reagents, which include human tissue samples, cell lines and certain enzymes. These raw materials are either freely available or easily available to us or to our customers at reasonable prices.

We rely on the quality and integrity of the raw materials that we use. We have encountered circumstances in which tissue samples that we acquired were found to be of poor quality. Such circumstances may delay and even interfere with our discovery and development efforts.

Intellectual Property Rights

Our intellectual property assets are among our principal assets. These assets include the intellectual property rights subsisting in our proprietary know-how and trade secrets, the copyrights subsisting in our software and related documentation and in our patents and patent applications. We seek to vigorously protect our rights and interests in our intellectual property. We expect that our commercial success will depend on, among other things, our ability to obtain commercially valuable patents especially for our therapeutic and diagnostic product candidates, maintain the confidentiality of our proprietary know-how and trade secrets and otherwise protect our intellectual property.

We seek patent protection for inventions that relate to our therapeutic and diagnostic potential product candidates as well as certain components of our technology platforms. We currently have 7 registered patents of which 6 are registered in the United States and 1 is registered in Australia. We also have 117 pending patent applications, which include 60 patent applications that have been filed in the United States and applications that have been filed under the Patent Cooperation Treaty for which we have not yet designated the countries of filing. We intend to continue to apply for patent protection for our therapeutic and diagnostic inventions, including for related inventions such as antibodies and peptides.

We also seek protection for our proprietary know-how and trade secrets that are not protectable or protected by patents, by way of safeguarding them against unauthorized disclosure. This is done through the extensive use of confidentiality agreements and assignment agreements with our employees and third parties as well as by technological means. We use license agreements both to access third party technologies and to grant licenses to third parties to exploit our intellectual property rights.

Competition

The biotechnology and pharmaceutical industries are highly competitive. Numerous entities in the United States and elsewhere compete with our efforts to commercialize our discoveries. Our competitors include pharmaceutical, biotechnology and diagnostic companies, academic and research institutions and governmental and other publicly funded agencies.

Many of our competitors are more established, benefit from greater market recognition and have greater financial, technical, human, research and development and marketing resources, as well as facilities and experience, than we do. These competitors may discover and develop product candidates, or market and sell products based on their discoveries, in advance of us or our collaborators and licensees. They may also obtain patent protection or other intellectual property rights that could limit or prevent us from pursuing the development and commercialization of our discoveries. This prospect is particularly pertinent to us since our discovery engines and related technologies are aimed at identifying, among other discoveries, novel

alternatively spliced variants of genes that are the basis of third parties' respective gene-based therapeutic or diagnostic products. We have already encountered circumstances where third parties attained intellectual property rights in their respective therapeutic or diagnostic products that preceded and interfered with the rights that we obtained. We expect to encounter similar such circumstances in relation to other therapeutic or diagnostic product candidates that we may wish to develop.

The human genomic pool is finite. To our knowledge, third parties, including our competitors, have been filing wide patent applications covering an increasing portion of the human genomic pool. We believe that our ability to continue and extract or use new information through EST-based methods is already limited compared to our ability two and three years ago respectively. This limitation results from, among other things, the existence of third parties' intellectual property rights subsisting in genomic based discoveries, which precede our rights.

Our discovery program depends, in large part, on our discovery engines and other technologies and our proprietary data to make inventions and establish intellectual property rights in genes and gene-based products, including mRNAs, proteins and peptides. There are a number of other means by which such inventions and intellectual property can be generated. We believe that our computational technologies, and specifically our LEADS-based discovery engines, provide us with a competitive advantage in the field of predicting gene based products, and occasionally gain some information on their biological importance. We believe that this advantage is made possible by the incorporation of ideas and methods from mathematics and computer science into biology, and by the modeling of significant biological phenomena and the resultant better research capabilities that we developed. Nevertheless, we may lose this advantage if our existing or future competitors make scientific and technological progress. In addition, we may discover and pursue the development of therapeutic or diagnostic product candidates that could conflict with our collaborators' discovery and development plans, including licensees or collaborators to whom we granted in the past a license to use our LEADS computational platform. The prospect of such a conflict arising is particularly pertinent in relation to those collaborators and licensees that received from us a license to use our LEADS computational platform to analyze raw data which is the same or similar to the raw data that we may analyze through LEADS.

We face, and expect to continue to face, competition from entities that discover and develop products that have a function similar or identical to the function of our therapeutic and diagnostic product candidates. In respect of our diagnostic product candidates, we potentially face competition from any company to the extent that it discovers or develops in-vitro based diagnostic products, and especially, if its products are aimed at diagnosing cancers and cardiovascular diseases. These companies include companies such as Roche, Abbott and Bayer as well as Corixa Corporation, diaDexus, Inc., and Celera Diagnostics. In respect of our therapeutic product candidates, our potential competitors comprise companies that develop or commercialize therapeutic protein or peptides such as Amgen, Inc., Weyth Pharmaceuticals, Inc., Genentech, Inc., Xencor, Inc. and Zymogenetics, Inc.

Government Regulation

Environmental Regulation

Some of our research and development activities involve the controlled use of biological and chemical materials, a small amount of which could be considered to be hazardous. We also have the facilities for safe use and handling of radioactive materials, although these facilities are currently not in use. We are subject to Israeli laws and regulations governing the use, storage, handling and disposal of all these materials and resulting waste products. We store relatively small amounts of biological and chemical materials. To our knowledge, we substantially comply with these laws and regulations. However, the risk of accidental contamination or injury from these materials cannot be entirely eliminated. In the event of an accident, we could be held liable for any resulting damages, and any liability could exceed our resources.

Regulation of Use of Human Tissue

We need to access and use various human or other organisms' tissue samples for the purpose of development of some of our products. Our access and use of these samples is subject to government regulation, in the US, Israel and elsewhere and may become subject to further regulation. US and other governmental agencies may also impose restrictions on the use of data derived from human or other tissue samples. To our knowledge, we substantially comply with these regulatory requirements.

Regulation of Products Developed with the Support of Research and Development Grants

For a discussion of regulations governing products developed with research and development grants from the Government of Israel, see "Item 5. Operating and Financial Review and Prospects; Research and Development, Patents and Licenses; Israeli Government Research and Development Programs."

Organizational Structure

We are the parent of two wholly-owned subsidiaries, Compugen USA, Inc., which is a corporation incorporated in Delaware and has its principal place of business in California, and Keddem Bioscience Ltd., which is a company incorporated in Israel and has its principal place of business in Ashqelon, Israel.

As of December 31, 2005, we also held approximately 84.7% of the outstanding share capital of Evogene Ltd., but only 23.36% of its share capital, on a fully-diluted basis. As of December 31, 2005, we had the power to vote 34.89% of Evogene's share capital, due to our granting of irrevocable proxies to a group of Evogene's investors. The proxies entitled their respective proxy holders to vote in a manner that they determined in their discretion. For more information on Evogene, see Item 7. "Major Shareholders and Related Party Transactions; Related Party Transactions; Evogene Ltd." As of February 16, 2006, Evogene completed a series of agreements with certain investors, under which it raised $7 million dollars and, as a result, we held approximately 14.76% of Evogene Ltd.'s issued share capitaland the power to vote approximately 14.76% of Evogene's share capital. Evogene is not consolidated into our consolidated financial statements for the year 2005. For an explanation of our reason for not consolidating Evogene into our financial statement, see Item 5. "Operating And Financial Review And Prospects;" "Critical Accounting Policies;" "Investment in Evogene Ltd." Evogene was formed under the laws of the State of Israel and has its principal place of business in Rehovot, Israel.

Property, Plant and Equipment

We lease an aggregate of approximately 28,200 square feet of office and biology laboratory facilities in Tel Aviv, Israel. The leases in Tel Aviv expire in December 2009.

Keddem Bioscience leases approximately 7,750 square feet of office and biology laboratory facilities in Ashqelon, Israel. The lease in Ashqelon expires on August 31, 2011, and Keddem Bioscience is entitled to terminate it effective on anniversary of the lease.

In addition, Compugen USA leases approximately 406 square feet of office space in San Jose, California which expires on May 30, 2006, and we have an option to extend it for one additional year. During 2005 Compugen USA also leased approximately 145 square feet in Rockville, Maryland. The term of our lease in Maryland expired in January 2006.

We believe that the facilities that we currently lease are sufficient for approximately the next 12 months.

There are no encumbrances on our rights in these leased properties or on any of the equipment that we own.

To our knowledge, there are no environmental issues that affect our use of the properties that we lease.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The following discussion of our critical accounting policies and our financial condition and operating results should be read in conjunction with our consolidated financial statements and related notes, prepared in accordance with US GAAP for the years ended December 31, 2005, 2004 and 2003 respectively, and with any other selected financial data included elsewhere in this annual report.

Background

We are a biotechnology discovery company focused on therapeutic and diagnostic product candidates. The Company's powerful predictive models and discovery engines enable the discovery of numerous potential therapeutics and diagnostic biomarkers. This capability results from the Company's pioneering and on-going incorporation of ideas and methods from mathematics, computer science, and physics into biology, chemistry and medicine. To date, our discovery efforts have focused mainly on cancer, cardiovascular and immune-related diseases. Product development is pursued both in-house and through collaborative arrangements. The Company's primary business goal is to out-license therapeutic and diagnostic product candidates for commercialization by leading companies under milestone and revenue sharing agreements.

During 2003 to 2005 our primary business activities evolved from using our intellectual property, scientific know-how and computational biology capabilities to develop, market and sell to third parties life science software products and services, to using these assets and capabilities for the in-house discovery of therapeutic and diagnostic product candidates.

We carry out our research activities through three units, which is designed to enable us to continue to focus on the discovery, validation and commercialization of our therapeutic and diagnostic biomarker product candidates. These three units consist of a therapeutics unit, a diagnostic biomarkers unit, and a research and discovery unit. These units are serviced and supported by our other units, which include finance, legal and business development units.

We develop technological platforms, discovery engines and other related technologies that enable the discovery and analysis of genes and gene-based products, including transcripts and proteins. These include our discovery engines, such as our therapeutic protein discovery engine and our diagnostic biomarkers discovery engines.

Our discovery engines are proprietary technologies that are designed to enable our researchers to identify proteins and transcripts that are suitable for the development of therapeutic and/or diagnostic product candidates. Our discovery engines extend the capabilities of our LEADS platform by incorporating sophisticated search and analysis algorithms to select the most promising therapeutic proteins and diagnostic biomarkers in a specific category or area of interest, from the many proteins identified by our technologies.

By using these discovery engines and related technologies, we have discovered novel molecules that may be suitable for developing therapeutic and diagnostic product candidates respectively. Based on our belief in the capabilities of our discovery engines and related technologies, it is our intention to continue our efforts in the selection of additional therapeutic and diagnostic biomarkers product candidates. We have an early stage in-house project for the discovery and early stage development of selected potential therapeutic and diagnostic product candidates. Going forward, we plan to continually develop and enhance our internal capabilities of discovering therapeutic and diagnostics product candidates. We intend to continue to pursue licensing arrangements and collaboration agreements with leading biotechnology, diagnostic and pharmaceutical companies, for the development and commercialization of product candidates that we discover through the use of our discovery engines and related technologies.

OPERATING RESULTS

Overview

We have incurred losses and our revenues are likely to decrease in the next few years.

Since our inception, we have incurred significant losses and, as of December 31, 2005, we had an accumulated deficit of $94.8 million (not including approximately $24.9 million in accumulated deficit attributable to the conversion of preferred shares upon the closing of our initial public offering). We expect to continue to incur net losses in the near future.

Prior to 2004, an important aspect of our commercialization activities involved the sale of hardware and software platforms, tools and databases, in which we incorporated certain aspects of our understandings and/or discoveries and made them available to our customers. For example, in 2004, our revenues were primarily attributable to the commercialization of our LEADS platform, Genecarta and OligoLibraries. The commercialization of these products is no longer pursued.

We now intend to commercialize the therapeutic and diagnostic product candidates that we discover by applying our intellectual property, scientific know-how and computational biology capabilities, including our discovery engines. To date, discoveries that we have generated from use of our discovery engines and related technologies have formed the basis of our collaborations with Diagnostic Products Corporation, Ortho-Clinical Diagnostics and Biosite. We continue to evaluate various opportunities for additional collaborations based on use of our discovery engines. We intend to continue to focus on the licensing out of our novel therapeutic and diagnostic product candidates, which we discovered and intend to continue to discover internally or with our collaborators. We intend that such licensing-out arrangements will be with pharmaceutical, biotechnology and diagnostics companies, who will develop and commercialize therapeutic or diagnostic products based on our discoveries. We intend that under these commercial arrangements we will receive milestone payments upon the successful completion of predetermined developmental stages and royalties from the sales of the therapeutic or diagnostics products, based on our discoveries.

During 2006 and beyond, we intend to continue in our efforts to enter into royalty and milestones bearing agreements with our prospective collaborators and licensees. We intend that the basis of these agreements will continue to be the licensing out of our intellectual property rights subsisting in our therapeutic and diagnostic product candidates generated from use of our discovery engines and related technologies.

We believe that the greatest long term and sustainable financial potential for us lies in the commercialization of specific therapeutic and diagnostic biomarker product candidates. For the purpose of attaining this goal, we have shifted our focus away from commercializing our computational platforms and tools (such as Genecarta and OligoLibraries), all of which yielded revenues in the short term. We believe that the commercialization of our therapeutic and diagnostic product candidates has the potential to generate revenues, in the long term, to a substantially greater extent than the long-term potential revenue-stream that could be generated from commercializing our hardware and software platforms, tools and databases.

Since we shifted focus away from commercializing our computationally-based products to the internal use of our capabilities, our revenues, decreased by approximately 75% in 2005, compared to 2004 and by approximately 61% in 2004 compared to 2003.

Our net research and development expenses are expected to account for more than 60% of our total operating expenses.

Our net research and development expenses are expected to be our major operating expense in 2006, accounting for more than 60% of our total 2006 operating expenses. Our research and development expenses have always comprised a significant portion of our expenses. In 2004 and 2005 we increased the

resources allocated to advance our internal therapeutic and diagnostic biomarkers pipeline.

Previously, we presented governmental and other grants as a component of our revenues and grants, based on the single step income statement presentation approach. These amounts have been reclassified for all periods presented and are now shown as a deduction from research and development expenses.

We base our budget and operating expenses on our cash flow.

We base our budget and operating expenses on our cash flow. For a detailed description of our cash and cash equivalents position, see "Liquidity and Capital Resources" in this Item 5.

Compensation expenses attributed to option grants.

We recorded compensation expenses of approximately $1.1 million in 2003, approximately $755,000 in 2004, and approximately $378,000 in 2005, in connection with the grant of share options. These expenses are mostly attributable to options that we granted to our consultants and to those of our employees and directors to whom we granted employee stock options at an exercise price below the fair market value at the date of grant. These amounts are amortized over the vesting periods of the individual share options. Based on options granted through December 31, 2005, and based on our ordinary share price on that date, we estimated that our future amortization of compensation expenses will be approximately $1.2 million in 2006 and approximately $550,000 in 2007. Since January 2006, new accounting standard FAS 123R applies. Standard FAS 123R determines the accounting treatment for share-based compensation to employees. The above future amortization of compensation expense estimates for 2006 and 2007 reflect the application of this standard. These estimates are subject to the amount of granted options at any given point in time. Our current policy is to grant options at the higher of the fair market value known on the date of grant or the average of our share price during the thirty trading days preceding the date of grant.

Impact of Inflation and a Devaluation of the Dollar against the New Israel Shekel

We hold most of our cash, cash equivalents and marketable securities in US dollars but incur a significant portion of our expenses, principally salaries and related personnel expenses, in New Israel Shekels. As a result, we are exposed to the risk that the US dollar will be devalued against the New Israel Shekels. In addition, we are exposed to the risk that the rate of inflation in Israel will exceed the rate of devaluation of the New Israel Shekels in relation to the US dollar or that the timing of this devaluation will lag inflation in Israel. Since a significant portion of our expenses are salaries and related expenses, which are paid in New Israel Shekels, this is a small risk. To date, our business has not been materially adversely affected by changes in the Israeli rate of inflation or the exchange rates of the NIS compared to the US dollar.

Critical Accounting Policies

The preparation of our consolidated financial statements and other financial information appearing in this annual report requires our management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We evaluate on an on-going basis these estimates, mainly related to revenues, allowance for doubtful debts, contingencies, and investment in affiliates.

We base our estimates on our experience and on various assumptions that we believe are reasonable under the circumstances. The results of our estimates form the basis for our management's judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Revenue Recognition

During 2003, 2004 and 2005 we generated most of our revenues from license fees related to the commercialization of our software products. We also generated revenues from the sale of services,

including from the provisions of maintenance, support, customization, training and installation services, and also from the sale of products (such as our OligoLibraries products).

We recognized revenues from collaboration arrangements in accordance with Statement of Position 81-1 "Accounting for Performance of Construction - Type and Certain Production - Type Contracts" ("SOP 81-1"). The reason for using this Statement of Position is that the various elements of our collaboration arrangements are deemed to be inseparable portions of an overall solution. We believe that revenues that we generated from our collaborations under which we commercialized our software products should be recognized in accordance with the development plan of each specific collaboration, using contract accounting on a percentage of completion method – the input measure prescribed in SOP 81-1. As a result, revenues that we generated from these collaboration arrangements were recognized in accordance with our estimate regarding the status of the collaborative project. Any revisions to estimates of the status of a project (and the consequent recognizable revenues) are recorded in the period during which we become aware of these changes. If we do not accurately estimate the resources required for or the scope of work to be performed under each such collaboration arrangement, or do not manage our projects properly within the planned periods of time or satisfy obligations under the contracts, then the service margins may be significantly and negatively affected or losses on existing contracts may have to be recognized. We periodically check the possibility of losses from collaboration arrangements, which should be recognized immediately, in accordance with our projections. During 2005, no provision for losses was required.

We recognized software license revenues in accordance with Statement of Position 97-2, "Software Revenue Recognition" ("SOP 97-2") as amended. We recognized revenues when both parties sign an agreement or other persuasive evidence of an arrangement exists, when the software has been shipped or electronically delivered, when the fees are fixed or determinable, and when collection of the resulting receivable is probable, and no other significant obligations remain. For multiple element arrangements, where vendor-specific objective evidence of fair value exists for all undelivered elements, we account for the delivered elements in accordance with the "residual method" prescribed by Statement of Position 98-9, "Modification of SOP 97-2, Software Revenue Recognition with Respect to Certain Transactions" ("SOP 98-9"). Vendor-specific objective evidence of fair value is based on the price a customer is required to pay when the element is sold separately. We assess whether the fee is fixed or determinable and collection is probable at the time of the transaction. In assessing whether the fee is fixed or determinable, we analyze the payment terms of the transaction and other factors, including the nature and class of customer, our historical experience of collecting under our payment terms without granting a concession, the possibility of the product becoming technologically obsolete before the payments become due and the likelihood of the customer asking for a refund. If we determine the fee is not fixed or determinable, we defer the revenue until the payments under the arrangement become due. We assess whether collection is probable based on a number of factors, including the customer's past transaction history and credit worthiness. If we determine that collection of a fee is not probable, we defer the fee and recognize revenue only at the time that collection becomes probable, which is generally upon the receipt of cash.

We recognized revenues from product sales in accordance with SAB 104 "Revenue Recognition" when shipment has occurred, persuasive evidence of an arrangement exists, the vendor's fee is fixed or determinable, no future obligations exist and collection is probable. We generally do not grant rights of return. Determination of the probability of collection is based on management's judgments regarding the payment of fees for services rendered and products delivered. Should changes in conditions cause management to determine that this criteria is not met for certain future transactions, revenue recognized for any reporting period could be adversely affected.

Revenue from maintenance contracts is recognized ratably over the term of the maintenance contract. Revenues related to other services are recognized as the services are rendered.

Contingencies

We periodically estimate the impact of various conditions, situations and/or circumstances involving uncertain outcomes to our financial condition and operating results. These events are called "contingencies", and the accounting treatment for such events is prescribed by the Statement of Financial

Accounting Standards No. 5, "Accounting for Contingencies" ("SFAS No. 5"). SFAS No. 5 defines a contingency as "an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur". Legal proceedings are a form of such contingencies.

We are not currently involved in any legal proceedings and are not required to assess the likelihood of any specific adverse judgments or outcomes of such proceedings or of any potential ranges of probable losses. A determination of the amount of any accruals, if required, for these contingencies would be made after careful analysis. We believe that as of December 31, 2005, the status of legal proceedings will not have a material impact on our financial condition, results of operations or cash flows. For more information in relation to legal proceedings, see "Item 8. Financial Information; Consolidated Statements and Other Financial Information; Legal Proceedings." It is possible, however, that future results of operations for any particular quarter or annual period could be materially affected by changes in our assumptions or as a result of the effectiveness of our strategies related to these legal proceedings.

Investment in Evogene Ltd.

In accounting for our investment in Evogene, we adopted FIN 46 on July 1, 2003. Under FIN 46, we determined that Evogene qualified as a Variable Interest Entity, an entity which has one of the following: (1) an insufficient amount of equity to carry on its principal operations, without additional subordinated financial support from other parties, (2) a group of equity owners that are unable to make decisions about the entity's activities, or (3) equity that does not absorb the entity's losses or receive the benefits of the entity.

FIN 46 requires consideration and estimates of a significant number of possible future outcomes of the Variable Interest Entity as well as the probability that each of the outcomes will occur. The results of each possible outcome are allocated to the parties holding interests in the Variable Interest Entity. Based on the allocation of possible outcomes, a calculation is performed to determine which party, if any, has a majority of potential negative outcomes (expected losses) or a majority of the potential positive outcomes (expected residual returns). That party, if any, is the Variable Interest Entity's primary beneficiary and is required to consolidate the Variable Interest Entity. Calculating the expected losses and expected residual returns is highly subjective and requires the use of significant estimates.

We have examined the potential future results of Evogene, assigning probabilities to each potential outcome, and allocated these potential outcomes to the Variable Interest Entity's variable interest holders. We have determined that we are not the primary beneficiary of Evogene, since we do not absorb the majority of the entity's expected losses or its expected residual returns. In 2005, we had the power to vote approximately 34.89% of Evogene's share capital due to our granting irrevocable proxies to a group of Evogene's investors with respect to most of our shares in Evogene. As of February 16, 2006, following a series of agreements that Evogene completed with certain investors, we held approximately 14.76% of the issued share capital of Evogene Ltd. and the power to vote approximately 14.76% of Evogene's share capital. For more information about our voting power in Evogene, see "Item 7. Major Shareholders and Related Party Transactions; Related Party Transactions; Evogene Ltd."

Under FIN 46, the reconsideration of a Variable Interest Entity's primary beneficiary status requires a triggering event, such as any of the following: (1) the entity's governing documents or contractual arrangement among the parties have been changed, (2) sales of part of the variable interests to unrelated parties, (3) acquirement of newly issued variable interest in the entity or a portion of the primary beneficiary's interest, or (4) decrease in assets due to losses incurred by the Variable Interest Entity. In 2005, we again evaluated FIN 46 following the consummation of an amended and restated convertible loan agreement in January 2005, between Evogene and certain investors. For more information on this transaction, see "Item 7. Major Shareholders and Related Party Transactions." Our conclusion from this evaluation is that we are still not the primary beneficiary of Evogene.

Results of Operations

Selected Financial Data

The following discussion and analysis is based on and should be read in connection with our audited consolidated financial statements, including the related notes, contained in "Item 18 – Financial Statements" and the other financial information appearing elsewhere in this annual report.

	Year ended December 31				
	2001*	**2002***	**2003***	**2004***	**2005**
	(US$ in thousands, except share and per share data)				
Consolidated Statements of Operations Data					
Revenues	$ 10,366	$ 9,262	$ 6,776	$ 2,630	$ 646
Cost of revenues	3,455	2,819	2,275	1,100	148
Research and development expenses	15,976	14,170	13,306	12,318	12,725
Less - governmental and other grants *	(994)	(1,835)	(2,050)	(1,397)	(2,254)
Research and development expenses, net *	14,982	12,335	11,256	10,921	10,471
Selling and marketing expenses	6,565	5,538	3,811	2,446	1,772
General and administrative expenses	4,383	3,614	3,650	3,740	3,133
Total operating expenses **	29,385	24,306	20,992	18,207	15,524
Operating loss	(19,019)	(15,044)	(14,216)	(15,577)	(14,878)
Financial and other income, net	3,875	2,840	2,774	1,855	900
Net loss	$ (15,144)	$ (12,204)	$ (11,442)	$ (13,722)	$ (13,978)
Net loss available to ordinary shares	(15,144)	(12,204)	(11,442)	(13,722)	(13,978)
Basic and diluted net loss per ordinary share	$ (0.58)	$ (0.47)	$ (0.43)	$ (0.50)	$ (0.50)
Weighted average number of ordinary shares used in computing basic and diluted net loss per share	26,005,784	26,103,343	26,409,180	27,473,341	27,774,535

	As of December 31,				
	2001*	2002*	2003*	2004*	2005
	(US$ in thousands)				
Consolidated Balance Sheet Data:					
Cash and cash equivalents, short-term deposits, marketable securities and cash held in favor of consortium partners	$32,347	$48,402	$16,707	$20,574	$31,821
Long-term investments in marketable securities and bank deposits	46,148	18,940	43,803	27,854	4,983
Receivables, net	3,163	4,601	1,456	1,545	676
Inventory	134	111	—	—	—
Total assets	87,289	77,257	67,526	55,353	42,106
Accumulated deficit	(68,388)	(80,592)	(92,034)	(105,756)	(119,734)
Total shareholders' equity	80,062	68,881	59,808	49,566	36,248

(*) Reclassified - previously, we presented governmental and other grants as a component of our revenues and grants, based on the single step income statement presentation approach. These amounts have been reclassified for all periods presented and are now shown as a deduction from research and development expenses.

(**) Includes deferred stock compensation – see Note 11 of our 2005 consolidated financial statements.

Years Ended December 31, 2005 and 2004

Revenues.

Previously, we presented governmental and other grants as a component of our revenues and grants, based on the single step income statement presentation approach. These amounts have been reclassified for all periods presented and are now shown as a deduction from research and development expenses. Governmental and other grants for 2005 and 2004 were approximately $2.3 million and $1.4 million, respectively.

Revenues decreased by 75% to approximately $646,000 in 2005 from approximately $2.6 million in 2004. The decrease in revenues was primarily due to decreased sales of LEADS and Oligolibraries. The decrease in the sales of these products is attributable to the shift in focus away from commercializing our computational products in favor of generating long-term revenues from commercializing the therapeutic and diagnostic product candidates that we discover and may initially develop. Revenues from Novartis and Abbott represented 97% of our revenues in 2005. Our agreement with Abbott expired in 2005.

Cost of Revenues. Cost of revenues decreased by 86.5% to approximately $148,000 for 2005 from approximately $1.1 million for 2004. This decrease was primarily due to decreased costs related to the sale of our OligoLibraries and LEADS products.

Research and Development Expenses, Net. Research and development expenses, net decreased by 4%, to approximately $10.5 million for 2005 from approximately $10.9 million for 2004. The decrease in our research and development expenses, net, was primarily due to an increase in governmental and other research and development grants that we received. Research and development expenses, net, as a percentage of revenues, increased from 415% in 2004 to 1,621% in 2005.

Selling and Marketing Expenses. Selling and marketing expenses decreased by 28% to approximately $1.8 million for 2005 from approximately $2.4 million for 2004. This decrease was due to our decision to

decrease our marketing and sales efforts for our computational products and related services. Selling and marketing expenses, as a percentage of revenues, increased from 93% in 2004 to 274% in 2005.

General and Administrative Expenses. General and administrative expenses decreased by 16% to approximately $3.1 million for 2005 from approximately $3.7 million for 2004. This decrease was primarily due to the closing of our offices in New Jersey. General and administrative expenses, as a percentage of revenues, increased from 142% for 2004 to 485% in 2005.

Financial Income, Net. Financial income, net, decreased by 52% to approximately $682,000 for 2005 from approximately $1.4 million for 2004. This decrease was attributable to manner in which we earned interest on three structured notes, at par value totaling $14 million. Whether or not these structured notes bear interest depends upon the rate for six-months LIBOR. For each day on which the six-month dollar LIBOR is below an agreed annual fixed rate, the investments bear coupon interest at the rate of 3.15%, 3.625% and 4.1% per annum respectively. For each day on which the six-month dollar LIBOR is above an agreed annual fixed rate, the investments, do not bear interest at all. The decrease was also attributable to lower levels of cash and cash related accounts. Financial income, net, as a percentage of revenues increased from 54% for 2004 to 106% for 2005.

Years Ended December 31, 2004 and 2003

Revenues. Revenues decreased by 61% to approximately $2.6 million in 2004 from approximately $6.8 million in 2003. The decrease in revenues was primarily due to decreased sales of LEADS, Genecarta, and Oligolibraries. The decrease in sales of these products is attributable to the shift in focus away from commercializing our computational products in favor of generating long-term revenues from commercializing the therapeutic and diagnostic product candidates that we discover and develop. Revenues from Novartis and Sigma-Genosys represented 61% of our revenues in 2004. Our agreement with Sigma-Genosys terminated in 2004.

Cost of Revenues. Cost of revenues decreased by 52% to approximately $1.1 million for 2004 from approximately $2.3 million for 2003. This decrease was primarily due to decreased costs related to the sale of LEADS, Genecarta and OligoLibraries.

Research and Development Expenses, net. Research and development expenses, net decreased by 3% to approximately $10.9 million for 2004 from approximately $11.3 million for 2003. The decrease in research and development expenses, net was primarily due to decrease in cost of salaries due to a reduction of employees, and decrease of depreciation expenses. Research and development expenses, net, as a percentage of revenues increased from 166% in 2003 to 415% in 2004.

Selling and Marketing Expenses. Selling and marketing expenses decreased by 36% to approximately $2.5 million for 2004 from approximately $3.8 million for 2003. This decrease was due to our decision to decrease our marketing and sales efforts for some of our existing hardware and software products and related services. Selling and marketing expenses, as a percentage of revenues increased from 56% in 2003 to 93% in 2004.

General and Administrative Expenses. General and administrative expenses increased by 2% to approximately $3.7 million for 2004 from approximately $3.65 million for 2003. This increase was primarily due to an increase in our CEO's salary, and to the costs associated with the closing of our offices in New Jersey. General and administrative expenses, as a percentage of revenues, increased from 54% for 2003 to 142% in 2004.

Financial Income, Net. Financial income, net, decreased by 33% to approximately $1.4 million for 2004 from approximately $2.1 million for 2003. This decrease was attributable to lower levels of cash and cash related accounts, and lower interest rates we received on short and long-term marketable securities., Financial income, net, as a percentage of revenues, increased from 31% for 2003 to 54% for 2004.

Governmental Policies that Materially Affected or Could Materially Affect Our Operations

Israeli companies are generally subject to income tax at the corporate tax rate of 31%, which is expected to be reduced to 29% in January 2007, and is expected to be further reduced to 27% in 2008 to 26% in 2009 and to 25% in 2010 and thereafter. However, several investment programs at our facility in Tel Aviv have been granted Approved Enterprise status under which we are eligible for a reduced corporate tax under the Law for the Encouragement of Capital Investments, 1959. Subject to compliance with applicable requirements, the portion of our profits that may be derived from the approved enterprise programs will be tax-exempt for a period of two years commencing in the first year in which we generate taxable income from the applicable Approved Enterprise. The portion of our profits that may be derived from our approved enterprise programs will be subject, for an additional period of five or eight years, to reduced corporate tax rates of between 10% and 25%. The tax rate within the range of 10% and 25% that may actually become payable is a function of the percentage of non-Israeli investors holding our ordinary shares .These reduced corporate tax rates will cease to apply upon the expiry of the earlier of twelve years from the time at which we attain a prescribed level of investment in our approved enterprise (known as "commencement of production") or 14 years from the date on which we received approval for an Approved Enterprise. The period of tax benefits with respect to our approved enterprise programs has not yet commenced, because we have not yet generated any taxable income. These benefits should result in income recognized by us being tax exempt or taxed at a lower rate for a specified period of time after we begin to report taxable income and exhaust any net operating loss carry-forwards. However, these benefits may not be applied to reduce the US federal tax rate for any income that our US subsidiary may generate. There can be no assurance that such tax benefits will continue in the future at their current levels, if at all.

As of December 31, 2005, we did not have any taxable income. As of December 31, 2005, our net operating loss carry-forwards for Israeli tax purposes amounted to approximately $62 million. Under Israeli law, these net-operating losses may be carried forward indefinitely and offset against certain future taxable income.

Until December 31, 2005, the net operating loss carry-forwards of our US subsidiary for US tax purposes amounted to approximately $15 million. These losses are available to offset any future US taxable income of our US subsidiary and will expire between the years 2012 and 2024.

Use of our US net operating losses may be subject to substantial annual limitation due to the "change in ownership" provisions of the Internal Revenue Code of 1986 and similar state provisions. The annual limitation may result in the expiration of net operating losses before utilization.

For a description of Israel government policies that affect our research and development expenses, and the financing of our research and development, see "Research and Development, Patents and Licenses; Research and Development Grants" in this Item 5 below.

LIQUIDITY AND CAPITAL RESOURCES

In 2005, as in 2004 and 2003, our sources of cash came from a private placement that took place in July 2000, from our IPO, which took place in August 2000, from revenues generated from sales, from governmental and other grants, receipts from the exercise of employee stock options, and from financing income. We used these funds primarily to finance our business operations.

Equity Financing

From our inception until the initial public offering of our ordinary shares in August 2000, we obtained financing primarily through private placements of equity securities, and, to a lesser extent, governmental and other grants and loans. Financing activities from private placements of preferred and ordinary shares, net of issuance costs, provided cash of approximately $14.8 million in 1998, approximately $19,000 in 1999 and approximately $35.5 million in 2000.

In August 2000, we sold 5,000,000 of our ordinary shares in the initial public offering of our shares on the Nasdaq National Market, and in September 2000, we sold an additional 750,000 ordinary shares upon the exercise by our underwriters of their over-allotment option. Our aggregate proceeds from these sales were $57.5 million ($51.1 million net of issuance expenses). All outstanding preferred shares were converted into ordinary shares upon the closing of the initial public offering.

We expect that we will need additional financing in the future to fund our activities.

Net Cash Used in Operating Activities

Net cash used in operating activities was approximately $5.6 million in 2003, approximately $12.2 million in 2004, and approximately $11.1 million in 2005. These amounts were used to fund our net losses for these periods, adjusted for non-cash expenses and changes in operating assets and liabilities. The sources of the cash that we used in our activities through 2005 was the cash we had in the bank, revenues and governmental and other grants that we received, the receipts from the exercise of employee stock options, and financing income. We expect that our sources of cash for 2006 will be similar. Our subsidiaries are not restricted from transferring funds to Compugen, although we do not expect any cash to flow in from them.

Net Cash Provided By Investing Activities

Net cash used in investing activities consists of proceeds from redemption of marketable securities, net of purchases of property and equipment, plus investment grants relating to fixed assets. Net cash generated by investing activities was approximately $4.9 million in 2003, approximately $5.9 million in 2004, and approximately $15.1 million in 2005. The increase in net cash provided by investing activities in 2005 is mainly attributable to us not purchasing any marketable securities in 2005 as opposed to 2004 during which we purchased marketable securities in the amount of approximately $8.2 million.

Net Cash Provided by Financing Activities

Our net cash provided by financing activities was approximately $3.3 million in 2003, approximately $2.7 in 2004, and approximately $178,000 in 2005. The principal sources of cash provided by financing activities in 2005 were proceeds that we received from the issuance of ordinary shares as result of the exercise of stock options by employees.

Net Liquidity

Liquidity refers to the liquid financial assets we have available to fund our business operations and pay for near term future obligations. These liquid financial assets consist of cash and cash equivalents as well as short-term and long-term marketable securities. As of December 31, 2005, we had cash and cash equivalents, cash held for the benefit of consortium partners, and short-term deposits and marketable securities of approximately $31.8 million, and long-term marketable securities of approximately $5 million. We believe that our existing cash and cash equivalents, short-term deposits and short-term and long-term marketable securities will be sufficient to fund our operations for at least the next two years. However, we expect that we will need additional financing in the future to fund our activities.

As of December 31, 2005, Keddem Bioscience had cash and cash equivalents and short-term deposits of approximately $767,000. We believe that Keddem Bioscience's existing cash and cash equivalents will be sufficient to fund its operations for approximately 7 months. Keddem Bioscience's external auditors have raised substantial doubts on Keddem BioScience's ability to continue as a going concern.

We have a commitment for capital expenditures in the amount of approximately $142,000 that relates to construction of our molecular biology laboratories and which comprises part of our current liabilities.

RESEARCH AND DEVELOPMENT, PATENTS AND LICENSES

We invest heavily in research and development. Research and development expenses, net, were our major operating expenses, representing more than 50% of the total operating expenses for each of 2003, 2004, and 2005. Our research and development expenses were $10.5 million in 2005, compared with $10.9 million in 2004 and $11.3 million in 2003. As of December 31, 2005, 92 of our employees were engaged in research and development on a full-time basis. This represents approximately 76% of our entire work force. As a result of the re-organization that we underwent in December 2005, as of January 31, 2006, 72 of our employees were engaged in research and development on a full-time basis, representing approximately 73% of our entire work force.

Consistent with our shift in focus away from selling our computational and software products, we now focus our research and development efforts on the development of our discovery engines and related technologies, and of our therapeutic proteins and diagnostic biomarker product candidates. We expect that in 2006 our research and development expenses will continue to be our major operating expense, representing more than 60% of our total operating expenses.

We believe that our future success will depend, in large, on our ability to continue to expand our inventory of promising potential therapeutic proteins and diagnostic biomarkers, which we intend to discover through the use of our discovery engines and related technologies and validate in our and third parties' respective molecular biology laboratories.

Research and Development Grants

We participate in programs offered both by the Office of the Chief Scientist under the Industry and Trade Ministry of Israel ("OCS") that supports research and development activities, by the Israel-U.S. Bi-national Industrial Research and Development Foundation ("BIRD") and by the European Community, under the European Union's 6th Framework Program. We received grants and other forms of consideration from the OCS of approximately $2.1 million in 2003, approximately $1.4 million in 2004 and, in 2005, from both the OCS and BIRD, in the aggregate amount of approximately $2.3 million. We have applied for additional grants from the Office of the Chief Scientist for research, technological development and demonstration activities in 2006.

The Office of the Chief Scientist

We received grants from the Office of the Chief Scientist for several projects. Under the terms of these grants, we will be required to pay royalties ranging between 3% to 5% of the net sales of products developed from the OCS-funded projects, beginning with the commencement of sales of such products and ending when 100% of the dollar value of the grant is repaid (100% plus LIBOR interest applicable to grants received on or after January 1, 1999). The royalty rate (between 3% and 5%) varies depending on the amount of years that lapse between receipt of the grant and its repayment by us. As of December 31, 2005, our contingent accrued obligation for royalties, based on royalty-bearing government grants, net of royalties already paid, totaled approximately $6.5 million, payable out of future net sales of products that were developed under Office of the Chief Scientist -funded projects.

Israeli law requires that the manufacture of products developed with government grants will be carried out in Israel, unless the OCS provides its approval to the contrary. Following legislative changes to Israeli legislation in 2005, this approval, if provided, is generally conditioned on an increase in the total amount to be repaid to the OCS, to up to 300% of the amount of funds granted. The specific increase within this ceiling would depend on the extent of the manufacturing to be conducted outside of Israel. Alternatively, the restriction on manufacturing outside of Israel shall not apply to the extent that plans to manufacture were disclosed when filing the application for funding (and provided the application was approved based on the information disclosed in the application). We believe that this restriction does not apply to the commercialization through licensing of product candidates that we develop by using or based on our OCS-funded technologies or discoveries. In such circumstances, the OCS will take into account the proposal that OCS-funded projects will have an overseas manufacturing component. Under applicable Israeli law, Israeli

government consent is required to transfer to Israeli third parties technologies developed under projects, which the government funded. Transfer of OCS-funded technologies outside of Israel is prohibited, unless conducted in accordance with the restrictions set forth under Israeli law. Israeli law further specifies that both the transfer of know-how as well as the transfer of intellectual property rights in such know-how are subject to the same restrictions. These restrictions do not apply to exports from Israel or the sale of products developed with these technologies.

In addition to the OCS programs described above, we participated in a number of research consortia in which Israeli research institutions and high technology companies are members. These consortia are devoted to the development of generic technologies in the fields of biotechnology, agricultural biotechnology and pharmaceuticals. The OCS MAGNET program sponsors these consortia. Under the terms of the MAGNET program, the OCS contributes 66% of the consortium's research budget that the OCS approves and the consortium industry members contribute the remaining 34%. No royalties are payable to the OCS with respect to this funding. Expenses in excess of the approved budget are borne by the consortium members.

In general, any member of a consortium that develops technology in the framework of a consortium retains the intellectual property rights to this technology and all other consortium members have the right to use and implement this technology without having to pay royalties to the developing consortium member, provided that the technology will not be transferred under any circumstances to any entity outside of the consortium. The terms of the program prohibit both the manufacture of products using technology developed in the context of the program outside of Israel and the transfer of technology developed under the program to any Israeli third party, without the prior written consent of the OCS.

Bi-national Industrial Research and Development Foundation (BIRD)

In 2005 we, together with OCD became jointly entitled to receive from BIRD a grant for our joint collaborative project with OCD, according to a budget that was approved by BIRD. The BIRD Foundation's mission is to stimulate, promote and support industrial research and development of mutual benefit to the US and to Israel. The BIRD foundation offers research and development grants of up to one million dollars for a collaboration.

We entered into a tripartite cooperation and project funding agreement with OCD and BIRD based on BIRD's standard terms and conditions. The term of the funded collaborative project is 4 years. BIRD's standard terms and conditions require its grantees to repay 100% of the grant monies, provided that repayment is made within the first year following expiry of the term of the project. For every year of delay in these repayments, the amounts to be repaid incrementally increase up to an amount of 150% in the fifth year following expiry of the term of the project. All amounts to be repaid to BIRD are subject to us generating revenue from commercializing the funded project and linked to the U.S. consumer price index.

The Governments of Israel and of the United States are each entitled to a non-exclusive, royalty-free license to make and use any products generated from the funded project. Otherwise, neither we not OCD are subject to any restrictions relating to the ownership or commercialization of the intellectual property and products generated from the funded collaborative project.

The European Union's 6th Framework Program

In 2005 we joined two research consortia under the European Community 6th Framework Program, which is a program based on the Treaty establishing the European Union, with the aim of promoting research and technology among the European Community members.

We are the appointed coordinator of one of these research consortia, which means that we are the consortium's primary contact with the European Community for the purpose of managing the consortium's progress. This includes a responsibility to distribute the research grant monies to the consortium members and to provide to the European Community reports describing the consortium's progress of the funded research.

The terms of the grant from the European Community do not require us to repay the grant monies that we receive, unless we or any of our consortium members default in our obligations such as carrying out the research that we undertook to perform, or in reporting the progress of the research. We received a portion of the grant and currently hold approximately $834,000 on behalf of other consortium members. This amount is due to be distributed to them in accordance with an agreement between the consortium members. See Notes 4 and 9 of our 2005 Consolidated Financial Statements.

TREND INFORMATION

Trend towards consolidation

There is a trend towards consolidation in the pharmaceutical and biotechnology industries, which may negatively affect our ability to enter into agreements. This trend often involves larger companies acquiring smaller companies, and this may result in the larger companies having greater financial resources and technological capabilities. This trend towards consolidation in the pharmaceutical and biotechnology industries may also result in there being fewer customers for our products and services. Also, if one of the consolidating companies already uses the technologies or services of our competitors, we may lose existing customers as a result of such consolidation.

Trend towards making genomic data and related software publicly available

Large amounts of genomic data are increasingly becoming available to the general public. To date, most of the public efforts relating to human genomics involved producing data under the Human Genome Project. Following the publication of the first draft of the human genome, there has been an increase in public efforts to develop analysis tools for understanding genomic, functional genomic and proteomic data. These efforts have already resulted and may further result in the future in the development of products, which are competitive to ours and that are available free of charge. Such developments could require us to lower our prices, could cause some of our products to be less commercially viable or to be obsolete, or could assist third parties to discover genes or proteins that are of interest to us.

The pharmaceutical industry is generally ready to consider in-licensing potential therapeutic products which are at the early stage of their development

Pharmaceutical and biotechnological companies are generally ready to consider in-licensing product candidates at a stage of development which is significantly earlier than Phase II clinical trials and even at pre-clinical stages. As a result, we are able to seek to enter into agreements relating to the further development and commercialization of our early stage product candidates.

However, there may be a trend towards pharmaceutical and biotechnological companies being willing to in-license only product candidates that are at a stage of development beyond the stage of development that we currently seek to attain for our product candidates, as has been the case in the past. In such circumstances, we may be required to invest a substantial amount of money and other resources in each product candidate, without assurance that its product candidates will be commercialized and the number of product candidates in which we will be able to invest our research and development resources will be limited.

If, consistent with our strategy for commercialization of our diagnostic and therapeutic product candidates, we are successful in commercializing our product candidates at an early stage of development, the consideration that we expect to receive would be relatively low. The consideration that we would expect to receive in consideration for commercializing our products candidates increases commensurately with the stage of development that we attain for our product candidates.

OFF-BALANCE SHEET ARRANGEMENTS

We are not a party to any material off-balance-sheet arrangements.

TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS

The table below summarizes our contractual obligations as of December 31, 2005, and should be read together with the accompanying comments that follow.

	Payments due by period			
	Total	Less than 1 year	1-3 years	3-5 years
Operating Lease Obligations	2,866	996	1,368	502
Accrued Severance Pay Reflected on our Balance	1,659			1,659
Other Long-Term Liabilities Reflected on our Balance Sheet under the GAAP of the Primary Financial Statements	60		20	40
Total	4,585	996	1,388	2,201

The above table does not include royalties that we may be required to pay to the OCS or BIRD. For more information, see "Research and Development, Patents and Licenses" in this Item 5. We are unable to reasonably estimate the time and the amounts that we will eventually be required to pay to the OCS and BIRD, if at all, since these amounts and times depend on our ability to sell products based on the OCS and BIRD -funded technologies and the timing of any such sales.

The above table also does not include contingent contractual obligations or commitments that may crystallize in the future, such as contractual undertakings to pay royalties subject to certain conditions occurring.

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

Directors and Senior Management

The following sets forth information with respect to our directors and executive officers as of February 1, 2006.

Name	Age	Positions
Martin S. Gerstel	64	Chairman of the Board of Directors
[1]Alex Kotzer	60	Chief Executive Officer, President and Director
Orna Berry, Ph.D	56	Director
David Schlachet	60	Director
Ruben Krupik	54	Director
Nurit Benjamini	39	Chief Financial Officer
Erez Chimovits	42	President, Compugen USA, Inc., and Executive Vice President, Commercial Operations
Noam Shani, Ph.D	43	Vice President, Therapeutics
[2]D'vorah Graeser, Ph.D	38	Vice President, Intellectual Property
[3]Anat Cohen Dayag, Ph.D	39	Vice President, Diagnostic Biomarkers
[3]Yossi Cohen**,** M.D**.**	34	Vice President, Research and Discovery

1 Alex Kotzer's appointment as our President and Chief Executive Officer became effective on September 1, 2005

2 D'vorah Graeser will no longer be an executive officer as of April 1, 2006

3 Anat Cohen Dayag and Yossi Cohen each assumed their position as executive officers in January 2006.

Martin S. Gerstel has served as our chairman since August 1997. Prior to relocating to Israel in 1994, Mr. Gerstel was co-chairman and CEO of ALZA Corporation, which he helped found in 1968. Mr. Gerstel is also the Chairman of Evogene Ltd. and Keddem Bioscience Ltd., co-founder and co-chairman of Itamar Medical, and serves as a director of Symyx Technologies, Yissum Ltd., Yeda Ltd. and the Foundation for the National Medals of Science and Technology. He is a member of the Board of Governors and the Executive Committee of The Weizmann Institute of Science and The Board of Governors of The Hebrew University of Jerusalem, and is an advisor to the Burrill Life Science Funds and the board of the Israel-US Bi-national Industrial Research and Development (BIRD) Foundation. Mr. Gerstel holds a B.S. from Yale University and an MBA from Stanford University.

Alex Kotzer joined Compugen in September 2005 as President and Chief Executive Officer and a director. Mr. Kotzer brings with him over thirty years of senior managerial experience in various industries. Prior to joining Compugen, he served for twelve years at Serono (virt-x: SEO and NYSE: SRA), a global biotechnology leader, headquartered in Switzerland. During his tenure at Serono, Mr. Kotzer held several senior positions, most recently as Vice President of Biotechnology Manufacturing. Previously, Mr. Kotzer was President and Chief Executive Officer of InterPharm, Serono's Israeli affiliate. Before joining Serono, he held a variety of managerial positions in the food and chemical industries. Mr. Kotzer received his B.Sc.

in Chemical Engineering from the Technion, Israel Institute of Technology, of Haifa, Israel.

Orna Berry, Ph.D joined our board of directors as an outside director in June 2001. She is a Venture Partner at Gemini Israel Funds, and the Chairperson at Lambda Crossing, Ltd. and at Adamind Ltd. From 1997 to 2000, she was the Chief Scientist of the Ministry of Industry, Trade and Labor of the Government of Israel. Dr. Berry was the co-founder of ORNET Data Communication Technologies Ltd. She served as the Chief Scientist of Fibronics and as a senior research engineer in several companies, including IBM and UNISYS. Dr. Berry received her Ph.D. in computer science from the University of Southern California and her M.A. and B.A. degrees in statistics and mathematics from Tel Aviv and Haifa Universities in Israel, respectively. Dr. Berry serves as an outside director on our board of directors for a fixed term, which expires in June 2007.

David Schlachet joined our board of directors as an outside director in June 2001. He is a managing partner of BioCom Management and Investment (2002) Ltd, which serves as the managing company of BioCom venture capital fund, focused on life sciences, and since 2005 he serves as the CEO of Syneron Medical Ltd. (Nasdaq: ELOS). He also serves on the Boards of Directors of the following companies: Poalim Capital Markets & Investments Ltd., Harel Capital Markets Ltd., Taya Investment Company Ltd., United Studios Ltd., Pharmos Ltd., Edgar Development and Investment Ltd., ProSeed Venture Capital Fund Ltd., and Israel Discount Bank Limited. From 1997 to July 2000, he was Chairman of the Board of Directors of Elite Industries Ltd. From 1996 to January 2000, Mr. Schlachet served as Vice President of the Strauss Group of companies. From 1990 to 1996, he was Vice President, Finance and Administration at the Weizmann Institute of Science. From 1989 to 1990, Mr. Schlachet was Chief Executive Officer of Yeda Research and Development Ltd. of the Weizmann Institute of Science. From 1974 to 1988, he was a senior manager at the Investment Company of Bank Poalim Ltd. Mr. Schlachet holds a B.Sc. in chemical engineering from the Technion, Israel Institute of Technology and an MBA from the Tel Aviv University, Israel. Mr. Schlachet serves as an outside director on our board of directors for a fixed term, which expires in June 2007.

Ruben Krupik joined our board of directors in 2003. Mr. Krupik serves as the President and CEO of Arte Venture Group Ltd., which provides a framework of business development, investments and Management for various large investment entities in Israel. Mr. Krupik serves as the Executive Director of Clal Biotechnology Industries, the general manager of Biomedical Investments, the active chairman of Steps Ventures, and the manager of the Arison Group's technology division. From 1991 to 2000 Mr. Krupik held a number of positions, including the President and CEO of RDC (Rafael Development Corporation Ltd.). Prior to that, Mr. Krupik held a number of senior management positions at Tadiran Communications Group. Mr. Krupik holds an LL.B. in law from the Tel Aviv University and a BA in Economics and Political Science from the Hebrew University, Israel.

Nurit Benjamini joined us in 2000 bringing over ten years of experience in the Israeli and international economic field. Prior to joining us, Ms. Benjamini served as CFO of Phone-Or Ltd. Between 1993 and 1998, Ms. Benjamini was CFO at Aladdin Knowledge Systems Ltd. (NASDAQ: ALDN). Ms. Benjamini holds a B.A. in Economics and Business and an MBA in Finance, both from Bar Ilan University, Israel.

Erez Chimovits joined us in 1999, holding several senior business development and sales positions before assuming his current position in 2001. Prior to joining us, Mr. Chimovits held various positions in business development, marketing and sales at Saifan Ltd. Mr. Chimovits holds a B.S. in Biology, an M.S. in Microbiology, and an MBA, all from the Tel Aviv University, Israel.

Noam Shani, Ph.D. joined us in 2004 from Medgenics Inc., where he served as Vice President of Research and Development and led the development of the company's technologies and applications, including all biological and clinical research. Prior to Medgenics, Dr. Shani was a senior scientist and project manager at Biotechnology General Ltd. In this capacity, he headed the company's generic recombinant protein drug development activities. Dr. Shani holds a B.S. in Biology from the Ben Gurion University, Israel and a M.S. and Ph.D. in Biology, both from the Weizmann Institute of Science, Israel. He completed a postdoctoral fellowship at Johns Hopkins University's School of Medicine, Maryland.

D'vorah Graeser, Ph.D. commenced working with us in 2004, bringing with her eight years of patent experience in both life science and computer-related fields. Prior to joining us, Dr. Graeser founded a boutique patent firm, which eventually merged with Ehrlich & Partners, a leading patent firm in Israel. Dr. Graeser was a partner at this firm until she joined us. Previously Dr. Graeser worked as a US Patent Agent at Dr. Mark Friedman Ltd., where she headed the department for computer-related patents and applications. Dr. Graeser holds a B.A. in Biochemistry from Harvard University and a Ph.D. in Pharmacology from the University of Michigan, Ann Arbor. She completed post-doctoral fellowships at both the Institute for Biomedical Computing at Washington University in St. Louis, Missouri and at the Imperial Cancer Research Fund in London, performing computer programming and experimental work for the Human Genome Project.

Anat Cohen-Dayag, Ph.D. joined Compugen in 2002. Prior to joining Compugen, she was head of research and development and member of the Executive Management at Mindsense Biosystems Ltd. Prior to Mindsense Biosystems, Dr. Cohen-Dayag served as a scientist at the R&D department of Orgenic. Dr. Cohen-Dayag holds a B.Sc. in Biology from the Ben-Gurion University, Israel, and an M.Sc. in Chemical Immunology and a Ph.D. in Cellular Biology, both from the Weizmann Institute of Science, Israel.

Yossi Cohen, M.D. joined Compugen in 2001. Dr. Cohen's diverse prior experience includes serving as a physician in the Israel Defense Forces and holding various software development positions in the Israeli hi-tech industry. Dr. Cohen has a B.Sc. in Electrical and Electronics Engineering from the Tel-Aviv University, Israel, and an M.Sc. in Neurobiology and an M.D., both from the Hebrew University, Israel.

Compensation

The aggregate compensation paid by us and by our wholly-owned subsidiaries to all persons who served as directors or senior management for the year 2005 (12 persons) was approximately $1,461,000. This amount includes approximately $86,000 set aside or accrued to provide pension, severance, retirement or similar benefits.

During 2005, we granted a total of 944,000 options to purchase ordinary shares to our directors and senior management, as a group. These options are exercisable at a range of between $3.2 and $6.1 per share, and expire ten years after their respective date of grant in the case of our employees and directors, and six years after their respective date of grant in the case of our consultants. As of December 31, 2005, there were a total of 2,533,420 outstanding options to purchase ordinary shares that were granted to our directors and senior management, and 192,100 outstanding options that were granted to the members of our scientific advisory board.

All members of our board of directors who are not our employees or consultants are reimbursed for their expenses for each meeting attended and are eligible to receive share options under our share option plans. The aggregate amount paid to all of our non-employee directors for the year ended December 31, 2005 was approximately $36,000. These fees are adjusted semi-annually to reflect changes prescribed by regulations under the Israel Companies Law, 5759-199 (the "Companies Law"), for payment to outside directors. Members of our scientific advisory board receive cash compensation and, have been granted and may be granted further stock options for their services.

Approvals Required for Compensation to our Directors

In accordance with the requirements of Israeli Law, we determine our directors' compensation in the following manner:

- first, a proposal for compensation is submitted to our audit committee, which then reviews the proposal;
- second, provided that the audit committee approves the proposed compensation, the proposal is then submitted to our board of directors for review, except that a director who is the beneficiary of the proposed compensation does not participate in any discussion or voting with respect to such proposal;

- finally, if our board of directors approves the proposal, it must then submit its recommendation to our shareholders, which is usually done during our shareholders' general meeting; and
- the approval of a majority of our shareholders is required to implement any such compensation proposal.

Board Practices

Election of Directors and Terms of Office

Our board of directors currently consists of five members, including our chairman and chief executive officer. Other than our two outside directors, our directors are elected by an ordinary resolution at the annual general meeting of our shareholders. In August 2003, our board of directors appointed Mr. Ruben Krupik to serve as one of our directors. By a shareholders' resolution dated August 30, 2005, our shareholders appointed Mr. Alex Kotzer to serve as a director of our company and Dr. Mor Amitai, who was not nominated by our board of directors to serve another term, ceased being a director on that date.

Unless they resign before the end of their term or are removed in accordance with our Articles of Association, all our directors, other than our outside directors, will serve as directors until our next annual general meeting of shareholders.

Dr. Orna Berry and Mr. David Schlachet serve as outside directors pursuant to the provisions of the Israel Companies Law for a second three-year term ending in June 2007. After this date, their term of service can not be renewed.

None of our directors or officers have any family relationship with any other director or officer.

None of our directors are entitled to receive any severance or similar benefits upon termination of his or her service, except for Mr. Alex Kotzer, who is entitled pursuant to the terms of his employment agreement, to receive severance in the amount of a multiple of six times his gross monthly salary, as may be updated from time to time if the company terminates his employment without justifiable cause. Mr. Alex Kotzer's entitlement to this severance payment is in addition to severance payment to which he would be entitled to receive under law in such circumstances.

Our Articles of Association permit us to maintain directors and officers' liability insurance and to indemnify our directors and officers for actions performed on behalf of the company, subject to specified limitations.

Outside and Independent Directors

The Companies Law requires Israeli companies with shares that have been offered to the public either in or outside of Israel to appoint at least two outside directors. No person may be appointed as an outside director if that person or that person's relative, partner, employer or any entity under the person's control, has or had, on or within the two years preceding the date of that person's appointment to serve as an outside director, had any affiliation with the company or any entity controlling, controlled by or under common control with the company. The term affiliation includes:

- an employment relationship;
- a business or professional relationship maintained on a regular basis;
- control; and
- service as an office holder.

No person may serve as an outside director if that person's position or business activities create, or may create, a conflict of interest with that person's responsibilities as an outside director or may otherwise interfere with his/her ability to serve as an outside director. If, at the time outside directors are to be appointed, all current members of the board of directors are of the same gender, then at least one outside

director must be of the other gender.

The Companies Law was recently amended to require that at least one outside director must have financial and accounting expertise and the other outside directors must possess certain professional qualifications that are promulgated by regulations to the Companies Law. These regulations provide that outside directors must possess a high level of understanding in business matters, to the extent that they are able to read and understand financial statements in depth and to comment on the manner in which financial data is presented. Each company's board of directors must determine each outside director's qualifications based on his or her education, experience and skills regarding financial matters and knowledge of financial statements in accordance with the Companies Law and Israeli securities laws.

Outside directors are to be elected by a majority vote at a shareholders' meeting, provided that either:

- the majority of shares voted at the meeting, including at least one-third of the shares held by non-controlling shareholders voted at the meeting, vote in favor of election of the director; abstaining votes shall not be counted in this vote, or
- the total number of shares held by non-controlling shareholders voted against the election of the director does not exceed one percent of the aggregate voting rights in the company.

The initial term of an outside director is three years and may be extended for an additional three years term. Outside directors may be removed only by the same percentage of shareholders as is required for their election, or by a court, and then only if the outside directors cease to meet the statutory qualifications for their appointment or if they violate their duty of loyalty to the company. Each committee of a company's board of directors must include at least one outside director.

An outside director is entitled to compensation as provided in regulations adopted under the Companies Law and is otherwise prohibited from receiving any other compensation, directly or indirectly, in connection with service provided as an outside director.

Dr. Orna Berry and Mr. David Schlachet currently serve as our outside directors under Israeli law and as our independent directors under Nasdaq requirements. They both serve on our audit committee.

In addition to the requirements of the Companies Law as described above, since our shares are listed on the Nasdaq National Market, a majority of our directors must be independent (as defined by the Nasdaq National Market’s Marketplace Rules), and our audit committee must be comprised of at least three members, all of whom must be independent (subject to limited exceptions). We currently meet these requirements.

Audit Committee

We have an audit committee consisting of three independent directors, all of whom are financially literate and one of whom has accounting or related financial management expertise. The members of the Audit Committee are, Mr. David Schlachet, who serves as the chairman of our Audit Committee, Ms. Orna Berry and Mr. Ruben Krupic. All of the members of our audit committee qualify as independent directors under the current Nasdaq National Market requirements. The Audit Committee has adopted a charter.

The responsibilities of the audit committee include identifying irregularities in the management of the company's business and approving related party transactions as required by law. An audit committee must consist of at least three directors, including all of its outside directors. The chairman of the board of directors, any director employed by or otherwise providing services to the company, and a controlling shareholder or any relative of a controlling shareholder, may not be a member of the audit committee. An audit committee may not approve an action or a transaction with a controlling shareholder, or with an office holder, unless at the time of approval two outside directors are serving as members of the audit committee and at least one of the outside directors was present at the meeting in which an approval was granted.

Other Committees

We have a Nominating Committee which consists of the three independent directors of our Board of Directors.

We do not have a compensation committee. This practice is compliant with Israeli law.

Approval of Compensation to Our Officers

The Companies Law prescribes that compensation to officers must be approved by a company's board of directors. In accordance with Article 52(d) of our Articles of Association, our board of directors authorized and empowered our Chief Executive Officer to appoint office holders and determine their terms of employment, without our board of director's approval. Compensation to our officers who serve members of our board of directors require the approval of our audit committee, the board of directors and shareholders, as specified above.

Internal Auditor

Under the Companies Law, the board of directors must appoint an internal auditor, nominated by the audit committee. The role of the internal auditor is to examine, among other matters, whether the company's actions comply with the law and orderly business procedure. Under the Companies Law, the internal auditor may be an employee of the company but not an office holder, or an affiliate, or a relative of an office holder or affiliate, and he or she may not be the company's independent accountant or its representative. We comply with the requirement of the Companies Law relating to internal auditors. Our internal auditors examine whether our various activities comply with the law and orderly business procedure.

Our internal auditors, Ezra Yehudah Management Services Ltd., are not employees, affiliates or officeholders of the company. They were appointed in 1999.

Scientific Advisory Board

Our scientific advisory board convenes once or twice annually, and we consult with its individual members when we determine that there is a need to do so. At the advisory board meetings, we review our primary ongoing and planned projects and development plans, and the advisory board recommends which projects and product candidates to pursue and in what priority. Our scientific advisory board currently includes:

Name	Affiliation
Nabil Hannah, Ph.D.	Former Executive Vice President, Research, Biogen Idec Inc.
C. Ronald Kahn, M.D.	President and Director, Joslin Diabetes Center, Mary K. Iacocca Professor, Harvard Medical School
Joseph Schlessinger, Ph.D.	William H. Prusoff Professor and Chairman of the Department of Pharmacology of the Yale University School of Medicine; Member, National Academy of Sciences, USA
Arthur Weiss, M.D., Ph.D.	Ephraim P. Engleman Distinguished Professor of Rheumatology; Investigator, Howard Hughes Medical Institute, University of California, San Francisco

Employees

The following table sets out the number of our employees engaged in specified activities, by geographic location both for the last three fiscal years and as of January 31, 2006.

Year Ended December 31,		**2005**	**2004**	**2003**
	Jan 31, 2006			
Research & Development				
Israel	71	92	90	95
USA	0	0	2	7
United Kingdom	1			1
Administration, Accounting and Operations				
Israel	21	23	24	24
USA	0	0	1	4
Sales, Marketing, Business Development and Support				
Israel	0	0	1	2
USA	5	5	4	7
United Kingdom	0	1	1	1
Total	98	121	123	141

The number of our employees as of January 31, 2006 was added to illustrate the impact the re-organization that we underwent in December 2005. The effective date for termination of most of our employees whose employment was terminated as part of the re-organization, was December 31, 2005. The effective date of termination of the employment of another 8 employees was in February 2006 or is in March 2006.

We and our Israeli employees are subject, by an extension order of the Israeli Ministry of Welfare, to a few provisions of collective bargaining agreements between the Histadrut, the General Federation of Labor Unions in Israel and the Coordination Bureau of Economic Organizations, including the Industrialists Associations. These provisions principally concern cost of living increases, recreation pay, travel expenses, vacation pay and other conditions of employment. We provide our employees with benefits and working conditions equal to or above the required minimum. Our employees are not represented by a labor union. We have written employment contracts with each of our employees, and we believe that our relations with our employees are good.

Share Ownership

Share Ownership by Directors and Senior Management

All of the persons listed above under the caption “Directors and Senior Management” own ordinary shares and/or options to purchase ordinary shares. Except as set forth in the table below, none of the directors or executive officers owns shares and/or options amounting to 1% or more of the outstanding ordinary shares. The following table sets forth certain information as of January 31, 2006, regarding the beneficial ownership by our directors and executive officers. All numbers quoted in the table are inclusive of options to purchase shares that are exercisable within 60 days after January 31, 2006.

Beneficial Owner	Amount Owned	Percent of Class
Martin S. Gerstel [1]	1,895,680	6.8%
All directors and senior management as a group [2]	2,404,773	8.6%

[1] Includes 550,000 shares held by Shomar Corporation, an affiliate of Mr. S. Gerstel, 1,142,568 shares held by Merrill Lynch IRA for Martin Gerstel, of which Martin Gerstel is the beneficiary, and options to purchase 203,112 shares that are exercisable within 60 days of January 31, 2006. Based on information disclosed by Mr. Martin S. Gerstel on Form 13G, filed with the SEC on February 6, 2006.

[2] Includes the shares that are beneficially owned by Martin S. Gerstel as noted on the first row of the above table.

Share Option Plans

We maintain three share option plans for our and our subsidiaries' employees, directors and consultants. In addition to the discussion below, see Note 11 of our Consolidated Financial Statements.

Our board of directors administers our share option plans and has the authority to designate all terms of the options granted under our plans including the grantees, exercise prices, grant dates, vesting schedules and expiration dates, which may be no more than ten years after the grant date. Options may not be granted with an exercise price of less than the fair market value of our ordinary shares on the date of grant, unless otherwise determined by our board of directors.

Compugen Ltd. Employee Share Option Plan (1996)

We have granted options to purchase up to 559,750 ordinary shares to our employees and consultants under the Compugen Ltd. Employee Share Option Plan (1996). As of January 31, 2006, options to purchase 79,000 ordinary shares, granted at a weighted average exercise price of approximately $2.01 per share, remained outstanding under the plan. These options expire ten years after the date of grant or four weeks after termination of a grantee’s employment or other relationship with us, without cause. If we terminate the grantee for cause, the options expire immediately. We do not intend to grant additional options under this plan.

Compugen Share Option Plan (1998)

Under the Compugen Share Option Plan (1998), we have granted options to purchase up to 2,289,250 ordinary shares to our and our subsidiaries’ employees, directors and consultants. As of January 31, 2006, options to purchase 624,909 ordinary shares were outstanding under the plan at a weighted average exercise price of approximately $2.26 per share. Options to purchase 1,216,875 ordinary shares under the plan have previously been exercised at an exercise price of approximately $1.56, and options to purchase 658,216 ordinary shares remain available for future grant. If a grantee leaves his or her employment or other relationship with us, the term of his or her unexercised vested options expire 90 days later.

Compugen Share Option Plan (2000)

Under the Compugen Share Option Plan (2000), we may grant options for up to an aggregate of 7,924,525 ordinary shares to our employees, directors and consultants and our subsidiaries' respective employees, directors and consultants. This total number automatically increases on January 1 of every year by the lesser of 1,500,000 shares or 4% of the total number of our then-outstanding shares, or such lower amount as shall be determined by the board of directors. If a grantee leaves his or her employment or other relationship with us, or if his or her relationship with us is terminated without cause, the term of his or her unexercised options will expire 90 days later. As of January 31, 2006, options to purchase 3,782,500 ordinary shares were outstanding under the plan at a weighted average exercise price of approximately $4.46 per share. Options to purchase 760,500 ordinary shares under the plan have previously been exercised at an exercise price of approximately $3.66, and options to purchase 3,381,524 ordinary shares remain available for future grant.

In 2003, the terms of this plan were modified to comply with changes in the Israeli tax law relating to the taxation of incentive options to Israeli resident employees. Pursuant to the Tax Reform (see “Item 10. Additional Information; Taxation; Israeli Tax Considerations; Tax Reform”) and in order to comply with the revised provisions of Section 102 of the Income Tax Ordinance (Amendment No. 132), 5762-2002 (the Ordinance), on February 4, 2003, our board of directors adopted an addendum to our share option plan which applies to options granted as of January 1, 2003 to grantees who are residents of Israel. This addendum does not affect grantees that are not residents of Israel.

On February 4, 2003, our board of directors further resolved to elect the “Capital Gains Track” (as defined in Section 102(b)(2) of the Ordinance) for the grant of options to Israeli grantees. Generally, under the Capital Gains Track, the tax liability to a Grantee resulting from the grant and exercise of options will be postponed until the time that shares that are acquired upon the exercise of options will be sold or released from trust, subject to fulfillment of the requirements of Section 102 of the Ordinance. Entitlement to the benefits under the Capital Gains Track is contingent upon the grantee of options holding them and the shares issued upon their exercise for a period of at least 24 months from the time of grant. Under the Capital Gains Track, a fixed rate of 25% apply to gains that are realized from the sale of shares issued upon exercise of options (i.e., for sales proceeds in excess of the exercise price of the options, assuming that the exercise price is equal to the fair market value of the shares on the date of the award), and provided that the sale occurs after the required holding period.

If a grantee sells shares or releases them from trust prior to expiration of the required holding period, the grantee will be subject to income tax on his gains at a rate which is his or her marginal income tax rate (currently up to 49%), as well as payment of associated health tax and national insurance payments. Additionally, in such circumstances, withholding requirements will apply and be carried out by the employing company in accordance with applicable laws, regulations and rules.

Neither we nor the grantee will be liable to pay social benefits payments in connection with the granting or exercise of options that are exercised under the Capital Gains Track mechanism, or upon the sale of the shares underlying such options or upon the release of such shares from the trust, provided that such sale or release occurs after the required holding period. However, if such sale or release occurs before expiry of the required holding period, for which our consent is required, both we and the grantee will bear each of our respective liability to pay social benefits payments.

We will not be entitled to a tax deduction for Israeli income tax purposes with respect to options granted under the Capital Gains Track.

Non-Plan Options

In 1996, we granted options to purchase a total of 249,250 ordinary shares to three of our employees. 133,847 of these options were forfeited without being exercised in November 1999. In addition, 115,403 of these options have been exercised to date. The terms of these options are the same as those granted under the Compugen Share Option Plan (1998). We do not intend to grant additional options under this plan.

Directors' Options

Prior to our initial public offering, we adopted a plan to grant options to our directors, effective as of the closing of our initial public offering. Pursuant to such plan, effective as of the closing of our initial public offering, we granted options to purchase 20,000 ordinary shares at an exercise price of $10.00 per share to each of our directors (serving on our board of directors on the date of the closing of our initial public offering) who were not our employees or consultants. Of these options, options to purchase 1,250 ordinary shares vest at the end of every three-month period following the date of grant. Pursuant to this plan, we also granted and will continue to grant to each new non-employee director options to purchase 20,000 ordinary shares at the time he or she becomes a director. Of these options, options to purchase 5,000 ordinary shares vest on the first anniversary of the grant date, and options to purchase 1,250 ordinary shares vest at the end of every three-month period afterwards. In addition, pursuant to the plan, we grant each director options to purchase an additional 5,000 ordinary shares on each anniversary of the initial date of grant of options to such director. Of these options, options to purchase 1,250 ordinary shares vest at the end of every three-month period during the fourth year after the date of grant. All of the options described above have been and will be granted under, and subject to, the terms of our share option plans in effect on the date of the grant of the option.

On September 3, 2002, our shareholders approved the following grants to our members of our board of directors: (i) each audit committee member shall be entitled to an annual grant of options to purchase 2,000 ordinary shares, (ii) each executive committee member shall be entitled to an annual grant of options to purchase 2,000 ordinary shares, and (iii) in addition to the previous grants, the chairman of the audit committee and the executive committee respectively, shall each be granted additional options to purchase 2,000 ordinary shares, each year. All of these options shall vest over a four-year period. These options shall be granted at the exercise price equal to the fair market value of our shares, at the time of grant.

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

Major Shareholders

The following table sets forth certain information regarding beneficial ownership of our ordinary shares as of December 31, 2005 by each person who is known by us to own beneficially more than 5% of our outstanding ordinary shares. The voting rights of our major shareholders do not differ from the voting rights of other holders of our ordinary shares.

Beneficial Owner	Number of Ordinary Shares Beneficially Owned	Percent of Ownership
Martin Gerstel [(1)]	1,692,568	6.1%
Clal Industries & Investments Ltd. [(2)]	3,056,274	11%
AXA Assurances I.A.R.D. Mutuelle [(3)]	4,718,037	16.9%

[(1)] Includes 550,000 shares held by Shomar Corporation, an affiliate of Mr. Gerstel, 1,142,568 shares held by Merrill Lynch IRA for Martin Gerstel, of which Martin Gerstel is the beneficiary. Based on information disclosed by Mr. Martin Gerstel on Form 13G, filed with the SEC on February 6, 2006.

[(2)] Includes 10,526 shares held by Clal Industries & Investments Ltd. and 3,045,748 shares held by Clal Biotechnology Industries Ltd. Clal Industries & Investments Ltd.'s address is 3 Azrieli Center, Tel Aviv 67023, Israel. This disclosure is based on information disclosed by Clal Industries & Investments Ltd. on Form 13D, filed with the SEC on May 19, 2003.

[(3)] This disclosure is based on information disclosed by AXA Assurances I.A.R.D. Mutuelle on Form 13G, field with the SEC on February 14, 2006.

As of January 31, 2006, there were a total of 101 holders of record of our ordinary shares, of which 65 were registered with addresses in the United States. Such United States holders were, as of such date, the holders of record of approximately 88.87% of the outstanding ordinary shares.

Related Party Transactions

It is our policy to enter into transactions with related parties on terms that, on the whole, are no less favorable than those that would be available from unaffiliated parties. Based on our experience in the business in which we operate and the terms of our transactions with unaffiliated third parties, we believe that all of the transactions described below met our policy standards at the time they occurred.

Evogene Ltd.

In October 1999, we formed a division focusing on agricultural biotechnology and plant genomics. On January 1, 2002, we turned the business of this division into a majority-owned subsidiary, Evogene. As part of this transaction, we extended to Evogene a loan in the amount of $900,000.

On January 6, 2003, a group of investors, led by Martin Gerstel, the Chairman of our board of directors, extended to Evogene a loan, convertible into equity, in the amount of $2,000,000. Following the closing of the convertible loan transaction, we granted these Investors an irrevocable proxy empowering them to vote 820,000 of our shares in Evogene (which constituted 50% of our shareholding of Evogene at the time). One of the investors' conditions for advancing funds to Evogene, was that we forgive our loan to Evogene in the amount of $900,000, which we agreed to do in the interests of Evogene's continued existence. In February 2004, Evogene and the investors entered into an amended and restated convertible loan agreement, under which the amount of the convertible loan was increased by additional $ 1,551,000. In January 2005, Evogene and investors entered into a convertible bridge loan agreement and an amendment to that

agreement, under which the amount of the convertible loan was $2,000,000. We did not participate in any of the investments in Evogene.

As a result of a series of transactions relating to an additional investment in Evogene, that closed on February 15, 2006, all those investors who extended to Evogene convertible loans, became the holders of shares in Evogene. We did not participate in the investment in Evogene. As a result of the most recent series of transactions, as of 16 February 2006, we own approximately 14.76% of Evogene's issued capital.

As of December 31, 2005, we held approximately 84.7% of Evogene's issued and outstanding share capital, but only 23.36% of Evogene's share capital, on a fully-diluted basis. As a result of us granting irrevocable proxies to investors in Evogene empowering them to vote 820,000 of our shares in Evogene in a manner that they determined in their discretion (and which constituted 50% of our shareholding of Evogene at the time of the grant) and of the issuance to us of 350,000 ordinary shares of Evogene under a Computational Tools License Agreement, with Evogene, as of December 31, 2005 we had the power to vote 34.89% of Evogene's share capital. For more information, see Note 1 of our 2005 Consolidated Financial Statements and "Item 5. Operating and Financial Review and Prospects; Critical Accounting Policies; Investment in Evogene.

As of December 31, 2005, Martin Gerstel, our chairman of the board, held approximately 7.52% of Evogene's issued and outstanding share capital (approximately 7.09% of Evogene's share capital, on a fully-diluted basis), and the power to vote approximately 10.94% of Evogene's share capital. Since December 19, 2004, Martin Gerstel has served as the chairman of Evogene's board of directors.

As of December 31, 2005, we did not have control over Evogene for the following reasons:

- We had less than 50% voting power in Evogene;
- Other investors in Evogene had the right to covert their loan to Evogene into preference shares, which they did in February 2006;
- Of the five directors serving on Evogene's board of directors in 2005, we had and continue to have only one representative;
- We had not been and continue not to be involved in the daily management of Evogene; and
- Under the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities", we were not and continue not to be a primary beneficiary of Evogene's business.

On August 1, 2004, we entered into an Extension Agreement to a Computational Tools License Agreement, with Evogene. The original license was granted to Evogene upon Evogene's incorporation on January 1, 2002. Under the extension agreement, the license was extended for two additional years, until December 31, 2007, in consideration of the issuance to us of 350,000 ordinary shares of Evogene. During these two years we are obligated to provide to Evogene limited support services at no additional charge. We consider the fair value of the equity instruments received to date in connection with Evogene to be minimal and as a result we did not recognize any revenues from these transactions.

On September 6, 2004, we entered into a Material Transfer Agreement with Evogene, under which we agreed to provide to Evogene the sequence information to certain of our proteins, as well as small amounts of purified antibodies that bind to these proteins, for the purpose of assisting Evogene to develop a method for producing mammalian proteins in trichome plant cells.

Keddem Bioscience Ltd.

On August 1, 2004, we turned our chemistry division into a wholly-owned subsidiary, Keddem Bioscience Ltd. The transaction was effected by way of a transfer to Keddem Bioscience of all of our assets and liabilities that were dedicated to the operation of our chemistry division, in consideration of the issuance to us of 2,999,900 ordinary shares NIS0.01 par value of Keddem Bioscience. On July 29, 2004 we entered into a Convertible Loan Agreement with Keddem Bioscience, under which we agreed to loan to

Keddem Bioscience up to US$1,572,000. The outstanding principal loan amount bears interest at an annual rate (each year considered separately) which is the greater of (i) 5%; and (ii) the 12 month LIBOR as determined on the first business day after the corresponding anniversary, compounded annually. The loan is convertible into Keddem Bioscience's shares at our discretion, until the earlier of: (x) the repayment date or (y) the merger, acquisition, IPO or similar event of Keddem Bioscience. If not converted, the loan is to be repaid by Keddem Bioscience upon the earlier of (i) June 30, 2011, and (ii) Keddem Bioscience defaulting under the loan agreement's terms.

On June 16, 2005, our board of directors resolved to advance to Keddem an amount of $100,000 for a period of one year, bearing interest at an annual rate of 5%. On November 1, 2005 our board of directors also resolved to assign to Keddem our entitlement to receive from the Investment Center of the Israel Ministry of Industry, Trade and Labor (the "Investment Center"), an amount of approximately $400,000 - on account of our investment in the expansion of, what was at the time, our Ashqelon computational chemistry facilities and the building of a laboratory there for drug development. In accordance with the terms of the loan, in January 2006, Keddem repaid to us the full amount of the $100,000 loan following its receipt of approximately $400,000 from the Investment Center.

Consulting Agreement with Shomar Corporation, a company controlled by Martin Gerstel, our Chairman of the Board of Directors

In October 1998, we entered into a consulting agreement with Shomar Corporation, a company controlled by Martin S. Gerstel, our Chairman of the board of directors. The agreement renews automatically each year unless terminated by either party. Under the agreement, as amended, Mr. Gerstel provides consulting services to us and is required to devote at least 50% of his business time to us. As compensation for his services under this agreement, we paid Shomar Corporation an annual consulting fee of $150,000, plus reimbursement of Mr. Gerstel's reasonable out-of-pocket expenses. This agreement includes non-disclosure and non-competition obligations in our favor.

On July 30, 2003, we granted to Martin Gerstel options to purchase 150,000 of our ordinary shares at an exercise price of $2.38 per share, under the terms of our 2000 Option Plan. This grant was made in consideration of Shomar Corporation's waiver of the annual consulting fees of $150,000 for each of the years 2003 through 2006 and was ratified by our shareholders in our annual shareholders' meeting convened on July 30 2003.

On July 30, 2003, we granted to Martin Gerstel options to purchase 100,000 of our ordinary shares, at the exercise price of $2.38 per share, under the terms of our 2000 Option Plan. This grant was made in consideration for his services as Chairman of our board of directors and was ratified by our shareholders in our annual shareholders' meeting convened on July 30 2003.

Except for this aforesaid remuneration, the reimbursement of Mr. Gerstel's reasonable expenses incurred in connection with the performance of services, in accordance with our consulting agreement with Shomar, and for remuneration that all of our non-employee directors receive, which is the maximum amount payable to external directors in accordance with the Companies Law, Mr. Gerstel does not receive any other direct or indirect compensation for his services to us.

ITEM 8. FINANCIAL INFORMATION

Consolidated Statements and Other Financial Information

Our consolidated financial statements are included on pages F-1 through F-35 of this annual report.

Legal Proceedings

Currently, we are not a party to any material pending legal proceedings. There are no legal proceedings pending or, to our knowledge, threatened against us or our subsidiaries and we are not involved in any legal proceedings that our management believes, individually or in the aggregate, would have a material adverse effect on our business, financial conditions or operating results.

Dividend Distributions

We have never paid any cash dividends on our ordinary shares, and we do not intend to pay cash dividends on our ordinary shares in the foreseeable future. Our current policy is to retain earnings for use in our business.

In the event that we decide to pay a cash dividend from income that is tax exempt under our approved enterprise status, we would be liable for corporate tax on the amount distributed at the rate of up to 25%, which would be in addition to the tax payable by the divided payee. See Note 14 of our Consolidated Financial Statements and "Item 10. Taxation." Cash dividends may be paid by an Israeli company only out of retained earnings as calculated under Israeli law. We currently have no retained earnings and do not expect to have any retained earnings in the foreseeable future.

Significant Changes

No significant changes have occurred since the date of the consolidated financial statements included in this annual report.

ITEM 9. THE OFFER AND LISTING

Markets and Share Price History

The principal trading market for our ordinary shares is the Nasdaq National Market, where our shares have been listed and traded under the symbol “CGEN” since our initial public offering in August, 2000. Our shares have also been traded on the Tel Aviv Stock Market under the Hebrew symbol which is equivalent to "CGEN" since January 7, 2002. The following table sets forth, for the periods indicated, the high and low reported sales prices of the ordinary shares on the Nasdaq National Market and on the Tel Aviv Stock Exchange:

	Nasdaq		***TASE**	
Last Six Calendar Months	**High**	**Low**	**High**	**Low**
January 2006	$5.220	$4.050	$5.304	$3.457
December 2005	$4.350	$2.550	$4.064	$2.578
November 2005	$3.200	$2.500	$2.996	$2.581
October 2005	$3.310	$2.460	$3.404	$2.698
September 2005	$3.840	$3.070	$3.822	$3.198
August 2005	$4.100	$3.360	$3.903	$3.352
Financial Quarters During the Past Two Full Fiscal Years				
Fourth Quarter of 2005	$4.350	$2.460	$4.064	$2.578
Third Quarter 2005	$4.100	$2.820	$3.903	$2.974
Second Quarter 2005	$4.380	$2.740	$4.276	$2.665
First Quarter 2005	$6.540	$3.800	$6.557	$3.844
Fourth Quarter of 2004	$5.250	$3.650	$5.262	$3.725
Third Quarter 2004	$5.410	$3.180	$5.180	$3.042
Second Quarter 2004	$7.190	$4.280	$7.055	$4.336
First Quarter 2004	$8.090	$5.010	$8.130	$5.127
Last Five Full Financial Years				
2005	$6.540	$2.460	$6.557	$2.578
2004	$8.090	$3.180	$8.130	$3.042
2003	$6.300	$1.500	$6.086	$1.505
2002	$5.240	$0.910	$6.335	$0.894
2001	$8.625	$2.600	--	--

*the currency by which our stock is traded on the Tel Aviv Stock Exchange is the New Israel Shekels. The above dollar amounts represent a conversion from New Israel Shekels to Dollar amounts in accordance with the Dollar - New Israel Shekel conversion rate as of the relevant date of trade.

ITEM 10. ADDITIONAL INFORMATION

Memorandum and Articles of Association

Objects and Purposes of the Company

We are registered under Israel's Companies Law, 1999 ("Companies Law") as a public company under the name Compugen Ltd. and public company number 51-177-963-9. The objective stated in our Articles of Association is to engage in any lawful activity.

Powers of the Directors

Pursuant to the Companies Law and our Articles of Association, a director is not permitted to vote on a proposal, arrangement or contract in which he or she has a personal interest. Also, the directors may not vote compensation to themselves or any members of their body without the approval of our audit committee and our shareholders at a general meeting. The requirements for approval of certain transactions are set forth below in “Item 10. Additional Information; Memorandum and Articles of Association; Approval of Certain Transactions”. The powers of our directors to enter into borrowing arrangements on our behalf are limited to the same extent as any other transaction by us.

Approval of Certain Transactions

The Companies Law codifies the fiduciary duties that office holders, including directors and executive officers, owe to a company. An office holder, as defined in the Companies Law, is a director, general manager, chief business manager, deputy general manager, vice general manager, executive vice president, vice president, other manager directly subordinate to the managing director or any other person assuming the responsibilities of any of the foregoing positions without regard to such person's title. An office holder's fiduciary duties consist of a duty of care and a duty of loyalty. The duty of loyalty includes avoiding any conflict of interest between the office holder's position in the company and his personal affairs, avoiding any competition with the company, avoiding exploitation of any business opportunity of the company in order to reap personal gain for himself or others, and revealing to the company any information or documents relating to the company's affairs which the office holder has received due to his position as an office holder. Each person listed in the table under "Directors and Senior Management", which is displayed under “Item 6. Directors, Senior Management and Employees; Directors and Senior Management”, is one of our office holders. Under the Companies Law, all arrangements as to compensation of office holders who are not directors, require approval of the board of directors, or a committee thereof or of persons to whom such power is delegated. Arrangements regarding the compensation of directors also require audit committee and shareholder approval, with the exception of compensation to outside directors in the amounts specified in the regulations promulgated under the Companies Law, all as described in “Item 6. Directors and Senior Management; Compensation.”

The Companies Law requires that an office holder promptly discloses any personal interest that he or she may have and all related material information known to him or her, in connection with any existing or proposed transaction by the company. The disclosure must be made to our board of directors or shareholders prior to the meeting at which the transaction is to be discussed. In addition, if the transaction is an extraordinary transaction, as defined under the Companies Law, the office holder must also disclose any personal interest held by the office holder's spouse, siblings, parents, grandparents, descendants, spouse's descendants and the spouses of any of the foregoing, or by any corporation in which the office holder is a five percent (5%) or greater shareholder, or holder of 5% or more of the voting power, director or general manager or in which he or she has the right to appoint at least one director or the general manager. An extraordinary transaction is defined as a transaction not in the ordinary course of business, not on market terms, or that is likely to have a material impact on the company's profitability, assets or liabilities.

In the case of a transaction which is not an extraordinary transaction, after the office holder complies with the above disclosure requirement, only board of directors’ approval is required unless the Articles of

Association of the company provide otherwise. A transaction must not be adverse to the company's interest. If the transaction is an extraordinary transaction, then, in addition to any approval required by the Articles of Association, the transaction must also be approved by the audit committee and by the board of directors, and under specified circumstances, by a meeting of the shareholders. An office holder who has a personal interest in a matter that is considered at a meeting of the board of directors or the audit committee may not be present at this meeting or vote on this matter.

The Companies Law applies the same disclosure requirements to a controlling shareholder of a public company, which is defined as a shareholder who has the ability to direct the activities of a company, other than in circumstances where this power derives solely from the shareholder's position on the board of directors or any other position with the company, and includes a shareholder that holds 25% or more of the voting rights if no other shareholder owns more than 50% of the voting rights in the company. Extraordinary transactions with a controlling shareholder or in which a controlling shareholder has a personal interest, and the terms of compensation of a controlling shareholder who is an office holder, require the approval of the audit committee, the board of directors and the shareholders of the company.

The shareholders' approval must either include at least one-third of the disinterested shareholders who are present, in person or by proxy, at the meeting, or, alternatively, the total shareholdings of the disinterested shareholders who vote against the transaction must not represent more than one percent (1%) of the voting rights in the company.

In addition, a private placement of securities that will increase the relative holdings of a shareholder that holds five percent (5%) or more of the company's outstanding share capital, assuming the exercise by such person of all of the convertible securities into shares held by that person, or that will cause any person to become a holder of more than five percent (5%) of the company's outstanding share capital, requires approval by the board of directors and the shareholders of the company. However, subject to certain exceptions, shareholders approval will not be required if the aggregate number of shares issued pursuant to such private placement, assuming the exercise of all of the convertible securities into shares being sold in such a private placement, comprises less than twenty percent (20%) of the voting rights in a company prior to the consummation of the private placement.

Under the Companies Law, a shareholder has a duty to act in good faith towards the company and other shareholders and refrain from abusing his power in the company. Shareholders' voting powers includes their power to vote in the general meetings of shareholders on the following matters:

- any amendment to the Articles of Association;
- an increase of the company's authorized share capital;
- a merger; and
- approval of interested party transactions.

In addition, any controlling shareholder, any shareholder who knows it can determine the outcome of a shareholders vote and any shareholder who, under our Articles of Association, can appoint or prevent the appointment of an office holder, is under a duty to act with fairness towards the company. The Companies Law does not describe the substance of this duty. The Companies Law requires that specified types of transactions, actions and arrangements be approved as provided for in a company's articles of association and in some circumstances by the audit committee, by the board of directors and by the shareholders. In general, the vote required by the audit committee and the board of directors for approval of these matters, in each case, is a majority of the disinterested directors participating in a duly convened meeting.

For information concerning the direct and indirect personal interests of some of our office holders and principal shareholders in transactions with us, see "Item 7. Major Shareholders; Related Party Transactions" above.

Rights Attached to Ordinary Shares

Our authorized share capital consists of 50,000,000 ordinary shares, par value NIS 0.01 per share. Holders of ordinary shares have one vote per share, and are entitled to participate equally in the payment of dividends and share distributions and, in the event of our liquidation, in the distribution of assets after satisfaction of liabilities to creditors. No preferred shares are currently authorized. All outstanding ordinary shares are validly issued and fully paid.

Transfer of Shares

Fully paid ordinary shares are issued in registered form and may be freely transferred under our Articles of Association unless the transfer is restricted or prohibited by another instrument.

Dividend and Liquidation Rights

We may declare a dividend to be paid to the shareholders of our ordinary shares according to their rights and interests in our profits. In the event of our liquidation, after satisfaction of liabilities to creditors, our assets will be distributed to the shareholders of our ordinary shares in proportion to the nominal value of their shareholdings. This right may be affected by the grant of preferential dividend or distribution rights to the shareholders of a class of shares with preferential rights that may be authorized in the future. Pursuant to Israel's securities laws, a company registering its shares for trade on the Tel Aviv Stock Exchange (TASE) may not have more than one class of shares for a period of one year following registration, after which it is permitted to issue preference shares. Under the Companies Law, the declaration of a dividend does not require the approval of the shareholders of the company, unless the company's Articles of Association require otherwise. Our Articles of Association provide that the board of directors may declare and distribute dividends without the approval of the shareholders.

To date, we have not declared or distributed any dividend.

Annual and Extraordinary General Meetings

We must hold our annual general meeting of shareholders each year no later than 15 months from the last annual meeting, at a time and place determined by the board of directors, upon at least 21 days' prior notice to our shareholders. A special meeting may be convened by request of two directors or by written request of one or more shareholders holding at least 5% of our issued share capital and 1% of the voting rights or one or more shareholders holding at least 5% of the voting rights. Shareholders requesting a special meeting must submit their proposed resolution with their request. Within 21 days of receipt of the request, the board of directors must convene a special meeting and send out notices setting forth the date, time and place of the meeting. Such notice must be given at least 21 days but not more than 35 days prior to the special meeting.

The quorum required for a meeting of shareholders consists of at least two shareholders present in person or by proxy who hold or represent between them at least 33.3% of the issued share capital. A meeting adjourned for lack of a quorum generally is adjourned to the same day in the following week at the same time and place or any time and place as the directors designate in a notice to the shareholders. At the reconvened meeting, the required quorum consists of any two members present in person or by proxy.

Voting Rights

Our ordinary shares do not have cumulative voting rights in the election of directors. As a result, the holders of ordinary shares that represent more than 50% of the voting power represented at a shareholders meeting have the power to elect all of our directors, except the outside directors whose election requires a special majority as described under the section entitled "Item 6. Directors, Senior Management and Employees; Board Practices; Outside and Independent Directors."

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

Under the Companies Law, unless otherwise provided in the Articles of Association or by applicable law, all resolutions of the shareholders require a simple majority and all shareholders' meetings require prior notice of at least 21 days. Our Articles of Association provide that all decisions may be made by a simple majority. See "Item 10. Additional Information; Memorandum and Articles of Association; Approval of Certain Transactions" above for certain duties of shareholders towards the company.

Limitations on the Rights to Own Securities

The ownership or voting of ordinary shares by non-residents of Israel is not restricted in any way by our articles of association or the laws of the State of Israel, except that nationals of countries which are, or have been, in a state of war with Israel may not be recognized as owners of our shares.

Anti-Takeover Provisions under Israeli Law

The Companies Law provides that an acquisition of shares in a public company must be made by means of a tender offer if, as a result of such acquisition, the purchaser would become shareholder with over 25% of the voting rights in the company. This rule does not apply if there is already another shareholder of the company with 25% or more of the voting rights. Similarly, the Companies Law provides that an acquisition of shares in a public company must be made by means of a tender offer if, as a result of the acquisition, the purchaser's shareholdings would entitle the purchaser to over 45% of the voting rights in the company, unless there is a shareholder with 50% or more of the voting rights in the company. These rules do not apply if the acquisition is made by way of a merger.

Finally, in general, Israeli tax law treats specified acquisitions less favorably than does US tax law. However, Israeli tax law provides for tax deferral in specified acquisitions, including transactions where the consideration for the sale of shares is the receipt of shares of the acquiring company.

Material Contracts

In June 2005, we announced the entry into a collaboration with Ortho-Clinical Diagnostics, Inc. ("OCD"), for the development and commercialization of immunoassay based diagnostic products that are based on the output of our diagnostic discovery engines. The terms of this agreement allow OCD to select up to nine diagnostic biomarkers and then we will collaborate on the initial clinical validation of the selected biomarkers. Under the agreement, successfully validated biomarkers will be developed into products and commercialized by OCD, and we will receive milestone payments and license fees for each commercialized biomarker, in addition to revenue-based royalties. We received together with OCD a grant from the Israel-U.S. Bi-national Industrial Research and Development Foundation for contribution to our research and development expenditures under our joint collaborative project.

In June 2005, we also announced the entry into a collaboration with Biosite Incorporated, for the development and commercialization of immunoassay based diagnostic products based on the output of our diagnostic discovery engines. Under the terms of this agreement, we granted to Biosite an exclusive license in the diagnostic field to use certain of our targets for immunoassay based diagnostic applications. In return for this grant, we are entitled to receive milestone payments and royalties from the sales of each diagnostic product emerging from the collaboration. We also retained the exclusive right to pursue further development of these targets in the therapeutic field, and for which Biosite will be entitled to receive from us milestone payments and royalties arising from any successful therapeutic application.

In April 2005, we announced a joint pilot research project with Novartis in the field of systems biology. Under the agreement, we were required to generate information about biological interaction networks through the development of a proprietary platform for research and analysis of microarray and other

biological data. In consideration for a one time payment by Novartis, Novartis obtained sole rights to the specific results of the project. We retained all rights to the research and discovery systems developed through the collaboration.

In August 2004, we entered into a broad pipeline discovery-based collaboration with Diagnostic Product Corporation ("DPC"), for the development and commercialization of diagnostic products based on the output of our diagnostic discovery engines, with an anticipated focus on cancer and cardiovascular disease. The terms of this agreement allow DPC to develop and commercialize immunoassay and nucleic-acid based diagnostic products that are based on candidate biomarkers that we already discovered, as well as additional candidates that may arise out of the collaboration.

Exchange Controls

Under Israeli Law, Israeli non-residents who purchase ordinary shares with certain non-Israeli currencies (including dollars) may freely repatriate in such non-Israeli currencies all amounts received in Israeli currency in respect of the ordinary shares, whether as a dividend, as a liquidating distribution, or as proceeds from any sale in Israel of the ordinary shares, provided in each case that any applicable Israeli income tax is paid or withheld on such amounts. The conversion into the non-Israeli currency must be made at the rate of exchange prevailing at the time of conversion. Under Israeli law, both residents and non-residents of Israel may freely hold, vote and trade ordinary shares.

Taxation

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

We urge shareholders and prospective purchasers of our ordinary shares to consult their own tax advisors as to the US, Israeli, or other tax consequences of the purchase, ownership and disposition of ordinary shares, including, in particular, the effect of any foreign, state or local taxes.

Israeli Tax Considerations

The following discussion refers to the current tax law applicable to companies in Israel, with special reference to its effect on us. This discussion also includes specified Israeli tax consequences to holders of our ordinary shares and Israeli Government programs benefiting us.

General Corporate Tax Structure

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

Tax Benefits Under the Law for the Encouragement of Capital Investments, 1959

The Law for the Encouragement of Capital Investment, 1959 (the “Investment Law”) provides that a proposed capital investment in production facilities or other eligible facilities may be designated as an "Approved Enterprise". To obtain an “Approved Enterprise” status, an application to the Investment Center of the Ministry of Industry, Trade and Labor (the “Investment Center”) needs to be submitted. Each instrument of approval for an Approved Enterprise relates to a specific investment program that is defined both by the financial scope of the investment, including sources of funds, and by the physical characteristics of the facility or other assets.

The tax benefits available under any instrument of approval relate only to taxable profits attributable to the specific program and are contingent upon meeting the criteria set out in the instrument of approval. If a company has more than one approval or only a portion of its capital investments are approved, its effective tax rate is the weighted average of the applicable rates**.** However, subject to certain qualifications, if a company with one or more approvals distributes dividends, the dividends are deemed attributable to the entire enterprise

Tax benefits for income from Approved Enterprises approved before April 1, 2005

Before April 1, 2005 an Approved Enterprise was entitled to receive either a grant from the Government of Israel or an alternative package of tax benefits ("Alternative Benefits"). We have elected to forego the entitlement to grants and have applied for the Alternative Benefits, under which undistributed income that we generate from our Approved Enterprises will be completely tax exempt (a "tax exemption") for two years commencing from the year that we first produce taxable income from the applicable Approved Enterprise. The portion of our profits derived from our approved enterprise programs will be subject to a tax rate of between 10% and 25% for an additional five to eight years. The tax rate within the range of 10% and 25% that may actually become payable is a function of the percentage of non-Israeli investors holding our ordinary shares. These reduced corporate tax rates will cease to apply upon the expiry of the earlier of twelve years from the time at which we attain a prescribed level of investment in our approved enterprise (known as "commencement of production") or 14 years from the date on which we received approval for an Approved Enterprise.

As a result of the transfer of certain assets to Keddem Bioscience under the Asset Purchase Agreement between us and Keddem Bioscience, Keddem Bioscience has also received the Approved Enterprise status under the Alternative Benefits track applying to the transferred assets. For more information about our agreement with Keddem Bioscience, see "Item 10. Additional Information; Material Contracts; Keddem Bioscience Ltd."

Alternative Benefits are available until the earlier of (i) seven or ten consecutive years, commencing in the year in which the specific Approved Enterprise first generates taxable income, (ii) 12 years from commencement of production, and (iii) 14 years from the date of approval of the Approved Enterprise status.

Dividends paid out of income generated by an Approved Enterprise (or out of dividends received from a company whose income is generated by an Approved Enterprise) are generally subject to withholding tax at the rate of 15%. This withholding tax is deductible at source by the Approved Enterprise. The 15% tax rate is limited to dividends and distributions out of income derived during the benefits period and actually paid at any time up to 12 years after commencement of production. Since we elected the Alternative Benefits track, we will be subject to pay corporate tax at the rate of 25% in respect of the gross amount of the dividend that we may distribute. If we will also be deemed to be a "Foreign Investors' Company" which is at least 49% owned by non-Israeli residents, the corporate tax rate paid by us in respect of dividend that we may distribute from income derived by our Approved Enterprises during the tax exemption period, may be taxed at a lower rate. Subject to certain conditions, a Foreign Investors' Company or "FIC" is a company with a level of foreign investment of more than 25%. The level of foreign investment is measured as the percentage of rights in the company (in terms of shares, rights to profits, voting and appointment of directors), and of combined share and loan capital, that are owned, directly or indirectly, by persons who are not residents of Israel.

Since we have elected the Alternative Benefits package, we are not obliged to attribute any part of dividend that we may distribute to exempt profits, and we may decide from which year's profits to declare dividends. We currently intend to reinvest any income that we may in the future derive from our Approved Enterprise programs and not to distribute the income as a dividend.

If we will qualify as a FIC, our Approved Enterprises will be entitled to additional tax benefits and we will be eligible for an extension of the period during which we will be entitled to tax benefits under our Approved Enterprise status (so that the benefit periods may be up to ten years) and for further tax benefits

if the level of foreign investment exceeds 49%.

The benefits available to an Approved Enterprise are subject to the fulfillment of conditions stipulated in the Investment Law and its regulations and the criteria in the specific certificate of approval, as described above. If we do not meet these conditions, we would be required to refund the amount of tax benefits, linked to the consumer price index and interest.

Tax benefits under an Amendment that became effective on April 1, 2005

On April 1, 2005, a significant amendment to the Investment Law became effective (the "Amendment"). The Amendment does not apply to benefits included in any certificate of approval that was granted before the Amendment came into effect, which will remain subject to the provisions of the Investment Law as they were on the date of such approval.

Under the Amendment, "Approved Enterprise" status will continue to be granted by the Investment Center to qualifying investments. However, the Amendment limits the scope of enterprises which may be approved by the Investment Center, by setting criteria for the approval of a facility as an Approved Enterprise, such as provisions generally requiring that at least 25% of the Approved Enterprise's income will be derived from export.

The Amendment provides that Approved Enterprise status will only be necessary for receiving grants. As a result, it is no longer necessary for a company to acquire Approved Enterprise status in order to receive the tax benefits previously available under the Alternative Benefits provisions. Rather, a company may claim the tax benefits offered by the Investment Law directly in its tax returns, provided that its facilities meet the criteria for tax benefits set out by the Amendment. Companies are entitled to approach the Israeli Tax Authority for a pre-ruling regarding their eligibility for benefits under the Amendment.

Tax benefits are available under the Amendment to production facilities (or other eligible facilities), which are generally required to derive more than 25% of their business income from export. In order to receive the tax benefits, the Amendment states that the company must make an investment which meets all the conditions set out in the Amendment for tax benefits and exceeds a minimum amount and a minimum percentage of the value of the company's production assets at the end of the calendar year preceding the expansion, that is specified in the Investment Law. Such investment allows the company to receive a "Benefited Enterprise" status, and may be made over a period of no more than three years ending at the end of the year in which the company requested to have the tax benefits apply to the Benefited Enterprise (the "Year of Election"). Where the company requests to have the tax benefits apply to an expansion of existing facilities, only the expansion will be considered to be a Benefited Enterprise and the company's effective tax rate will be the weighted average of the applicable rates. In this case, the minimum investment required in order to qualify as a Benefited Enterprise is required to exceed a minimum amount and a minimum percentage of the value of the company's production assets at the end of the calendar year preceding the expansion.

The extent of the tax benefits available under the Amendment to qualifying income of a Benefited Enterprise are determined by the geographic location of the Benefited Enterprise. The location will also determine the period for which tax benefits are available.

Dividends paid out of income derived by a Benefited Enterprise will be treated similarly to payment of dividends by an Approved Enterprise under the Alternative Benefits track. Therefore, dividends paid out of income derived by a Benefited Enterprise (or out of dividends received from a company whose income is derived from a Benefited Enterprise) are generally subject to withholding tax at the rate of 15%, deductible at source. The reduced rate of 15% is limited to dividends and distributions out of income derived from a Benefited Enterprise during the benefits period and actually paid at any time up to 12 years thereafter. A company qualifying for tax benefits under the Amendment which pays a dividend out of income derived by its Benefited Enterprise during the tax exemption period will be subject to tax in respect of the gross amount of the dividend at the otherwise applicable rate of 25%, (or lower in the case of a qualified "FIC"

which is at least 49% owned by non-Israeli residents). The dividend recipient would be subject to tax at the rate of 15% on the amount received which tax would be deducted at source.

The Amendment sets a minimal amount of foreign investment required for a company to be regarded a FIC.

Tax Benefits for Research and Development

Israeli tax law allows, under specific conditions, a tax deduction in the year incurred for expenditures, including capital expenditures, relating to scientific research and development projects, if the expenditures are approved by the relevant Israeli government ministry, determined by the field of research, and the research and development is for the promotion of the company and is carried out by or on behalf of the company seeking the deduction. Expenditures not so approved are deductible over a three-year period.

Tax Benefits under the Law for the Encouragement of Industry (Taxes), 1969

The Law for the Encouragement of Industry (Taxes), 1969, generally referred to as the Industry Encouragement Law, provides several tax benefits for industrial companies. An industrial company is defined as a company resident in Israel, at least 90% of the income of which in a given tax year exclusive of income from specified government loans, capital gains, interest and dividends, is derived from an industrial enterprise owned by it. An industrial enterprise is defined as an enterprise whose major activity in a given tax year is industrial production activity.

Under the Industry Encouragement Law, industrial companies are entitled to a number of corporate tax benefits, including:

- deduction of purchase of know-how and patents over an eight-year period; and
- the right to elect, under specified conditions, to file a consolidated tax return with additional related Israeli industrial companies and an industrial holding company.

Under some tax laws and regulations, an industrial enterprise may be eligible for special depreciation rates for machinery, equipment and buildings. These rates differ based on various factors, including the date the operations begin and the number of work shifts. An industrial company owning an approved enterprise may choose between these special depreciation rates and the depreciation rates available to the approved enterprise. We are entitled to choose an accelerated rate of depreciation.

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

We believe that we currently qualify as an industrial company within the definition of the Industry Encouragement Law. We cannot assure you that the Israeli tax authorities will agree that we qualify, or, if we qualify, that we will continue to qualify as an industrial company or that the benefits described above will be available to us in the future.

Special Provisions Relating to Taxation under Inflationary Conditions

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

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

by the applicable annual rate of inflation is added to taxable income; and

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

Capital Gains Tax on Sale of our Publicly Traded Ordinary Shares by both residents and non-residents of Israel.

Israeli law generally imposes a capital gains tax on the sale of capital assets located in Israel, including shares in Israeli resident companies, unless a specific exemption is available or unless a treaty between Israel and the country of the non-resident provides otherwise.

On January 1, 2006 an amendment to the Israeli tax regime became effective (the "2006 Tax Reform"). The 2006 Tax Reform significantly changed the tax rates applicable to income derived from shares.

According to the 2006 Tax Reform, an individual is subject to a 20% tax rate on real capital gains derived from the sale of shares, as long as the individual is not a "substantial shareholder" (generally a shareholder with 10% or more of the right to profits, right to nominate a director and voting rights) of the company issuing the shares. The rate on the gains from publicly traded shares applicable to gains that were realized before January 1, 2006 was 15%.

A substantial shareholder will be subject to tax at a rate of 25% in respect of real capital gains derived from the sale of shares issued by the company in which he is a substantial shareholder. The determination of whether the individual is a substantial shareholder will be made on the date that the securities are sold. In addition, the individual will be deemed to be a substantial shareholder if at any time during the 12 months preceding this date he had been a substantial shareholder.

With respect to gains accrued before January 1, 2003, regulations promulgated under the Israeli Income Tax Ordinance provided for an exemption from Israeli capital gains tax on gains that were derived from the sale of shares of an "Industrial Company", as defined by the Industry Encouragement Law. This exemption only applied to shares that were traded on specified non-Israeli markets, including the NASDAQ National Market, provided that the sellers purchased their shares either in the company's initial public offering or in public market transactions thereafter. The exemption did not apply to shareholders who are in the business of trading securities, or to shareholders that are Israeli resident companies and subject to the Income Tax Law (Inflationary Adjustments) - 1985. We believe that we are currently an Industrial Company, as defined by the Industry Encouragement Law. The status of a company as an Industrial Company may be reviewed by the tax authorities from time to time. There can be no assurance that the Israeli tax authorities will not deny our status as an Industrial Company, possibly with retroactive effect.

Corporations are subject to corporate tax rates in respect of total income, including capital gains. The 2006 Tax Reform provides that the corporate tax rate will be reduced gradually from 34% in 2005 to 31% in 2006, 29% in 2007, 27% in 2008, 26% in 2009 and 25% in 2010. However, between 2006 and 2009, corporations whose taxable income was not determined immediately before the 2006 Tax Reform was published, pursuant to part B of the Israeli Income Tax Law (Inflationary Adjustments), 1985 or pursuant to the Income Tax Regulations (Rules on Bookkeeping by Foreign Invested Companies and Certain Partnership and Determination of their Chargeable Income), 1984 ("Dollar Regulations") will generally be taxed at a rate of 25% on their capital gains from the sale of their shares.

Non-residents of Israel will generally be exempt from any capital gains tax from the sale of publicly traded shares so long as the gains are not derived through a permanent establishment that the non-resident maintains in Israel, and so long as the shares remain listed for trading on a designated stock market. These provisions dealing with capital gains are not applicable to a person whose gains from selling or otherwise disposing of the Shares are deemed to be business income.

In addition, pursuant to the Convention Between the Government of the United States of America and the Government of Israel with Respect to Taxes on Income, as amended (the "United States- Israel Tax

Treaty"), the sale, exchange or disposition of ordinary shares by a person who qualifies as a resident of the United States within the meaning of the United States-Israel Tax Treaty and who is entitled to claim the benefits afforded to such person by the United States- Israel Tax Treaty (a "Treaty United States Resident") generally will not be subject to the Israeli capital gains tax unless such "Treaty United States Resident" holds, directly or indirectly, shares representing 10% or more of our voting power during any part of the 12-month period preceding such sale, exchange or disposition, subject to certain conditions. However, under the United States-Israel Tax Treaty, such "Treaty United States Resident" would be permitted to claim a credit for such taxes against the United States federal income tax imposed with respect to such sale, exchange or disposition, subject to the limitations in United States laws applicable to foreign tax credits. The United States-Israel Tax Treaty does not relate to United States state or local taxes.

Non-residents of Israel are subject to income tax on income accrued or derived from sources in Israel. These sources of income include passive income, including dividends, royalties and interest, as well as non-passive income from services rendered in Israel. On distribution of dividends other than bonus shares or stock dividends, income tax is withheld at source, at the rate of 20% for dividends paid to an individual who is not a substantial share holder, 25% for dividends paid to a substantial shareholder or a foreign corporation, and 15% for dividends generated by an approved enterprise, unless in each case a different rate is provided in a treaty between Israel and shareholder's country of residence. Under the US-Israel tax treaty, the maximum tax on dividends paid to a holder of ordinary shares who is a US resident will be 25%. However, the maximum tax rate on dividends not generated by an approved enterprise paid to a US corporation holding at least 10% of our voting power is 12.5%.

United States Federal Income Tax Considerations

The following discusses the material United States federal income tax consequences to a holder of our ordinary shares who qualifies as a US Holder, which is defined as:

- a citizen or resident of the United States;
- a corporation created or organized under the laws of the United States, the District of Columbia, or any state; or
- a trust or estate, treated, for United States federal income tax purposes, as a domestic trust or estate.

This definition is based on current provisions of the Internal Revenue Code of 1986 (the "Code"), as amended, current and proposed Treasury regulations promulgated under the Code, and administrative and judicial decisions as of the date of this prospectus, all of which are subject to change, possibly on a retroactive basis. This definition does not encompass any aspect of state, local or non-United States tax laws.

Further, this definition does not purport to be a comprehensive description of all of the tax considerations that may be relevant to US Holders entitled to special treatment under United States federal income tax laws, for example, financial institutions, insurance companies, tax-exempt organizations and broker-dealers, and it does not address all aspects of United States federal income taxation that may be relevant to any particular shareholder based on the shareholder's individual circumstances. In particular, this definition does not address the potential application of the alternative minimum tax, nor the special United States federal income tax rules applicable in special circumstances, including to US Holders who:

- have elected mark-to-market accounting;
- hold our ordinary shares as part of a straddle, hedge or conversion transaction with other investments;
- own directly, indirectly or by attribution at least 10% of our voting power; and
- have a functional currency that is not the US dollar.

Additionally, this definition does not consider the tax treatment of partnerships or persons who hold ordinary shares through a partnership or other pass-through entity or the possible application of United States federal gift or estate taxes. Material aspects of United States federal income tax relevant to a holder

other than a US Holder are also described below.

Taxation of Dividends Paid On Ordinary Shares

A US Holder will be required to include in gross income as ordinary income the amount of any distribution paid on ordinary shares, including any Israeli taxes withheld from the amount paid, to the extent the distribution is paid out of our current or accumulated earnings and profits as determined for United States federal income tax purposes. Distributions in excess of these earnings and profits will be applied against and will reduce the US Holder's basis in the ordinary shares and, to the extent in excess of this basis, will be treated as gain from the sale or exchange of ordinary shares.

Dividend income earned by individuals may be eligible for a reduced rate of taxation. Dividend income will be taxed at the applicable long-term capital gains rate if the dividend is received from a "qualified foreign corporation," and the shareholder of such foreign corporation holds such stock for more than 60 days during the 120 day period that begins on the date that is 60 days before the ex-dividend date for the stock. The holding period is tolled for any days on which the shareholder has reduced his risk of loss. A "qualified foreign corporation" is one that is eligible for the benefits of a comprehensive income tax treaty with the United States. A foreign corporation will be treated as qualified with respect to any dividend paid, if its stock is readily tradable on an established securities market. However, a foreign corporation will not be treated as qualified if it is a Passive Foreign Investment Company (as discussed below) for the year in which the dividend was paid or the preceding year.

Distributions of current or accumulated earnings and profits paid in foreign currency to a US Holder will be includible in the income of a US Holder in a US dollar amount calculated by reference to the exchange rate on the day the distribution is received. A US Holder that receives a foreign currency distribution and converts the foreign currency into US dollars subsequent to receipt will have foreign exchange gain or loss based on any appreciation or depreciation in the value of the foreign currency against the US dollar, which will generally be US source ordinary income or loss.

As described above, we will generally be required to withhold Israeli income tax from any dividends paid to holders who are not resident in Israel. See "Israeli Tax Considerations — Taxation of Non-Resident Holders of Shares." If a US Holder receives a dividend from us that is subject to Israeli withholding, the following would apply:

- You must include the gross amount of the dividend, not reduced by the amount of Israeli tax withheld, in your US taxable income.
- You may be able to claim the Israeli tax withheld as a foreign tax credit against your US income tax liability.
- The foreign tax credit is subject to significant and complex limitations. Generally, the credit can offset only the portion of your US tax attributable to your net foreign source passive income. Additional special rules apply to taxpayers predominantly engaged in the active conduct of a banking, insurance, financing or similar business. Additionally, if we pay dividends at a time when 50% or more of our stock is owned by US persons, you may be required to treat the part of the dividend attributable to US source earnings and profits as US source income, possibly reducing the allowable credit, unless you elect to calculate your foreign tax credit separately with respect to our dividends.
- A US Holder will be denied a foreign tax credit with respect to Israeli income tax withheld from dividends received on the ordinary shares to the extent the US Holder has not held the ordinary shares for at least 16 days of the 30-day period beginning on the date which is 15 days before the ex-dividend date or to the extent the US Holder is under an obligation to make related payments with respect to substantially similar or related property. Any days during which a US Holder has substantially diminished its risk of loss on the ordinary shares are not counted toward meeting the 16-day holding period required by the statute.
- If you do not elect to claim foreign taxes as a credit, you will be entitled to deduct the Israeli income tax withheld from your Compugen dividends in determining your taxable income.

Individuals who do not claim itemized deductions, but instead utilize the standard deduction, may not claim a deduction for the amount of the Israeli income taxes withheld.

- If you are a US corporation holding our stock, you cannot claim the dividends-received deduction with respect to our dividends.

Special rules, described below, apply if we are a passive foreign investment company.

Taxation of the Disposition of Ordinary Shares

Subject to the description of the passive foreign investment company rules below, upon the sale, exchange or other disposition of our ordinary shares, a US Holder will recognize capital gain or loss in an amount equal to the difference between the US Holder's basis in the ordinary shares, which is usually the cost of these shares, and the amount realized on the disposition. If, as anticipated, the ordinary shares are publicly traded, a disposition of shares will be considered to occur on the trade date, regardless of the holder's method of accounting. Capital gain from the sale, exchange or other disposition of ordinary shares held more than one year is long-term capital gain and is eligible for a reduced rate of taxation for non-corporate holders. Gain or loss recognized by a US Holder on a sale, exchange or other disposition of ordinary shares generally will be treated as United States source income or loss for United States foreign tax credit purposes. The deductibility of capital losses is subject to limitations for both corporate and individual shareholders.

A US Holder that uses the cash method of accounting calculates the US dollar value of the proceeds received from a sale of ordinary shares as of the date that the sale settles, and will generally have no additional foreign currency gain or loss on the sale, while a US Holder that uses the accrual method of accounting is required to calculate the value of the proceeds of the sale as of the trade date and may therefore realize foreign currency gain or loss, unless the US Holder has elected to use the settlement date to determine its proceeds of sale for purposes of calculating this foreign currency gain or loss. In addition, a US Holder that receives foreign currency upon disposition of our ordinary shares and converts the foreign currency into US dollars subsequent to receipt will have foreign exchange gain or loss based on any appreciation or depreciation in the value of the foreign currency against the US dollar, which will generally be US source ordinary income or loss.

Tax Consequences If We Are a Passive Foreign Investment Company

Generally, a foreign corporation is treated as a passive foreign investment company ("PFIC") for United States federal income tax purposes for any tax year if, in such tax year, either (i) 75% or more of its gross income is passive in nature (the "Income Test"), or (ii) the average percentage of its assets during such tax year that produce, or are held for the production of, passive income (determined by averaging the percentage of the fair market value of its total assets which are passive assets as of the end of each quarter of such year) is 50% or more (the "Asset Test").

Because less than 75% of our gross income in 2005 and in prior years constituted passive income, as defined for purposes of the Income Test, we believe that application of the Income Test would have not have resulted in our classification as a PFIC for any of such years.

For 2001, 2002 and 2003, however, it is possible that we could be classified as a PFIC under the Asset Test principally because a significant portion of our assets consisted of the cash raised in connection with both a public offering and a private offering of our ordinary shares in 2000, coupled with the decline in the public market value of our ordinary shares during 2001, 2002 and through the beginning of 2003 and the timing of the required valuations, although there is no definitive method prescribed in the Code, United States Treasury Regulations or administrative or judicial interpretations thereof for determining the value of a foreign corporation's assets for purposes of the Asset Test. While the legislative history of the United States Taxpayer Relief Act of 1997 indicates that "the total value of a publicly-traded foreign corporation's assets generally will be treated as equal to the sum of the aggregate value of its outstanding stock plus its liabilities", there remains substantial uncertainty regarding the valuation of a publicly-traded foreign corporation's assets for purposes of the Asset Test.

In view of the uncertainty regarding the valuation of our assets for purposes of the Asset Test and the complexity of the issues regarding our treatment as a PFIC, US shareholders are urged to consult their own tax advisors for guidance as to our status as a PFIC. For those US shareholders who determine that we were a PFIC and notify us in writing of their request for the information required in order to effectuate the QEF Election described below, we will promptly make such information available to them.

If we are treated as a PFIC for United States federal income tax purposes for any year during a US shareholder's holding period of ordinary shares and the US shareholder does not make a QEF Election or a "mark-to-market" election (both as described below), any gain recognized by the US shareholder upon the sale of ordinary shares (or the receipt of certain distributions) would be treated as ordinary income. This income would be allocated over the US shareholder's holding period with respect to his ordinary shares and an interest charge would be imposed on the amount of deferred tax on the income allocated to prior taxable years.

Although we will be generally treated as a PFIC as to any US shareholder if we are a PFIC for any year during the U.S. Shareholder's holding period, if we cease to satisfy the requirements for PFIC classification, then under such circumstances, the US shareholder may avoid the consequences of PFIC classification for subsequent years if he elects to recognize gain based on the unrealized appreciation in the ordinary shares through the close of the tax year in which we cease to be a PFIC. Additionally, if we are treated as a PFIC, a US shareholder who acquires ordinary shares from a decedent would be denied the normally available step-up in tax basis for these ordinary shares to fair market value at the date of death and instead would have a tax basis equal to the decedent's tax basis in these ordinary shares.

For any tax year in which we are treated as a PFIC, a US shareholder may elect to treat his ordinary shares as an interest in a qualified electing fund (a "QEF Election"), in which case, the US shareholder would be required to include in income currently his proportionate share of our earnings and profits in years in which we are a PFIC regardless of whether distributions of our earnings and profits are actually distributed to the US shareholder. Any gain subsequently recognized upon the sale by the US shareholder of his ordinary shares, however, generally would be taxed as capital gain.

As an alternative to a QEF Election, a US shareholder may elect to mark his ordinary shares to market annually, recognizing ordinary income or loss (subject to certain limitations) equal to the difference between the fair market value of his ordinary shares and the adjusted tax basis of his ordinary shares. Losses would be allowed only to the extent of net mark-to-market gain accrued under the election.

We cannot assure you that we will avoid becoming a PFIC. US holders who hold ordinary shares during a period when we are a PFIC will be subject to the foregoing rules, even if we cease to be a PFIC. US Holders are urged to consult their tax advisors about the PFIC rules, including QEF elections.

United States Federal Income Tax Consequences for Non-US Holders of Ordinary Shares

Except as described in "Information Reporting and Back-up Withholding" below, a Non-US Holder of ordinary shares will not be subject to US federal income or withholding tax on the payment of dividends on, and the proceeds from the disposition of, ordinary shares, unless:

- the item is effectively connected with the conduct by the Non-US Holder of a trade or business in the United States and, in the case of a resident of a country which has a tax treaty with the United States, the item is attributable to a permanent establishment or, in the case of an individual, a fixed place of business, in the United States;
- the Non-US Holder is an individual who holds the ordinary shares as a capital asset and is present in the United States for 183 days or more in the taxable year of the disposition and does not qualify for an exemption; or
- the Non-US Holder is subject to tax under the provisions of United States tax law applicable to US expatriates.

Information Reporting and Back-up Withholding

US Holders generally are subject to information reporting requirements with respect to dividends paid in the United States on ordinary shares. Existing regulations impose back-up withholding on dividends paid in the United States on ordinary shares unless the US Holder provides IRS Form W-9 or otherwise establishes an exemption. US Holders are subject to information reporting and back-up withholding at a rate of 28% on proceeds paid from the disposition of ordinary shares unless the US Holder provides IRS Form W-9 or otherwise establishes an exemption.

Non-US Holders generally are not subject to information reporting or back-up withholding with respect to dividends paid on, or upon the disposition of, ordinary shares, provided that the non-US Holder provides a taxpayer identification number, certifies to its foreign status, or otherwise establishes an exemption.

Prospective investors should consult their tax advisors concerning the effect, if any, of these Treasury regulations on an investment in ordinary shares. The amount of any back-up withholding will be allowed as a credit against a US or Non-US Holder's United States federal income tax liability and may entitle the Holder to a refund, provided that specified required information is furnished to the IRS.

Documents on Display

We are required to file reports and other information with the SEC under the Securities Exchange Act of 1934 and the regulations thereunder applicable to foreign private issuers. You may inspect and copy reports and other information filed by us with the SEC at the SEC's public reference facilities described below. Although as a foreign private issuer we are not required to file periodic information as frequently or as promptly as United States companies, we generally announce publicly our quarterly and year-end results promptly and file periodic information with the SEC under cover of Form 6-K. As a foreign private issuer, we are also exempt from the rules under the Exchange Act prescribing the furnishing and content of proxy statements and our officers, directors and principal shareholders are exempt from the reporting and other provisions in Section 16 of the Exchange Act.

You may review a copy of our filings with the SEC, including any exhibits and schedules, at the SEC's public reference facilities in Room 1024, Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549 and at the regional office of the SEC located at the Northwestern Atrium Center, 500 West Madison Street, Suite 1400, Chicago, Illinois 60661 and at the offices of the Israel Securities Authority at 22 Kanfei Nesharim St., Jerusalem, Israel. You may also obtain copies of such materials from the Public Reference Section of the SEC, Room 1024, Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549, at prescribed rates. You may call the SEC at 1-800-SEC-0330 for further information on the public reference rooms. As a foreign private issuer we were only required to file through the SEC's EDGAR system as of November 2002. Our periodic filings are therefore available on the SEC's Website www.sec.gov from that date. You may read and copy any reports, statements or other information that we file with the SEC, through the SEC's EDGAR system available on the SEC's website and at the SEC facilities listed above. These SEC filings are also available to the public on the Israel Securities Authority's website at www.isa.gov.il and from commercial document retrieval services.

Any statement in this annual report about any of our contracts or other documents is not necessarily complete. If the contract or document is filed as an exhibit to this annual report, the contract or document is deemed to modify the description contained in this annual report. We urge you to review the exhibits themselves for a complete description of the contract or document.

ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to a variety of risks, including changes in interest rates and foreign currency exchange risk and inflation. On December 31, 2005 and December 31, 2004, $14 million of our available cash was invested in market risk sensitive instruments. These instruments are three structured notes that we acquired from three separate and unaffiliated issuers. These bear an interest rate, which is dependent upon the six-months LIBOR rate. For more information on the manner in which the interest rate is calculated, see Note 6 of our 2005 Consolidated Financial Statements.

We may, in the future, undertake hedging or other similar transactions or invest in other market risk sensitive instruments, if our management will determine that it is necessary to offset these risks.

Interest Rate Risk

As of December 31, 2005, we had $36.8 million in cash, cash equivalents and marketable securities. We invest our cash surplus in bank deposits and marketable securities. Since these investments typically carry fixed interest rate, excluding our structure note, and since our policy and practice is to hold these investments to maturity, financial income over the holding period is not sensitive to changes in interest rates.

Foreign Currency Exchange Risk and Inflation

Since the majority of our cash, cash equivalents and marketable securities are held in US dollars, we believe that inflation and fluctuations in the NIS/US dollar exchange rate have no material effect on our revenues.

We incur a significant portion of our expenses, principally salaries and related personnel expenses, in New Israel Shekels, or NIS. As a result, we are exposed to the risk that the rate of inflation in Israel will exceed the rate of devaluation of the NIS in relation to the US dollar or that the timing of this devaluation lags behind inflation in Israel. In addition, we are exposed to the risk that the US dollar will be devalued against the NIS. To date, we have not been materially affected by changes in the Israeli rate of inflation or the exchange rates of the NIS compared to the US dollar.

ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

Not applicable.

PART II

ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

None.

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

Material Modifications to the Rights of Security Holders

None.

Use of Proceeds

None.

ITEM 15. CONTROLS AND PROCEDURES

Our disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed in this report is recorded, processed, summarized and reported on a timely basis. Under the supervision of our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this annual report. Our Chief Executive Officer and Chief Financial Officer have also concluded that there were no significant changes in our internal controls or in other factors that could significantly affect the internal controls subsequent to that date of evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

ITEM 16. RESERVED

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Our board of directors has determined that Mr. David Schlachet, who chairs our audit committee, is our “audit committee financial expert”. Mr. Schlachet is "independent" as defined by Nasdaq.

ITEM 16B. CODE OF ETHICS

Our board of directors adopted a code of ethics that applies to our chief executive officer, chief financial officer, director of finance, controller, and other persons performing similar functions.

The code of ethics is posted on our website, addressed www.cgen.com.

ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The following table presents the fees paid to our external auditors for professional services rendered in the years ended December 31, 2005 and 2004:

	2005	2004
Audit Fees	$55,000	$55,000
Audit Related Fees	-	-
Tax Fees	$10,000	$13,000
All Other Fees	$2,120	$1,935
Total	**$67,120**	**$69,935**

"Audit Fees" are fees for professional services rendered in connection with the audit of our consolidated annual financial statements and review of our unaudited interim financial statements;

"Audit Related Fees" are fees for professional services rendered in connection with the audit and other assignments, relating to internal accounting functions and procedures;

"Tax Fees" are fees for services rendered in connection with tax compliance, tax planning and tax advice; and

"All Other Fees" are fees for consulting services rendered to us.

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

None.

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

None.

PART III

ITEM 17. FINANCIAL STATEMENTS

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

ITEM 18. FINANCIAL STATEMENTS

See pages F-1 to F-35.

ITEM 19. EXHIBITS

Index to Exhibits

Exhibit Number	Description
*1.1	Form of Articles of Association of Issuer
10.1	Consent of Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global, dated 23rd March 2006.
10.2	Consent of Kesselman & Kesselman, member of PriceWaterhouseCoopers, independent auditors of Keddem Bioscience, dated March 27, 2006.
10.3	Audit Report by Kesselman & Kesselman, member of PriceWaterhouseCoopers, independent auditors of Keddem Bioscience, dated February 6, 2005.
12.1	Certification by Chief Executive Officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
12.2	Certification by Chief Financial Officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
12.3	Certification by Chief Executive Officer pursuant to section 906 of the Sarbanes-Oxley Act of 2002.
12.4	Certification by Chief Financial Officer pursuant to section 906 of the Sarbanes-Oxley Act of 2002.

* Filed as exhibit to our registration statement on Form F-1, registration number 333-12316, as amended, filed with the Securities and Exchange Commission, and is hereby incorporated by reference.

SIGNATURES

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the registrant hereby certifies that it meets all the requirements for filing on Form 20-F and has duly caused this annual report to be signed on its behalf by the undersigned, thereunto duly authorized, in the city of Tel Aviv, State of Israel, on this 27th day of March, 2006.

COMPUGEN LTD.

Signature: \s\ Mr. Alex Kotzer

Name: Alex Kotzer
Title: President, Chief Executive Officer and Director
Date: March 27, 2006

Exhibit 12.1

CERTIFICATION PURSUANT TO SECTION 302
OF THE SARBANES-OXLEY ACT OF 2002

I, Mr. Alex Kotzer, certify that:

1. I have reviewed this annual report on Form 20-F of Compugen Ltd.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;

4. The company's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the company and have:

a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c. evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation ; and

d. disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and

5. The company's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and the audit committee of the company's board of directors (or persons performing the equivalent functions):

a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and

b. any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

\s\ Alex Kotzer

Title: President, Chief Executive Officer and Director
Date: March 27, 2006

Exhibit 12.2

CERTIFICATION PURSUANT TO SECTION 302
OF THE SARBANES-OXLEY ACT OF 2002

I, Nurit Benjamini, certify that:

1. I have reviewed this annual report on Form 20-F of Compugen Ltd.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;

4. The company's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the company and have:

a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c. evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation ; and

d. disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and

5. The company's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and the audit committee of the company's board of directors (or persons performing the equivalent functions):

a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and

b. any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

\s\ Nurit Benjamini

Title: Chief Financial Officer
Date: March 27, 2006

Exhibit 12.3

CERTIFICATION PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002

In connection with the annual report of Compugen Ltd. (the "Company") on Form 20-F for the periods ending December 31, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I the undersigned, being the President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

1. The Report fully complies with the requirements of sections 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

\s\ Alex Kotzer

Title: President, Chief Executive Officer and Director
Date: March 27, 2006

The foregoing certification is being furnished solely to accompany the Report pursuant to 18 U.S.C. No. 1350, and is not being filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and is not to be incorporated by reference into any filing of the Company, whether made before or after the date hereof, regardless of any general incorporation language in such filing.

Exhibit 12.4

CERTIFICATION PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002

In connection with the annual report of Compugen Ltd. (the "Company") on Form 20-F for the periods ending December 31, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I the undersigned, being the Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

1. The Report fully complies with the requirements of sections 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

\s\ Nurit Benjamini

Title: Chief Financial Officer
Date: March 27, 2006

The foregoing certification is being furnished solely to accompany the Report pursuant to 18 U.S.C. No. 1350, and is not being filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and is not to be incorporated by reference into any filing of the Company, whether made before or after the date hereof, regardless of any general incorporation language in such filing.