RADA ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARY

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2015

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 subsidiary as of December 31, 2015 and 2014 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, 2015. 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, 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, 2015 and 2014, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2015, in conformity with U.S. generally accepted accounting principles.

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

Haifa, Israel
May 15, 2016

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	December 31, 2015	December 31, 2014
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 1,754	$ 1,786
Restricted deposits	609	349
Trade receivables (net of allowance for doubtful accounts of $10 and $24 at December 31, 2015 and 2014)	4,038	3,455
Costs and estimated earnings in excess of billings on uncompleted contracts	2,207	2,657
Other accounts receivable and prepaid expenses	206	428
Inventories, net	6,565	6,651
Total current assets	15,379	15,326
LONG-TERM RECEIVABLES AND OTHER DEPOSITS	119	1,394
PROPERTY, PLANT AND EQUIPMENT, NET	3,078	2,790
GOODWILL	-	587
Total assets	$ 18,576	$ 20,097

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, 2015	December 31, 2014
LIABILITIES AND EQUITY		
CURRENT LIABILITIES:		
Bank credit	$ 2,416	$ 1,589
Trade payables	1,961	1,315
Convertible Note and Loans from shareholders, net (Note 9)	1,634	8,120
Other accounts payable and accrued expenses	2,846	4,267
Total current liabilities	8,857	15,291
LONG-TERM LIABILITIES:		
Accrued severance pay and other long term liability	660	634
Total long-term liabilities	660	634
COMMITMENTS AND CONTINGENT LIABILITIES		
EQUITY:		
Share capital -		
Ordinary shares of NIS 0.015 par value each - Authorized: 30,000,000 shares at December 31, 2015 and 16,333,333 shares at December 31, 2014; Issued and outstanding: 15,898,965 and 8,988,396 shares at December 31, 2015 and December 31, 2014 respectively	146	119
Additional paid-in capital	82,427	70,884
Accumulated other comprehensive income	387	536
Accumulated deficit	(74,453)	(67,992)
Total RADA Electronic Industries shareholders' equity	8,507	3,547
Non-controlling interest	552	625
Total equity	9,059	4,172
Total liabilities and equity	$ 18,576	$ 20,097

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, 2015	2014	2013
Revenues:			
Products	$ 12,375	$ 20,927	$ 20,443
Services	2,489	1,554	1,318
	14,864	22,481	21,761
Cost of revenues:			
Products	11,139	15,124	16,487
Services	1,152	820	673
	12,291	15,944	17,160
Gross profit	2,573	6,537	4,601
Operating costs and expenses:			
Research and development, net	693	789	1,459
Marketing and selling	2,358	2,392	1,959
General and administrative	1,858	1,901	1,919
Goodwill impairment	587	-	-
Total operating costs and expenses	5,496	5,082	5,337
Operating income (loss)	(2,923)	1,455	(736)
Amortization of shareholders' convertible loans discount and beneficial conversion feature	2,684	43	489
Other financial expenses, net	890	1,211	1,418
Total financial expenses, net (Note 14)	3,574	1,254	1,907
Net income (loss)	(6,497)	201	(2,643)
Less: Net income (loss) attributable to non-controlling interest	(36)	(7)	(8)
Net income (loss) attributable to RADA Electronic Industries' shareholders	$ (6,461)	$ 208	$ (2,635)
Net income (loss) per share attributable to RADA Electronic Industries' shareholders			
Basic and diluted net income (loss) per Ordinary share	$ (0.54)	$ 0.02	$ (0.30)
Weighted average number of Ordinary shares used for computing basic and diluted net income (loss) per share	11,904,088	8,944,803	8,918,647

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,		
	2015	2014	2013
Net income (loss)	$ (6,497)	$ 201	$ (2,643)
Other Comprehensive Income (loss):			
Change in foreign currency translation adjustment	(186)	(14)	99
Total comprehensive income (loss)	(6,683)	187	(2,544)
Less: comprehensive income (loss) attributable to non-controlling interest	(73)	(10)	12
Comprehensive income (loss) attributable to RADA Electronic Industries' shareholders	$ (6,610)	$ 197	$ (2,556)

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 1,2013	8,918,647	$ 119	$ 70,884	$ 468	$ (65,565)	$ 623	$ 6,529
Net loss					(2,635)	(8)	(2,643)
Other comprehensive income				79		20	99
Balance at December 31, 2013	8,918,647	$ 119	$ 70,884	$ 547	$ (68,200)	$ 635	$ 3,985
Cashless exercise of Warrants	69,749	(*)	(*)				-
Net income (loss)					208	(7)	201
Other comprehensive income (loss)				(11)		(3)	(14)
Balance at December 31, 2014	8,988,396	$ 119	$ 70,884	$ 536	$ (67,992)	$ 625	$ 4,172
Issuance of Ordinary shares, net of issuance costs of $1,070	6,910,569	27	7,403	-	-	-	7,430
Beneficial conversion feature related to convertible loans from shareholders (Note 9)	-	-	4,140	-	-	-	4,140
Net income (loss)	-	-	-	-	(6,461)	(36)	(6,497)
Other comprehensive income (loss)				(149)	-	(37)	(186)
Balance at December 31, 2015	15,898,965	$ 146	$ 82,427	$ 387	$ (74,453)	$ 552	$ 9,059

(*) Represents an amount lower than $1.

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, 2015	2014	2013
Cash flows from operating activities:			
Net income (loss)	$ (6,497)	$ 201	$ (2,643)
Adjustments required to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	651	690	752
Impairment of goodwill	587	-	-
Amortization of discount on convertible note and loans	2,684	43	489
Severance pay, net	53	(15)	50
Decrease (increase) in trade receivables, net	(583)	1,435	491
Decrease (increase) in other accounts receivable and prepaid expenses	224	13	484
Grants received from Chief Scientist's Office (OCS)	-	-	15
Decrease (increase) in unbilled receivables	1,467	(599)	(236)
Decrease (increase) in inventories	(487)	111	449
Increase (decrease) in trade payables	584	(1,594)	981
Increase (decrease) in other accounts payable and accrued expenses	(1,448)	(163)	600
Net cash provided by (used in) operating activities	(2,765)	122	1,432
Cash flows from investing activities:			
Purchase of property, plant and equipment	(374)	(328)	(370)
Increase in deposits, net	(10)	2	3
Change in restricted deposits, net	6	392	282
Net cash provided by (used in) investing activities	(378)	66	(85)

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31, 2015	2014	2013
Cash flows from financing activities:			
Proceeds from loans from shareholders	-	1,000	850
Issuance of Ordinary shares, net	7,430	-	-
Proceeds from (repayment of) short-term bank credit, net	827	(298)	(1,285)
Repayment of short-term loans from shareholders	(5,030)	(1,230)	-
Net cash provided by (used in) financing activities from continuing operations	3,227	(528)	(435)
Effect of exchange rate changes on cash and cash equivalents	(116)	(11)	61
Increase (decrease) in cash and cash equivalents	(32)	(351)	973
Cash and cash equivalents at the beginning of the year	1,786	2,137	1,164
Cash and cash equivalents at the end of the year	$ 1,754	$ 1,786	$ 2,137

	Year ended December 31, 2015	2014	2013
(b) Supplemental disclosures of cash flow activities:			
Net cash paid during the year for:			
Income taxes	$ 15	$ 35	$ 14
Interest	$ 2,106	$ 57	$ 180
(c) Non-cash transactions			
Transfer of inventory to property, plant and equipment	$ 573	$ 37	$ 25
Purchase of property, plant and equipment in credit	$ 62	$ 144	$ 11

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 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. 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 the "subsidiary"). CACS was established with a Chinese third party, which owns the remaining 20% equity interest.

c. Revenues from major customers accounted for 64%, 71% and 77% of total revenues for the years ended December 31, 2015, 2014 and 2013, respectively (see Note 16c).

d. *Liquidity and Capital Resources:*

Since incorporation, the Company incurred an accumulated deficit of $74,453. On April 16, 2015, the Company's shareholders approved an outline for the repayment of the Company's debts to its lenders ("Debt"), according to which, the Company would offer new Ordinary shares in a registered public offering (the "Offering"). It was agreed that if the net proceeds of the Offering were insufficient to repay the Debt in full, the lenders would be entitled to convert some or all of the remaining Debt into Ordinary shares.

The terms of the conversion were agreed as follows: (i) the minimum amount to be converted at any one time is $300 of Debt; (ii) the share issue price will be the lower of $1.00 or 15% below the preceding 7 days VWAP (volume weighted average price); and (iii) any unconverted Debt will continue to be subject to the terms of the extended standstill agreement (see also Note 9).

On April 27, 2015, the Company entered into an amendment to its standstill agreement with the lenders under which the termination of the forbearance period was been extended to the earlier of (i) August 31, 2016 or (ii) 30 days after the closing of the Offering resulting in the repayment of at least $7,500 of the Debt. Pursuant to this amendment, the default interest payable, as of and after February 1, 2015, on all outstanding principal amounts is Libor + 9% (see also Note 9).

On July 30, 2015, the Company announced the closing of its public offering of 6,910,569 Ordinary shares, offered at a price to the public of $1.23 per share. The gross proceeds to the Company were $8,500, before deducting underwriting discounts and commissions and other offering expenses payable by the Company. Issuance costs amounted to approximately $1,070.

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

NOTE 1:- GENERAL (Cont.)

d. *Liquidity and Capital Resources (Cont.)*

The Company repaid $5,030 of the principal of the outstanding Debt and approximately $2,080 of the then outstanding accrued interest.

Subsequent to the balance sheet date, on May 15, 2016, the Company's shareholders approved an investment transaction with a new investor (the "Investor") according to which the investor will become a controlling shareholder of the Company and the Company will issue 17,021,277 Ordinary shares, in consideration for the aggregate amount of approximately $4,000, or a price per each share of $0.235 (the "Initial Investment"). The Company will also issue to the Investor, without additional consideration, warrants to purchase: (i) 8,510,638 additional Ordinary shares at an exercise price per Ordinary share of $0.235 (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 7,272,727 Ordinary shares at an exercise price per Ordinary share of $0.275 (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") (see also Note 17).

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 shareholders due on August 31, 2016.

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 0.015, at a price per share equal to the lower of: (i) $1.20, 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 $0.235.

As of December 31, 2015, the Company's cash position (cash and cash equivalents) totaled approximately $1,754. The Company’s current operating plan includes various assumptions concerning the level and timing of cash receipts from existing and anticipated orders in 2016, current credit facilities available, the abovementioned Initial Investment and cash outlays for operating expenses and capital expenditures. Management believes that these funds, together with its existing operating plan, are sufficient for the Company and its subsidiary to meet its obligations as they come due at least for a period of twelve months from the date 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, a substantial portion of the costs of the Company is incurred in U.S dollars.

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

b. Financial statements in U.S. dollars (Cont.)

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.

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 long term and 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 0.91%.

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.

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

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.

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. As of December 31, 2015, 2014 and 2013, no impairment losses have been identified.

i. Goodwill

Goodwill has been recorded in the Company's financial statements as a result of acquisitions. Goodwill represents excess of the costs over the net tangible and intangible assets acquired of businesses acquired Under ASC 350, "Intangible - Goodwill and Other", according to which goodwill is not amortized.

According to ASC 350, goodwill impairment testing is a two-step process. The first step involves comparing the fair value of a company's reporting units to their carrying amount. The Company elects to perform an annual impairment test of goodwill as of December 31 of each year, or more frequently if impairment indicators are present (as of December 31, 2015 and 2014, the Company’s management was in the opinion that the Company operates as one reporting unit). If the fair value of the reporting unit is determined to be greater than its carrying amount, there is no impairment.

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

i. Goodwill (Cont.)

If the reporting unit's carrying amount is determined to be greater than the fair value, the second step must be completed to measure the amount of impairment, if any. Step two calculates the implied fair value of goodwill by deducting the fair value of all tangible and intangible assets, excluding goodwill, of the reporting unit from the fair value of the reporting unit as determined in step one. The implied fair value of the goodwill in this step is compared to the carrying value of goodwill.

If the implied fair value of the goodwill is less than the carrying value of the goodwill, an impairment loss equivalent to the difference is recorded. As of December 31, 2015, the Company identified impairment of goodwill and accordingly recorded impairment charge of its goodwill in the amount of $587 (see also Note 8). As of December 31, 2014 and 2013, no impairment losses were identified.

j. 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 Chief Scientist's Office of the Israeli Ministry of Economy ("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 11b).

k. 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.

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, 2015 and 2014.

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

l. 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, 2015, 2014 and 2013 amounted to $553, $674 and $483, respectively.

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.

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.

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

m. Fair value of financial instruments (Cont.)

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, 2015 and 2014:

	December 31, 2014			
	Level 1	Level 2	Level 3	Total
Derivatives:				
Foreign currencies derivatives	$ -	$ (216)	$ -	$ (216)
Total	$ -	$ (216)	$ -	$ (216)

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

n. 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 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 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.

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

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 total accumulated other comprehensive income, net was as follows:

	December 31,	
	2015	**2014**
Accumulated foreign currency translation differences	$ 387	$ 536

The following table summarizes the changes in accumulated balances of other comprehensive income, net of taxes for the year ended December 31, 2015:

	Accumulated foreign currency translation differences	**Total**
Balance as of December 31, 2014	$ 536	$ 536
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 liability from these warranties is not material as of December 31, 2015 and 2014.

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

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, 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.

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, 2015 and 2014, the provision for estimated losses identified is $27 and $0, 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.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

q. Revenue recognition (Cont.)

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

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, 2015 and 2014, the fair value of the outstanding forward contracts was $23 and $216, respectively, which was recorded in other accruals against financial expenses.

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

t. Recently Issued Accounting Standards:

ASU 2014-09 - Revenue from Contracts with Customers (Topic 606):
In May 2014, the FASB issued guidance on revenue from contracts with customers that will supersede most current revenue recognition guidance, including industry-specific guidance. The underlying principle is that an entity will recognize revenue upon the transfer of goods or services to customers in an amount that the entity expects to be entitled to in exchange for those goods or services. The guidance provides a five-step analysis of transactions to determine when and how revenue is recognized. Other major provisions include capitalization of certain contract costs, consideration of the time value of money in the transaction price, and allowing estimates of variable consideration to be recognized before contingencies are resolved in certain circumstances. The guidance also requires enhanced disclosures regarding the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. The guidance is effective for the interim and annual periods beginning on or after December 15, 2017 (early adoption is permitted for the interim and annual periods beginning on or after December 15, 2016). The guidance permits the use of either a retrospective or cumulative effect transition method. The Company is currently evaluating the impact of the guidance on its consolidated financial statements.

ASU 2014-15 - Presentation of Financial Statements-Going Concern (Subtopic 205-40):
In August 2014, the FASB issued ASU 2014-15, Presentation of Financial Statements-Going Concern (Subtopic 205-40): "Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern", which defines management's responsibility to assess an entity's ability to continue as a going concern, and to provide related footnote disclosures if there is substantial doubt about its ability to continue as a going concern. The pronouncement is effective for annual reporting periods ending after December 15, 2016, with early adoption permitted.

ASU 2015-15 - Interest-Imputation of Interest (Subtopic 835-30):
In April 2015, the FASB issued guidance on debt issuance costs. The guidance requires entities to present debt issuance costs related to a recognized debt liability as a direct deduction from the carrying amount of that debt in the balance sheet. This guidance does not contain guidance for debt issuance costs related to line-of-credit arrangements. Consequently, in August 2015, the FASB issued additional guidance to add paragraphs indicating that the SEC staff would not object to an entity deferring and presenting debt issuance costs related to line-of-credit arrangements as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. The guidance is effective for the interim and annual periods beginning on or after December 15, 2015. 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.

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

t. Recently Issued Accounting Standards (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 is currently evaluating the potential effect of the guidance on its consolidated financial statements.

ASU 2015-17 - Income Taxes (Topic 740):
In November 2015, FASB issued guidance on balance sheet classification of deferred taxes. The new guidance requires entities to present all deferred tax assets and liabilities, along with any related valuation allowance, as non-current on the balance sheet. The guidance is effective for interim and annual periods beginning after December 15, 2016 (early adoption is permitted). The Company has not yet adopted ASU 2015-17 and does not expect the adoption of this guidance to have a material impact on its consolidated financial position of results of operations.

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. ASC 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 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:

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

NOTE 3:- CONTRACTS IN PROGRESS (Cont.)

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

	December 31, 2015	December 31, 2014
Costs incurred on uncompleted contracts	$ 19,167	$ 18,417
Estimated earnings	6,465	8,544
	25,632	26,961
Less - billings and progress payments	23,425	23,287
Costs and estimated earnings in excess of billings on uncompleted contracts	2,207	3,674
Less: Long-term portion	-	(1,017)
Costs and estimated earnings in excess of billings on uncompleted contracts - Current portion	$ 2,207	$ 2,657

NOTE 4:- OTHER ACCOUNTS RECEIVABLE AND PREPAID EXPENSES

	December 31, 2015	December 31, 2014
Prepaid expenses	$ 146	$ 279
Government institutions	12	53
Advance payment to vendors	48	96
	$ 206	$ 428

NOTE 5:- INVENTORIES

	December 31, 2015	December 31, 2014
Raw materials	$ 3,169	$ 2,891
Work in progress, net *)	2,087	2,394
Finished goods	1,309	1,366
	$ 6,565	$ 6,651

*) Net of provision for losses on long-term contracts as of December 31, 2015 and 2014, in the amount of $27 and $0, respectively.

Write-offs of inventories for the years ended December 31, 2015, 2014 and 2013 amounted to $153, $138 and $313, respectively. The write-offs were due to slow-moving items and excess inventories and were recorded in cost of revenues.

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

NOTE 6:- LONG TERM RECEIVABLES AND DEPOSITS

	December 31, 2015	December 31, 2014
Costs and estimated earnings in excess of billings on uncompleted contracts (see Note 3)	$ -	$ 1,017
Restricted deposits	64	330
Leasing deposits	55	47
	$ 119	$ 1,394

NOTE 7:- PROPERTY, PLANT AND EQUIPMENT, NET

	December 31, 2015	December 31, 2014
Cost:		
Factory building	$ 1,989	$ 1,989
Other buildings	1,291	1,366
Machinery and equipment *)	9,822	9,530
Office furniture and equipment	628	435
Leasehold improvements	300	231
	14,030	13,551
Accumulated depreciation:		
Factory building	1,958	1,898
Other buildings	777	726
Machinery and equipment *)	7,743	7,693
Office furniture and equipment	353	332
Leasehold improvements	121	112
	10,952	10,761
Depreciated cost	$ 3,078	$ 2,790

*) Includes machinery at cost of $374 and accumulated depreciation of $37, which are under operating leases to customers.

Write-offs of machinery and equipment (cost and accumulated depreciation) for the years ended December 31, 2015, 2014 and 2013 amounted to $191, $0 and $333, respectively. The write-offs are due to fully depreciated assets that are no longer in use.

Depreciation expense amounted to $651, $690 and $752 for the years ended December 31, 2015, 2014 and 2013, respectively.

As for charges, see Note 11e.

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

NOTE 8:- GOODWILL

	December 31,	
	2015	2014
Beginning balance	$ 587	$ 587
Impairment of Goodwill *)	(587)	-
	$ -	$ 587

*) During the fourth quarter of 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,	
	2015	2014
Loan in U.S. dollars from shareholders	$ -	$ 5,120
Convertible note from shareholders	3,090	3,000
Less: Beneficial Conversion Feature	(1,456)	-
	$ 1,634	$ 8,120

In December 2007, the Company issued a convertible note in the amount of $3,000 to its then 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, exercisable for a period of five years. The convertible note had interest at the rate of six-month LIBOR+3.5% and had a conversion price of $2.09 per share. The principal was due on December 2010. In 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 therefore was expired. 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 to the modification, the discount was amortized over the term of the extended note using the interest method.

In July 2008, the Company entered into a $1,500 loan agreement with its then controlling shareholder. The loan bears interest of LIBOR+3% payable at the beginning of each quarter. In September 2012, an amendment to the finance agreement was signed, according to which, the then controlling shareholder agreed to lend to the Company $1,148 in addition to the then remaining unpaid loan amount of $352.

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

A. LOANS AND CONVERTIBLE NOTE FROM SHAREHOLDERS (Cont.)

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 of the open balance due was repaid. In August 2013, the Company and the then controlling shareholder agreed on a second amendment to the loan agreement whereby an additional $350 was provided to the Company to be repaid on December 31, 2013, and the remaining $1,150 to be repaid according to a standstill agreement. The Company repaid the $350 in February 2014.

In February 2012, the Company entered into a $3,000 loan agreement with an entity affiliated with its then controlling shareholder and another shareholder. The then controlling shareholder provided $2,700 and the other shareholder provided $300. Of such amount, $1,700 was used to repay in full an outstanding amount due. The loan bears interest at the rate of the greater of three months LIBOR+5% per annum, or 7% per annum. In March 2014, $30 was repaid to the other shareholder. As of December 31, 2014, the principal of the loan is $2,970. Interest is payable quarterly in arrears. The principal of the loan should have been repaid on February 28, 2014.

The loan provided by the then 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.

According to the standstill agreement the principal amounts of the Debt bears additional default interest rate of 5%.

As part of this loan agreement, the Company issued 1,200,000 warrants at an exercise price of $2.50 per share, exercisable for a period of three years. In September 2014, 120,000 warrants were exercised (see Note 12(b)). 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, was amortized over the term of the loan using the effective interest method pursuant to ASC 835.

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

In April 2014 the Company and the then controlling shareholder agreed on an additional short-term loan in the amount of up to $1,000. The loan bears an interest rate of LIBOR+3.5%, and was to be repaid by the Company by December 31, 2014.

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.)

In February 2013, the Company entered into a "standstill agreement" with its then controlling shareholder and another shareholder (the "parties"), according to which those shareholders would not take any action, or otherwise exercise their rights, with respect to the collection of the Debt until January 31, 2014. According to the standstill agreement, all remaining balances of unpaid loans bears additional default interest rate as originally agreed in the loan agreements.

In April 2014, the agreement was extended to January 31, 2015.

On April 27, 2015, a second amendment was approved by the parties as follows: the termination of the forbearance period was extended to the earlier of (i) August 31, 2016, or (ii) 30 days after the closing of the Offering resulting in the repayment of at least $7,500 of the Debt. Pursuant to such amendment, the default interest payable, as of and after February 1, 2015, on all outstanding principal amounts is Libor + 9%.

Following the closing of the Offering, the forbearance period was extended to August 31, 2016.

In April 2015, the Company's shareholders approved an outline for the repayment of the Debt, according to which, the Company would offer new Ordinary shares in the Offering. It was agreed that if the net proceeds of the Offering were insufficient to repay the Debt in full, the lenders would be entitled to convert some or all of the remaining Debt into Ordinary shares.

Under the terms of the outline the terms of the conversion were: (i) the minimum amount to be converted at any one time is $300 of Debt; (ii) the share issue price will be the lower of $1.00 or 15% below the preceding 7 days VWAP (volume weighted average price); and (iii) any unconverted Debt would continue to be subject to the terms of the extended standstill agreement. The Company accounted for the modification in accordance with ASC 470-50, noting the debt is considered "substantially different" and applied extinguishment accounting. Accordingly, the original debt was derecognized and the new debt was recorded at fair value, with the difference recognized as an extinguishment loss of approximately $84 with related parties in additional paid-in-capital under ASC 470-50-40-2. In addition, the above terms represented contingent conversion option, and therefore, the Company measured the contingent Beneficial Conversion Feature ("BCF") in accordance with the guidance of ASC 470-20-30-5 by using the most favorable conversion price that would be in effect at the conversion date, assuming there are no changes to the current circumstances except for the passage of time, hence used $1.00 to calculate the BCF. Accordingly, the outline resulted in a BCF in the amount of approximately $8,204, recorded as a discount to the debt with corresponding adjustment to additional paid-in-capital. Such BCF non-cash expenses are amortized through August 31, 2016, the contractual term of the debt in financial expenses, net.

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.)

In August 2015, following the Offering, the Company repaid $5,090 of the total Debt of $8,120 and $1,825 of accrued interest and its withholding taxes ($600) to the Lenders. The Company treated the repayment as extinguishment in accordance with the original terms of the debt with any gain or loss on the extinguishment recorded in additional paid-in-capital according with ASC 470-40-50-2. In effect, the contingent BCF is resolved and the only remaining BCF provided to the Lenders is of the remaining $3,090 principal amount.

As of December 31, 2015, the outstanding principal of the convertible loans amounted to $3,090, with remaining discount of $1,540. As of December 31, 2015, accrued interest amounted to $115 and included other accrued payables. Through December 31, 2015, the Company recorded discount amortization expenses in the amount of $2,684 in financial expenses, net.

B. BANK CREDIT

	December 31,	
	2015	2014
Bank Credit	$ 2,416	$ 1,589

The Company has an annual line of bank credit of $750 out of which $744 was fully utilized as of December 31, 2015, and a line of credit for customers guarantees of approximately $623, out of which $386 was utilized as of December 31, 2015. In addition, the Company may secure borrowing with one of its banks against specific accounts receivables of up to $2,250. As of December 31, 2015, the Company secured borrowings against specific accounts receivables in the amount of $1,672 (see also Note 11f).

The annual average interest rate on the lines of credit is 3.5% at December 31, 2015.

The guarantees are secured by a first priority floating charge on all of the Company's 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 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,	
	2015	2014
Payroll and related accruals	$ 1,815	$ 1,476
Accrued expenses - subcontractors	79	392
Accrued expenses	565	486
Accrued interest due to shareholders loan	115	1,041
Tax authorities	224	602
Derivatives Instruments	23	216
Others	25	54
	$ 2,846	$ 4,267

NOTE 11:- COMMITMENTS AND CONTINGENT LIABILITIES

a. As of December 31, 2015, 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. As of December 31, 2015, the Company received total grants from the OCS in the amount of $5,545 including LIBOR interest.

The total amount of royalties charged to operations for the years ended December 31, 2015, 2014 and 2013 was approximately $55, $18 and $12, respectively. As of December 31, 2015, the Company's contingent liability for royalties, net of royalties paid or accrued, totaled approximately $1,500. Research and development grants received from the OCS, amounted to $0, $0 and $15 in the years ended December 31, 2015, 2014 and 2013, respectively.

c. Research and development projects undertaken by the Company were partially financed by the Binational Industrial Research and Development Foundation ("BIRD-F"). The Company is committed to pay royalties to the BIRD-F at a rate of 5% of sales proceeds generating from projects for which the BIRD-F provided funding up to 150% of the sum financed by the BIRD-F.

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, 2015, the Company's total obligation for royalties, net of royalties paid or accrued, totaled approximately $2,066. Since the Company had stated to BIRD-F that no revenues were generated from the funded projects, BIRD-F agreed that no royalties are due until future revenues, if any, are received. No royalties were charged to operations for the years ended December 31, 2015, 2014 and 2013.

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

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

d. The Company's offices in Netanya, Israel are leased under a non-cancelable operating lease expiring on January 31, 2018. 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, 2015, are approximately as follows:

2016	$ 713
2017	577
2018	90
2019	6
	$ 1,386

Lease expense for the years ended December 31, 2015, 2014 and 2013 was $761, $754 and $747, respectively.

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, including its shareholders.

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, 2015, is approximately $386.

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 April 16, 2015, the Company's shareholders approved the following:

The increase of the Company's authorized share capital by NIS 200,000 such that following the increase, the authorized share capital will equal NIS 450,000 divided into 30,000,000 Ordinary shares, par value NIS 0.015 each.

On July 30, 2015, the Company announced the closing of an underwritten public offering of 6,910,569 Ordinary shares, offered at a price to the public of $1.23 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.

See also Note 17 for subsequent events.

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

NOTE 12:- SHAREHOLDERS' EQUITY (Cont.)

Stock option plans:

In April 2015, the Company's Board of Directors approved the adoption of Israeli Employee Stock Option Plan (the "Plan"), which authorized the grant of options to purchase up to an aggregate of 3,000,000 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.

Each award agreement will provide the schedule under which such awards may be exercised (“Vesting Schedule”). The Vesting Schedule of an award will be determined by the Administrator provided that (to the extent permitted under Applicable Law) the Administrator, in its absolute discretion, shall have the authority to accelerate the vesting of any outstanding Option at such time and under such circumstances as it, in its sole discretion, deems appropriate. Subject to the Vesting Schedule, Awards may be exercised into Award Shares during the ten (10) year period from the adoption date of the Plan unless otherwise determined by the Administrator (to the extent permitted under Applicable Law and the Plan). No grants were made in 2015 under the Plan.

b. Warrants:

During February 2012, pursuant to 2012 loan agreement (see Note 9) the Company issued warrants to purchase 1,200,000 Ordinary shares at an exercise price of $2.5 per share for a period 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.

During September 2014, 120,000 warrants were exercised for 69,749 Ordinary shares on a cashless basis as agreed in the applicable warrant agreement. The remaining 1,080,000 warrants expired in February 2015.

NOTE 13:- TAXES ON INCOME

a. The Israeli corporate tax rate and real capital gains tax in Israel were 25% in 2013, 26.5% in 2014, and 26.5% in 2015.

In January 2016, the Israeli Parliament approved a reduction of the corporate rate to 25% effective as of January 1, 2016.

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.

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

NOTE 13:- TAXES ON INCOME (Cont.)

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, 2015, the net operating tax loss carryforward relating to the Company in Israel amounted to approximately $62,355, including a carryforward capital loss amounting to approximately $3,400. 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 $16,803 will not be utilized, 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.

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,	
	2015	2014
Net operating loss carry forward	$ 16,439	$ 16,389
Allowance and reserve	364	346
Total deferred tax assets before valuation allowance	16,803	16,735
Valuation allowance	(16,803)	(16,735)
Net deferred tax assets	$ -	$ -

As of December 31, 2015 and December 31, 2014, the Company has provided valuation allowances in respect of deferred tax assets resulting from tax loss carry forward 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.

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

NOTE 13:- TAXES ON INCOME (Cont.)

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, 2015 and 2014, there were no unrecognized tax benefits that if recognized would affect the annual effective tax rate.

NOTE 14:- FINANCIAL EXPENSES, NET

	Year ended December 31,		
	2015	**2014**	**2013**
Income:			
Foreign currency exchange differences	$ 131	$ 208	$ 15
Interest on cash equivalents and restricted deposits	4	5	12
	(135)	(213)	(27)
Expenses:			
Amortization of shareholders' convertible loans discount and BCF	2,684	43	489
Interest on shareholders' convertible note and loans	575	708	729
Withholding taxes on interest of convertible note and loans from shareholders	119	294	205
Bank commissions and others	149	144	292
Foreign currency exchange differences	161	271	135
Interest on loans from banks and other credit balances	21	7	84
	3,709	1,467	1,934
Total financial expenses, net	$ 3,574	$ 1,254	$ 1,907

NOTE 15:- RELATED PARTY BALANCE AND TRANSACTIONS

For the year ended December 31, 2015, the Company incurred $575 in respect of interest on loans received from its shareholders.

See also Notes 9 and 17 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 (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,		
	2015	2014	2013
Israel	$ 6,062	$ 5,005	$ 4,267
Asia	3,482	6,604	5,466
North America	3,558	8,072	5,091
Latin America	1,614	2,731	6,798
Europe	148	69	139
Total	$ 14,864	$ 22,481	$ 21,761

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,		
	2015	2014	2013
		%	
Customer A	23	10	12
Customer B	-	-	11
Customer C	9	16	20
Customer D	12	22	17
Customer E	7	13	17
Customer F	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, 2015	December 31, 2014
Israel	$ 2,686	$ 2,820
China	392	557
	$ 3,078	$ 3,377

NOTE 17:- SUBSEQUENT EVENTS

On May 15 2016, the Company's shareholders approved Investment Transaction, according to which a new investor (the "Investor") will become the controlling shareholder of the Company.

Pursuant to the Investment Transaction the Company will issue 17,021,277 new Ordinary shares to the Investor in consideration for approximately 4,000, or a price per share of $0.235 In addition, the Company will issue to the Investor warrants to purchase: (i) an additional 8,510,638 Ordinary shares at an exercise price per Ordinary share of $0.235 (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 7,272,727 Ordinary shares at an exercise price per Ordinary share of $0.275 (resulting in an aggregate exercise price of $2,000), exercisable for a period of 48 months following the date of the Initial Investment.

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 shareholders due on August 31, 2016.

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 0.015, at a price per share equal to the lower of: (i) $1.20, 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 $0.235.

In addition, on May 15 2016, the Company's shareholders approved the increase of the Company's share capital to NIS 675,000. Following the increase, the authorized share capital shall equal NIS 1,125,000 divide into 75,000,000 Ordinary shares, par value NIS 0.015 each.