

RADA ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARY

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2013

U.S. DOLLARS IN THOUSANDS

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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 subsidiary as of December 31, 2013 and 2012 and the related consolidated statements of operations, comprehensive income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2013. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these 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, based on our audit, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and subsidiary as of December 31, 2013 and 2012, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2013, in conformity with U.S. generally accepted accounting principles.

Haifa, Israel
April 30, 2014

/s/Kost Forer Gabbay & Kasierer
KOST FORER GABBAY & KASIERER
A Member of Ernst & Young Global

**RADA ELECTRONIC INDUSTRIES LTD.
AND ITS SUBSIDIARY**

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	December 31,	
	2013	2012
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 2,137	\$ 1,164
Restricted deposits	1,033	1,311
Trade receivables (net of allowance for doubtful accounts of \$36 and \$15 at December 31, 2013 and 2012)	4,890	5,381
Costs and estimated earnings in excess of billings on uncompleted contracts	2,031	1,748
Other accounts receivable and prepaid expenses	412	939
Inventories	6,798	7,272
<u>Total</u> current assets	17,301	17,815
LONG-TERM RECEIVABLES AND OTHER DEPOSITS	1,133	1,160
PROPERTY, PLANT AND EQUIPMENT, NET	2,986	3,324
GOODWILL	587	587
<u>Total</u> assets	\$ 22,007	\$ 22,886

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

**RADA ELECTRONIC INDUSTRIES LTD.
AND ITS SUBSIDIARY**

CONSOLIDATED BALANCE SHEETS

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

	December 31,	
	2013	2012
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Bank credit	\$ 1,887	\$ 3,172
Trade payables	2,909	1,948
Convertible note and Loans from a shareholder, net	8,307	6,968
Other accounts payable and accrued expenses	4,350	3,750
	<u>17,453</u>	<u>15,838</u>
LONG-TERM LIABILITIES:		
Accrued severance pay and other long term liability	<u>569</u>	<u>519</u>
Total long-term liabilities	<u>569</u>	<u>519</u>
COMMITMENTS AND CONTINGENT LIABILITIES		
EQUITY:		
Share capital -		
Ordinary shares of NIS 0.015 par value - Authorized: 16,333,333 shares at December 31, 2013 and 2012; Issued and outstanding: 8,918,647 shares at December 31, 2013 and December 31, 2012 respectively	119	119
Additional paid-in capital	70,884	70,884
Accumulated other comprehensive income	547	468
Accumulated deficit	<u>(68,200)</u>	<u>(65,565)</u>
Total RADA Electronic Industries shareholders' equity	<u>3,350</u>	<u>5,906</u>
Non-controlling interest	<u>635</u>	<u>623</u>
Total equity	<u>3,985</u>	<u>6,529</u>
Total liabilities and equity	<u>\$ 22,007</u>	<u>\$ 22,886</u>

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

**RADA ELECTRONIC INDUSTRIES LTD.
AND ITS SUBSIDIARY**

CONSOLIDATED STATEMENTS OF OPERATIONS

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

	Year ended December 31,		
	2013	2012	2011
Revenues:			
Products	\$ 20,443	\$ 20,073	\$ 17,469
Services	1,318	1,478	1,936
	<u>21,761</u>	<u>21,551</u>	<u>19,405</u>
Cost of revenues:			
Products	16,487	15,453	12,707
Services	673	780	1,093
	<u>17,160</u>	<u>16,233</u>	<u>13,800</u>
Gross profit	<u>4,601</u>	<u>5,318</u>	<u>5,605</u>
Operating costs and expenses:			
Research and development, net	1,459	2,423	2,543
Marketing and selling	1,959	1,664	2,106
General and administrative	1,919	2,137	1,944
<u>Total operating costs and expenses</u>	<u>5,337</u>	<u>6,224</u>	<u>6,593</u>
Operating loss	(736)	(906)	(988)
Financial expenses, net	1,907	1,149	531
Net loss	(2,643)	(2,055)	(1,519)
Less: Net (income) loss attributable to non-controlling interest	8	4	(7)
Net loss attributable to RADA Electronic Industries' shareholders	<u>\$ (2,635)</u>	<u>\$ (2,051)</u>	<u>\$ (1,526)</u>
Net loss per share attributable to RADA Electronic Industries' shareholders:			
Basic and diluted net loss per Ordinary share	<u>\$ (0.30)</u>	<u>\$ (0.23)</u>	<u>\$ (0.17)</u>
Weighted average number of Ordinary shares used for computing basic and diluted net loss per share	<u>8,918,647</u>	<u>8,918,647</u>	<u>8,918,647</u>

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

**RADA ELECTRONIC INDUSTRIES LTD.
AND ITS SUBSIDIARY**

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

U.S. dollars in thousands

	Year ended December 31,		
	2013	2012	2011
Net Loss	\$ (2,643)	\$ (2,055)	\$ (1,519)
Less: Net (income) loss attributable to non-controlling interest	8	4	(7)
Net loss attributable to RADA Electronic Industries' shareholders	\$ (2,635)	\$ (2,051)	\$ (1,526)
Other comprehensive income:			
Change in foreign currency translation adjustment	\$ 99	\$ 32	\$ 64
Less: other comprehensive income attributable to non-controlling interest	20	7	13
Other comprehensive income attributable to RADA Electronic Industries' shareholders	\$ 79	\$ 25	\$ 51
Comprehensive loss	\$ (2,544)	\$ (2,023)	\$ (1,455)
Less: comprehensive income attributable to non-controlling interest	12	3	20
Comprehensive loss attributable to RADA Electronic Industries' shareholders	\$ (2,556)	\$ (2,026)	\$ (1,475)

**RADA ELECTRONIC INDUSTRIES LTD.
AND ITS SUBSIDIARY**

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' 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, 2011	8,868,857	119	70,060	392	(61,988)	600	9,183
Exercise of options	49,790	*)	116	-	-	-	116
Other comprehensive income	-	-	-	51	-	13	64
Net loss	-	-	-	-	(1,526)	7	(1,519)
Balance at December 31, 2011	8,918,647	119	70,176	443	(63,514)	620	7,844
Issuance of warrants to shareholders			708				708
Other comprehensive income				25		7	32
Net loss					(2,051)	(4)	(2,055)
Balance at December 31, 2012	8,918,647	119	70,884	468	(65,565)	623	6,529
Other comprehensive income				79		20	99
Net loss					(2,635)	(8)	(2,643)
Balance at December 31, 2013	<u>8,918,647</u>	<u>119</u>	<u>70,884</u>	<u>547</u>	<u>(68,200)</u>	<u>635</u>	<u>3,985</u>

*) Represents an amount lower than \$1.

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

**RADA ELECTRONIC INDUSTRIES LTD.
AND ITS SUBSIDIARY**

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2013	2012	2011
<u>Cash flows from operating activities:</u>			
Net loss	\$ (2,643)	\$ (2,055)	\$ (1,519)
Adjustments required to reconcile net loss to net cash provided by (used in) operating activities:			
Depreciation and amortization	752	897	951
Amortization of discount on convertible note and loans	489	516	212
Severance pay, net	50	19	1
Decrease in trade receivables, net	491	1,539	2,532
Decrease (increase) in other accounts receivable and prepaid expenses	484	(337)	(417)
Grants received from Chief Scientist's Office (OCS)	15	142	382
Decrease (increase) in unbilled receivables	(236)	(943)	1,224
Decrease (increase) in inventories	449	325	(2,069)
Increase (decrease) in trade payables	981	(463)	(697)
Increase (decrease) in other accounts payable and accrued expenses	600	(392)	(1,972)
	<u>1,432</u>	<u>(752)</u>	<u>(1,372)</u>
<u>Cash flows from investing activities:</u>			
Purchase of property, plant and equipment	(370)	(688)	(218)
Increase (decrease) in deposits	3	(3)	17
Change in restricted cash	282	472	348
	<u>(85)</u>	<u>(219)</u>	<u>147</u>

**RADA ELECTRONIC INDUSTRIES LTD.
AND ITS SUBSIDIARY**

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2013	2012	2011
<u>Cash flows from financing activities:</u>			
Proceeds from loans from a shareholder, net of issuance expenses	850	3,998	1,700
Repayment of long term loan from shareholders	-	(2,229)	(529)
Short-term bank credit, net	(1,285)	(761)	188
Exercise of options and warrants	-	-	116
Net cash provided by financing activities from continuing operations	(435)	1,008	1,475
Effect of exchange rate changes on cash and cash equivalents	61	20	7
Increase in cash and cash equivalents	973	57	257
Cash and cash equivalents at the beginning of the year	1,164	1,107	850
Cash and cash equivalents at the end of the year	<u>\$ 2,137</u>	<u>\$ 1,164</u>	<u>\$ 1,107</u>

	Year ended December 31,		
	2013	2012	2011
<u>(b) Supplemental disclosures of cash flow activities:</u>			
Net cash paid during the year for:			
Income taxes	<u>\$ 14</u>	<u>\$ 84</u>	<u>\$ 63</u>
Interest	<u>\$ 180</u>	<u>\$ 304</u>	<u>\$ 168</u>
<u>(c) Non-cash transactions</u>			
Transfer of inventory to property, plant and equipment	<u>\$ 25</u>	<u>\$ 58</u>	<u>\$ 629</u>
Purchase of property, plant and equipment in credit	<u>\$ 11</u>	<u>\$ 31</u>	<u>\$ -</u>

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 1:- GENERAL

- a. RADA Electronic Industries Ltd. ("the Company") is an Israel - 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, or UAVs, store management systems and interface computers) and land radar for force and border protection applications (active protective systems for armored fighting vehicles, hostile fire detection and perimeter surveillance). The Company also provides test and repair services using its CATS testers and test program sets for commercial aviation electronic systems mainly through its Chinese subsidiary.

The Company is organized and operates as one operating segment.

- b. As reflected in the consolidated financial statements as of December 31, 2013, the Company has an accumulated deficit of \$68,200. Based on existing and anticipated orders in 2014 and the Company's current credit facilities, management believes that the anticipated cash flows from operations and liquidity resources will enable the Company to finance its operations at least through December 31, 2014.
- c. The Company operates a 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 "subsidiary"). CACS was established with a Chinese third party, which owns the remaining 20% equity interest.
- d. Revenues from major customers accounted for 81%, 68% and 64% of total revenues for the years ended December 31, 2013, 2012 and 2011, respectively (see Note 15c).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

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:

Most of the revenues of the Company are generated in U.S. dollars. In addition, a substantial portion of the costs of the Company is 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 remeasured into U.S. dollars in accordance with ASC 830, "Foreign Currency Matters". All transaction gains and losses of the remeasured 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 component of accumulated other comprehensive income (loss) in shareholders' 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

d. Reclassification:

Certain amounts in prior years' financial statements have been reclassified to conform to the current year's presentation. Withholding taxes expenses were reclassified from General and administrative to net financial expenses. This reclassification did not impact total assets, total liabilities, stockholders' equity, and results of operations and cash flows.

e. 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.

f. Restricted deposit:

Restricted cash is invested in short-term bank deposits (less than three months), which are mainly used as security for the Company's guarantees to customers. The deposits are in U.S. dollars and bear a variable interest of up to 0.5%.

g. 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

h. 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:

	<u>%</u>
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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

i. 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. As of December 31, 2013, 2012 and 2011, no impairment losses have been identified.

j. Goodwill

Goodwill represents excess of the costs over the net assets of businesses acquired. Under ASC 350, "Intangibles- Goodwill and Other", goodwill acquired in a business combination should not be amortized. ASC 350 requires goodwill to be tested for impairment at least annually or between annual tests in certain circumstances, and written down when impaired.

ASC 350 prescribes a two-phase process for impairment testing of goodwill. The first phase screens for impairment while the second phase (if necessary) measures impairment. In the first phase of impairment testing, goodwill attributable to each of the reporting units is tested for impairment by comparing the fair value of each reporting unit with its carrying value. The Company determines its fair value according to the Company's market capitalization and the goodwill was tested for impairment by comparing the fair market value with its carrying amount. As of December 31, 2013, no impairment indicators have been identified. As a result, step two was not required..

k. Research and development costs:

Research and development costs, net of participation grants, include costs incurred for research and development and are expensed as incurred.

The Company received royalty-bearing grants, from the Chief Scientist's Office of the Israeli Ministry of Industry, Trade and Labor ("OCS") 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 10b).

l. 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

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

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, 2013 and 2012.

m. 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 shall be made by the Company to the employee.

The Company's liability for severance pay for the employees that are not under section 14 is calculated pursuant to Israel's Severance Pay Law, 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, 2013, 2012 and 2011 amounted to \$483, \$562 and \$583, respectively.

n. 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

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.
- 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, 2013 and 2012:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

- n. Fair value of financial instruments (Cont.):

	December 31, 2012			
	Level 1	Level 2	Level 3	Total
Derivatives:				
Foreign currencies derivatives	\$ -	\$ 151	\$ -	\$ 151
Total	\$ -	\$ 151	\$ -	\$ 151

	December 31, 2013			
	Level 1	Level 2	Level 3	Total
Derivatives:				
Foreign currencies derivatives	\$ -	\$ 46	\$ -	\$ 46
Total	\$ -	\$ 46	\$ -	\$ 46

- o. Concentrations of credit risk:

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

The Company's cash and cash equivalents and restricted cash are mainly held in U.S. dollars with major banks in Israel. 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 trade receivables are derived from sales to large and solid organizations located mainly in the United States, Asia, South 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.

The Company has no off-balance sheet credit risks.

- p. 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

p. Comprehensive income (loss) (Cont.):

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

In June 2011, the FASB issued ASU 2011-05, "Comprehensive Income (Topic 220): Presentation of Comprehensive Income", which is effective for annual reporting periods beginning after December 15, 2011. Accordingly, the Company adopted ASU 2011-05 on January 1, 2012. This guidance eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders' equity. Upon adoption of the new guidance, the Company elected to present a separate statement of consolidated comprehensive income.

The components of accumulated other comprehensive income (loss), net of taxes were as follows:

	Year ended December 31,		
	2013	2012	2011
Foreign currency translation differences	\$ 547	\$ 468	\$ 443

q. 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 liability from these warranties is not material as of December 31, 2013 and 2012.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

r. 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, avionics for UAVs, and land radar for force 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 Automated Test Equipment ("ATE") mainly through CACS.

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.

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, 2013 and 2012, the provision for estimated losses identified is \$41 and \$583, respectively.

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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

- r. Revenue recognition (Cont.):

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.

- s. 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, 2013, 2012 and 2011, all the outstanding options, convertible notes and warrants have been excluded from the computation of diluted net income (loss) per share, since their effect is anti-dilutive.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

t. 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 balances 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 cash flow hedge transactions) or recognized in other comprehensive income until the hedged item is recognized in earnings (for fair value 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 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, 2013 and December 31, 2012, the fair value of the outstanding forward contracts is \$46 which was recorded in other receivables against financial income and \$151 which was recorded in accruals against financial expenses, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 3:- CONTRACTS IN PROGRESS

Amounts included in the consolidated financial statements, which relate to unbilled receivables are classified as current assets. Summarized below are the components of the amounts:

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

	December 31,	
	2013	2012
Costs incurred on uncompleted contracts, net *)	\$ 35,032	\$ 13,946
Estimated earnings	5,221	5,267
	40,253	19,213
Less - billings and progress payments	37,205	16,401
Costs and estimated earnings in excess of billings on uncompleted contracts	3,048	2,812
Less: Long-term portion	(1,017)	(1,064)
Costs and estimated earnings in excess of billings on uncompleted contracts - Current portion	\$ 2,031	\$ 1,748

(*) Net of OCS grants in the amount of \$15 and \$313 as of December 31, 2013 and 2012 respectively (see Note 10b).

NOTE 4:- LONG-TERM RECEIVABLES AND OTHER DEPOSITS

	December 31,	
	2013	2012
Prepaid expenses	\$ 250	\$ 356
Government institutions	79	265
Derivative instruments	46	151
Other	37	167
	\$ 412	\$ 939

**RADA ELECTRONIC INDUSTRIES LTD.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 5:- INVENTORIES

	December 31,	
	2013	2012
Raw materials	\$ 3,833	\$ 2,747
Work in progress	2,157	3,885
Finished goods	808	640
	\$ 6,798	\$ 7,272

Write-offs of inventories for the years ended December 31, 2013, 2012 and 2011 amounted to \$313, \$72 and \$136, 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 DEPOSITS

	December 31,	
	2013	2012
Costs and estimated earnings in excess of billings on uncompleted contracts (see Note 3)	\$ 1,017	\$ 1,064
Restricted deposits	38	42
Leasing deposits	78	54
	\$ 1,133	\$ 1,160

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 7:- PROPERTY, PLANT AND EQUIPMENT

	December 31,	
	2013	2012
Cost:		
Factory building	\$ 1,989	\$ 1,989
Other buildings	1,371	1,329
Machinery and equipment (*)	9,095	8,934
Office furniture and equipment	411	399
Leasehold improvements	209	208
	13,075	12,859
Accumulated depreciation:		
Factory building	1,821	1,741
Other buildings	674	622
Machinery and equipment (*)	7,173	6,783
Office furniture and equipment	311	293
Leasehold improvements	110	96
	10,089	9,535
Depreciated cost	\$ 2,986	\$ 3,324

(*) Write-offs of machinery and equipment (cost and accumulated depreciation) for the years ended December 31, 2013, 2012 and 2011 amounted to \$333, \$3,502 and \$0 respectively. The write-offs are due to fully depreciated assets that are no longer in use.

Depreciation expense amounted to \$752, \$742 and \$797 for the years ended December 31, 2013, 2012 and 2011, respectively.

As for charges, see Note 10e.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 8:- BANK CREDIT AND LOANS

Current maturities

	December 31,	
	2013	2012
Loan in U.S. dollars from shareholders (1,2,3)	\$ 5,307	\$ 3,968
Convertible note from controlling shareholder, net (4)	3,000	3,000
Bank credit (5)	1,887	3,172
	\$ 10,194	\$ 10,140

In July 2008, the Company entered into a \$1,500 loan agreement with its controlling shareholder. The loan bears interest of LIBOR+3% payable at the beginning of every quarter. During September 2012 an amendment to the finance agreement was signed, according to which, the controlling shareholder agreed to lend to the company \$1,148 in addition to the then remaining unpaid loan amount of \$352, to support the development efforts. The loan bears interest of LIBOR+3% which was to be payable in two equal installments of \$750 each, in December 2012 and February 2013. During March 2013 \$350 out of the open balance due was repaid.

In August 2013 the Company and the controlling shareholder amended the loan agreement whereby an additional amount of \$350 was provided to the Company to be repaid on December 31, 2013, and the remaining \$1,150 to be repaid according to the Standstill agreement (Note 8 (4)). The company returned the \$350 in February 2014.

In August 2013 the Company and the controlling shareholder agreed on an additional short term loan in the amount of up to \$1,000 (the "New Loan"). The New Loan bears an interest rate of LIBOR+3.5%, to be repaid by the Company by December 31, 2013. In September 2013 the controlling shareholder granted under this new loan an amount of \$850. In February 2014 the Company repaid this Loan.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 8:- BANK CREDIT AND LOANS (Cont)

1. In September 2011 the Company entered into a revolving loan agreement ("September loan agreement") with its controlling shareholder in the amount of \$1,700. The loan carried interest at the rate of three month LIBOR+2.5% per annum.

2. During February, 2012, in order to finance future operations, the Company entered into a \$3,000 loan agreement ("February Agreement") with an entity affiliated with its controlling shareholder and another shareholder. The controlling shareholder provided \$2,700 and the other shareholder provided \$300. Of such amount, \$1,700 was used to repay in full the outstanding amount due and payable under the September loan agreement (Note 8 (1)). The loan bears interest at the rate of the greater of three months LIBOR+5% per annum, or 7% per annum. Interest is payable quarterly in arrears. The principal of the loan should have been repaid on February 28, 2014.

The loan provided by the controlling shareholder is secured by a floating charge over all of the Company's assets that are subordinated to the specific and floating charges over the Company's assets that were granted to certain banks and financing institutes.

As part of this loan agreement the Company issued 1,200,000 warrants at an exercise price of \$2.5 per share for a term of three years (see Note 11c). The transaction was accounted for as a Debt Instruments with Detachable Warrants in accordance with ASC 470-20. The total amount of discount on the loan as a result of the allocated proceeds attributable to the warrants feature amounting to \$708, is amortized over the term of the loan using the effective interest method pursuant to ASC 835.

The loan was classified as a short term loan due to the fact that the Company has failed to repay a convertible note issued to its controlling shareholder as mentioned in section 4 below. According to the standstill agreement the amounts of \$3,000 bears additional default interest rate of 5%.

3. During December 2007, the Company issued a convertible note in the amount of \$3,000 to its controlling shareholder, and warrants to purchase up to an aggregate of 1,578,947 ordinary shares at an exercise price of \$2.38 per share for a term of five years. The principal was due on December 2010. During October 2010, the maturity date of the convertible note was extended to October 2012 and the expiration date of the warrants was extended to October 2014. The convertible note bears interest at a rate of six-month LIBOR + 3.5% which was 3.96% at December 31, 2010 and it is convertible into Ordinary shares at a conversion price of \$2.09 per share. The transaction was accounted for as a modification of debt accordance with ASC 470-50, "Debt". As a result, the Company recorded a discount on the convertible note of \$451

Due the modification. The discount was amortized over the term of the extended note using the interest method. As of December 31, 2013, the Company did not repay the convertible note principal of \$3,000. From January 2013 the loan bears default increased interest rate of LOBOR +7.5%.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 8:- BANK CREDIT AND LOANS (Cont)

4. During April, 2013, the Company entered into a "standstill agreement" with its controlling shareholder and another shareholder, according to which those shareholders will not take any action, or otherwise exercise their rights, with respect to the collection of loans in the total amount of \$7,500 at least until January 31, 2014. According to the agreement, all remaining balances of unpaid loans bears additional default interest rate as originally agreed in the loan agreements. During April 2014 the agreement termination date was extended to January 31, 2015. As of April 30, 2014 all the loan amounts included in the agreement were not yet repaid.

5. The Company has an annual line of bank credit of \$1,000 out of which \$953 was fully utilized as of December 31, 2013, and a line of credit for guarantees of approximately \$1,307, out of which \$1,243 was utilized as of December 31, 2013. In addition, the Company may secure borrowing with one of its banks against specific accounts receivables up to \$2,250. As of December 31, 2013, the Company secured borrowings against specific accounts receivables in the amount of \$934 (see also Note 10f).

The annual average interest rate on the lines of credit is 3.63% at December 31, 2013.

The guarantees are secured by a first priority floating charge on all of our assets and by a fixed charge on goodwill (intangible assets), 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 our assets without the Banks' consent, or (iii) declaring dividends to its shareholders.

NOTE 9:- OTHER ACCOUNTS PAYABLE AND ACCRUED EXPENSES

	December 31,	
	2013	2012
Payroll and related accruals	\$ 1,895	\$ 1,719
Accrued expenses - subcontractors	1,053	883
Accrued expenses	607	564
Accrued commissions	434	357
Tax authorities	361	140
Others	-	87
	\$ 4,350	\$ 3,750

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 10:- COMMITMENTS AND CONTINGENT LIABILITIES

- a. As of December 31, 2013, 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 OCS. In return for the OCS'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 OCS, 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. The Company's total obligation for royalties, net of royalties paid or accrued, totaled approximately \$1.5M as of December 31, 2013. The total amount of royalties charged to operations for the years ended December 31, 2013, 2012 and 2011 was approximately \$12, \$6 and \$1, respectively. As of December 31, 2013, the company received total grants from the OCS in the amount of \$5,545. Research and development grants received from the OCS, amounted to \$15, \$142 and \$382 in the years ended December 31, 2013, 2012 and 2011, respectively.
- c. Research and development projects undertaken by the Company were partially financed by the Binational Industrial Research and Development Fund ("BIRD") Foundation. The Company is committed to pay royalties to the BIRD Foundation at a rate of 5% of sales proceeds generating from projects for which the BIRD Foundation provided funding up to 150% of the sum financed by the BIRD Foundation.

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. The Company's total obligation for royalties, net of royalties paid or accrued, totaled approximately \$2,066 as of December 31, 2013. No royalties were charged to operations for the years ended December 31, 2013, 2012 and 2011

- d. The Company's offices in Netanya, Israel are rented under a non-cancelable operating lease expiring January 31, 2015. In addition, the Company's motor vehicles are rented under operating leases.

Annual minimum future rental commitments under these leases, at exchange rates in effect on December 31, 2013, are approximately as follows:

2014	\$ 688
2015	179
2016	<u>82</u>
	<u>\$ 949</u>

Lease expense for the years ended December 31, 2013, 2012 and 2011 was \$747, \$783 and \$878, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 10:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont)

- e. 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.

- f. 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, 2013 is approximately \$1,243

NOTE 11:- 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.

- b. Stock option plans:

In 2003, the Company's Board approved the adoption of Israeli Employee Stock Option Plan ("the Plan"), which authorized the grant of options to purchase up to an aggregate of 1,666,667 Ordinary shares (in 2006 the Company's Board approved an increase in the plan by an additional 500,000 options), respectively, 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. One third of the options granted under the Company's Plan vest immediately on the grant date and the remaining two thirds vest ratably over two years. Compensation expense is recognized by the straight-line method.

The exercise price of an option granted to an employee may not be less than 60% of the fair market value of the Ordinary shares on the date of grant of the option. The exercise price of an option granted to a non-employee director or consultant may not be less than 80% of the fair market value of the Ordinary shares on the date of grant of the option. Any options that are cancelled or forfeited before expiration become available for future grants. At December 31, 2013, all outstanding options from last year were expired due to the plan expiry.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 11:- SHAREHOLDERS' EQUITY (Cont.)

Transactions related to the above Plan (including warrants to directors) during the year ended December 31, 2013 were as follows:

	Year ended December 31, 2013			
	Amount of options	Weighted average exercise price	Weighted average remaining contractual term (in years)	Aggregate intrinsic value
Options outstanding at beginning of year	718,573	\$ 2.45	1.07	\$ -
Options expired	(718,573)	\$ 2.45	1.07	\$ -
Options outstanding at end of year	-	-	-	\$ -

Share based compensation for the years ended December 31, 2013, 2012 and 2011 was \$0 each year.

c. Warrants:

As of December 31, 2013, warrants to purchase 1,200,000 Ordinary shares were outstanding. During February 2012, pursuant to 2012 loan agreement the Company issued warrants to purchase 1,200,000 Ordinary shares at an exercise price of \$2.5 per share for a term of three years.

The fair value of the warrants was based on the Black-Scholes-Merton option-pricing model, assuming a stock price of \$2.04, a risk free interest of 0.41%, a volatility factor of 52.5%, dividend yield of 0% and contractual life of three years.

NOTE 12:- TAXES ON INCOME

- a. The Israeli corporate tax rate was 24% in 2011 and 25% in 2012 and 2013. On December 5, 2011, the "Knesset" (Israeli parliament) passed the Law for Tax Burden Reform (Legislative Amendments), 2011 ("the Law") which, among others, cancels effective from 2012, the scheduled reduction in the corporate tax rate. The Law also increases the corporate tax rate to 25% in 2012. In view of this increase in the corporate tax rate to 25%, as above, the real capital gain tax rate and the real betterment tax rate were also increased accordingly.
- b. On August 5, 2013, the "Knesset" issued the Law for Changing National Priorities (Legislative Amendments for Achieving Budget Targets for 2013 and 2014), 2013 ("the Budget Law"), which consists, among others, of fiscal changes whose main aim is to enhance the collection of taxes in those years.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 12:- TAXES ON INCOME (Cont)

- c. These changes include, among others, increasing the corporate tax rate from 25% to 26.5%, cancelling the reduction in the tax rates applicable to privileged enterprises (9% in development area A and 16% elsewhere) and, in certain cases, increasing the rate of dividend withholding tax within the scope of the Law for the Encouragement of Capital Investments to 20% effective from January 1, 2014. There are also other changes such as taxation of revaluation gains effective from August 1, 2013. The provisions regarding revaluation gains will become effective only after the publication of regulations defining what should be considered as "retained earnings not subject to corporate tax" and regulations that set forth provisions for avoiding double taxation of overseas assets. As of the date of approval of these financial statements, these regulations have not been issued.
- d. 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.

- e. As of December 31, 2013, the net operating tax loss carryforward relating to the Company in Israel amounted to approximately \$ 67.7 million, including a carryforward capital loss amounting to approximately \$ 3.8 million. 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 amounting to approximately \$ 17.3 million will not be utilized, the Company recorded a valuation allowance for the entire balance of the deferred tax asset relating to the carryforward losses.

- f. 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 12:- 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,	
	2013	2012
Net operating loss carry forward	\$ 16,926	\$ 15,653
Allowance and reserve	351	334
Total deferred tax assets before valuation allowance	17,277	15,987
Valuation allowance	(17,277)	(15,987)
Net deferred tax assets	\$ -	\$ -

As of December 31, 2013 and December 31, 2012, the Company has provided valuation allowances in respect of deferred tax assets resulting from tax loss carry forward and other temporary differences, since they have a history of operating losses and current uncertainty concerning its ability to realize these deferred tax assets in the future.

The Company account for its income tax uncertainties in accordance with FASB ASC No. 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, 2013 and 2012, there were no unrecognized tax benefits that if recognized would affect the annual effective tax rate.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 13:- FINANCIAL EXPENSES, NET

	Year ended December 31,		
	2013	2012	2011
Income:			
Foreign currency exchange differences	\$ 15	\$ 166	\$ 395
Interest on cash equivalents and restricted deposits	12	18	20
Others	-	31	197
	(27)	(215)	(612)
Expenses:			
Interest on convertible note and loans from shareholders	729	376	159
Withholding taxes of Interest to convertible note and loans from shareholders	205	106	53
Amortization of discount on a convertible note and loans from shareholders	489	516	212
Foreign currency exchange differences	135	60	288
Interest on loans from banks and other credit balances	84	26	27
Bank commissions and others	292	280	404
	1,934	1,364	1,143
	\$ 1,907	\$ 1,149	\$ 531

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 14:- RELATED PARTY BALANCE AND TRANSACTIONS

For the year ended December 31, 2013, the Company incurred \$491 in respect of interest on loans received from its shareholders.

See also Notes 8 and 11c for transactions with the Company's shareholders.

NOTE 15:- 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 (see also Note 1a).

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,		
	2013	2012	2011
Israel	\$ 4,267	\$ 5,329	\$ 7,009
Asia	5,466	4,594	3,110
North America	5,091	2,370	1,876
Latin America	6,798	8,943	7,289
Europe	139	315	121
Total	\$ 21,761	\$ 21,551	\$ 19,405

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 15:- MAJOR CUSTOMERS AND GEOGRAPHIC INFORMATION (Cont.)

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,		
	2013	2012	2011
	%		
Customer A	1	5	13
Customer B	12	11	17
Customer C	11	9	8
Customer D	20	32	23
Customer E	2	11	3
Customer F	17	6	8
Customer G	17	5	2

d. Long-lived assets by geographic areas:

	December 31,	
	2013	2012
Israel	\$ 2,930	\$ 3,262
China	644	649
	\$ 3,574	\$ 3,911
