RADA ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2016

U.S. DOLLARS IN THOUSANDS

INDEX

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors of

RADA ELECTRONIC INDUSTRIES LTD.

We have audited the accompanying consolidated balance sheets of RADA Electronic Industries Ltd. (the "Company") and its subsidiaries as of December 31, 2016 and 2015 and the related consolidated statements of operations, comprehensive income (loss), changes in equity and cash flows for each of the three years in the period ended December 31, 2016. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2016 and 2015, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2016, in conformity with U.S. generally accepted accounting principles.

Haifa, Israel
March 27, 2017

/s/ Kost Forer Gabbay & Kasierer
Kost Forer Gabbay & Kasierer
A member of Ernst & Young Global

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	December 31, 2016	December 31, 2015
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 1,205	$ 734
Restricted deposits	317	609
Trade receivables (net of allowance for doubtful accounts of $14 and $2 at December 31, 2016 and 2015)	5,006	3,646
Costs and estimated earnings in excess of billings on uncompleted contracts (Note 3)	1,096	2,207
Other accounts receivable and prepaid expenses	349	204
Inventories, net (Note 5)	7,102	5,691
Current assets related to discontinued operations	2,254	2,288
Total current assets	17,329	15,379
LONG-TERM ASSETS:		
Long-term receivables and other deposits (Note 6)	742	119
Property, plant and equipment, net (Note 7)	2,650	2,687
Long-term assets related to discontinued operations	266	391
Total assets	$ 20,987	$ 18,576

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

CONSOLIDATED BALANCE SHEETS

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

	December 31, 2016	December 31, 2015
LIABILITIES AND EQUITY		
CURRENT LIABILITIES:		
Bank credit (Note 9)	$ 575	$ 2,416
Trade payables	2,557	1,951
Convertible note and loans from shareholders, net (Note 9)	-	1,634
Other accounts payable and accrued expenses (Note 10)	1,987	2,630
Advances from customers, net	839	-
Current liabilities related to discontinued operations	265	226
Total current liabilities	6,223	8,857
LONG-TERM LIABILITIES:		
Convertible loan from shareholders, net (Note 9)	3,072	-
Accrued severance pay and other long term liability	663	660
Total long-term liabilities	3,735	660
COMMITMENTS AND CONTINGENT LIABILITIES (Note 11)		
EQUITY:		
Share capital (Note 12) -		
Ordinary shares of NIS 0.03 par value - Authorized: 37,500,000 and 15,000,000 shares at December 31, 2016 and at December 31, 2015 respectively; Issued and outstanding: 21,246,502 and 7,949,444 at December 31, 2016 and at December 31, 2015 respectively.	250	146
Additional paid-in capital	89,407	82,427
Accumulated other comprehensive income	222	387
Accumulated deficit	(79,363)	(74,453)
Total RADA Electronic Industries shareholders' equity	10,516	8,507
Non-controlling interest	513	552
Total equity	11,029	9,059
Total liabilities and equity	$ 20,987	$ 18,576

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

CONSOLIDATED STATEMENTS OF OPERATIONS

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

	Year ended December 31, 2016	Year ended December 31, 2015	Year ended December 31, 2014
Revenues:			
Products	$ 11,663	$ 12,375	$ 20,927
Services	1,158	1,699	698
	12,821	14,074	21,625
Cost of revenues:			
Products	10,594	11,139	15,124
Services	785	526	160
	11,379	11,665	15,284
Gross profit	1,442	2,409	6,341
Operating costs and expenses:			
Research and development, net	758	693	789
Marketing and selling	2,269	2,357	2,392
General and administrative	1,814	1,513	1,667
Goodwill impairment	-	587	-
Total operating costs and expenses	4,841	5,150	4,848
Operating income (loss)	(3,399)	(2,741)	1,493
Amortization of shareholders' convertible loans discount and beneficial conversion feature (BCF)	1,116	2,684	43
Other financial expenses, net	405	893	1,213
Total financial expenses, net (Note 14)	1,521	3,577	1,256
Net income (loss) from continuing operations	(4,920)	(6,318)	237
Net income (loss) from discontinued operations	13	(179)	(36)
Net income (loss)	$ (4,907)	$ (6,497)	$ 201
Net income (loss) attributable to non-controlling interest	3	(36)	(7)
Net income (loss) attributable to RADA Electronic Industries' shareholders	(4,910)	(6,461)	208
Basic and diluted net income (loss) from continuing operations	$ (0.35)	$ (0.53)	$ 0.03
Basic and diluted net income (loss) from discontinued operations per Ordinary share	$ 0.00	$ (0.00)	$ (0.00)
Basic and diluted net income (loss)	$ (0.35)	$ (0.55)	$ (0.02)
Weighted average number of Ordinary shares used for computing basic and diluted net income (loss) per share	14,029,346	11,904,088	8,944,803

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

U.S. dollars in thousands

	Year ended December 31,		
	2016	2015	2014
Net income (loss)	$ (4,907)	$ (6,497)	$ 201
Other Comprehensive Income (loss):			
Change in foreign currency translation adjustment	(207)	(186)	(14)
Total comprehensive income (loss)	(5,114)	(6,683)	187
Less: comprehensive income (loss) attributable to non-controlling interest	(39)	(73)	(10)
Comprehensive income (loss) attributable to RADA Electronic Industries' shareholders	$ (5,075)	$ (6,610)	$ 197

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

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

U.S. dollars in thousands, except share data

	Number of Ordinary shares (**)	Share capital	Additional paid-in capital	Accumulated other comprehensive income	Accumulated deficit	Non controlling interest	Total equity
Balance at January 1,2014	4,459,285	$ 119	$ 70,884	$ 547	$ (68,200)	$ 635	$ 3,985
Cashless exercise of Warrants	34,875	(*)	(*)				-
Net income (loss)					208	(7)	201
Other comprehensive loss				(11)		(3)	(14)
Balance at December 31, 2014	4,494,160	$ 119	$ 70,884	$ 536	$ (67,992)	$ 625	$ 4,172
Issuance of Ordinary shares, net of issuance costs of $1,070	3,455,284	27	7,403	-	-	-	7,430
Beneficial conversion feature related to convertible loans from shareholders (Note 9)	-	-	4,140	-	-	-	4,140
Net loss	-	-	-	-	(6,461)	(36)	(6,497)
Other comprehensive loss				(149)	-	(37)	(186)
Balance at December 31, 2015	7,949,444	$ 146	$ 82,427	$ 387	$ (74,453)	$ 552	$ 9,059
Beneficial conversion feature related to convertible loans from shareholders (Note 9)	-	-	123	-	-	-	123
Extinguishment of convertible loan	-	-	(359)	-	-	-	(359)
Share-based compensation to employees	-	-	111	-	-	-	111
Issuance of shares and warrants, net of issuance costs of $204	10,415,400	82	5,714	-	-	-	5,796
Exercise of warrants and conversion of convertible loan to Ordinary shares	2,881,658	22	1,391	-	-	-	1,413
Net income (loss)	-	-	-	-	(4,910)	3	(4,907)
Other comprehensive loss	-	-	-	(165)	-	(42)	(207)
Balance at December 31, 2016	21,246,502	$ 250	$ 89,407	$ 222	$ (79,363)	$ 513	$ 11,029

(*) Represents an amount lower than $1.
(**) See Note 12a.

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2016	2015	2014
Cash flows from operating activities:			
Net income (loss)	$ (4,907)	$ (6,497)	$ 201
Adjustments required to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	554	548	575
Impairment of goodwill	-	587	-
Extinguishment and amortization expenses related to beneficial conversion feature and discount of convertible loans	1,116	2,684	43
Severance pay, net	37	53	(15)
Decrease (increase) in trade receivables, net	(1,360)	(607)	1,583
Decrease (increase) in other accounts receivable and prepaid expenses	(135)	81	13
Share based compensation to employees	111	-	-
Decrease (increase) in costs and estimated earnings in excess of billings	403	1,467	(599)
Decrease (increase) in inventories	(1,503)	(499)	153
Increase (decrease) in trade payables	592	602	(1,598)
Increase (decrease) in other accounts payable, accrued expenses and advances from customers, net	173	(1,437)	(172)
Net cash provided by (used in) operating activities from continuing operations	(4,919)	(3,018)	184
Cash flows from investing activities:			
Purchase of property, plant and equipment	(411)	(366)	(296)
Decrease (increase) in deposits, net	11	(10)	2
Change in restricted deposits, net	356	6	392
Net cash provided by (used in) investing activities from continuing operations	(44)	(370)	98

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2016	**2015**	**2014**
Cash flows from financing activities:			
Proceeds from convertible loans from shareholders	3,175	-	1,000
Issuance of Ordinary shares, net	5,796	7,430	-
Exercise of warrants	1,300	-	-
Proceeds from (repayment of) short-term bank credit, net	(1,841)	827	(298)
Repayment of short-term loans from shareholders	(2,988)	(5,030)	(1,230)
Net cash provided by (used in) financing activities from continuing operations	5,442	3,227	(528)
Net cash provided by (used in) operating activities from discontinued operations	298	253	(62)
Net cash used in investing activities from discontinued operations	(34)	(8)	(32)
Net cash provided by (used in) financing activities from discontinued operations	-	-	-
Effect of exchange rate changes of discontinued operation on cash and cash equivalents	(133)	(116)	(11)
Increase (decrease) in cash and cash equivalents	610	(32)	(351)
Cash and cash equivalents at the beginning of the year	1,754	1,786	2,137
Cash and cash equivalents at the end of the year	2,364	1,754	1,786
Less cash and cash equivalents of discontinued operation at the end of the year	1,159	1,020	1,075
	$ 1,205	$ 734	$ 711

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2016	**2015**	**2014**
(b) Supplemental disclosures of cash flow activities:			
Net cash paid during the year for:			
Income taxes	$ 16	$ 15	$ 35
Interest	$ 658	$ 2,106	$ 57
(c) Non-cash transactions			
Conversion of convertible loan including unpaid interest	$ 113	$ -	$ -
Transfer of inventory to property, plant and equipment	$ 92	$ 573	$ 37
Purchase of property, plant and equipment in credit	$ 14	$ 62	$ 144

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

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

NOTE 1:- GENERAL

a. RADA Electronic Industries Ltd. (the "Company") is an Israeli based defense electronics contractor that specialize in the development, manufacture and sale of data recording and management systems (such as digital video and data recorders, ground debriefing stations, head-up display cameras), inertial navigation systems for air and land applications, avionics solutions (such as aircraft upgrades, avionics for unmanned aircraft vehicles, ("UAVs"), store management systems and interface computers) and land radar for defense forces and border protection applications (active protective systems for armored fighting vehicles, hostile fire detection and perimeter surveillance).

The Company also provides test and repair shop using its Automated Test Equipment ("ATE") products in Beijing, China, through its 80% owned Chinese subsidiary, Beijing Huari Aircraft Components Maintenance and Services Co. Ltd. ("CACS" or the "subsidiary"). CACS was established with a Chinese third party, which owns the remaining 20% equity interest (see Note 1b).

The Company is organized and operates as one operating segment.

b. Discontinued operations

During 2016, the Company committed to a plan to sell its test and repair services activity (provide through the Company's 80% owned subsidiary, CACS) in order to focus in its core business.

The results of the discontinued operations including prior periods' comparable results, assets and liabilities which have been retroactively included in discontinued operations as separate line items in the statements of operations and balance sheets, are presented below:

	Year ended December 31,		
	2016	2015	2014
Revenues	$ 909	$ 790	$ 856
Cost of sales	698	626	660
Operating expenses	197	347	239
Operating income (loss)	14	(183)	(43)
Finance income (expenses), net	(1)	4	7
Net income (loss)	13	(179)	(36)

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

NOTE 1:- GENERAL (Cont.)

The major classes of assets and liabilities that were classified as discontinued operations were:

	Year ended December 31, 2016	Year ended December 31, 2015
Cash and cash equivalents	$ 1,159	$ 1,020
Trade receivables	244	392
Other accounts receivable and prepaid expenses	6	2
Inventories	845	874
PROPERTY, PLANT AND EQUIPMENT, NET	266	391
Total assets of discontinued operations	2,520	2,679
Trade payables	54	10
Accrued expenses and other liabilities	211	216
Total liabilities of discontinued operations	$ 265	$ 226

c. Revenues from major customers accounted for 83%, 84% and 83% of total revenues for the years ended December 31, 2016, 2015 and 2014, respectively (see Note 16c).

d. Liquidity and Capital Resources:

On May 15, 2016, the Company's shareholders approved an investment transaction with new investor (the "Investor") after which the Investor has become a controlling shareholder of the Company. The Company issued 8,510,638 Ordinary shares, in consideration for an aggregate amount of approximately $4,000, or a price per each share of $0.47 (the "Initial Investment"). The Company have also issued to the Investor, warrants to purchase: (i) 4,255,319 additional Ordinary shares at an exercise price per Ordinary share of $0.47 (resulting in an aggregate exercise price of $2,000) exercisable for a period of 24 months following the date of the Initial Investment and (ii) warrants to purchase an additional 3,636,363 Ordinary shares at an exercise price per Ordinary share of $0.55 (resulting in an aggregate exercise price of $2,000) exercisable for a period of 48 months following the date of the Initial Investment (collectively: the "Warrants").

In addition, as part of the investment transaction, the Investor has agreed to grant the Company an option, exercisable in the discretion of either the Investor or the Company, to obtain a convertible loan from the Investor in the principal amount of up to $3,175, which may be used solely for the purpose of the repayment of the outstanding convertible loan and accrued interest to existing shareholder due on August 31, 2016.

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

NOTE 1:- GENERAL (Cont.)

During the term of the loan, the Investor will have the right, but not the obligation, at its sole discretion, to convert the then remaining convertible loan amount into Ordinary shares, par value NIS 0.03, 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 the Company's 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.

On June 16, 2016, the Company obtained the loan from the Investor and repaid the outstanding loan balance in the amount of $2,988, including accrued interest of $247 to its former controlling shareholder.

In August and November 2016, the Investor had exercised warrants for an aggregate of 2,659,575 Ordinary shares, at an exercise price of $0.47 per share, for an aggregate total consideration of $1,250.

On November 15, 2016, the Company completed a $2,000 directed registered offering of 1,904,762 Ordinary shares at a price per share of $1.05 to an additional investor.

In January 2017, subsequent to the balance sheet date, the Investor had exercised warrants to 531,915 Ordinary shares at an exercise price per share of $0.47, for a total consideration of $250.

Since incorporation, the Company incurred an accumulated deficit of $79,363. As of December 31, 2016, the Company's cash position (cash and cash equivalents) totaled approximately $2,364 (including cash and cash equivalents attributable to the discontinued operations). In addition, for the years ended December 31, 2016 and 2015, the Company had recurring losses and negative cash flow from operating activity. The Company’s current operating plan includes various assumptions concerning the level and timing of cash receipts from existing and anticipated orders in 2017, current credit facilities available, the abovementioned Initial Investment and cash outflow from operating activity and capital expenditures. Management believes that these funds together with a commitment from the Company's controlling shareholder to financially support the Company as needed, are sufficient for the Company and its subsidiaries to meet their obligations as they come due at least for a period of twelve months from the date of issuance of the consolidated financial statements.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("US GAAP"). The significant accounting policies followed in the preparation of the financial statements, applied on a consistent basis, are as follows:

a. Use of estimates:

The preparation of financial statements in conformity with ("US GAAP") requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

The Company's management believes that the estimates, judgment and assumptions used are reasonable based upon information available at the time they were made.

b. Financial statements in U.S. dollars:

The majority of the revenues of the Company are generated in U.S. dollars. In addition, substantial portions of the costs of the Company are incurred in U.S dollars.

The Company's management believes that the dollar is the currency of the primary economic environment in which the Company operates. Thus, its functional and reporting currency is the dollar.

Accordingly, monetary accounts maintained in currencies other than the dollar are re-measured into U.S. dollars in accordance with ASC 830, "Foreign Currency Matters". All transaction gains and losses of the re-measured monetary balance sheet items are reflected in the statement of operations as financial income or expenses, as appropriate, in the period in which the currency exchange rate changes.

The financial statements of the Company's foreign subsidiary, whose functional currency is not the U.S. 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 separate component of accumulated other comprehensive income (loss) in equity.

c. Basis of consolidation:

The consolidated financial statements include the accounts of the Company and its subsidiary. Inter-company transactions and balances have been eliminated upon consolidation.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

d. Cash equivalents:

All highly liquid investments that are readily convertible to cash and are not restricted as to withdrawal or use and the period to maturity of which did not exceed three months at time of deposit, are considered cash equivalents.

e. Restricted deposit:

Restricted cash is invested in short-term bank deposits (less than twelve months), which are mainly used as security for the Company's guarantees to customers and lines of credits with banks. The deposits are in U.S. dollars and bear a variable interest of up to 0.70%.

f. Inventories:

Inventories are stated at the lower of cost or market value. Inventory write-offs are provided to cover risks arising from slow-moving items, excess inventories and for market prices lower than cost (see also Note 5).

Cost is determined as follows:

Raw materials and components - using the FIFO cost method.

Work in progress and finished goods - represents the cost of manufacturing with the addition of allocable indirect manufacturing costs.

Costs incurred on long-term contracts in progress include direct labor, material, subcontractors, other direct costs and an allocation of overhead, which represent recoverable costs incurred for production.

g. Property, plant and equipment:

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

	%
Factory and other buildings	4
Machinery and equipment	7 - 33
Office furniture and equipment	6 - 15

Leasehold improvements are depreciated over the shorter of the estimated useful life or the lease period.

Assets, in respect of which investment grants have been received, are presented at cost less the related grant amount. Depreciation is based on net cost.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

h. Impairment of long-lived assets:

The Company's long-lived assets are reviewed for impairment in accordance with ASC 360, "Property, plant and equipment", whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable.

Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the assets to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. 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, 2015 and 2014, no impairment losses have been identified.

As required by ASC 820, "Fair Value Measurement", the Company applies assumptions that market place participations would consider in determines the fair value of long-lived assets (or asset group).

i. Research and development costs:

Research and development costs, net of participation grants, include costs incurred for research and development, are charged to the statement of operations as incurred.

The Company received royalty-bearing grants, from the Israeli Innovation Authority ("IIA") for the purpose of partially funding research and development projects. The grants are recognized as a deduction from research and development costs incurred (see also Note 11b).

j. Income taxes:

The Company accounts for income taxes in accordance with ASC 740, "Income taxes". This statement prescribes the use of the liability method whereby deferred tax assets and liability account balances are determined based on differences between financial reporting and tax based assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

The Company provides a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company applies ASC 740-10. ASC 740-10 contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with ASC 740. 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. The adoption of ASC 740-10 did not result in a change in the Company's accumulated deficit. The Company did not record any provision in connection with ASC 740-10 as of December 31, 2016 and 2015.

k. Severance pay:

The Company's agreements with most of its employees are in accordance with section 14 of the Severance Pay Law - 1963, under which the Company's contributions for severance pay shall be instead of severance compensation. Upon release of the policy to the employee, no additional liability exists between the parties regarding the matter of severance pay and no additional payments will be made by the Company to the employee.

The Company's liability for severance pay for the employees that are not covered in section 14 is calculated pursuant to Israel's Severance Pay Law - 1963, based on the most recent salary of the employees as of the balance sheet date less monthly deposits for insurance policies and/or pension funds. Employees are entitled to one month's salary for each year of employment or a portion thereof.

The carrying value of deposited funds includes profits (losses) accumulated up to the balance sheet date. The deposited funds may be withdrawn only upon the fulfillment of the obligations pursuant to Israeli severance pay law or labor agreements.

Severance expense recorded in the statement of operations is net of interest and other income accumulated in the deposits. Severance expense for the years ended December 31, 2016, 2015 and 2014 amounted to $251, $553 and $674, respectively.

l. Accounting for share-based compensation:

The Company accounts for share-based payment in accordance with ASC 718, "Compensation - Stock Compensation", which requires the measurement and recognition of compensation expense based on estimated fair values for all share-based payment awards made to employees on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as an expense over the requisite service periods in the Company's statement of operations.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The fair value for the Company's stock options granted to employees and directors was estimated using a Black-Scholes option-pricing model with the following weighted-average assumptions:

	December 31,	
	2016	2015
Dividend yield	0%	-
Risk-free interest rate	1.19%	-
Expected term (in years)	4.5	-
Volatility	80%	-

The dividend yield assumption is based on the Company's historical and expectation of future dividend payouts and may be subject to changes in the future.

The computation of expected volatility is based on realized historical share price volatility of the Company's share.

The risk-free interest rate assumption is the implied yield currently available on the U.S treasury yield zero-coupon issues with a remaining term equal to the expected life term of the Company's options.

The expected term of the options represents the period of time that the options are expected to be outstanding and is based on the simplified method, as allowed under Staff Accounting Bulletin No. 110, which is the mid-point between the vesting date and the end of the contractual of the option.

m. Fair value of financial instruments:

The Company measures its financial instruments at fair value. Fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability.

A three-tier fair value hierarchy is established as a basis for considering such assumptions and for inputs used in the valuation methodologies in measuring fair value:

Level 1 - Valuations based on quoted prices in active markets for identical assets that the Company has the ability to access. Valuation adjustments and block discounts are not applied to Level 1 instruments. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgment.

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Level 2 - Valuations based on one or more quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

Level 3 - Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

The availability of observable inputs can vary from investment to investment and is affected by a wide variety of factors, including, for example, the type of investment, the liquidity of markets and other characteristics particular to the transaction. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment and the investments are categorized as Level 3.

The carrying amount of cash and cash equivalents, restricted deposits, trade receivables, other accounts receivable, bank credit and current maturities of long term loans, trade payables and other accounts payable approximate their fair value due to the short-term maturity of these instruments.

Foreign currency derivative contracts are classified within Level 2 as the valuation inputs are based on quoted prices and market observable data of similar instruments.

The following table presents the Company's assets (liabilities) measured at fair value on a recurring basis at December 31, 2016 and 2015:

	December 31, 2016			
	Level 1	Level 2	Level 3	Total
Derivatives:				
Foreign currencies derivatives	$	(8)	$ -	(8)
Total	$	(8)	$ -	(8)

	December 31, 2015			
	Level 1	Level 2	Level 3	Total
Derivatives:				
Foreign currencies derivatives	$ -	(23)	$ -	(23)
Total	$ -	(23)	$ -	(23)

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

n. Concentrations of credit risk:

Financial instruments that potentially subject the Company and its subsidiary to concentrations of credit risk consist principally of cash and cash equivalents, restricted cash, trade receivables and long-term receivables.

The Company's and its subsidiary's cash and cash equivalents and restricted deposits are mainly held in U.S. dollars with major banks in Israel and China. Management believes that the financial institutions that hold the Company's investments are institutions with high credit standing, and accordingly, minimal credit risk exists with respect to these investments.

The Company's and its subsidiary's trade receivables are derived from sales to large and solid organizations located mainly in the United States, Asia, Latin America and Israel. The Company performs ongoing credit evaluations of its customers and to date has not experienced any material losses. An allowance for doubtful accounts is determined with respect to these amounts that the Company has determined to be doubtful of collection. The allowance is computed for specific debts and the collectability is determined based upon the Company's experience.

o. Comprehensive income (loss):

The Company accounts for comprehensive income in accordance with ASC 220, "Comprehensive Income". This statement establishes standards for the reporting and display of comprehensive income and its components.

Comprehensive income generally represents all changes in shareholders' equity during the period except those resulting from investments by, or distributions to, shareholders.

Accordingly, the Company presents a separate consolidated statement of comprehensive income (loss).

The following tables summarizes the changes in accumulated balances of other comprehensive income, net of taxes for the years ended December 31, 2016 and 2015:

	Accumulated foreign currency translation differences	Total
Balance as of December 31, 2015	$ 387	$ 387
Net current period other comprehensive loss	(165)	(165)
Balance as of December 31, 2016	$ 222	$ 222

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

	Accumulated foreign currency translation differences	Total
Balance as of December 31, 2014	$ 536	$ 536
Net current period other comprehensive loss	(149)	(149)
Balance as of December 31, 2015	$ 387	$ 387

p. Warranty:

In connection with the sale of its products, the Company provides product warranties for periods between one to two years. Based on past experience and engineering estimates, the estimated liability from these warranties is $35 as of December 31, 2016 and 2015.

q. Revenue recognition:

The Company generates revenues mainly from the sale of products and from long-term fixed price contracts of defense electronics as follows: data recording and management systems, inertial navigation systems for air and land applications, avionics solutions, and avionics for UAVs, and land radar for defense forces and border protection applications. In addition, the Company provides manufacturing, development and product support services.

The Company also generates revenues from repair services using its ATE mainly through CACS. (See Note 1b)

Product revenues:

The Company recognizes revenue from sales of products in accordance with ASC 605-10, "Revenue Recognition" (Formerly "Staff Accounting Bulletin ("SAB") No. 104").

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 Company has determined that 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 the Company can objectively and reliably demonstrate that the criteria specified in the acceptance provisions are satisfied.

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Revenues from long-term fixed price contracts which provide a substantial level of development efforts are recognized in accordance with ASC 605-35, "Construction-Type and Production-Type contracts", using contract accounting on a percentage of completion method in accordance with the "Input Method". 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. As of December 31, 2016 and 2015, the provision for estimated losses identified is $0 and $27, respectively.

Revenues from 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.

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 determinable by management, on a cumulative catch-up basis.

The Company believes that the use of the percentage of completion method is appropriate as the Company has the ability to make reasonably dependable estimates of the extent of progress towards completion, contract revenues and contract costs. In addition, contracts executed include provisions that clearly specify the enforceable rights regarding services to be provided and received by the parties to the contracts, the consideration to be exchanged and the manner and terms of settlement.

In all cases, the Company expects to perform its contractual obligations and its customers are expected to satisfy their obligations under the contract.

Service revenues:

Revenues from services are recognized as the services are performed.

r. Basic and diluted net income (loss) per share:

Basic net income (loss) per share is computed based on the weighted average number of Ordinary shares outstanding during each year. Diluted net income (loss) per share is computed based on the weighted average number of Ordinary shares outstanding during each year, plus dilutive potential Ordinary shares considered outstanding during the year in accordance with ASC 260, "Earnings per share".

For the years ended December 31, 2016, 2015 and 2014, all options, convertible notes and warrants have been excluded from the computation of diluted net income (loss) per share, since their effect is anti-dilutive.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

s. Derivatives and hedging:

The Company accounts for derivatives and hedging based on ASC 815, "Derivatives and hedging", as amended and related Interpretations. ASC 815 requires the Company to recognize all derivatives on the balance sheet at fair value. If a derivative meets the definition of a hedge and is so designated, depending on the nature of the hedge, changes in the fair value of the derivative will either be offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings (for fair value hedge transactions) or recognized in other comprehensive income (loss) until the hedged item is recognized in earnings (for cash flow hedge transactions).

The ineffective portion of a derivative's change in fair value is recognized in earnings. If a derivative does not meet the definition of a hedge, the changes in the fair value are included in earnings. Cash flows related to such hedges are classified as operating activities.

The Company enters into forward exchange contracts and option contracts in order to limit the exposure to exchange rate fluctuation associated with payroll expenses mainly incurred in NIS. Since the derivative instruments that the Company holds do not meet the definition of hedging instruments under ASC 815, any gain or loss derived from such instruments is recognized immediately as financial expenses, net.

As of December 31, 2016 and 2015, the fair value of the outstanding forward contracts was $8 and $23, respectively, which was recorded in other accruals against financial expenses.

t. 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. The Company 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.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

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 then 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. The Company does 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. The Company is 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). The Company is currently evaluating the potential effect of the guidance on its consolidated financial statements.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

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). The Company does 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.

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

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. The Company is currently evaluating the potential effect of the guidance on its consolidated cash flow statement.

NOTE 3:- CONTRACTS IN PROGRESS

Amounts included in the consolidated financial statements, which relate to unbilled receivables are classified as current assets. Billings in excess of costs and estimated earnings on uncompleted contracts are classified as current liabilities. Summarized below are the components of the amounts:

Costs and estimated earnings in excess of billings on uncompleted contracts:

	December 31,	
	2016	**2015**
Costs incurred on uncompleted contracts	$ 21,616	$ 19,167
Estimated earnings	9,067	6,465
	30,683	25,632
Less - billings and progress payments	28,879	23,425
Costs and estimated earnings in excess of billings on uncompleted contracts	1,804	2,207
Less: Long-term portion	708	-
Costs and estimated earnings in excess of billings on uncompleted contracts - Current portion	$ 1,096	$ 2,207

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

NOTE 4:- OTHER ACCOUNTS RECEIVABLE AND PREPAID EXPENSES

	December 31, 2016	December 31, 2015
Prepaid expenses	$ 248	$ 146
Government authorities	51	12
Advance payments to vendors	50	46
	$ 349	$ 204

NOTE 5:- INVENTORIES

	December 31, 2016	December 31, 2015
Raw materials	$ 2,873	$ 2,323
Work in progress, net *)	3,032	2,087
Finished goods	1,197	1,281
	$ 7,102	$ 5,691

*) Net of provision for losses on long-term contracts as of December 31, 2016 and 2015, in the amount of $0 and $27, respectively.

Write-offs of inventories for the years ended December 31, 2016, 2015 and 2014 amounted to $144, $153 and $138, respectively. The write-offs were due to slow-moving items and excess inventories and were recorded in cost of revenues.

NOTE 6:- LONG TERM RECEIVABLES AND OTHER DEPOSITS

	December 31, 2016	December 31, 2015
Costs and estimated earnings in excess of billings on uncompleted contracts (see Note 3)	$ 708	$ -
Restricted deposits	-	64
Leasing deposits	34	55
	$ 742	$ 119

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

NOTE 7:- PROPERTY, PLANT AND EQUIPMENT, NET

	December 31,	
	2016	**2015**
Cost:		
Factory building	$ 1,989	$ 1,989
Machinery and equipment *)	8,821	8,419
Office furniture and equipment	657	556
Leasehold improvements	241	227
	11,708	11,191
Accumulated depreciation:		
Factory building	1,974	1,958
Machinery and equipment *)	6,658	6,144
Office furniture and equipment	296	281
Leasehold improvements	130	121
	9,058	8,504
Depreciated cost	$ 2,650	$ 2,687

*) Includes machinery at cost of $374 as of December 31, 2016 and 2015, and accumulated depreciation of $74 and $37 as of December 31, 2016 and 2015, respectively, which are under operating leases to customers.

Write-offs of machinery and equipment (cost and accumulated depreciation) for the years ended December 31, 2016, 2015 and 2014 amounted to $0, $191 and $0, respectively. The write-offs are due to fully depreciated assets that are no longer in use.

Depreciation expense amounted to $554, $548 and $575 for the years ended December 31, 2016, 2015 and 2014, respectively.

As for charges, see Note 11d.

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

NOTE 8:- GOODWILL

	December 31, 2016	December 31, 2015
Opening balance	$ -	$ 587
Impairment of Goodwill	-	(587)
	$ -	$ -

In 2015, the Company determined that sufficient indicators of potential impairment existed which require goodwill impairment analysis. These indicators included the trading value of the Company's stock at the time of the impairment test, coupled with existing market conditions and business trends. Based on the step one and step two analyses, the Company recorded goodwill impairment charge in 2015, in the amount of $587.

NOTE 9:- BANK CREDIT AND LOANS

A. Loans and convertible note from shareholders

	December 31, 2016	December 31, 2015
Convertible note from shareholders	$ 3,175	$ 3,090
Less: Beneficial Conversion Feature	(103)	(1,456)
	$ 3,072	$ 1,634

In May 2016, as part of the investment transaction (see Note 1d), the Investor has agreed to grant the Company an option, exercisable in the discretion of either the Investor or the Company, to obtain a convertible loan from the Investor in the principal amount of up to $3,175, which may be used solely for the purpose of the repayment of the outstanding convertible loan and accrued interest to existing shareholders due on August 31, 2016. The convertible loan bears interest of LIBOR+6%, which paid on a quarterly basis.

On June 16, 2016, the Company obtained the loan from the Investor and repaid an outstanding loan balance in the amount of $2,988 and accrued interest of $247 to its former controlling shareholder.

On August 21, 2016, a shareholder of the Company converted the then outstanding loan balance in the amount of $102 and accrued interest of $11 into 115,700 Ordinary shares.

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

NOTE 9:- BANK CREDIT AND LOANS (Cont.)

A. Loans and convertible note from shareholders (Cont.):

During the term of the loan, the Investor will have the right, but not the obligation, at its sole discretion, to convert the then remaining convertible loan amount into Ordinary shares, par value NIS 0.03, 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 the Company's 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.

The Company accounted for the repayment of the then outstanding loan as extinguishment of convertible debt instrument with beneficial conversion feature in accordance with ASC 470-20-40-3. As a result, the Company recorded the amount of the requisition price to be allocated to the repurchase of the beneficial conversion feature in the amount of $359 against additional-paid-in capital and recognized a loss from extinguishment of $37. In addition, the Company recorded a beneficial conversion feature related to the convertible loan as debt discount in the amount of $123. The discount is amortized over the term of the convertible loan using the interest method.

Amortization of shareholders' convertible loans discount and beneficial conversion feature expenses amounted to $1,116, $2,684 and $43 for the years ended December 31, 2016, 2015 and 2014, respectively.

B. Bank Credit

	December 31, 2016	December 31, 2015
Bank Credit	$ 575	$ 2,416

The Company may secure borrowing with one of its banks against specific accounts receivables of up to $2,250, out of which, $575 was utilized as of December 31, 2016. The annual average interest rate on the lines of credit is LIBOR + 3.5% at December 31, 2016. In addition, the Company has a line of credit for customers guarantees of $633, which was fully utilized as of December 31, 2016. The guarantees are secured by a first priority floating charge on all of the Company's assets and, unpaid share capital and insurance rights (rights to proceeds on insured assets in the event of loss).

The agreements with the banks prohibit the Company from: (i) selling or otherwise transferring any assets except in the ordinary course of business, (ii) placing a lien on the Company's assets without the bank's consent, or (iii) declaring dividend to its shareholders.

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

NOTE 10:- OTHER ACCOUNTS PAYABLE AND ACCRUED EXPENSES

	December 31,	
	2016	2015
Payroll and related accruals	$ 1,269	$ 1,700
Accrued expenses – subcontractors	129	79
Accrued expenses	447	464
Accrued interest due to shareholders loan	71	115
Tax authorities	31	224
Derivatives instruments	8	23
Others	32	25
	$ 1,987	$ 2,630

NOTE 11:- COMMITMENTS AND CONTINGENT LIABILITIES

a. As of December 31, 2016, the Company was not a party to any legal proceedings.

b. The Company's research and development efforts have been partially financed through royalty-bearing programs sponsored by the IIA. In return for the IIA's participation, the Company is committed to pay royalties at a rate ranging from 3% to 5% of sales of the products whose research was supported by grants received from the IIA, up to 100% of the amount of such participation received linked to the U.S. dollar. The obligation to pay these royalties is contingent on actual sales of the products and in the absence of such sales, no payment is required. As of December 31, 2016, the Company received total grants from the IIA in the amount of $5,545, including LIBOR interest.

The total amount of royalties charged to operations for the years ended December 31, 2016, 2015 and 2014, were approximately $130, $55 and $18, respectively. As of December 31, 2016, the Company's contingent liability for royalties, net of royalties paid or accrued, totaled approximately $1,469.

There were no research and development grants received from the IIA in the years ended December 31, 2016, 2015 and 2014.

c. The Company's offices in Netanya, Israel, are leased under a non-cancelable operating lease expiring on January 31, 2018. In March 2017, subsequent to the balance sheet date, the Company extended the lease period until January 31, 2022. In addition, the Company's motor vehicles are leased under operating leases.

Annual minimum future rental commitments under these leases, at exchange rates in effect on December 31, 2016, are approximately as follows:

2017	$ 598
2018	148
2019	22
	$ 768

NOTE 11:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

Lease expenses for the years ended December 31, 2016, 2015 and 2014, were $707, $761 and $754, respectively.

d. Floating charges have been recorded on all of the Company's assets and specific charges have been recorded on certain assets in respect of the Company's liabilities to its banks and other creditors, including its shareholders.

e. The Company provides bank guarantees to its customers and others in the ordinary course of business. The guarantees which are provided to customers are to secure advances received at the commencement of a project or to secure performance of operational milestones. The total amount of bank guarantees provided to customers and others as of December 31, 2016, is approximately $633.

NOTE 12:- SHAREHOLDERS' EQUITY

a. Share capital:

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

On August 31, 2016, the Company held an Extraordinary General Meeting of Shareholders on which it was approved to consolidate the registered (authorized) share capital of the Company as follows: every two (2) Ordinary shares with a nominal (par) value of NIS 0.015 each will be consolidated into one (1) Ordinary share with a nominal (par) value of NIS 0.03 each. All Ordinary shares, options, warrants, convertible loan, conversion options and per share amounts have been adjusted to give retroactive effect to this reverse split for all periods presented.

On May 15, 2016, the Company's shareholders had approved the increase of the Company's authorized share capital by NIS 675,000 and as a result the authorized share capital will equal NIS 1,125,000 divided into 37,500,000 Ordinary shares, par value NIS 0.03 each (adjusted to reflect the shares reverse share split effected in September 2016).

On July 30, 2015, the Company announced the closing of an underwritten public offering of 3,455,284 Ordinary shares, offered at a price to the public of $2.46 per share. The gross proceeds to the Company were $8,500, before deducting underwriting discounts and commissions and other offering costs of approximately $1,070.

On May 15, 2016, the Company's shareholders approved an investment transaction with the Investor according to which the Investor became a controlling shareholder of the Company and the Company issued 8,510,638 Ordinary shares and Warrants (see Note 12c), in consideration for the aggregate amount of approximately $4,000. Offering costs amounted to $169.

On August 21, 2016, a shareholder of the Company converted the outstanding loan balance in the amount of $102 and accrued interest of $11 into 115,700 Ordinary shares.

NOTE 12:- SHAREHOLDERS' EQUITY (Cont.)

On November 15, 2016, the Company completed a $2,000 directed registered offering of 1,904,762 Ordinary shares at a price per share of $1.05 to an additional investor. Offering costs amounted to $35.

b. Stock option plans:

In April 2015, the Company's Board of Directors adopted the "2015 Share Option Plan" (the "Plan"), which authorized the grant of options to purchase up to an aggregate of 1,500,000 Ordinary shares to officers, directors, consultants and key employees of the Company and its subsidiary. Options granted under the Plan expire within a maximum of ten years from adoption of the plan.

In June 2016, the Company granted options to certain employees and officers of the Company, to purchase a total 984,375 Ordinary shares at an exercise price of $0.9 per share. The options will vest as follows: 25% of the options granted to each employee will vest in June 2017; additional 75% shall vest in three equal annual installments of 25% each until June 2020. These options shall be exercisable for 48 months following the date of the vesting.

As part of the June 2016 grant, the Company's former CEO was granted options to purchase 168,750 Ordinary shares at an exercise price of $0.90 per Ordinary share. The former CEO resigned in November 2016.

In November 2016, the Company's Audit Committee (in its capacity as Compensation Committee) and Board of Directors have determined, subject to shareholders approval, to extend until January 2017, the exercise date of the former CEO options by accelerating the vesting of 126,563 Options as of December 31, 2016. Pursuant to the terms of the plan, the former CEO is eligible to exercise such number of the options (or any part thereof) within 90 days of the date of his resignation.

In November 2016, the Company's Audit Committee (in its capacity as Compensation Committee) and Board of Directors have determined, subject to shareholders approval to grant its new appointed CEO additional options as follows (i) options to purchase 68,750 Ordinary shares at an exercise price of $1.16 per Ordinary share that will vest ratably over a period of four (4) years and (ii) options to purchase 150,000 Ordinary shares at an exercise price of $1.16 per Ordinary share that will vest immediately in lieu of 99 vacation days that were accrued and redeemable for his benefit. These options shall be exercisable for 48 months.

On January 15, 2017, subsequent to balance sheet date, the Company's Shareholders had approved the CEO grant, and former CEO acceleration.

In December 2016, the Company granted options to purchase 40,000 Ordinary shares at an exercise price of $1.17 per Ordinary share, that will vest immediately in lieu of 36 vacation days that were accrued and redeemable for an employee benefit. These options shall be exercisable for 48 months.

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

NOTE 12:- SHAREHOLDERS' EQUITY (Cont.)

As of December 31, 2016, 513,125 options are available for future grant under the Plan.

A summary of the Company's activity for options granted to employees and directors under the Plan is as follows:

	Year ended December 31, 2016		
	Number of options	Weighted average exercise price	Aggregate Intrinsic Value Price
Outstanding at the beginning of the period	-	$ -	
Granted	1,024,375	0.91	
Exercised	-	-	
Forfeited	(37,500)	0.9	
Cancelled	-	-	
Outstanding at the end of the period	986,875	$ 0.91	$ 246
Exercisable	-	-	-
Vested and expected to vest	892,187	$ 0.91	$ 221

Intrinsic value of exercisable options (the difference between the Company's closing share price on the last trading day in the period and the exercise price, multiplied by the number of in-the-money options) represents the amount that would have been received by the employees and directors option holders had all option holders exercised their options on December 31, 2016. This amount changes based on the fair market value of the Company's Ordinary share.

As of December 31, 2016, there was approximately $564 of unrecognized compensation expense related to non-vested stock options, expected to be recognized up to four years.

The total equity-based compensation expense related to all of the Company's equity-based awards, recognized for the year ended December 31, 2016 and 2015, was comprised as follows:

	Year ended December 31,	
	2016	2015
Cost of revenues	70	-
Marketing and selling	12	-
General and administrative	29	-
	111	-

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

NOTE 12:- SHAREHOLDERS' EQUITY (Cont.)

c. Warrants:

On May 18, 2016, the Company issued to the Investor (see Note 1d), warrants to purchase: (i) 4,255,319 additional Ordinary shares at an exercise price per Ordinary share of $0.47 (resulting in an aggregate exercise price of $2,000), exercisable for a period of 24 months following the date of the Initial Investment and (ii) warrants to purchase an additional 3,636,363 Ordinary shares at an exercise price per Ordinary share of $0.55 (resulting in an aggregate exercise price of $2,000), exercisable for a period of 48 months following the date of the Initial Investment.

On May 18, 2016, as part of the investment transaction, the Company issued to a consultant, 510,638 warrants to purchase Ordinary shares at an exercise price per Ordinary share of $0.47, exercisable for a period of 18 months following the date of the Initial Investment.

In August 2016, the Investor had exercised 531,915 Ordinary shares at an exercise price per share of $0.47 in consideration of $250 thousands to the Company and in November 2016 additional 2,127,660 Ordinary shares were exercised at an exercise price per share of $0.47 in consideration of $ 1,000 to the Company.

In September 2016, the consultant had exercised 106,383 Ordinary shares at an exercise price per share of $0.47, in consideration of $50.

The Company's outstanding warrants as of December 31, 2016, are as follow:

Issuance date	Outstanding and exercisable	Exercise price	Exercisable through
May 18, 2016	1,595,944	0.47	May 18, 2018
May 18, 2016	3,636,364	0.55	May 18, 2020
May 18, 2016	404,255	0.55	November 18, 2017

In January 2017, subsequent to the balance sheet date, the Investor had exercised additional 531,915 Ordinary shares at an exercise price per share of $0.47 in consideration of $250.

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

NOTE 13:- TAXES ON INCOME

a. The Israeli corporate tax rate and real capital gains tax were 26.5% in 2014 and 2015 and 25% in 2016.

In December 2016, the Israeli Parliament approved the Economic Efficiency Law (Legislative Amendments for Applying the Economic Policy for the 2017 and 2018 Budget Years), 2016 which reduces the corporate income tax rate to 24% (instead of 25%) effective from January 1, 2017 and to 23% effective from January 1, 2018.

b. Tax benefits under the Law for the Encouragement of Industry (Taxes), 1969:

The Company qualifies as an "Industrial Company" under the Law for the Encouragement of Industry (Taxes), 1969 (the “Industrial Encouragement Law”). The Industrial Encouragement Law defines an “Industrial Company” as a company that is resident in Israel and that derives at least 90% of its income in any tax year, other than income from defense loans, capital gains, interest and dividends, from an enterprise whose major activity in a given tax year is industrial production.

The principal benefit from the above law is the deduction of expenses in connection with a public offering. Also, under the industrial Encouragement Law an "Industrial Company" is entitled to special rates of depreciation for industrial equipment and in addition to amortization of the cost of purchased know-how and patents over an eight year period for tax purposes and an accelerated depreciation rate on equipment.

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

c. As of December 31, 2016, the net operating tax loss carryforward relating to the Company in Israel amounted to approximately $67,681, not including a carryforward capital loss amounting to approximately $3,450. Carryforward losses in Israel may be carried forward indefinitely and may be offset against future taxable income.

As the Company believes that it is more likely than not that the deferred tax assets in respect of these carryforward losses will not be utilize, the Company recorded a full valuation allowance for the entire balance of the deferred tax asset relating to the carryforward losses.

d. The main reconciling items between the statutory tax rate of the Company and the effective tax rate is the valuation allowance recorded in respect of the deferred tax assets relating to net operating loss carryforward and other temporary differences due to the uncertainty of the realization of such tax assets.

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

NOTE 13:- TAXES ON INCOME (Cont.)

Deferred income taxes:

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

	December 31,	
	2016	2015
Net operating losses carryforward	$ 16,920	$ 16,439
Capital loss carryforward	862	862
Allowances and reserve	325	364
Total deferred tax assets before valuation allowance	18,107	17,665
Valuation allowance	(18,107)	(17,665)
Net deferred tax assets	$ -	$ -

As of December 31, 2016 and December 31, 2015, the Company has provided valuation allowances in respect of deferred tax assets resulting from tax losses carryforward and other temporary differences, since it has a history of operating losses and current uncertainty concerning its ability to realize these deferred tax assets in the future.

The Company accounts for its income tax uncertainties in accordance with ASC 740, which clarifies the accounting for uncertainties in income taxes recognized in a company's financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return.

As of December 31, 2016 and 2015, there were no unrecognized tax benefits that if recognized would affect the annual effective tax rate.

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

NOTE 14:- FINANCIAL EXPENSES, NET

	Year ended December 31, 2016	2015	2014
Income:			
Foreign currency exchange differences	$ 8	$ 131	$ 208
Interest on cash equivalents and restricted deposits	9	4	5
	17	135	213
Expenses:			
Amortization of shareholders' convertible loans discount and BCF	1,116	2,684	43
Interest on shareholders' convertible note and loans	270	575	708
Withholding taxes on interest of convertible note and loans from shareholders	-	119	294
Bank commissions and others	100	152	146
Foreign currency exchange differences	25	161	271
Interest on loans from banks and other credit balances	27	21	7
	1,538	3,712	1,469
Total financial expenses, net	$ 1,521	$ 3,577	$ 1,256

NOTE 15:- RELATED PARTY BALANCE AND TRANSACTIONS

For the year ended December 31, 2016, the Company incurred $270 in respect of interest on loans received from its shareholders.

In January 2017, subsequent to the balance sheet date, the Company's shareholders meeting approved that in addition to the directors' fees to be paid to all of the Company's directors commencing as of January 1, 2017, the Company will pay the Investor (see Note 1d) an additional monthly payment of approximately $4.6 (NIS 17,500) for time devoted by the Company's Executive Chairman of the Board of Directors, which is also a co-owner of the Investor, to such position. As of the first calendar year in which the Company's consolidated audited financial statements will reflect net income (before taxes), such additional payment will be increased to approximately $9 (NIS 35,000).

In addition, the Company's shareholders meeting approved a new engagement letter with a director of the Company (the "Director"), according to which the Director will be entitled to receive a commission of 2.5% of the net revenues received by the Company with respect to specific transactions introduced to the Company by the Director, subject to a detailed agreement to be entered into by the Director and the Company and the prior approval of any such transactions by the Company and the Audit Committee.

See also Note 9 for transactions with the Company's shareholders.

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

NOTE 16:- MAJOR CUSTOMERS AND GEOGRAPHIC INFORMATION

a. In accordance with Statement of ASC 280, "Segment Reporting", the Company is organized and operates as one business segment, which develops, manufactures and sells ATE products, avionics equipment and aviation data acquisition and debriefing systems.

b. Revenues by geographic areas:

Revenues are attributed to geographic area based on the location of the end customers as follows:

	Year ended December 31,		
	2016	2015	2014
Israel	$ 7,358	$ 6,062	$ 5,005
Asia	2,499	2,692	5,748
North America	1,553	3,558	8,072
Latin America	1,289	1,614	2,731
Europe	122	148	69
Total	$ 12,821	$ 14,074	$ 21,625

c. Major customers:

Revenues from single customers that exceed 10% of the total revenues in the reported years as a percentage of total revenues are as follows:

	Year ended December 31,		
	2016	2015	2014
		%	
Customer A	20	24	11
Customer B	17	9	6
Customer C	16	7	3
Customer D	13	10	16
Customer E	11	13	23
Customer F	6	8	14
Customer G	-	13	10

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

NOTE 16:- MAJOR CUSTOMERS AND GEOGRAPHIC INFORMATION (Cont.)

d. Long-lived assets by geographic areas:

	December 31,	
	2016	2015
Israel	$ 2,650	$ 2,687
China	266	391
	$ 2,916	$ 3,078