

RADA ELECTRONIC INDUSTRIES LTD  
Form 20-F  
March 27, 2017

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

FORM 20-F

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

OR

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

For the fiscal year ended December 31, 2016

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

OR

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

Date of event requiring this shell company report.....

Commission file number: 0-15375

RADA ELECTRONIC INDUSTRIES LTD.  
(Exact name of Registrant as specified in its charter  
and translation of Registrant's name Into English)

Israel  
(Jurisdiction of incorporation or organization)

7 Giborei Israel Street, Netanya 4250407, Israel  
(Address of principal executive offices)

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(Name, telephone, facsimile number and address of company contact person)

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

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Ordinary Shares, NIS 0.030 Par Value	NASDAQ Capital Market

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

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

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

Ordinary Shares, par value NIS 0.030 per share...	21,246,502
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(As of December 31, 2016)

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

Yes \* No S

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

Yes \* No S

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 S No \*

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes S No \*

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer   Accelerated filer   Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP   International Financial Reporting Standards as issued by the International Accounting Standards Board   Other

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow:

Item 17 \*   Item 18 \*

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

Yes \* No S

This annual report on Form 20-F is incorporated by reference into the registrant's Registration Statement on Form F-3, File No.333-212643 and into the registrant's Registration Statement on Form S-8, File No. 333-213284.

## INTRODUCTION

We are an Israel based defense electronics company. We specialize in the development, manufacturing, marketing and sales of military avionics systems and inertial navigation systems for manned and unmanned aircraft, and tactical land radars for force and border protection applications.

Our shares are traded on the NASDAQ Capital Market under the symbol "RADA". As used in this annual report, the terms "we," "us" and "our" mean RADA Electronic Industries Ltd. and its subsidiaries, unless otherwise indicated.

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

Statements made in this annual report concerning the contents of any contract, agreement or other document are summaries of such contracts, agreements or documents and are not complete descriptions of all of their terms. If we filed any of these documents as an exhibit to this annual report or to any previous filing with the Securities and Exchange Commission, or the SEC, you may read the document itself for a complete recitation of its terms.

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

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## PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

## A. Selected Financial Data

We derived the following consolidated statements of operations data for the years ended December 31, 2014, 2015 and 2016 and the consolidated balance sheet data as of December 31, 2015 and 2016 from our audited consolidated financial statements included elsewhere in this annual report. We derived the consolidated statements of operations data for the years ended December 31, 2012 and 2013, and the consolidated balance sheet data as of December 31, 2012, 2013 and 2014 from our audited consolidated financial statements that are not included in this annual report. (See Item 4A. "Discontinued Operations")

	Year Ended December 31,				
	2012	2013	2014	2015	2016
	(U.S. dollars in thousands)				
Revenues	\$20,535	\$21,007	\$21,625	\$14,074	\$12,821
Cost of revenues	15,532	16,609	15,284	11,665	11,379
Gross profit	5,003	4,398	6,341	2,409	1,442
Research and development, net	2,423	1,459	789	693	758
Marketing and selling	1,663	1,958	2,392	2,357	2,269
General and administrative	1,802	1,683	1,667	1,513	1,814
Goodwill impairment	-	-	-	587	-
Operating income (loss)	(885 )	(702 )	1,493	(2,741 )	(3,399 )
Financial expense, net	1,153	1,901	1,256	3,577	1,521
Net income (loss) from continuing operations	(2,038 )	(2,603 )	237	(6,318 )	(4,920 )
Net income (loss) from discontinued operations	(17 )	(40 )	(36 )	(179 )	13
Net income (loss)	(2,055 )	(2,643 )	201	(6,497 )	(4,907 )
Net income (loss) attributable to non-controlling interest from discontinued operations	(4 )	(8 )	(7 )	(36 )	3
Net income (loss) attributable to RADA Electronic Industries' shareholders	(2,051 )	(2,635 )	208	(6,461 )	(4,910 )
Basic and diluted net income (loss) per Ordinary share attributable for RADA Electronic Industries' shareholders	\$(0.46 )	\$(0.60 )	\$0.02	\$(0.53 )	\$(0.35 )
Weighted average number of shares used to compute basic and diluted net income (loss) per share	4,459	4,459	8,945	11,904	14,029

	As of December 31,				
	2012	2013	2014	2015	2016
	(U.S. dollars in thousands)				
<b>BALANCE SHEET DATA:</b>					
Working capital (deficiency)	\$1,977	\$(152 )	\$35	\$6,522	\$11,106
Total assets	22,886	22,007	20,097	18,576	20,987
Short-term credits and current maturities of long-term loans	7,140	7,194	6,709	-	-
Convertible note - short term	3,000	3,000	3,000	3,090	3,175
Long-term shareholders loans, net of current maturities	-	-	-	-	-
Shareholders' equity	5,906	3,350	3,547	8,507	10,516

#### B. Capitalization and Indebtedness

Not applicable.

#### C. Reasons for the Offer and Use of Proceeds

Not applicable.

#### D. Risk Factors

Investing in our ordinary shares involves a high degree of risk and uncertainty. You should carefully consider the risks and uncertainties described below before investing in our ordinary shares. Our business, prospects, financial condition and results of operations could be adversely affected due to any of the following risks. In that case, the value of our ordinary shares could decline, and you could lose all or part of your investment.

#### Risks Related to Our Business and Our Industry

We have a history of operating losses and may not be able to sustain profitability in the future. To the extent that we continue to incur operating losses, we may not have sufficient working capital to fund our operations in the future.

We incurred operating losses in four of the five years ended December 31, 2016, including a loss of \$4.9 million in the year ended December 31, 2016. We may not be able to achieve or sustain profitable operations in the future or generate positive cash flows from operations. As of December 31, 2016, our accumulated deficit was \$79 million and we had cash, cash equivalents and short-term bank deposits of \$1.2 million, compared to cash, cash equivalents and short-term bank deposits of \$0.7 million as of December 31, 2015. Based on our current operations, we believe our existing funds will be sufficient to fund our operations in 2017. To the extent that we incur operating losses in the future or are unable to generate free cash flows from our business, we may not have sufficient working capital to fund our operations and will be required to obtain additional financing. Such financing may not be available, or, if available, may not be on terms satisfactory to us. If adequate funds are not available to us, our business, and results of operations and financial condition will be adversely affected.

We may need to raise additional capital in the future, which may substantially dilute the holdings of our shareholders.

In order to obtain working capital for our operations and to repay the outstanding debt due to our then principal shareholder, we completed a follow-on public offering of 3,455,284 ordinary shares, offered at a price to the public of \$2.46 per share on July 30, 2015. We then entered into an investment transaction with DBSI on May 18, 2016, according to which we sold 8,510,638 ordinary shares to DBSI for \$4 million, reflecting a price per share of \$0.47. We also issued to DBSI, without additional consideration, warrants to purchase 4,255,319 ordinary shares at an

exercise price per share of \$0.47 (or \$2 million in the aggregate) exercisable for a period of 24 months and warrants to purchase 3,636,363 ordinary shares at an exercise price per share of \$0.55 (or \$2 million in the aggregate) exercisable for a period of 48 months. DBSI also agreed to provide our company with a three-year \$3,175,000 convertible loan bearing interest of Libor plus 6%, which was funded on June 16, 2016 and was used to repay the outstanding convertible loan and accrued interest owed to an entity owned by our former principal shareholder, Mr. Howard Yeung. In November 2016, we sold 1,904,762 of our ordinary shares to The Phoenix Insurance Company Ltd. and its affiliate, Shotfut-Menayot-Israel-HaPhoenix Amitim Ltd., two Israeli institutional investors, at a price of \$1.05 per share, or approximately \$2 million in the aggregate. At the same time, DBSI invested an additional \$1 million in our company through the exercise of 2,127,660 warrants. As of March 2017, DBSI has paid us 1.5 million to exercise warrants to purchase 3,191,490 ordinary shares. We may need additional working capital in the future to repay our debt and fund our operations. Such financing may not be available, or, if available, may not be on terms satisfactory to us. If adequate funds are not available to us, our business, and results of operations and financial condition will be adversely affected.

Competition in the market for defense electronics is intense. Our products may not achieve market acceptance, which could adversely affect our business, financial condition and results of operations.

The market for our products is highly competitive and we may not be able to compete effectively in our market. Our principal competitors in the defense electronics market include Elbit Systems Ltd., United Technologies Aerospace Systems, Honeywell International Inc., Israel Aerospace Industries Ltd., or IAI, Northrop Grumman Corporation, Sagem Avionics LLC, Thales Group, Zodiac Aerospace Group and SRC Inc. We expect to continue to face competition from these and other competitors. Most of our competitors are larger and have substantially greater resources than us, including financial, technological, marketing and distribution capabilities, and enjoy greater market recognition than we do. These competitors are able to achieve greater economies of scale and may be less vulnerable to price competition than us. We may not be able to offer our products as part of integrated systems to the same extent as our competitors or successfully develop or introduce new products that are more cost effective or offer better performance than those of our competitors. Failure to do so could adversely affect our business, financial condition and results of operations.

We may not be able to implement our growth strategy which could adversely affect our business, financial condition and results of operations.

In line with our growth strategy, we entered into a number of strategic relationships with Embraer S.A., or Embraer, Hindustan Aeronautics Ltd., or HAL, IAI, Lockheed Martin Corporation, or Lockheed Martin, Boeing Defense, Space & Security, or Boeing, Rafael Advanced Defense Systems Ltd., or Rafael, Israel Military Industries Ltd., or IMI, and DRS Technologies, or DRS, to increase our penetration into the defense electronics market. We are currently investing and intend to continue to invest significant resources to develop these relationships and additional new relationships. Should our relationships fail to materialize into significant agreements or should we fail to work efficiently with these companies, we may lose sales and marketing opportunities and our business, results of operations and financial condition could be adversely affected.

Our growth is dependent in part on the development of new products, based on internal research and development. We may not accurately identify market needs before we invest in the development of a new product. In addition, we might face difficulties or delays in the development process that will result in our inability to timely offer products that satisfy the market and competing products may emerge during the development and certification process.

While we have met with initial success in the introduction of our advanced ground radars for tactical applications such as defense forces protection and border protection, there can be no assurance that we will succeed in obtaining general market acceptance or that we will ever recover our investment in this new product family.

We have developed a number of radar hardware platforms for use in combat vehicles and tactical protection applications for defense forces and border protection. In December 2014, we announced the first significant order for this product family, a \$4.5 million order from the Israel Ministry of Defense. To date, we have received \$11.4 million in orders for our ground radar products, but cannot assure you that our ground radars will achieve broad market acceptance.

Reductions in defense budgets worldwide may cause a reduction in our revenues, which would adversely affect our business, operating results and financial condition.

Substantially all of our revenues are derived from the sale of products with military applications. These revenues totaled approximately \$12 million, or 100 % of our revenues in 2016, \$14.1 million, or 99.9% of our revenues, in the year ended December 31, 2015 and \$21.6 million, or 99.9% of our revenues, in the year ended December 31, 2014. The defense budgets of a number of countries have declined and may be reduced in the future. Declines in defense budgets may result in reduced demand for our products and manufacturing services. This would result in reduction in our core business' revenues and adversely affect our business, results of operations and financial condition.

Unfavorable national and global economic conditions could have a material adverse effect on our business, operating results and financial condition.

During periods of slowing economic activity our customers may reduce their demand for our products and technology, which would reduce our sales, and our business, operating results and financial condition may be adversely affected. Economies throughout the world currently face a number of challenges, including threatened sovereign defaults, credit downgrades, restricted credit for businesses and consumers and potentially falling demand for a variety of products and services.

In June 2016, a majority of voters in the United Kingdom elected to withdraw from the European Union in a national referendum (Brexit). The referendum was advisory, and the terms of any withdrawal are subject to a negotiation period that could continue for a few years after the government of the United Kingdom formally initiates a withdrawal process. Nevertheless, the referendum has created significant uncertainty about the future relationship between the United Kingdom and the European Union, and has given rise to calls for certain regions within the United Kingdom to preserve their place in the European Union by separating from the United Kingdom as well as for the governments of other E.U. member states to consider withdrawal.

These developments, or the perception that any of them could occur, could have a material adverse effect on global economic conditions and the stability of global financial markets, and could significantly reduce global market liquidity and restrict the ability of key market participants to operate in certain financial markets. Asset valuations, currency exchange rates and credit ratings may be especially subject to increased market volatility. Any of these events would likely harm our business, operating results and financial condition.

Sales of our products are subject to governmental procurement procedures and practices; termination, reduction or modification of contracts with our customers or a substantial decrease in our customers' budgets may adversely affect our business, operating results and financial condition.

Our products are primarily sold to governmental agencies, governmental authorities and government-owned companies, many of which have complex and time consuming procurement procedures. A substantial period of time often elapses from the time we begin marketing a product until we actually sell that product to a particular customer. In addition, our sales to governmental agencies, authorities and companies are directly affected by these customers' budgetary constraints and the priority given in their budgets to the procurement of our products. A decrease in governmental funding for our customers' budgets would adversely affect our results of operations. This risk is heightened during periods of global economic slowdown. Accordingly, governmental purchases of our systems, products and services may decline in the future as the governmental purchasing agencies may terminate, reduce or modify contracts or subcontracts if:

- their requirements or budgetary constraints change;
- they cancel multi-year contracts and related orders if funds become unavailable;
  - they shift spending priorities into other areas or for other products; or
- they adjust contract costs and fees on the basis of audits.

Any such event may have a material adverse effect on us.

Further, our business with the State of Israel and other governmental entities is, in general, subject to delays in funding and performance of contracts and the termination for convenience (among other reasons) of contracts or subcontracts with governmental entities. The termination, reduction or modification of our contracts or subcontracts with the Government of Israel in the event of change in requirements, policies or budgetary constraints would have an adverse effect on our business, operating results and financial condition.

If we do not receive the governmental approvals necessary for the export of our products, our revenues may decrease. Similarly, if our suppliers and partners do not receive government approvals necessary to export their products or designs to us, our revenues may decrease and we may fail to implement our growth strategy.

Israel's defense export policy regulates the sale of our systems and products. Current Israeli policy encourages export to approved customers of defense systems and products, such as ours, as long as the export is consistent with Israeli government policy. A license is required to initiate marketing activities. We are also required to obtain a specific export license for any hardware exported from Israel. We may not be able to receive all the required permits and licenses for which we may apply in the future. If we do not receive the required permits for which we apply, our revenues may decrease.

We are subject to laws regulating export of "dual use" items (items that are typically sold in the commercial market, but that also may be used in the defense market) and defense export control legislation. Additionally, our participation in governmental procurement processes in Israel and other countries is subject to specific regulations governing the conduct of the process of procuring defense contracts. Furthermore, solicitations for procurements by governmental purchasing agencies in Israel and other countries are governed by laws, regulations and procedures relating to procurement integrity, including avoiding conflicts of interest and corruption in the procurement process. We may not be able to respond quickly and effectively to changing laws and regulations and any failure to comply with such laws and regulations may subject us to significant liability and penalties.

We depend on sales to key customers and the loss of one or more of our key customers would result in a loss of a significant amount of our revenues, which would adversely affect our business, financial condition and results of operations.

A significant portion of our revenues is derived from a small number of customers. During the years ended December 31, 2016 and 2015, 83% and 71% of our revenues, respectively, were attributable to six customers. We anticipate that a significant portion of our future revenues will continue to be derived from sales to a small number of customers. No assurances can be given that our customers will continue to purchase our products, that we will be successful in any bid for new contracts to provide such products, or that if we are granted subsequent orders, such orders would be of a scope comparable to the sales that we have experienced to date. If our principal customers do not continue to purchase products from us at current levels or if we do not retain such customers and we are not able to derive sufficient revenues from sales to new customers to compensate for their loss, our revenues would be reduced and adversely affect our business, cash flows, financial condition and results of operations.

We depend on suppliers of components for our products and if we are unable to obtain these components when needed, we could experience delays in the manufacturing of our products and our financial results could be adversely affected.

We acquire most of the components for the manufacturing of our products from suppliers and subcontractors, most of whom are located in Israel and the United States. A number of these suppliers are currently the sole source of one or more components upon which we are dependent. Suppliers of some of the components for manufacturing require us to place orders with significant lead-time to assure supply in accordance with our manufacturing requirements. Inadequacy of operating funds may cause us to delay the placement of such orders and may result in delays in supply. Delays in supply may significantly hurt our ability to fulfill our contractual obligations and may significantly hurt our business and result of operations. In addition, we may not be able to continue to obtain such components from these suppliers on satisfactory commercial terms. Temporary disruptions of our manufacturing operations would ensue if we were required to obtain components from alternative sources, which may have an adverse effect on our financial results.

Rapid technological changes may adversely affect the market acceptance of our products and could adversely affect our business, financial condition and results of operations.

The defense electronics market in which we compete is subject to technological changes, introduction of new products, change in customer demands and evolving industry standards. Our future success will depend upon our ability to keep pace with technological developments and to timely address the increasingly sophisticated needs of our customers by supporting existing and new technologies and by developing and introducing enhancements to our current products and new products. We may not be successful in developing and marketing enhancements to our products that will respond to technological change, evolving industry standards or customer requirements. In addition, we may experience difficulties that could delay or prevent the successful development, introduction and sale of such enhancements and such enhancements may not adequately meet the requirements of the market and may not achieve any significant degrees of market acceptance. If release dates of our new products or enhancements are delayed or, if when released, they fail to achieve market acceptance, our business, operating results and financial condition may be adversely affected.

We enter into fixed-price contracts that could subject us to losses in the event we fail to properly estimate our costs.

We enter into firm fixed-price contracts. If our initial cost estimates are incorrect, we can lose money on these contracts. Because many of these contracts involve new technologies, unforeseen events, such as technological difficulties and other cost overruns, can result in the contract pricing becoming less favorable or even unprofitable to us and have an adverse impact on our financial results.

Breaches of network or information technology security, natural disasters or terrorist attacks could have an adverse effect on our business.

Cyber-attacks or other breaches of network or IT security, natural disasters, terrorist acts or acts of war may cause equipment failures or disrupt our systems and operations. We may be subject to attempts to breach the security of our networks and IT infrastructure through cyber attack, malware, computer viruses and other means of unauthorized access. The potential liabilities associated with these events could exceed the insurance coverage we maintain. Our inability to operate our facilities as a result of such events, even for a limited period of time, may result in significant expenses or loss of market share to other competitors in the defense electronics market. In addition, a failure to protect the privacy of customer and employee confidential data against breaches of network or IT security could result in damage to our reputation. To date, we have not been subject to cyber-attacks or other cyber incidents which, individually or in the aggregate, resulted in a material impact to our operations or financial condition.





We are subject to risks associated with international operations; we generate a significant portion of our sales from customers located in countries that may be adversely affected by political or economic instability and corruption.

We are an aviation and defense company with worldwide operations. Although 65% of our sales are in Israel and North America, we expect to derive an increasing portion of our sales and future growth from other regions such as Latin America, India and Central and Eastern Europe, which may be more susceptible to political or economic instability. In addition, in many less-developed markets, we rely heavily on third-party representatives, consultants and other agents for business development, marketing and distribution of our products. Many of these third-parties do not have internal compliance resources comparable to ours. Business activities in many of these markets have historically been more susceptible to corruption. If our efforts to screen third party agents and detect cases of potential misconduct fail, we could be held responsible for the noncompliance of these third parties under applicable laws and regulations, which may adversely affect our reputation and our business, financial condition or results of operations.

Exports accounted for 43% of our sales in 2016, 57% of our sales in 2015 and 77% of our sales in 2014. Our reliance on export sales subjects us to many risks inherent in engaging in international business, including:

- Limitations and disruptions resulting from the imposition of government controls;
- Changes in regulatory requirements;
- Export license requirements;
- Economic or political instability;
- Trade restrictions;
- Changes in tariffs;
- Currency fluctuations;
- Longer receivable collection periods and greater difficulty in accounts receivable collection;
- Greater difficulty in safeguarding intellectual property;
- Difficulties in managing overseas subsidiaries and international operations; and
- Potential adverse tax consequences.

We may not be able to sustain or increase revenues from international operations and may encounter significant difficulties in connection with the sale of our products in international markets. Any of those events may adversely affect our business, operating results and financial condition.

In the United States, the new Trump Administration has called for substantial change to fiscal, tax and trade policies that may adversely affect our business. We cannot predict the impact, if any, of these changes to our business. However, it is possible that these changes could adversely affect our business.

In addition, as a company registered with the SEC, we are subject to the regulations imposed by the Foreign Corrupt Practices Act, or FCPA, which generally prohibits registrants and their intermediaries from making improper payments to foreign officials for the purpose of obtaining or keeping business or obtaining an improper business benefit. We have adopted proactive procedures to promote compliance with the FCPA, but we may be held liable for actions taken by our strategic or local partners or agents even though these partners may not themselves be subject to

the FCPA. Any determination that we have violated the FCPA could materially and adversely affect our business, results of operations, and cash flows.

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Currency exchange rate fluctuations in the world markets in which we conduct business could have a material adverse effect on our business, results of operations and financial condition.

Most of our revenues are in dollars or are linked to the dollar, while a portion of our expenses, principally salaries and related personnel expenses, are incurred in other currencies, particularly in NIS. Therefore, our costs in such other currencies, as expressed in dollars, are influenced by the exchange rate between the dollar and the relevant currency. We are also exposed to the risk that the rate of inflation in Israel will exceed the rate of depreciation of the NIS in relation to the dollar or that the timing of this depreciation lags behind inflation in Israel. This would have the effect of increasing the dollar cost of our operations. In the past, the NIS exchange rate with the dollar and other foreign currencies has fluctuated, generally reflecting inflation rate differentials. We cannot predict any future trends in the rate of inflation in Israel or the rate of depreciation or appreciation of the NIS against the dollar. If the dollar cost of our operations in Israel increases, our dollar-measured results of operations will be adversely affected. We engage in currency hedging transactions intended to partly reduce the effect of fluctuations in foreign currency exchange rates on our results of operations. However, such transactions may not materially reduce the effect of fluctuations in foreign currency exchange rates on our results of operations.

Claims that our products infringe upon the intellectual property of third parties may require us to incur significant costs, enter into licensing agreements or license substitute technology.

Third parties may assert infringement claims against us or claims that we have violated a patent or infringed on a copyright, trademark or other proprietary right belonging to them. Any infringement claim, even one without merit, could result in the expenditure of significant financial and managerial resources to defend against the claim. Moreover, a successful claim of product infringement against us or a settlement could require us to pay substantial amounts or obtain a license to continue to use the technology that is the subject of the claim, or otherwise restrict or prohibit our use of the technology. We might not be able to obtain a license from the third party asserting the claim on commercially reasonable terms, if at all. We also may not be able to obtain a license from another provider of suitable alternative technology to permit us to continue offering the product. Infringement claims asserted against us could have a material adverse effect on our business, operating results and financial condition.

Regulations that impose disclosure requirements regarding the use of “conflict” minerals mined from the Democratic Republic of Congo and adjoining countries in our products will result in additional cost and expense and could result in other significant adverse effects.

Rules adopted by the SEC implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act impose diligence and disclosure requirements regarding the use of “conflict” minerals mined from the Democratic Republic of Congo and adjoining countries in our products. Compliance with these rules may result in additional cost and expense, including for due diligence to determine and verify the sources of any conflict minerals used in our products, in addition to the cost of remediation and other changes to products, processes, or sources of supply as a consequence of such verification activities. These rules may also affect the sourcing and availability of minerals used in the manufacture of our products to the extent that there may be only a limited number of suppliers offering “conflict free” metals that can be used in our products. There can be no assurance that we will be able to obtain such metals in sufficient quantities or at competitive prices. Also, since our supply chain is complex, we may face reputational challenges with our customers, shareholders and other stakeholders if we are unable to sufficiently verify the origins of the metals used in our products. We may also encounter customers who require that all of the components of our products be certified as conflict free. If we are not able to meet customer requirements, such customers may choose to disqualify us as a supplier, which could impact our sales and the value of portions of our inventory.

We may fail to maintain effective internal controls in accordance with Section 404 of the Sarbanes-Oxley Act of 2002, which could have an adverse effect on our financial results and the market price of our ordinary shares.

The Sarbanes-Oxley Act of 2002 imposes certain duties on us and our executives and directors. Our efforts to comply with the requirements of Section 404(a) of the Sarbanes-Oxley Act of 2002 governing internal controls and procedures for financial reporting, which started in connection with our 2007 Annual Report on form 20-F, have resulted in increased general and administrative expense and a diversion of management time and attention, and we expect these efforts to require the continued commitment of significant resources. We may identify material weaknesses or significant deficiencies in our assessments of our internal controls over financial reporting. Failure to maintain effective internal controls over financial reporting could result in investigation or sanctions by regulatory authorities and could have a material adverse effect on our operating results, investor confidence in our reported financial information and the market price of our ordinary shares.

#### Risk Factors Related to Our Ordinary Shares

Because one of our shareholders, DBSI, owns a majority of our outstanding shares, investors will not be able to affect the outcome of shareholder votes.

DBSI currently beneficially owns 13,423,907 of our ordinary shares, or approximately 50.7% of our outstanding shares. For as long as DBSI, or any shareholder, has a controlling interest in our company, it will have the ability to exercise a controlling influence over our business and affairs, including any determinations with respect to potential mergers or other business combinations involving us, our acquisition or disposition of assets, our incurrence of indebtedness, our issuance of any additional ordinary shares or other equity securities, our repurchase or redemption of ordinary shares and our payment of dividends. Similarly, as long as DBSI has a controlling interest in our company, it will have the power to determine or significantly influence the outcome of matters submitted to a vote of our shareholders, including the power to elect all of the members of our board of directors (except external directors, within the meaning of Israeli law), or prevent an acquisition or any other change in control of us. Because the interests of our controlling shareholders may differ from the interests of our other shareholders, actions taken by it with respect to us may not be favorable to our other shareholders.

If we fail to maintain compliance with NASDAQ's continued listing requirements, our shares may be delisted from the NASDAQ Capital Market.

Our ordinary shares are listed on the NASDAQ Capital Market under the symbol "RADA." To continue to be listed on the NASDAQ Capital Market, we need to satisfy a number of conditions, including minimum shareholders' equity of at least \$2.5 million and a minimum closing bid price per share of \$1.00. On October 1, 2015 Rada received notification from NASDAQ for not maintaining a minimum bid price of US\$1.00 per share for 30 consecutive business days (Listing Rule 5550(a) (2)). We were given 180 calendar days, or until March 29, 2016, to regain compliance. On March 30, 2016, we received notification from NASDAQ that we are eligible for an additional 180 calendar days to regain compliance. Following a reverse split of our ordinary shares, on September 29, 2016, we regained compliance with Listing Rule 5550(a)(2) and our shares continued to be listed on the NASDAQ Capital Market.

If in the future, our share price drops again and remains under \$1.00 for 30 consecutive business days, and if we are ultimately delisted from NASDAQ, trading in our ordinary shares would be conducted on a market where an investor would likely find it significantly more difficult to dispose of, or to obtain accurate quotations as to the value of, our ordinary shares..

Our share price has been volatile in the past and may decline in the future.

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

- Quarterly variations in our operating results;
- Operating results that vary from the expectations of securities analysts and investors;

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Changes in expectations as to our future financial performance, including financial estimates by securities analysts and investors;

· Announcements of technological innovations or new products by us or our competitors;

· Announcements by us or our competitors of significant contracts, acquisitions, strategic partnerships, joint ventures or capital commitments;

· Changes in the status of our intellectual property rights;

· Announcements by third parties of significant claims or proceedings against us;

· Additions or departures of key personnel;

· Future sales of our ordinary shares;

· Delisting of our shares from the NASDAQ Capital Market; and

· Stock market price and volume fluctuations.

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

In the past, securities class action litigation has often been brought against companies following periods of volatility in the market price of its securities. We may in the future be the target of similar litigation. Securities litigation could result in substantial costs and divert management's attention and resources both of which could have a material adverse effect on our business and results of operations.

Substantial future sales of our ordinary shares by our principal shareholders may depress our share price.

If our principal shareholders, sell substantial amounts of their ordinary shares, including shares registered under effective registration statements and shares issuable upon the exercise of outstanding warrants or upon the conversion of convertible notes, or if the perception exists that our principal shareholders may sell a substantial number of our ordinary shares, the market price of our ordinary shares may fall. Any substantial sales of our shares in the public market also might make it more difficult for us to sell equity or equity related securities in the future at a time and on terms we deem appropriate.

We do not intend to pay dividends.

We have never declared or paid cash dividends on our ordinary shares and do not expect to do so in the foreseeable future. The declaration of dividends is subject to the discretion of our board of directors and will depend on various factors, including our operating results, financial condition, future prospects and any other factors deemed relevant by our board of directors. You should not rely on an investment in our company if you require dividend income from your investment in our company. The success of your investment will likely depend entirely upon any future appreciation of the market price of our ordinary shares, which is uncertain and unpredictable. There is no guarantee that our ordinary shares will appreciate in value or even maintain the price at which you purchased your ordinary shares.

We may in the future be classified as a passive foreign investment company, or PFIC, which will subject our U.S. investors to adverse tax rules.

For U.S. federal income tax purposes, we will generally 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 quarterly value of our assets for the taxable year produce or are held for the production of passive income. Based on certain estimates of our gross income and gross assets and the nature of our business, we do not expect that we will be classified as a PFIC for the taxable year ending December 31, 2016. There can be no assurance that we will not be considered a PFIC for any future taxable year. If we were determined to be a PFIC for U.S. federal income tax purposes, highly complex rules would apply to U.S. holders owning our ordinary shares and such U.S. holders could suffer adverse U.S. tax consequences. Accordingly, you are urged to consult your tax advisors regarding the application of such rules. U.S. residents should carefully read Item 10E. "Additional Information - Taxation - United States Federal Income Tax Consequences" for a more complete discussion of the U.S. federal income tax risks related to owning and disposing of our ordinary shares.



## Risks Relating to Our Location in Israel

Political, economic and military instability in Israel may disrupt our operations and negatively affect our business condition, harm our results of operations and adversely affect our share price.

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

In recent years, there have been hostilities between Israel and Hezbollah in Lebanon and Hamas in the Gaza strip, both of which resulted in rockets being fired into Israel causing casualties and disruption of economic activities. In addition, Israel faces threats from more distant neighbors, in particular, Iran. Also, in recent years riots and uprisings in several countries in the Middle East and neighboring regions have led to severe political instability in several neighboring states and to a decline in the regional security situation. Such instability may affect the local and global economy, could negatively affect business conditions and, therefore, could adversely affect our operations. To date, these matters have not had any material effect on our business and results of operations; however, the regional security situation and worldwide perceptions of it are outside our control and there can be no assurance that these matters will not negatively affect our business, financial condition and results of operations in the future.

Furthermore, we could be adversely affected by the interruption or reduction of trade between Israel and its trading partners. Some countries, companies and organizations continue to participate in a boycott of Israeli companies and others doing business with Israel or with Israeli companies. As a result, we are precluded from marketing our products to these countries, companies and organizations. Foreign government defense export policies towards Israel could also make it more difficult for us to obtain the export authorizations necessary for our activities. Also, over the past several years there have been calls in Europe and elsewhere to reduce trade with Israel. Restrictive laws, policies or practices directed towards Israel or Israeli businesses may have an adverse impact on our operations, our financial results or the expansion of our business.

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

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

We may not be able to enforce covenants not-to-compete under current Israeli law.

We have non-competition agreements with most of our employees, many of which are governed by Israeli law. These agreements generally prohibit our employees from competing with us or working for our competitors for a specified period following termination of their employment. However, Israeli courts are reluctant to enforce non-compete undertakings of former employees and tend, if at all, to enforce those provisions for relatively brief periods of time in restricted geographical areas and only when the employee has unique value specific to that employer's business and not just regarding the professional development of the employee. Any such inability to enforce non-compete covenants may cause us to lose any competitive advantage resulting from advantages provided to us by such confidential information.



We may become subject to claims for remuneration or royalties for assigned service invention rights by our employees, which could result in litigation and adversely affect our business.

A significant portion of our intellectual property has been developed by our Israeli employees in the course of their employment for us. Under the Israeli Patent Law, 5727-1967 (the "Israeli Patent Law"), inventions conceived by an employee during the term and as part of the scope of his or her employment with a company are regarded as "service inventions," which belong to the employer, absent a specific agreement between the employee and employer giving the employee service invention rights. The Israeli Patent Law also provides that if there is no such agreement between an employer and an employee, the Israeli Compensation and Royalties Committee (the "C&R Committee"), a body constituted under the Israeli Patent Law, shall determine whether the employee is entitled to remuneration for his inventions. The C&R Committee (decisions of which have been upheld by the Israeli Supreme Court) has held that employees may be entitled to remuneration for their service inventions despite having specifically waived any such rights. Further, the C&R Committee has not yet set specific guidelines regarding the method for calculating this remuneration or the criteria or circumstances under which an employee's waiver of his right to remuneration will be disregarded. We generally enter into intellectual property assignment agreements with our employees pursuant to which such employees assign to us all rights to any inventions created in the scope of their employment or engagement with us. Although our employees have agreed to assign to us service invention rights and have specifically waived their right to receive any special remuneration for such assignment beyond their regular salary and benefits, we may face claims demanding remuneration in consideration for assigned inventions. As a consequence of such claims, we could be required to pay additional remuneration or royalties to our current or former employees, or be forced to litigate such claims, which could negatively affect our business.

Service and enforcement of legal process on us and our directors and officers may be difficult to obtain.

Service of process upon our directors and officers and the Israeli experts named in this annual report, most of who reside outside the U.S., may be difficult to obtain within the U.S. Furthermore, since substantially most our assets, our directors and officers and the Israeli experts named in this annual report are located outside the U.S., any judgment obtained in the U.S. against us or these individuals or entities may not be collectible within the U.S.

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

The rights and responsibilities of our shareholders are governed by Israeli law and differ in some respects from those of a typical U.S. corporation.

We are incorporated under Israeli law and the rights and responsibilities of holders of our ordinary shares are governed by our articles of association and by Israeli law. These rights and responsibilities differ in some respects from the rights and responsibilities of shareholders in typical U.S. corporations. In particular, a shareholder of an Israeli company has a duty to act in good faith in exercising his or her rights and fulfilling his or her obligations toward the company and other shareholders and to refrain from abusing his power in the company, including, among other things, in voting at the general meeting of shareholders on certain matters. Israeli law provides that these duties are applicable to shareholder votes at the general meeting with respect to, among other things, amendments to a company's articles of association, increases in a company's authorized share capital, mergers and actions and transactions involving interests of officers, directors or other interested parties which require the shareholders' approval. In addition, a controlling shareholder of an Israeli company or a shareholder who knows that he or she possesses the power to determine the outcome of a vote at a meeting of our shareholders, or who has, by virtue of the company's articles of association, the power to appoint or prevent the appointment of an office holder in the company, or any other power with respect to the company, has a duty of fairness toward the company. However, Israeli law does not define the substance of this duty of fairness. There is little case law available to assist in understanding the

implications of these provisions that govern shareholder behavior.

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Israeli government programs and tax benefits may be terminated or reduced in the future.

We participate from time to time in programs of the Israeli Innovation Authority (formerly the Office of the Chief Scientist) of the Israeli Ministry of Economy, or Innovation Authority, for which we receive funding for the development of technologies and products. The benefits available under these programs depend on meeting specified conditions. For more information about these programs see Item 5. "Operating and financial review and prospects – Research & Developments – Israeli Innovation Authority." If we fail to comply with these conditions, we may be required to pay additional penalties, make refunds and may be denied future benefits. From time to time, the government of Israel has discussed reducing or eliminating the benefits available under these programs, and therefore these benefits may not be available to us in the future at their current levels or at all.

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

As a foreign private issuer whose shares are listed on the NASDAQ Capital Market, we are permitted to follow certain home country corporate governance practices instead of certain requirements of The NASDAQ Stock Market Rules. Among other things, as a foreign private issuer we may follow home country practice with regard to the composition of the board of directors, director nomination procedure, and quorum at shareholders' meetings. In addition, we may follow our home country law, instead of the NASDAQ Stock Market Rules -which require that we obtain shareholder approval for certain dilutive events such as for the establishment or amendment of certain equity based compensation plans, an issuance that will result in a change of control of the company, certain transactions other than a public offering involving issuances of a 20% or more interest in the company, and certain acquisitions of the stock or assets of another company. A foreign private issuer that elects to follow a home country practice instead of NASDAQ requirements must submit to NASDAQ in advance a written statement from an independent counsel in such issuer's home country certifying that the issuer's practices are not prohibited by the home country's laws. In addition, a foreign private issuer must disclose in its annual reports filed with the SEC each such requirement that it does not follow and describe the home country practice followed by the issuer instead of any such requirement. Accordingly, our shareholders may not be afforded the same protection as provided under NASDAQ's corporate governance rules.

#### ITEM 4. INFORMATION ON THE COMPANY

##### A. History and Development of the Company

We were incorporated under the laws of the State of Israel on December 8, 1970. We are a public limited liability company under the Israeli Companies Law 1999-5759, or the Israeli Companies Law, and operate under this law and associated legislation. Our registered offices and principal place of business are located at 7 Giborei Israel Street, Netanya 4250407, Israel, and our telephone number is +972-9-892-1111. Our website address is [www.rada.com](http://www.rada.com). The information on our website is not incorporated by reference into this annual report.

We develop, manufacture and sell defense electronics, including avionics solutions (including avionics for unmanned aerial vehicles), airborne data/video recording and management systems, tactical land-based radars for defense forces and border protection systems, and inertial navigation systems. In addition, while we continue to sell and support our legacy commercial aviation products and services, in 2016 we decided to actively pursue the sale of our Chinese subsidiary, Beijing Hua Rui Aircraft Maintenance and Service, Co., Ltd., known as CACS, which is the main platform of our test and repair shop activity. The results presented in this annual report were adjusted to present CACS' results in a separate line as "Discontinued Operations".

## B. Business Overview

### Industry Overview

Our activity is primarily focused on the defense electronics market. This is a growing market that is currently a large part of the defense industry. The defense electronics market reflects two contradictory trends, the proliferation of defense electronics, which has been offset by the significant reduction in the price of electronic systems which is reducing the dollar value of the market. Today, new military vehicles of all kinds are equipped with significantly more electronic systems than they used to carry in the past. The increasing usage of advanced electronics in modern vehicles, including upgrades of existing technology and the growing use of unmanned vehicles of all kinds, have provided significant growth to the market.

Today's advanced defense electronics systems typically incorporate components that are derived from the industrial or the consumer electronics markets, especially from the telecom markets. Most of the defense electronics systems are built with commercial components and even with sub-systems, which reduce the overall price, and at the same time generate complex obsolescence issues.

Purchasers of defense electronics products are either governments or major integrators. Engagement in business relationships with these customers is complex, has a long sales cycle and requires long-term commitments for future support of delivered hardware. Production batches of such products are usually small.

Suppliers of defense electronic systems are either providers of sub-systems to major integrators or providers of integrated systems to the industry or to the armed forces. These companies are typically very large and have diversified product offerings.

New products in the defense electronic market are usually developed utilizing internal and customer sponsored research and development funds and are tailored to specific customer needs. In many cases, the customer who pays for the design and adaptation limits the use of intellectual property that was funded by it for other applications, due to either commercial or security reasons.

## Products and Services

We primarily provide integrated solutions. Our aim is to provide not only state-of-the-art products, but to also provide comprehensive end-to-end solutions for one or more systems. Our current product lines are:

- Military avionics (Data/video recorders, core avionics for aircraft and UAVs);
- Inertial navigation systems for aerial and land platforms;
- Tactical Radars for defense forces and border protection systems (land based).

While we continued to support our legacy commercial aviation test stations in 2016, we decided to sell CACS, our main platform for our test and repair shop activity.

## Military Avionics

We are one of the world's leaders in the field of mission data recording, management, and post-mission analysis and debriefing. Over the past 25 years we have developed, fielded and supported a wide range of solid-state digital recorders, cameras and debriefing systems for aerospace and military applications, including:

- Flight data recorders, or FDR, for fighter aircraft;
- Digital video/audio/data recorders, or DVDR (with data transfer functions);
- High-rate (no compression) data recorders, or HRDR, for aircraft and airborne pods;
- Video recorders and airborne data servers, or VRDS, the latest approach to avionic data management;
- A wide range of head-up-displays color video cameras, or HCVC, for fighter aircraft; and
- A variety of ground debriefing solutions, or GDS.

Featuring state-of-the-art technologies, our digital recorders are designed for military applications. Our high-performance recorders provide simultaneous, high-capacity video (both analog and digital/HD), audio and data recording, high throughput and mass storage handling capabilities, supporting rapid dissemination and real time playback. Our video recorders implement MPEG-2 and/or MPEG-4 (H.264) compression formats, supporting up to 128GB of solid state memory, facilitating continuous recording over extended mission durations.

Our GDS feature synchronized video, audio, data, and air combat maneuvering debriefing. GDS vary from personal, laptop-size debriefing units, through robust desktop multi-channel systems supporting the mission debriefing of four-aircraft formations up to large-scale simultaneous debriefing systems. These network-based systems support large numbers of participants operating from different locations, and provide advanced data management features.

We have been a developer and manufacturer of core avionics systems for over 30 years. We currently offer a wide spectrum of military avionics systems designed for integration in new and upgraded military aircraft and UAVs worldwide. Our avionics solutions range from fully integrated avionics suites, MOTS core avionics subsystems, to tailor-made "built-to-spec" units, backed by our teams of experts dedicated to providing global technical and maintenance support.

Our avionics systems are easily adapted to western, eastern, and indigenous-origin platforms of all kinds. We provide our avionic expertise as team members and subcontractors and as prime contractors for avionic upgrades. In

particular, our avionics for UAVs are extremely compact through modern board connectivity solutions, use of innovative conductive cooling techniques, withstand extreme environmental conditions and are very reliable and affordable.

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We offer the following avionics solutions:

- Complete integrated avionics upgrade suites for fighters and mission aircraft;
- Mission and display computers;
- Weapon management systems;
- Data interface and processing computers;
- Mission data recorders and debriefing solutions;
- HUD video cameras;
- INS;

Avionics for UAVs (Interface control processors, engine control computers, Payload management computers, and others).

- R-100F: FOG-based, navigation-grade embedded GPS-INS for fighters and helicopters;

- R-200M: Compact, MEMS-based, multiple-sensor aided INS for UAVs and backup INS for manned aircraft;

MAVINS – Modular Avionics and MEMS-Based INS: A specially-designed, compact integrated solution for UAVs and disposable applications.

Our airborne products and system solutions are fully qualified and operated by leading air forces and prime integrators worldwide, such as the Israeli Air Force, or IAF, Lockheed Martin, Boeing Company, GE Aviation, HAL, Embraer, IAI, Rafael, the Chilean Air Force, Indra Systemas S.A., and many others. Our units are installed onboard F-16, F-15, A-4, Jaguar, MiG-27, Su-30MKI, Dhruv Helicopter, MiG-29, Super-Tucano and other aircraft, and onboard a continuously-growing number of UAVs.

## Tactical Radars for Defense Forces and Border Protection Solutions

We develop advanced ground-based radars for tactical applications such as defense forces protection and border protection. Our pulse Doppler, software-defined radars are solid-state, fully digital, incorporate active electronically scanned array, or AESA antenna, are compact, mobile and highly reliable, provide hemispheric spatial coverage and multi-mission capabilities, and demonstrate unprecedented performance-to-price ratio.

The asymmetric and irregular conflicts in which modern armies are engaged with in recent years dictate the needs for instantaneous and real-time intelligence, minimal cycle time for target acquisition, highly accurate weapons with minimal collateral damage and discrimination between hostiles and civilians. Our tactical radars, which move with the maneuvering combat units in the field and operate on-the-move, provide the real-time knowledge of whether and from where they are threatened, detect all relevant threats, whether unfriendly fire or drones/UAVs/fighters/helicopters from any angle (including very high angles), discriminate among threats and provide the needed intelligence for any course of action, whether counter-fire or avoidance. The performance-over-price ratio of our radars makes them ideal solutions to the needs and requirements imposed by the asymmetric arena.

We have developed various radar hardware platforms: the compact hemispheric radar, or CHR, which is tailored for use in combat vehicles and short-range protection applications; and a family of multi-mission hemispheric radars, or MHRs, which are tailored for use in force and border protection applications. We offer the MHR, the enhanced MHR, or eMHR, and the improved and enhanced MHR, or ieMHR; all share the same basic characteristics, but differ in range, size, weight, and price. For each radar platform we implement several operational missions by changing the radar operational parameters.

The current operational missions of the CHR are the following:

The RPS-10 radar sensors for active protection systems, or APS, detect all relevant threats that may be fired at § combat vehicles, including RPGs, anti-tank guided missiles (ATGMs) and projectiles and provide 360° hemispheric coverage. The system delivers threat data to the APS, enabling it to neutralize threats.

The RPS-12 short-range hemispheric air surveillance radar system can detect, classify and track aerial vehicles at § ranges of up to 10km, with emphasis on small UAVs. Mobile or stationary, the system can be integrated with any § C4I system and other radars and sensors, and can operate either as a stand-alone, or as part of a large-scale surveillance system.

The RPS-14 radar system for perimeter and border protection can detect, identify, and track aerial and surface § intruders including slow and small aircraft, vehicles, vessels, and pedestrians at tactical ranges. The RPS-14 can operate either as a stand-alone, or as part of a large-scale surveillance system.

The RPS-15 comprehensive hostile fire management system for combat vehicle detects, tracks, classifies, and § locates direct and elevated threats fired at combat vehicles, allowing the mobile force to successfully complete its mission while operating in a hostile environment.

The current operational missions of the MHR family of radar platforms are the following:

The RPS-40/70/80 hostile fire detection radar systems detect, track, classify and locate direct and elevated threats § fired at stationary or mobile forces. They compute the Point-Of-Origin (POO) and Point-Of-Impact (POI) of the § threats, which may be rockets, artillery, mortars, ATGMs, RPGs, and more other threats. The systems can be integrated with any protection and Command, Control, Communications, Computers and Intelligence (C4I) system and be installed at stationary bases and posts, or onboard fighting vehicles.

The RPS-42/72/82 tactical hemispheric air surveillance radar systems can detect, classify and track all types of aerial vehicles, including fighters, helicopters, UAVs, transport aircraft, etc. at tactical ranges. Mobile or stationary, the § systems can be integrated with any C4I system and other radars and sensors, and can operate either as a stand-alone, or as part of a large-scale surveillance system.

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The RHS-44/74/84 radar systems for border protection can detect, identify, and track aerial and surface border § intruders including slow and small aircraft, vehicles, vessels, and pedestrians at tactical ranges. The systems can operate either as a stand-alone, or as part of a large-scale surveillance system.

Among our customers for radar systems are leading defense forces and industries worldwide, including the Israeli MOD, IMI, Artis, Lockheed Martin, Boeing, DRS, the U.S. Navy, Indian Security Forces, Elettronica S.p.A and additional air defense prime integrators and end-users. Some of our customers have purchased a small number of our radars for evaluation and integration in their air defense and/or other systems. These may turn into larger production orders upon evaluation and if such systems begin full rate production.

### Business Development, Sales and Marketing

#### Strategy

Our business development strategy is based on the following principles:

Becoming a reliable and dependable supplier of sensors and sub-systems to defense system integrators and major platforms manufacturers with global sales, such as Embraer, HAL, Lockheed Martin, Boeing, IMI, IAI, Rafael, DRS and others.

Expanding our global business development efforts and potential customer base by engaging business development consultants and service providers in the countries and territories in which our products may be used, and actively managing this global network; and

Establishing strategic partnerships with leading integrators in the prime target markets for tactical radars, i.e. the US, Europe, India; such partnerships may involve indigenization and localization of our technologies to enable sales in significant quantities in these markets.

#### Strategic Relationships and Customers

As part of our strategy, we entered into a number of strategic relationships with leading global defense contractors and several air forces. We have focused our marketing and sales efforts to support these relationships.

Lockheed Martin. Lockheed Martin is the manufacturer of the F-16 aircraft, one of the most popular fighter aircraft in the western world today. We are supplying the DVDR and GDS for new F-16 aircraft production and for F-16 upgrade programs led by Lockheed Martin. In 2015, Lockheed Martin ordered a single radar system for integration in their internally funded high energy laser research and development program.

Israel Military Industries. IMI is a world leader in the field of APS for land platforms and is the developer and manufacturer of the "Iron Fist" APS. We are teamed with IMI on the integration and production of our RPS-10 radars as part of their "Iron Fist" APS solution for local and global customers. During 2016 there was a global increase in the interest of major forces in APS; as a result, IMI is currently engaged in extensive efforts to integrate, test and provide its APS to customers in Europe and North America. We have sold dozens of CHR radars to IMI support these activities.

Israel Aerospace Industries. We actively supply avionics and test equipment to four different divisions of IAI, and in particular to the LAHAV and MALAT divisions, who are major aircraft integrators and utilize our products and services for repeated follow-on orders.

Hindustan Aeronautics Ltd. HAL is the major aerospace integrator in India. We are currently cooperating with four divisions of HAL and supply DVDRs, HCVCs, GDS, support equipment and other services in growing numbers.

Embraer S.A. The Military Aircraft Division of the Brazilian aircraft manufacturer is a strategic customer. In addition to supplying avionics such as DVDR, INS and HCVC to Embraer, we are participating to a greater degree in Embraer's programs through the development and supply of avionic units per their specifications and their training and support activities.

Rafael Advanced Defense Systems Ltd. Rafael is a world leader in the development and supply of missiles, smart weapons and pods of various types. Rafael has become a strategic customer of ours as a result of our development and production of a few advanced built-to-specification products in recent years. Recently, Rafael selected the MHR as the radar for the "Drone Dome" system that is designed to counter UAVs and drones, and is purchasing radars from us for test and evaluation.

Boeing Defense, Space and Security, Boeing, a provider of air defense and high-energy laser systems, has acquired our MHR in 2013 for evaluation of its use as part its directed energy tactical systems. We also provide Boeing with recorders and debriefing stations for the T-45 VMTS, and have received follow-on orders from them.

DRS Technologies, LLC. DRS is a major player in the defense electronics market in North America, with a focus on tactical systems and radars. In 2015, we signed a teaming agreement with DRS to market, sell, produce and maintain our tactical radars in the North American market. DRS has acquired a few MGR radars, and are actively promoting it as part of their system solution to counter-UAVs and drones, and for short-range air defense.

European Air Defense Integrator. A European air defense integrator purchased a radar for integration and testing and we have signed a value-added representation agreement with it for certain countries where they have a dominant position in sales of air defense and other solutions. Military Forces. We are the sole providers of digital recorders and debriefing solutions to an air force in Latin America. We are the primary provider of recorders and debriefing solutions to a major Asian air force. Our tactical radars for air defense are under evaluation by a Far-East country's army that has acquired a few units, while two other Asian forces have purchased radars for air surveillance and counter-mortar applications. Our tactical radars are used by the US Navy/Marines as part of their ground based air defense advanced technology development program. All these military forces introduce the potential of prolonged cooperation and are strategic customers of ours.

#### Business Development and Marketing

Our chief executive officer, Mr. Dov Sella, leads our business development and marketing efforts. We currently employ eight additional professionals in the marketing and sales of our products, four of them part-time. Our program managers, chief technology officer and our engineering departments support our marketing and sales efforts with respect to proposal preparations and products demonstrations. In addition, we have business development consultants in Israel, Europe, South America and Asia who receive success fees for sales generated by them, and four part-time consultants who assist us in the development of the North American market.

The Israeli Ministry of Defense has historically supported, and continues to support, our marketing efforts through its defense export assistance branch and through various projects for the IDF and its related divisions. There is no guarantee that this type of assistance will be available to us in the future.

We take part and present our tactical radars at the major land systems exhibitions on a regular basis, such as the Association of the United States Army (AUSA) Annual Meeting in Washington, D.C., Eurosatory in Paris, DSEI in London, and in regional exhibitions such as Seoul Aerospace & Defense, MSPO in Poland, DefExpo in India and others.

Fixed Price Contracts

The vast majority of our contracts are fixed-price contracts, under which the price is not subject to adjustment by reason of the costs incurred in the performance of the contracts, as long as the costs incurred and work performed fall within governmental guidelines. Under our fixed-price contracts, we assume the risk of increased or unexpected costs that may reduce our profits or even generate losses. This risk can be particularly significant under fixed-price contracts for research and development involving new technologies.

Our books and records may be subject to audits by the Israeli Ministry of Defense and other governmental agencies, including the U.S. Department of Defense. These audits may result in adjustments to contract costs and profits.

## Principal Customers

Generally, we complete a few major transactions each year, each in an amount comprising more than 10% of our revenues for such year. As a result, each year a significant portion of our revenues is derived from a small number of customers. The following table sets forth our principal customers in 2014, 2015 and 2016:

	Percentage of Revenues		
	2014	2015	2016
Israel Aerospace Industries	11 %	24 %	20 %
Ministry of Defense	6 %	9 %	17 %
RAFAEL	3 %	7 %	16 %
Embraer S.A.	16 %	10 %	13 %
Hindustan Aeronautics Ltd	23 %	13 %	11 %
Lockheed Martin Corporation	14 %	8 %	6 %

Although we continually strive to increase the number of our customers, we anticipate that a significant portion of our future revenues will continue to be derived from a small number of customers. Because of our dependency on a small number of customers and on government contracts, we are subject to business risks, including changes in governmental appropriations and changes in national defense policies and priorities. Although many of the programs in which we participate as a contractor or subcontractor may extend for several years, our business is dependent upon annual appropriations and funding of new and existing contracts. Most of the contracts are subject to termination for the convenience of the customer, pursuant to which the customer pays only for reimbursement of costs incurred and the applicable profit on work performed. The Israeli government or any other government may discontinue funding purchases of our products over the long term.

## Geographical Markets

We sell our products to various air forces and companies worldwide. The following table presents our revenues by geographical markets for the periods indicated:

	2014	2015	2016
Israel	23 %	43 %	57 %
South and Latin America	13 %	11 %	10 %
Asia	27 %	20 %	19 %
North America	37 %	25 %	13 %
Europe	0 %	1 %	1 %

## Competition

The markets for our products are highly competitive. Our principal competitors include Elbit Systems Ltd., United Technologies Aerospace Systems, Honeywell International Inc., IAI, Northrop Grumman Corporation, Sagem Avionics LLC., Thales Group, Zodiac Aerospace Group and SRC Inc. We expect to continue to face competition from these and other competitors. Currently, all of our competitors are larger and have substantially greater resources than us, including financial, technological, marketing and distribution capabilities, and enjoy greater market recognition than we do. These competitors may be able to achieve greater economies of scale and may be less vulnerable to price competition than us. We may not be able to offer our products as part of integrated systems to the same extent as our competitors or successfully develop or introduce new products that are more cost effective or offer better performance than those of our competitors. Failure to do so could adversely affect our business, financial condition and results of operations.





## Government Regulations

Israel's defense export policy regulates the sales of our systems and products. Current Israeli policy encourages export to approved customers of defense systems and products, such as ours, as long as the export is consistent with Israeli government policy.

A license is required to initiate marketing activities. We are also required to obtain a specific export license for any hardware exported from Israel. We are regulated by an Israeli law regulating export of "dual use" items (items that are typically sold in the commercial market, but that also may be used in the defense market) and the Defense Export Control Law and its supplemental regulations. Those laws and regulations govern the enforcement of export control and defined certain new areas of licensing, particularly with respect to transfer of technology. It is not certain that we will receive all the required permits and licenses for which we may apply in the future. Our participation in governmental procurement processes in Israel and other countries is subject to specific regulations governing the process of procuring defense contracts. Furthermore, solicitations for procurements by governmental purchasing agencies in Israel and other countries are governed by laws, regulations and procedures relating to procurement integrity, including avoiding conflicts of interest and corruption in the procurement process.

In addition, antitrust laws and regulations in Israel and other countries often require governmental approvals for transactions that are considered to limit competition. Such transactions may include cooperative agreements for specific programs or areas, as well as mergers and acquisitions.

## Proprietary Information

We generally do not consider patent protection significant to our current operations and rely upon a combination of security devices, trade secret laws and contractual restrictions to protect our rights in our products. Our policy is to require employees and consultants to execute confidentiality agreements upon the commencement of their relationships with us. These measures may not be adequate to protect our technology from third-party infringement, and our competitors might independently develop technologies that are substantially equivalent or superior to ours. Additionally, our products may be sold in foreign countries that provide less protection for intellectual property rights than that provided under U.S. or Israeli laws.

The Israeli government usually retains certain rights in technologies and inventions resulting from our performance as a prime contractor or subcontractor under Israeli government contracts and may generally disclose such information to third parties, including other defense contractors. When the Israeli government funds research and development, it may acquire rights to proprietary data and title to inventions; we may retain a non-exclusive, royalty-free license for such inventions. However, if the Israeli government purchases only the end product, we may retain the principal rights and the government may use the data and take an irrevocable, non-exclusive, royalty-free license.

## Manufacturing and Quality Management

Our production plant is located in Beit She'an, Israel. The plant is equipped to handle most of our manufacturing processes and testing requirements. For a few specific processes we utilize outsourced resources. This structure allows us flexibility and versatility.

We place great emphasis on quality control in our production processes. Commencing with customer requirements and expectations, via raw material inspection through completion, specifications are repeatedly checked. We maintain a quality assurance team that participates in every stage of the design and manufacturing of the products. Our quality management system is certified by the Standards Institute of Israel, or SII, pursuant to ISO 9001:2008 for hardware design and production and ISO 90003:2004 for software design. SII performs quality system audits twice a year and various customers perform audits four to six times a year. Our environmental management system is certified by SII to ISO 14001:2004. Our quality management system is also certified according to AS-9100C, a quality management

system for aerospace requirements.

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According to the standard warranty incorporated in most of our sales contracts, we warrant that our products will be free from defects in design, materials or workmanship, and guarantee repair or replacement of defective parts typically for periods between one to two years following delivery of a product to a customer. We also provide maintenance services to customers who sign maintenance contracts.

#### Source and Availability of Raw Materials

We acquire most of the components for the manufacturing of our products from suppliers and subcontractors, most of whom are located in Israel and the United States. Some of these suppliers are currently the sole source of one or more components upon which we are dependent. Since many of our purchases require long lead-times, a delay in supply of an item can significantly delay the delivery of a product. To date, we have not experienced any particular difficulties in obtaining timely deliveries of necessary components. We depend on a limited number of suppliers of components for our products and if we are unable to obtain these components when needed, we would experience delays in manufacturing our products and our financial results could be adversely affected.

#### C. Organizational Structure

We own 80% interest in CACS, a company based in China that is engaged in aircraft repair services. In 2010, we and our local partner in China, Tianzhu Forest Development Co., or Tianzhu, agreed that Tianzhu would divest its 20% interest and CACS would become a wholly-owned subsidiary, but the necessary approvals for such sale have never been obtained. Recently, we resolved to pursue a sale of our interest in our CACS subsidiary. The results presented in this annual report were adjusted to present CACS' results in a separate line as "Discontinued Operations".

#### D. Property, Plants and Equipment

We own a 30,000 square feet industrial building in Beit She'an, Israel. The building, which includes manufacturing facilities and warehouse space, is situated on land leased from the Israel Land Authority for a period of 49 years ending in 2034. The plant has sufficient capacity to meet our current requirements.

Our executive offices and research and development facilities are located in a 17,782 square feet office facility in Netanya, Israel. The lease for this facility expires in January 2022. The aggregate annual rent for our offices in Israel was approximately \$320,000 in 2016.

#### ITEM 4A. UNRESOLVED STAFF COMMENTS

Not applicable.

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

##### A. Operating Results

The following discussion of our results of operations should be read together with our consolidated financial statements and the related notes, which appear elsewhere in this annual report. The following discussion contains forward-looking statements that reflect our current plans, estimates and beliefs and involve risks and uncertainties. Our actual results may differ materially from those discussed in the forward-looking statements. Factors that could cause or contribute to such differences include those discussed below and elsewhere in this annual report.

##### Overview

We develop, manufacture and sell defense electronics including military avionics systems for manned and unmanned aircraft, inertial navigation systems, and tactical land radars for force and border protection applications. We sell and

support our commercial aviation electronic products and services, mainly through CACS, our 80% -owned Chinese subsidiary. Recently, we resolved to pursue a sale of our interest in our CACS subsidiary. The results presented in this annual report were adjusted to present CACS' results in a separate line as "Discontinued Operations".

## General

Our consolidated financial statements appearing in this annual report are prepared in dollars and in accordance with U.S. GAAP. Transactions and balances originally denominated in dollars are presented at their original amounts. Transactions and balances in other currencies are remeasured into dollars in accordance with the principles set forth in the Financial Accounting Standards Board, or FASB, Accounting Standards Codification, or ASC 830. The majority of our sales are made outside of Israel and a substantial part of them are in dollars. In addition, a substantial portion of our costs are incurred in dollars. Since the dollar is the primary currency of the economic environment in which we operate, the dollar is our functional and reporting currency and, accordingly, monetary accounts maintained in currencies other than the dollar are remeasured using the foreign exchange rate at the balance sheet date. Operational accounts and non-monetary balance sheet accounts are measured and recorded at the exchange rate in effect at the date of the transaction. All monetary balance sheet accounts have been remeasured using the exchange rates in effect at the balance sheet date. Statement of operations amounts have been remeasured using the average exchange rate for the period. The financial statements of our foreign subsidiary, whose functional currency is not the dollar, have been translated into dollars. All balance sheet amounts have been translated using the exchange rates in effect at balance sheet date. Statement of operation amounts have been translated using the average exchange rate prevailing during the year. Such translation adjustments are reported as a component of accumulated other comprehensive income (loss) in shareholders' equity.

## Discussion of Critical Accounting Policies and Estimations

Our critical accounting policies, including the assumptions and judgments underlying them, are disclosed in the notes to our consolidated financial statements. These policies have been consistently applied in all material respects. While the estimates and judgments associated with the application of these policies may be affected by different assumptions or conditions, we believe the estimates and judgments associated with the reported amounts are appropriate under the circumstances. We believe the following accounting policies are the most critical in fully understanding and evaluating our financial condition and results of our operations under U.S. GAAP.

**Revenue Recognition.** Our revenues are mainly derived from sales of defense electronics (solid-state recorders, computers, radars, etc.) and their supporting ground systems (automated testers, data debriefing stations). Product revenue is recognized when there is persuasive evidence of an arrangement, the fee is fixed or determinable, delivery of the product to the customer has occurred and the collection of the fee is probable. If the product requires specific customer acceptance, revenue is deferred until customer acceptance occurs or the acceptance provisions lapse, unless we can objectively and reliably demonstrate that the criteria specified in the acceptance provisions are satisfied.

Revenues from long-term fixed price contracts are recognized by the percentage-of-completion method in accordance with the "input method." We apply this method when the total of the costs and revenues of the contract can reasonably be estimated. The percentage of completion is determined based on the ratio of actual costs incurred to total costs estimated to be incurred over the duration of the contract. With regard to contracts for which a loss is anticipated, a provision is made for the entire amount of the estimated loss at the time such loss becomes evident. Estimated gross profit or loss from long-term contracts may change due to changes in estimates resulting from differences between actual performance and original forecasts. Such changes in estimated gross profit or loss are recorded in results of operations when they are reasonably determined by management, on a cumulative catch-up basis. Revenues under long-term fixed-price contracts that involve both development and production are recorded using the cost-to-cost method (development phase) and units-of-delivery method (production phase) as applicable to each phase of the contract, as the basis to measure progress toward completion.

We also generate revenues from repair services using our automated test equipment, mainly through CACS (now classified as a discontinued operation). Revenues from services are recognized when the service is performed.



Impairment of Long-Lived Assets. We are required to assess the impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. We assess the impairment of our assets based on a number of factors, including any significant changes in the manner of our use of the respective assets or the strategy of our overall business and significant negative industry or economic trends. Upon determination that the carrying value of a long-lived asset may not be recoverable, based upon a comparison of expected undiscounted future cash flows to the carrying amount of the asset, an impairment charge is recorded in the amount of the carrying value of the asset exceeds its fair value. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. As of December 31, 2016 and 2015, no impairment losses have been identified

Accounting for income taxes. On January 1, 2007, we adopted FASB ASC 740-10 "Income Taxes," which contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with ASC 740-10. The first step is to evaluate the tax position taken or expected to be taken in a tax return by determining if the weight of available evidence indicates that it is more likely than not that, on an evaluation of the technical merits, the tax position will be sustained on audit, including resolution of any related appeals or litigation processes. The second step is to measure the tax benefit as the largest amount that is more than 50% likely to be realized upon ultimate settlement ASC 740-10. We provided a valuation allowance in respect to the deferred tax assets resulting from operating loss carryforwards and other temporary differences. Our management currently believes that since our company has a history of losses, it is more likely than not that the deferred tax regarding the loss carryforwards and other temporary differences will not be realized in the foreseeable future.

Inventory valuation. The majority of our inventory consists of work in progress, raw materials and components. Inventories are valued at the lower of cost or market. Cost of finished goods is determined on the basis of direct manufacturing costs plus allocable indirect costs representing allocable operating overhead expenses and manufacturing costs. Raw material is valued using the "FIFO" method. We assess the valuation of our inventory on a quarterly basis and periodically write down the value for different finished goods and raw material items based on their potential utilization. If we consider specific inventory to be damaged, we write such inventory down to zero. Inventory write-offs are provided to cover risks arising from slow-moving items, discontinued products, and excess inventories. The process for evaluating these write-offs often requires us to make subjective judgments and estimates concerning the future utilization of the inventory items. Inventory write-offs were \$144,000, \$153,000 and \$138,000 as of December 31, 2016, 2015 and 2014, respectively.

Allowance for doubtful accounts. Our trade receivables are derived from sales to customers all over the world. We perform ongoing credit evaluations of our customers. In certain circumstances, we may require letters of credit or prepayments. We maintain an allowance for doubtful accounts for estimated losses from the inability of our customers to make required payments that we have determined to be doubtful of collection. We determine the adequacy of this allowance by regularly reviewing our accounts receivable and evaluating individual customers' receivables, considering customers' financial condition, credit history and other current economic conditions. If a customer's financial condition were to deteriorate which might impact its ability to make payment, then additional allowances may be required. Provisions for doubtful accounts are recorded in general and administrative expenses. Our allowance for doubtful accounts was \$14,000, \$2,000, \$16,000 as of December 31, 2016, 2015 and 2014, respectively.

We account for stock-based compensation in accordance with the provisions of ASC 718, "Compensation - Stock Compensation". Under the fair value recognition provisions of ASC 718, stock-based compensation cost is estimated at the grant date based on the fair value of the award and is recognized as expense ratably over the requisite service period of the award. We estimate the fair value of stock options granted using the Black-Scholes-Merton option-pricing model.

The fair value of an award is affected by our stock price on the date of grant and other assumptions, including the estimated volatility of our stock price over the term of the awards and the estimated period of time that we expect employees to hold their stock options. Share-based compensation expense recognized in our consolidated statements of operations was reduced for estimated forfeitures.

Discontinued Operations. Under ASC 205, "Presentation of Financial Statements - Discontinued Operation" when a component of an entity, as defined in ASC 205, has been disposed of or is classified as held for sale, the results of its operations, including the gain or loss on its component are classified as discontinued operations and the assets and liabilities of such component are classified as assets and liabilities attributed to discontinued operations; that is, provided that the operations, assets and liabilities and cash flows of the component have been eliminated from the company's consolidated operations and the company will have no significant continuing involvement in the operations of the component. Subsequent to our determination to sell our interest in CACS, CACS' results are accounted as discontinued operation and appear in this annual report in a separate line item as "Discontinued Operations".

#### Explanation of Key Income Statement Items

Revenues. Our revenues are mainly derived from sales of defense electronics and their supporting ground systems.

Cost of Revenues. Cost of revenues consists primarily of salaries, raw materials, subcontractor expenses, related depreciation costs, inventories write-downs and overhead allocated to cost of revenues activities.



**Marketing and Selling Expenses** Marketing and selling expenses consist primarily of salaries for marketing and business development personnel, marketing activities, public relations, promotional materials, travel expenses, trade show exhibit expenses, and success fees to business development consultants.

**General and Administrative Expenses.** General and administrative expenses consist primarily of salaries and related expenses for executive, accounting, legal, administrative personnel, professional fees, provisions for doubtful accounts and other general corporate expenses.

**Research and Development Expenses, net.** Research and development expenses consist primarily of salaries for research and development personnel, use of subcontractors and other costs incurred in the process of developing product prototypes.

**Financial Expenses, Net.** Financial expenses consist of interest and bank expenses, interest on convertible note and loans, amortization expenses of discount on convertible note, deferred charges and currency remeasurement losses. Financial income consists of interest on cash and cash equivalent balances and currency remeasurement gains.

## Results of Operations

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

	Year Ended December 31,		
	2014	2015	2016
Revenues	100 %	100 %	100 %
Cost of revenues	70.7 %	82.9 %	88.7 %
Gross profit	29.3 %	17.1 %	11.3 %
Research and development, net	3.6 %	4.9 %	5.9 %
Marketing and selling	11.1 %	16.7 %	17.7 %
General and administrative	7.7 %	14.9 %	14.1 %
Operating income (loss)	6.9 %	(19.5)%	(26.5)%
Financial expenses, net	(5.8 )%	(25.4)%	(11.9)%
Net income (loss) from continuing operations	1.1 %	(44.9)%	(38.4)%
Net income (loss) from discontinued operations	(0.17)%	(1.3 )%	0.1 %
Net income (loss)	0.93 %	(46.2)%	(38.3)%
Net income (loss) attributable to non-controlling interest	(0.0 )%	(0.2 )%	0.0 %
Net income (loss) attributable to RADA Electronic Industries' shareholders	0.9 %	(45.9)%	(38.3)%

## Year Ended December 31, 2016 Compared with Year Ended December 31, 2015

**Revenues.** Our revenues decreased by 9% to \$12.8 million in 2016 from \$14.1 million in 2015 mainly due to delays in securing expected contracts that were delayed to later dates.

**Cost of Revenues.** Cost of revenues decreased by 2% to \$11.4 million in 2016 from \$11.7 million in 2015. The decrease in our cost of revenues is attributable to the reduction in sales .

**Gross Profit.** Our gross profit decreased by 40% to \$1.4 million in 2016 from \$2.4 million in 2015. Our gross profit margin was approximately 11.2% in 2016 and 17% in 2015. The decrease in our gross profit and gross profit margin in 2016 was mainly attributable to the decrease in revenues and the relatively lower decrease in cost of revenues.

Research and Development Expenses, Net. Our research and development expenses increased by 9.4% to \$758,000 in 2016 from \$693,000 in 2015. The relatively low level of expenditures in both 2016 and 2015 reflects maturation of our radar products.. We expect that our research and development expenses in 2017 will remain similar to those we incurred in 2016 and we will sustain a base level of development for our existing products, as well as developing new applications for our products.

Marketing and Selling Expenses. Marketing and selling expenses decreased by 4% to approximately \$2.27 million in 2016 from \$2.36 million in 2015. We maintained a similar level of marketing and selling expenses primarily due to our efforts to sell our new radar products, mainly reflected in the costs incurred as part of our participation in field demonstrations requested by our potential customers.

General and Administrative Expenses. General and administrative expenses decreased by 14% to approximately \$1.8 million in 2016 from \$2.1 million in 2015. Our general and administrative expenses in 2015 include a \$0.6 million charge due to goodwill impairment. We expect that in 2017 our general and administrative expenses will remain similar to those we incurred in 2016.

Financial Expenses, Net. Our financial expenses, net, decreased by 57% to \$1.5 million in 2016 compared to \$3.6 million in 2015. Our non-cash financial expense resulting from the amortization of the discount on a convertible note and loans from shareholders was \$1,116,000 in 2016 compared to \$2,684,000 in 2015. Our interest expense, net, was \$270,000 in 2016 compared to \$575,000 in 2015. We expect that in 2017 our financial expenses will decrease in comparison to those we incurred in 2016 as our current convertible loan does have a beneficial conversion feature.

#### Year Ended December 31, 2015 Compared with Year Ended December 31, 2014

Revenues. Our revenues decreased by 35% to \$14.1 million in 2015 from \$21.6 million in 2014 mainly due to delays in securing expected contracts that were delayed to later dates.

Cost of Revenues. Cost of revenues decreased by 24% to \$11.7 million in 2015 from \$15.3 million in 2014. The decrease in our cost of revenues is attributable to the reduction in sales and the significant reduction of low margin programs in 2015 compared to 2014. Cost of revenues as a percentage of sales increased to 82.8% from 70.6% in 2014 due to the large reduction in overall sales.

Gross Profit. Our gross profit decreased by 62% to \$2.4 million in 2015 from \$6.3 million in 2014. Our gross profit margin was approximately 17% in 2015 and 29% in 2014. The decrease in our gross profit and gross profit margin in 2015 was mainly attributable to the decrease in revenues and the relatively lower decrease in cost of revenues.

Research and Development Expenses, Net. Our research and development expenses, net, decreased by 12% to approximately \$0.7 million in 2015 from \$0.8 million in 2014. Our research and development expenses decreased as the result of the maturation of our radar products.

Marketing and Selling Expenses. Marketing and selling expenses decreased by 1% to approximately \$2.36 million in 2015 from \$2.4 million in 2014. We have maintained a similar level of marketing and selling expenses primarily due to our efforts to sell our new radar products, mainly reflected in the costs incurred as part of our participation in field demonstrations requested by potential customers.

General and Administrative Expenses. General and administrative expenses increased by 26% to approximately \$2.1 million in 2015 from \$1.7 million in 2014. Our general and administrative expenses in 2015 include an approximately \$0.6 million charge due to goodwill impairment.

Financial Expenses, Net. Our financial expenses, net, increased by 185% to \$3.6 million in 2015 compared to \$1.2 million in 2014. Our non-cash expense resulting from the amortization of the discount on a convertible note and loans

from shareholders was \$2,684,000 in 2015 compared to \$43,000 in 2014. Our interest expense, net, was \$575,000 in 2015 compared to \$708,000 in 2014. Foreign currency exchange differences, net resulted in a loss of \$30,000 in 2015 compared to loss of \$63,000 in 2014, primarily due to changes in the NIS/dollar exchange rate.

## Our Location in Israel

We are incorporated under the laws of the State of Israel, and our principal executive offices and principal manufacture, research and development facilities are located in Israel. See Item 3D "Key Information – Risk Factors – Risks Relating to Our Location in Israel" for a description of governmental, economic, fiscal, monetary or political policies or factors that have materially affected or could materially affect our operations.

## Corporate Tax Rate

Israeli companies were generally subject to corporate tax at a rate of 25% in 2016. In December 2016, the Israeli Parliament approved a measure whereby the corporate tax rate would be reduced in two stages from 25% to 23%, starting with a corporate income tax rate of 24% beginning in January 2017 which is to be reduced to 23% beginning in January 2018.

As of December 31, 2016, our net operating loss carry forward for Israeli tax purposes was approximately \$71 million, including capital loss carry forwards of approximately \$3.4 million.

## Trade Relations

Israel is a member of the United Nations, the International Monetary Fund, the International Bank for Reconstruction and Development, and the International Finance Corporation. Israel is a member of the World Trade Organization and is a signatory to the General Agreement on Tariffs and Trade. Israel is a member of the Organization for Economic Co-operation and Development, or the OECD, an international organization whose members are governments of mostly developed economies. The OECD's main goal is to promote policies that will improve the economic and social well-being of people around the world. In addition, Israel has been granted preferences under the Generalized System of Preferences from the U.S., Australia, Canada and Japan. These preferences allow Israel to export the products covered by such programs either duty-free or at reduced tariffs.

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

## Impact of Currency Fluctuation and of Inflation

A significant portion of the cost of our Israeli operations, primarily personnel and facility-related, is incurred in NIS. Therefore, our NIS related costs, as expressed in dollars, are influenced by the exchange rate between the dollar and the NIS. In addition, if the rate of inflation in Israel will exceed the rate of devaluation of the NIS in relation to the dollar, or if the timing of such devaluations were to lag considerably behind inflation, our cost as expressed in dollars may increase. NIS linked balance sheet items, may also create foreign exchange gains or losses, depending upon the relative dollar values of the NIS at the beginning and end of the reporting period, affecting our net income and earnings per share. Although we may use hedging techniques, we may not be able to eliminate the effects of currency fluctuations. Therefore, exchange rate fluctuations could have a material adverse impact on our operating results and share price. The caption "Financial expenses, net" in our consolidated financial statements includes the impact of these factors as well as traditional interest income or expense. See Note 14 to our consolidated financial statements.



The following table sets forth, for the periods indicated, (i) depreciation or appreciation of the NIS against the most important currency for our business, the dollar, until December 31 each year and the year before, and (ii) inflation as reflected in changes in the Israeli consumer price index.

	Year Ended December 31,				
	2012	2013	2014	2015	2016
NIS vs. U.S. Dollar	(2.3)%	(7.0)%	12 %	0.3 %	(1.5)%
Israeli Consumer Price Index	1.6 %	1.8 %	(0.2)%	(1 )%	(0.2)%

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

#### Recently Issued Accounting Standards

##### ASU 2014-15 - Presentation of Financial Statements - Going Concern (Subtopic 205-40):

In August 2014, the FASB issued guidance on disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern (ASU 2014-15), which defines management's responsibility to evaluate whether there is substantial doubt about a company's ability to continue as a going concern. ASU 2014-15 also provide principles and definitions that are intended to reduce diversity in the timing and content of disclosures in the financial statement footnotes. This guidance is effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. we adopted the provisions of ASU 2014-15 for the year ended December 31, 2016. The adoption of ASU 2014-15 did not have a material impact on the consolidated financial statements.

##### ASU 2016-09 - Compensation - Stock Compensation (Topic 718):

In March 2016, the FASB issued guidance on improvements to Employee Share-Based Payments. The standard requires among others that excess tax benefits or deficiencies for share-based payments be recorded as income tax benefit of expense, rather than within additional paid in capital, in the period the shares vest. Cash flows related to excess tax benefits will be included in operating activities instead of separately classified as a financing activity. The new guidance is effective for fiscal years beginning after December 15, 2016. Early adoption is permitted. We do not expect this guidance to have a material effect on its consolidated financial statements at the time of adoption of this standard.

##### ASU 2016-18 - Statement of Cash Flows (Topic 230):

In November 2016, the FASB issued Accounting Standards Update No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash. The ASU requires that the Consolidated Statement of Cash Flows explain the change in total cash and equivalents and amounts generally described as restricted cash or restricted cash equivalents when reconciling the beginning-of-period and end-of-period total amounts. The ASU also requires a reconciliation between the total of cash and equivalents and restricted cash presented on the Consolidated Statement of Cash Flows and the cash and equivalents balance presented on the Consolidated Balance Sheet. ASU 2016-18 is effective retrospectively on January 1, 2018, with early adoption permitted. We are currently evaluating the potential effect of the guidance on its consolidated financial statements.

ASU 2016-02 - Leases (Topic 842):

In February 2016, the FASB issued guidance on the recognition, measurement, presentation and disclosure of leases for both parties to a contract (i.e. lessees and lessors). The new standard requires lessees to apply a dual approach, classifying leases as either finance or operating leases based on the principle of whether or not the lease is effectively a financed purchase by the lessee. This classification will determine whether lease expense is recognized based on an effective interest method or on a straight-line basis over the term of the lease, respectively. A lessee is also required to record a right-of-use asset and a lease liability for all leases with a term of greater than 12 months regardless of their classification. Leases with a term of 12 months or less will be accounted for in a manner similar to the accounting under existing guidance for operating leases today. The new standard requires lessors to account for leases using an approach that is substantially equivalent to existing guidance for sales-type leases, direct financing leases and operating leases. Topic 842 supersedes the previous leases standard, ASC 840, "Leases". The guidance is effective for the interim and annual periods beginning on or after December 15, 2018 (early adoption is permitted). We are currently evaluating the potential effect of the guidance on its consolidated financial statements.

ASU 2015-11 - Inventory (Topic 330):

In July 2015, the FASB issued guidance on current accounting for inventory measurement. The new guidance requires entities to measure inventory at the lower of cost or net realizable value. Net realizable value is defined by the guidance as the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. The guidance is effective for the interim and annual periods beginning on or after December 15, 2016 (early adoption is permitted). We do not expect this guidance to have a material effect on its consolidated financial statements at the time of adoption of this standard.

ASU 2014-09 - Revenue from Contracts with Customers (Topic 606):

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers" (Topic 606), which will replace existing requirements in U.S. GAAP, including industry-specific requirements, significantly expand the disclosure requirements and provide companies with a single revenue recognition model for recognizing revenue from contracts with customers. ASU 2014-09 also provides for additional disclosure requirements. The FASB has recently issued several amendments to the new standard, including clarification on accounting for licenses of intellectual property and identifying performance obligations. The amendments include ASU No. 2016-08, "Revenue from Contracts with Customers (Topic 606)-Principal versus Agent Considerations", which was issued in March 2016, and clarifies the implementation guidance for principal versus agent considerations in ASU 2014-09, and ASU No. 2016-10, "Revenue from Contracts with Customers (Topic 606)-Identifying Performance Obligations and Licensing", which was issued in April 2016, and amends the guidance in ASU No. 2014-09 related to identifying performance obligations and accounting for licenses of intellectual property.

The new standard permits adoption either by using (i) a full retrospective approach for all periods presented in the period of adoption or (ii) a modified retrospective approach with the cumulative effect of initially applying the new standard recognized at the date of initial application and providing certain additional disclosures. While ASU 2014-09 was to be effective for annual periods and interim periods beginning after December 15, 2016, on July 9, 2015, the FASB approved the deferral of the effective date to periods beginning on or after December 15, 2017.

Accordingly, the Company intends to adopt ASU 2014-09 on January 1, 2018 and continues to deliberate the selection of the transition method. The Company has made progress toward completing the evaluation of the potential changes from adopting the new standard in its financial reporting and disclosures. The Company expects to predominantly complete the contract evaluation and validate the impact of the accounting and disclosure changes on its business processes, controls and systems during the first half of 2017, design any changes to such business processes, controls and systems by the middle of 2017, and implement the changes over the remainder of 2017.





The adoption of the new standard may primarily impact the Company's contracts where revenue is currently recognized using the percentage-of-completion units-of-delivery method, with the possible resulting impact being revenue which may be recognized earlier in the performance period as it incur costs, as opposed to when units are delivered. This change may also impact the Company's balance sheet presentation with a possible decrease in inventories, an increase in contract assets (i.e., unbilled receivables) and a net increase to retained earnings to primarily reflect the impact of converting units-of-delivery contracts to the cost-to-cost method for recognizing revenue and profits.

ASU 2016-15 - Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. In August 2016, the FASB issued guidance on the classification of Certain Cash Receipts and Cash Payments which intended to reduce diversity in practice in how certain cash receipts and cash payments are presented and classified in the Consolidated Statement of Cash Flows by providing guidance on eight specific cash flow issues. ASU 2016-15 is effective retrospectively on January 1, 2018, with early adoption permitted. We are currently evaluating the potential effect of the guidance on its consolidated cash flow statement.

## B. Liquidity and Capital Resources

We have historically met our financial requirements primarily through cash generated by operations, funds generated by our public offering in 1985, private placements of our ordinary shares and debt securities, loans from our principal shareholders, short-term loans and credit facilities from banks (most recently Bank Leumi Le-Israel B.M. and the Israeli branch of State Bank of India, or the Banks), research and development grants from the government of Israel and the Israel-U.S. Binational Industrial Research and Development Foundation, investment grants for approved enterprise programs and marketing grants from the government of Israel.

We had working capital of \$11.1 million as of December 31, 2016 compared with a working capital of \$6.5 million at December 31, 2015. Cash and cash equivalents amounted to \$1.2 million as of December 31, 2016 compared to \$0.7 million as of December 31, 2015. Short-term and long-term bank deposits and restricted bank deposits amounted to \$0.32 million as of December 31, 2016 compared to \$0.68 million as of December 31, 2015.

As of December 31, 2016, we had \$0.6 million of secured borrowing with a bank against specific accounts receivable. In addition, the Banks provided \$0.6 million of guarantees on our behalf, mainly to our customers and suppliers in the ordinary course of business. The guarantees are secured by a first priority floating charge on all of our assets and by a fixed charge on our property in Beit She'an, unpaid share capital and insurance rights (rights to proceeds on insured assets in the event of loss). Our agreements with the Banks prohibit us from: (i) selling or otherwise transferring any assets except in the ordinary course of business; (ii) placing a lien on our assets without the Banks' consent; or (iii) declaring dividends to our shareholders.

In April 2014, we borrowed \$1.0 million from Faith Content Development Limited, or FCD, a company controlled by Mr. Yeung, who was at the time our controlling shareholder, in order to facilitate further development of our INS technology and for working capital. This loan carried interest at LIBOR + 3.5% payable at the beginning of every quarter and the principal was due on January 31, 2015. Due to our cash flow and working capital difficulties, we were not able to timely and fully make the repayment of interest and principal amounts to FCD for this loan and previous loans from FCD and Mr. Ben Zion Gruber, our director. As a result we were required to pay the default interest on account of all such loans, which were subject to acceleration. However, we entered into a standstill agreement with our lenders, according to which, except in extraordinary circumstances, no action was to be taken to accelerate the loans or to exercise their rights prior to January 31, 2014. On April 2014 and June 2015, the standstill agreement was amended and the forbearance period pursuant to such agreement was extended until August 31, 2016. Pursuant to an amendment of the standstill agreement, as of and after February 1, 2015 the default interest on all outstanding principal amounts was Libor + 9%.

On July 30, 2015, we completed a public offering of 3,455,284 ordinary shares, offered at a price to the public of \$2.46 per share. We received gross proceeds of \$8.5 million before deducting underwriting discounts and commissions and other offering expenses. Issuance costs amounted to approximately \$1.07 million. As of December 31, 2015 the remaining principal amount of the debt owed under the Standstill Agreement was \$3.09 million.

On May 15, 2016, our shareholders approved the sale to DBSI of 8,510,638 of our ordinary shares in consideration for approximately \$4 million, reflecting a price per share of \$0.47. In addition, we issued to DBSI warrants to purchase: (i) an additional 4,255,319 ordinary shares at an exercise price per share of \$0.47 (resulting in an aggregate exercise price of \$2 million), exercisable for a period of 24 months following the date of the initial investment and (ii) warrants to purchase an additional 3,636,363 shares at an exercise price per share of \$0.55 (resulting in an aggregate exercise price of \$2 million), exercisable for a period of 48 months following the date of the initial investment.

DBSI also granted the company an option, exercisable by either us or DBSI, for us to obtain a three -year loan in the principal amount of up to \$3.175 million solely for the purpose of the repayment of the outstanding shareholders' debt. We exercised such option in June 2016 and used the funds to fully repay our outstanding shareholders' debt.

During the term of the loan which has a three -year term, DBSI has the right, but not the obligation, at its sole discretion, to convert the then remaining convertible loan amount into ordinary shares at a price per share equal to the lower of: (i) \$2.40, or (ii) a five percent (5%) discount to the FMV (the average of the closing prices of our Ordinary Shares over the 5 consecutive trading days ending on the last trading day prior to the date of conversion), but in no event less than \$0.47. These additional issuances would substantially dilute the ownership interests and voting rights of our shareholders.

In connection with the DBSI transaction, we issued warrants to purchase 255,319 ordinary shares to each of Legos Advisors Ltd. and Mr. Avi Geffen as commission and finder's fees.

On November 15, 2016, we completed a \$2 million directed registered offering of 1,904,762 ordinary shares at a price per share of \$1.05 to The Phoenix Insurance Company Ltd. and its affiliate, Shotfut-Menayot-Israel-HaPhoenix Amitim Ltd. At the same time, DBSI invested an additional \$1 million in our company through the exercise of 2,127,660 warrants.

On August 29, 2016, DBSI exercised warrants to purchase 531,915 ordinary shares at an exercise price per share of \$0.47 resulting in proceeds of \$0.25 million to our company,

On January 17, 2017 DBSI exercised warrants to purchase 531,915 ordinary shares at an exercise price per share of \$0.47 resulting in proceeds of \$0.25 million to our company.

On May 15, 2016, our shareholders approved a NIS 675,000 increase to our share capital. Following the increase, our authorized share capital is NIS 1,125,000 divided into 37,500,000 ordinary shares, par value NIS 0.030 each (as adjusted to reflect the one share for two shares reverse share split effected in September 2016).

On September 13, 2016 we effected a one share for two shares reverse share split in order to meet the minimum market price requirements of the NASDAQ. All historical share amounts have been adjusted in this annual report to reflect that reverse split.

We made capital expenditures of \$0.41 million in the year ended December 31, 2016, primarily for machinery and equipment. We currently do not have any significant capital spending or purchase commitments.

## Cash Flows

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

	Year ended December 31,		
	2014	2015	2016
	(U.S. dollars in thousands)		
Net cash provided by (used in) operating activities from continuing operations	184	(3,018)	(4,919)
Net cash provided by (used in) investing activities from continuing operations	98	(370 )	(44 )
Net cash provided by (used in) financing activities from continuing operations	(528 )	3,227	5,442
Net cash provided by (used in) operating activities from discontinued operations	(62 )	253	298
Net cash used in investing activities from discontinued operations	(32 )	(8 )	(34 )
Net cash provided by (used in) financing activities from discontinued operations	-	-	-
Effect of exchange rate changes on cash and cash equivalents	(11 )	(116 )	(133 )
Increase (decrease) in cash and cash equivalents	(351 )	(32 )	610
Cash and cash equivalents at beginning of the year	2,137	1,786	1,754
Cash and cash equivalents at end of the year	1,786	1,754	2,364
Less cash and cash equivalents of discontinued operation at the end of the year	1,075	1,020	1,159
	711	734	1,205

## Continuing Operation:

Net cash used in operating activities was \$4,919,000 in 2016. This was primarily due to our loss in 2016 and increase in inventories of \$1,503,000, an increas