

ELTEK LTD  
Form 20-F  
April 02, 2015

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington D.C. 20549

FORM 20-F

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

OR

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

For the fiscal year ended December 31, 2014

OR

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

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

OR

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

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

Commission file number 0-28884

ELTEK LTD.

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

Israel

(Jurisdiction of incorporation or organization)

20 Ben Zion Gelis Street, Sgoola Industrial Zone, Petach Tikva 4927920, Israel  
(Address of principal executive offices)

Amnon Shemer, +972-3-9395025 (phone), +972-3- 9342584 (fax)  
20 Ben Zion Gelis Street, Sgoola Industrial Zone, Petach Tikva 4927920, Israel  
(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

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

| Title of each class                    | Name of each exchange on which registered |
|--|---|
| Ordinary Shares, NIS 0.6 Nominal Value | NASDAQ Capital Market                     |

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

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

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

10,142,762 Ordinary Shares, nominal value NIS 0.6 per share (as of December 31, 2014)

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

Yes  No

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

Yes  No

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

Yes  No

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

Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

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

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

Item 17  Item 18

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

Yes  No

## INTRODUCTION

Eltek Ltd., incorporated in 1970 under the laws of the State of Israel, manufactures, markets and sells custom made printed circuit boards, or PCBs, including high density interconnect, or HDI, flex-rigid and rigid, with high layer count boards. Our principal customers include manufacturers of defense and aerospace, medical, industrial, telecom and networking equipment, as well as contract electronic manufacturers. Since our initial public offering in January 1997, our ordinary shares have been listed on the NASDAQ Stock Market (symbol: ELTK) and are presently listed on the NASDAQ Capital Market. As used in this annual report, the terms “we,” “us” and “our” mean Eltek Ltd. and its subsidiaries, unless otherwise indicated.

Our functional currency is New Israeli Shekel while our reporting currency is the U.S. dollar. All references in this annual report to “dollars” or “\$” are to U.S. dollars and all references in this annual report to “NIS” are to New Israeli Shekels. Our consolidated financial statements appearing in this annual report are prepared in accordance with U.S. GAAP. The consolidated financial statements appearing in this annual report are translated into dollars at the representative rate of exchange under the current rate method. Under such method, the income statement and cash flows statement items for each year (or period) stated in this report are translated into dollars using the average exchange rates in effect at each period presented, and assets and liabilities for each year (or period) are translated using the exchange rate as of December 31 of each year as published by the Bank of Israel (\$1.00 = NIS 3.889 as of December 31, 2014), except for equity accounts, which are translated using the rates in effect at the date of the transactions. All resulting exchange differences that do not affect our earnings are reported in the accumulated other comprehensive income as a separate component of shareholders’ equity.

Statements made in this annual report concerning the contents of any contract, agreement or other document are summaries of such contracts, agreements or documents and are not complete descriptions of all of their terms. If we filed any of these documents as an exhibit to this annual report or to any registration statement or annual report that we previously filed, you may read the document itself for a complete description of its terms.

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

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PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. Selected Financial Data

The selected financial data, set forth in the table below, have been derived from our audited historical financial statements for the five years ended December 31, 2014. The selected consolidated financial data as of December 31, 2014 and 2013 and for each of the three years ended December 31, 2014 have been prepared in accordance with U.S. GAAP, and are derived from our audited consolidated financial statements and accompanying notes included in Item 18, "Financial Statements." The selected consolidated financial data as of December 31, 2012 and 2011 and for the year ended December 31, 2010 have been derived from our previously published audited consolidated financial statements, which are not included in this annual report. The selected financial data set forth below should be read in conjunction with and are qualified entirely by reference to Item 5. "Operating and Financial Review and Prospects" and our consolidated financial statements and notes thereto included elsewhere in this annual report.

## CONSOLIDATED STATEMENT OF OPERATIONS DATA

| Year ended December 31,   | 2014  | 2013      | 2012      | 2011      | 2010      |
|---|---|-----------|-----------|-----------|-----------|
|   | (\$ and share data in thousands, except per share data) |           |           |           |           |
| Revenues  | 46,626  | 50,235    | 45,646    | \$ 46,830 | \$ 37,514 |
| Cost of revenues  | (40,604 )   | (42,242 ) | (37,836 ) | (38,101 ) | (32,690 ) |
| Gross profit  | 6,022   | 7,933     | 7,810     | 8,729     | 4,824     |
| R&D expenses  | (72 )   |           |           |           |           |
| Selling, general and administrative expenses  | (6,773 )  | (6,722 )  | (6,040 )  | (6,155 )  | (6,033 )  |
| Impairment on goodwill  | (80 )   | -         | (481 )    | -         | -         |
| Total operating expenses  | (6,925 )  | (6,722 )  | (6,521 )  | (6,155 )  | (6,033 )  |
| Operating profit (loss)   | (903 )  | 1,271     | 1,289     | 2,574     | (1,209 )  |
| Financial expenses, net   | (356 )  | (439 )    | (543 )    | (740 )    | (609 )    |
| Other income, net   | 38  | (26 )     | 2         | 12        | 2         |
| Profit (loss) before income tax expense   | (1,221 )  | 806       | 748       | 1,846     | (1,816 )  |
| Income tax (expense) benefit  | (1,634 )  | 2,975     | (52 )     | (31 )     | (19 )     |
| Net profit (loss)   | (2,855 )  | 3,781     | 696       | 1,815     | (1,835 )  |
| Net profit (loss) attributable to non-controlling interest  | 190   | 42        | 6         | (31 )     | (113 )    |
| Net profit (loss) attributable to Eltek Ltd. shareholders   | (2,665 )  | 3,823     | 690       | 1,846     | (1,722 )  |
| Basic and diluted net profit (loss) per ordinary share attributable to Eltek Ltd.                                 | (0.26 )   | 0.53      | 0.1       | 0.28      | (0.26 )   |
| Weighted average number of ordinary shares used to compute basic and diluted net profit (loss) per ordinary share | 10,143  | 7,199     | 6,610     | 6,610     | 6,610     |

## CONSOLIDATED BALANCE SHEETS DATA:

|   | As at December 31,               |        |          |          |          |
|---|----------------------------------|--------|----------|----------|----------|
|   | 2014                             | 2013   | 2012     | 2011     | 2010     |
|   | (\$ and share data in thousands) |        |          |          |          |
| Working capital (deficit)               | (72 )                            | 1,997  | (2,712 ) | (1,787 ) | (4,064 ) |
| Total assets                            | 26,266                           | 31,454 | 23,449   | 22,869   | 23,837   |
| Long-term liabilities                   | 2,087                            | 1,749  | 943      | 1,754    | 2,849    |
| Total shareholders' equity              | 9,307                            | 13,251 | 5,412    | 4,631    | 3,149    |
| Number of issued and outstanding shares | 10,143                           | 10,143 | 6,610    | 6,610    | 6,610    |

## B. Capitalization and Indebtedness

Not applicable.

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

Not applicable.

## D. Risk Factors

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

## Risks Relating to Our Business and Market

One key customer accounts for a significant portion of our revenues. The loss of this customer or other key customers would have an adverse impact on our business results.

In the years ended December 31, 2014, 2013 and 2012, one customer (consisting of ten affiliated companies) accounted for 20.6%, 18.4% and 17.2% of our total revenues, respectively. We expect that a significant portion of our future revenues will continue to be dependent on a small number of customers. If we are unable to retain our key customers, or maintain our level of business with such customers, or, if we are unable to attract sufficient new business to compensate for the loss of or reduction in business from any of our key customers, our results of operations and financial condition would be adversely affected.

Our results of operations may be adversely affected by currency fluctuations.

Our revenues and expenses are denominated in NIS, dollars and Euros. Due to the different proportions of currencies our revenues and expenses are denominated in, fluctuations in rates of exchange between NIS and other currencies may affect our operating results and financial condition. The NIS value of our dollar and Euro denominated revenues are negatively impacted by the depreciation of the dollar and the Euro against the NIS. The average exchange rate for the NIS against the dollar was 1.3% lower in 2014 than in 2013, which had a negative impact on our operating results

in 2014. In the past, the NIS exchange rate against the dollar and other foreign currencies fluctuated, generally reflecting inflation rate differentials. We cannot predict any future trends in the rate of inflation in Israel or the rate of depreciation or appreciation of the NIS against the dollar. If NIS value of our dollar or Euro denominated revenues decreases, our results of operations will be adversely affected.

We are currently not engaged in hedging transactions. If we were to decide to enter into any hedging transactions in the future in order to protect ourselves in part from currency fluctuations, we may not be successful in our hedging efforts, or such transactions, if entered into may not materially reduce the effect of fluctuations in foreign currency exchange rates on our results of operations. Such hedging transactions may not necessarily mitigate the longer-term impact of currency fluctuations on the operating costs of our business operations, and may result in additional expenses.

Economic downturns and disruptions in financial markets can adversely affect our business and results of operations.

Our results of operations can be materially affected by adverse conditions in the financial markets and depressed economic conditions generally. Worsening economic conditions, such as the ongoing Eurozone crisis, may result in diminished demand for our products and in decreased sales volumes. Recessionary environments adversely affect the demand for our products as a result of constraints on capital spending by our customers. In addition, this could result in longer sales cycles, slower acceptance of new products and increased competition for our products, which in turn could cause us to reduce prices for our products resulting in reduced gross margins. Any of these events may adversely affect our business, operating results and financial condition.

Continued losses of our Germany-based subsidiary, Kubatronik, could adversely affect our financial results

Our Germany-based subsidiary, Kubatronik Leiterplatten GmbH, or Kubatronik, has incurred losses in recent years. During the fiscal year 2014, we have financed Kubatronik's operational losses in the aggregate amount of 657,000 Euros (\$863,000) such that Kubatronik's intercompany debt as of December 31, 2014 amounted to approximately 737,000 Euros (\$895,000). In the event Kubatronik is unable to repay its debt to us, we may be required to record this inter-company debt as a loss. In the event the performance of Kubatronik does not improve, we may need to record impairment losses in respect of our investment. Also, continued losses by Kubatronik may have an adverse impact on our cash flows and financial results.

We are subject to environmental laws and regulations. Compliance with those laws and regulations requires us to incur costs and we are subject to fines or other sanctions for non-compliance.

Our operations are regulated under various environmental laws and regulations that govern, among other things, the discharge of hazardous materials into the air and water, as well as the handling, storage and disposal of such materials. Compliance with these laws and regulations is a major consideration for PCB manufacturers because metals and chemicals classified as hazardous substances are used in the manufacturing process. Since May 2003, our environmental management system has been ISO 14001 certified. This certification was based on successful implementation of environmental management requirements and includes ongoing monitoring of our processes, raw materials and products. The certification is subject to periodic compliance audits conducted by the Israeli Institute of Standards. If, in the future, we are found to be in violation of environmental laws or regulations, we could be liable for damages, costs of remedial actions, may be subject to criminal prosecution including a range of potential penalties, and could also be subject to revocation of permits necessary to conduct our business or any part thereof. Any such liability or revocation could have a material adverse effect on our business, financial condition and results of operations. Environmental laws could become more stringent over time, imposing greater compliance costs and increasing risks and penalties associated with a violation. A shortage of water in Israel may reduce the allocation of water available to manufacturing plants, including ours, which could affect the concentrations of pollutants in our wastewater, making it harder to comply with the foregoing regulations, in which event we would be required to invest additional funds to improve our wastewater treatment systems.

The cost of compliance with environmental laws and regulations depends in part on the requirements in such laws and regulations and on the method selected to implement them. If new or more restrictive standards are imposed, the cost of compliance could be very high and have an adverse impact on our revenues and results of operations if we cannot recover those costs through the rates that we charge our customers.

Our customers are also required to comply with various government regulations, legal requirements and industry standards, including many of the industry-specific regulations discussed above. Our customers' failure to comply could affect their businesses, which in turn would affect our sales to them. In addition, if our customers are required by regulation or other requirements to make changes in their product lines, these changes could significantly disrupt particular programs for these customers and create inefficiencies in our business.



Rapid changes in the Israeli and international electronics industries and recessionary pressure may adversely affect our business.

Our principal customers include manufacturers of defense and aerospace, medical, industrial, telecom and networking equipment, as well as contract electronic manufacturers. The electronics industry is subject to rapid technological changes and products obsolescence. Discontinuance or modification of products containing printed circuit boards, or PCBs, manufactured by us could have a material adverse effect on us. In addition, the electronics industry is subject to sharp economic cycles. Increased or excess production capacity by our competitors in the PCB industry and recessionary pressure in major electronics industry segments may result in intensified price competition and reduced margins. As a result, our financial condition and results of operations may be adversely affected. A decline in the Israeli and international electronic markets may cause a decline in our revenues and adversely affect our operating results and financial condition in the future.

We have in the past been, and currently are, subject to claims and litigation relating to environmental matters. If we are found to be in violation of environmental laws, we could be liable for damages and costs of remediation and may be subject to a halt in production, which may adversely affect our business, operating results and financial condition.

We have in the past been, and currently are, subject to claims and litigation relating to environmental matters. We may be subject to further environmental claims alleging that we are in violation of environmental laws. If we are unsuccessful in such claims and other future claims and litigations or if actual results are not consistent with our assumptions and judgments, we may be exposed to losses that could be material to our company.

On August 25, 2009, we received a notice from the Petach Tikva Municipality claiming that random automatic wastewater sampling in proximity of our plant indicates high levels of metal concentrations which exceed the amounts permitted by law. The Municipality requested our explanations to such alleged violation and further informed us that its environmental department has determined to initiate procedures against any plant that is not in compliance with the permitted concentrations. On September 16, 2009, we sent a letter to the Municipality explaining that we have invested extensive funds and resources each year in order to comply with all environmental legal requirements. We further indicated that we have been and are still engaged in several projects to reduce salt and metal concentrations in our plant wastewater and that we constantly update our procedures with respect to environmental matters. In addition, we proposed to collaborate with the Municipality and conduct mutual tests to ensure maximum protection of the environment. To date, we have not yet received any response from the Municipality to our letter dated September 16, 2009.

In January 2014 and in July 2014, we received notices from Meitav, the water company of the Petach Tikva municipality, requiring payment of fees totaling NIS 1.4 million (\$400,000) excluding VAT, for discharges of industrial wastewater allegedly not meeting the applicable standards into the municipal sewage system. The payment demands were made on the basis of four samplings conducted by Meitav in our premises during 2013.

We presented to Meitav our plans for a new wastewater treatment facility, in an effort to have Meitav rescind or reduce its demand for payment. Management believes that that we have good arguments against such demand for payment and that we will not be required to pay to Meitav any amounts exceeding the amounts provided for in our financial statements.

In July 2014, we entered into an agreement with Elad Technologies (L.S) Ltd., pursuant to which, Elad Technologies will build and operate a wastewater treatment facility for our use. The new wastewater treatment facility is expected to be completed in the second half of 2015.

If we are found to be in violation of environmental laws, then in addition to fees, we could be liable for damages, costs of remedial actions and a range of potential penalties, and could also be subject to revocation of permits necessary to

conduct our business or any part thereof. Any such liability or revocation could have a material adverse effect on our business, financial condition and results of operations.

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Because competition in the PCB market is intense, our business, operating results and financial condition may be adversely affected.

The global PCB industry is highly fragmented and intensely competitive. It is characterized by rapidly changing technology, frequent new product introductions and rapidly changing customer requirements. We compete principally in the market for complex, flex-rigid and rigid multi-layer PCBs. In the Israeli market we mainly compete with PCB Technologies Ltd. and major international PCB exporters, mainly from South East Asia, Europe and North America. In the European market we mainly compete with Advanced Circuit Boards NV (Belgium), AT&S Austria Technologie & Systemtechnik AG (Austria), Dyconex and Cicor (Switzerland), Graphics, Exception PCB and Invotec (United Kingdom), Cistelaier and Somacis (Italy), Schoeller-Electronics GmbH (formerly Ruwel Werke GmbH) (Germany) and certain other German companies. In the North American market we mainly compete with Viasystems North America, Inc. (previously known as DDi Corp.), KCA Electronics Inc., Lenthor Engineering, Printed Circuits, Inc., Teledyne and TTM Technologies Inc. and certain other American companies. Many of these competitors have significantly greater financial and marketing resources than us. Our current competition in the rigid PCB segment is mainly from PCB manufacturers in South East Asia (mainly in China), which have substantially lower production costs than us. Continued competitive pressures could cause us to lose significant market share.

We are dependent upon a select number of suppliers of key raw materials and the loss of one or more of these suppliers would adversely affect our manufacturing ability. If these suppliers delay or discontinue the manufacture or supply of these raw materials, we may experience delays in production and shipments, increased costs and cancellation of orders for our products.

We currently obtain our key raw materials from a select number of suppliers. We do not have long-term supply contracts with our suppliers and our principal suppliers may not continue to supply raw materials to us at current levels or at all. Any delays in delivery of or shortages in these raw materials could interrupt and delay manufacturing of our products and may result in the cancellation of orders for our products.

As the majority of PCB manufacturing is centered in South East Asia, raw material suppliers may focus their attention and give higher priority to manufacturers in those areas, which may interrupt the supply of raw materials to us. In addition, these suppliers could discontinue the manufacture or supply of these raw materials at any time. During the years ended December 31, 2014, 2013 and 2012, our purchases from one supplier accounted for 24.1% 23.1% and 24.5% of our total consolidated raw material costs, respectively. We may not be able to identify and integrate alternative sources of supply in a timely fashion. Any transition to alternate suppliers may result in delays in production and shipment and increased expenses and may limit our ability to deliver products to our customers. Furthermore, if we are unable to identify an alternative source of supply, we may have to modify our products or a large portion of our production process to use a substitute raw material, which may cause delays in production and shipments, increased design and manufacturing costs and increased prices for our products.

We may not succeed in our efforts to expand into the U.S. defense market. If we are unsuccessful, our future revenues and profitability would be adversely affected.

In January 2009, we received International Traffic in Arms Regulations (ITAR) registration from the U.S. Department of State, which certifies us to sell our PCBs to the U.S. defense market. Our business plan assumes an increase in revenues to the U.S. defense market. However, our efforts to enter into to the U.S. defense market may not succeed and sales to the defense and aerospace industries may be affected by cutbacks in U.S. government spending, and this may not become a substantial market for us. If we are unsuccessful in such efforts, our future revenues and profitability would be adversely affected. In the event of a change in control of our company, the U.S. Department of State may investigate the transfer of control and oppose the transaction. In such an event we may lose our ITAR certification, which could adversely affect our future revenues and profitability. In November 2013, Nistec Ltd., or

Nistec, an Israeli private company controlled by Mr. Yitzhak Nissan, acquired a controlling interest in our company. While the U.S. Department of State did not object to this change in our control, we cannot assure you that such transaction may not be opposed in the future.

We may encounter difficulties with our international operations and sales that may have a material adverse effect on our sales and profitability.

We have manufacturing facilities in Israel and Germany and generate a large percentage of our sales in Israel, Europe and North America. We intend to increase our business in North America, including sales to U.S. military contractors. However, contracts with U.S. military agencies, as well as military equipment manufacturers in Europe, are subject to certain regulatory restrictions and approvals, which we may not be able to comply with or obtain. We may not be able to maintain or increase international market demand for our products. To the extent that we cannot do so, our business, operating results and financial condition may be adversely affected.

International operations are subject to inherent risks, including the following:

- the impact of possible recessionary environments in multiple foreign markets;
- changes in regulatory requirements and complying with a wide variety of foreign laws;
  - tariffs and other trade barriers;
- the imposition of exchange or price controls or other restrictions on the conversion of foreign currencies;
  - difficulties and costs of staffing and managing foreign operations; and
  - political and economic instability.

We may not be successful in achieving the potential benefits of our new relationship with Nistec.

In November 2013, Nistec acquired a controlling interest in our company. Acquisition transactions are subject to a variety of risks that could seriously harm our business, financial condition, results of operations, and share price. These risks include, among others:

- incurrence of unexpected expenses associated with acquisitions and their integration into our company;
- difficulties in the assimilation and integration of operations, personnel, technologies, products, and information systems of the companies;
  - diversion of management's attention from other business concerns;
  - contractual disputes;
- entering geographic and business markets in which we have no or only limited prior experience;
  - potential loss of key employees;
  - incompatible business cultures;
- difficulties in implementing and maintaining uniform standards, controls and policies;
- the impairment of relationships with employees and customers as a result of integration of new personnel; and
- potential inability to retain, integrate and motivate key management, marketing, technical sales and customer support personnel.

Compliance with the conditions of a new business permit may be costly.

In connection with the change of control of our company that resulted from Nistec's acquisition of a controlling stake in our company, Israeli law requires us to obtain a new business permit in order to continue operating our business. We have submitted an application for this permit, but we have not yet received the new permit. The new permit is expected to be subject to certain conditions, especially conditions imposed by the Israeli Ministry for Environmental Protection. Compliance with these conditions may be costly.



We had a history of operating losses and may not be able to achieve and sustain long term profitable operations. We may not have sufficient resources to fund our operations in the future.

We have not maintained consistent profitable operations in the past, and there can be no assurance that we will be able to operate profitably in the future. To the extent that we incur operating losses in the future, we may have insufficient working capital to fund our operations. If we do not generate sufficient cash from operations, we will be required to obtain additional financing or reduce our level of expenditure. Such financing may not be available in the future, or, if available, may not be on terms favorable to us. If adequate funds are not available to us, our business, and results of operations and financial condition will be materially and adversely affected.

Our quarterly operating results fluctuate significantly. Results of operations in any period should not be considered indicative of the results to be expected for any future period.

Our quarterly operating results have fluctuated significantly in the past and are likely to fluctuate significantly in the future. Our future operating results will depend on many factors, including (but not limited to) the following:

- the size and timing of significant orders and their fulfillment;
- demand for our products and the mix of products purchased by our customers;
- competition from lower priced manufacturers;
- fluctuations in foreign currency exchange rates, primarily the NIS against the dollar and the Euro;
  - manufacturing yield;
  - plant utilization;
  - availability of raw materials;
- plant or line shutdowns to repair or replace malfunctioning manufacturing equipment;
  - the length of our sales cycles;
  - changes in our strategy;
  - the number of working days in the quarter;
  - changes in seasonal trends; and
- general domestic and international economic and political conditions.

Due to the foregoing factors, quarterly revenues and operating results are difficult to forecast, and it is likely that there will be significant differences between the results of one quarter to another.

Quarterly sales and operating results are also difficult to forecast because quarterly sales and results are dependent, almost exclusively, on the volume and timing of orders during the quarter and our customers generally operate with a short delivery cycle and expect delivery of a significant portion of our production within 30 working days. The delivery of such orders is subject to the number of available working days during the quarter, which can fluctuate significantly from quarter to quarter due to holidays and vacations. Certain prototype and pre-production runs require

even shorter turn-around times stemming from customers' product launches and design changes. In addition, there might be sudden increases, decreases or cancellations of orders for which there are commitments, which further characterize the electronics industry and the companies that operate in it. The industry practice is to make such changes without any penalties, except for the time and materials expended on the order.

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Our expenses are, in significant part, relatively fixed in the short-term. If revenue levels fall below expectations, our net income is likely to be disproportionately adversely affected because a proportionately smaller amount of the expenses varies with our revenues. We may not be able to be profitable on a quarterly or annual basis in the future. An ongoing pattern of cancellations, reductions in orders and delays could have a material adverse effect on our results of operations. Due to all of the foregoing, it is very difficult to predict revenues for any future quarter with any significant degree of accuracy. Accordingly, we believe that period-to-period comparisons of our operating results are not necessarily meaningful and should not be relied upon as indications of future performance.

We may not be in compliance with financial covenants in our loan agreements in the future.

We are subject to financial covenants in the loan agreements from the banks that provide us with our credit facilities and long-term loans. The borrowings from our banks are secured by specific liens on certain assets, by a first priority charge on the rest of our now-owned or after-acquired assets and by a fixed lien on goodwill (intangible assets) and insurance rights (rights to proceeds on insured assets in the event of damage). In addition, the agreements prohibit us from selling or otherwise transferring any assets except in the ordinary course of business or from placing a lien on our assets without the banks' consent.

Both of our banks require us to be in compliance with certain financial covenants in each fiscal year. Our compliance with the financial covenants is measured annually based on our annual audited financial statements. In recent years, we were forced to seek waivers of certain of these covenants. Both banks have the right to demand immediate repayment of the loans and lines of credit in the event of a change of control in our company, if such a change occurred without their prior approval. Our failure to remain in compliance with each of the banks' covenants, obtain waivers, negotiate agreements with new covenant terms, or obtain additional financing, if required, may adversely affect our business, results of operations and financial position.

Our products and related manufacturing processes are often highly complex and therefore we may be delayed in product shipment. Also our products may at times contain manufacturing defects, which may subject us to product liability and warranty claims.

Our business involves highly complex manufacturing processes that are subject to periodic failure. Process failures have occurred in the past and have resulted in delays in product shipments, and process failures may occur in the future. Further, we face an inherent business risk of exposure to warranty and product liability claims, which are likely to be substantial in light of the use of our products in business-critical applications. Our products may fail to perform as expected or may be alleged to result in bodily injury or property damage. If we were to manufacture and deliver products to our customers that contain defects, whether caused by a design, manufacturing or component failure, or by deficiencies in the manufacturing processes, it may result in delayed shipments to customers and reduced or cancelled customer orders. In addition, if any of our products are or are alleged to be defective, we may be required to participate in a recall of such products. Over the years we have been involved in claims or litigation relating to allegedly defective products. A successful warranty or product liability claim against us in excess of our established warranty and legal reserves or available insurance coverage, or a requirement that we participate in a product recall may have a material adverse effect on our business, financial condition, results of operations or cash flows and may harm our business reputation, which could lead to customer cancellations or non-renewals.

Our operating margins may be affected as a result of price increases for our principal raw materials.

In recent years, the significant increase in oil and energy costs and commodity prices (such as copper, gold and glass fibers) put pressure on our suppliers to increase their prices for most of our principal raw materials. We may not be successful in our attempts to negotiate lower price increases than requested by our suppliers. We have faced pressure to raise our prices for our products to compensate for supplier price increases in order to maintain our operating margins, and we may not be able to maintain moderate price increases as we have in the past. Future price increases

for our principal raw materials may materially affect our operating margins and future profitability.

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Obstacles in our transition to a new enterprise resource planning (“ERP”) system may adversely affect our business and results of operations and the effectiveness of our internal control over financial reporting .

In the third quarter of 2014, we began the implementation of a new ERP system that will deliver a new generation of work processes and information systems. ERP implementations are complex and time-consuming projects and involve substantial expenditures. ERP implementations also require transformation of business and financial processes. We expect to complete the implementation of our new ERP system in 2015. If we do not effectively implement the new ERP system as planned or if the system does not operate as intended, it could adversely affect our financial reporting systems, our ability to produce financial reports and the effectiveness of our internal control over financial reporting.

We will require additional capital in the future, which may not be available to us.

Our working capital requirements and cash flow provided by our operating and financing activities are likely to vary greatly from quarter to quarter, depending on the following factors: (i) the timing of orders and deliveries; (ii) net profit in the period; (iii) the purchase of new equipment; (iv) the build-up of inventories; (v) the payment terms offered to our customers; (vi) the payment terms offered by our suppliers; and (vii) approval of the current or additional lines of credit and long-term loans from banks.

As of December 31, 2014, we had revolving lines of credit aggregating - \$2.7 million with our banks, all of which were fully utilized as of such date, and \$2.3million of long-term loans, including supplier credits. These credit facilities may not remain available to us in the future. Furthermore, under certain circumstances the banks may require us to accelerate or make immediate payment in full of our credit facilities. All of our assets are pledged as security for our liabilities to our banks, whose consents are required for any future pledge of such assets.

During the last several years we were unable to fully fund our technological development requirements due to our losses and limited financial resources. In order to remain competitive, we will be required to acquire new equipment and implement new technologies, which are likely to require significant capital investment that may not be available to us. In November 2013, we raised \$4.2 million from Nistec ,which is now our controlling shareholder, in a private placement of our ordinary shares. To the extent that the funds generated from our operations and from our existing capital resources are insufficient to fund our operating and financial requirements, we will be required to raise additional funds through public or private financing or other sources. If additional funds are raised through the issuance of equity securities, the percentage ownership of our then current shareholders will be diluted. We do not have any committed sources of additional financing, and additional financing, if necessary, may not be available on commercially reasonable terms, if at all. If adequate funds are not available on terms acceptable to us, we may be required to delay, scale back or eliminate certain aspects of our operations, and our business, financial condition and results of operations would be materially adversely affected.

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

Cyber-attacks or other breaches of network or information technology (IT) security, natural disasters, pandemics, terrorist acts or acts of war may cause equipment failures or disrupt our systems and operations. Although we have not experienced any of these events as of the date of this annual report, we expect that our inability to operate our facilities as a result of such events, even for a limited period of time, may result in significant expenses and/or loss of market share to other competitors in the global PCB industry. While we maintain insurance coverage for some of these events, the potential liabilities associated with these events could exceed the insurance coverage we maintain. In addition, a failure to protect the privacy of customer and employee confidential data against breaches of network or IT security could result in damage to our reputation. Any of these occurrences could adversely affect our results of operations and financial condition.

In particular, both unsuccessful and successful cyber-attacks on companies have increased in frequency, scope and potential harm in recent years. We have been subject, and will likely continue to be subject, to attempts to breach the security of our networks and IT infrastructure through cyber-attack, malware, computer viruses and other means of unauthorized access. However, to date, we have not been subject to cyber-attacks or other cyber incidents which, individually or in the aggregate, resulted in a material impact to our operations or financial condition. While we use firewall and anti-virus systems, there is no assurance that cyber-attacks will always be blocked or discovered, and as a result, we may encounter damages to our computer network servers, manipulation of our data (including production, financial and other information).

If our workforce will be represented by a labor union we could incur additional costs or experience work stoppages as a result of the renegotiation of our labor contracts.

In November 2011, we were notified by the General Federation of Labor in Israel, or the Histadrut, that more than one-third of our employees in Israel had decided to join the Histadrut and that they established an employees' union committee. In 2012, a significant portion of our employees decided to resign their membership in the Histadrut, which then ceased to represent our employees. If our employees are represented by a union in the future, we could incur additional costs, experience work stoppages, either of which could adversely affect our business operations, including through a loss of revenue and strained relationships with customers.

New requirements related to conflict-free minerals may disrupt our operations, cause us to incur additional expenses, create challenges with our customers, or result in other significant adverse effects.

In August 2012, the SEC adopted new due diligence, disclosure and reporting requirements pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, regarding the use of certain minerals and derivative metals referred to collectively as "conflict minerals". Conflict minerals include tantalum, tin, gold, and tungsten. We use some of such minerals as component parts in our products. We have implemented procedures to investigate whether any such minerals that we manufacture or use in our products originated in the Democratic Republic of the Congo or adjoining countries. Our first report under these requirements was due by June 2, 2014, and was filed on May 27, 2014. Complying with these new SEC rules will be both time-consuming and costly. In addition, these rules could harm the sourcing, supply, and price of raw materials that we use in our products. If we cannot timely verify the sources of all conflict minerals used in our products, or if we cannot replace any conflict minerals sourced from the Democratic Republic of the Congo or adjoining countries with acceptable alternatives, we may face reputational damage or be unable to satisfy customers who require all of the components of our products to be certified as "conflict-free". If we cannot meet such customer requirements, our customers may choose not to purchase our products, and our results of operations would be materially adversely affected.

In addition to SEC regulations, industry standards and our customers may require us to comply with their own social responsibility, conflict minerals, quality or other business policies or standards, which may be more restrictive than current laws and regulations and our pre-existing policies, before they commence, or continue, doing business with us. Such policies or standards may be customer-driven, established by the industries in which we operate, or imposed by third party organizations. Our compliance with these policies, standards and third-party certification requirements could be costly, and our failure to comply could adversely affect our operations, customer relationships, reputation and profitability.

Increased regulation associated with climate change and greenhouse gas emissions could impose significant additional costs on operations.

Various governments and governmental agencies have adopted or are contemplating statutory and regulatory changes in response to the potential impacts of climate change and emissions of greenhouse gases. International treaties or agreements may also result in increasing regulation of climate change and greenhouse gas emissions, including the introduction of greenhouse gas emissions trading mechanisms. Any such law or regulation regarding climate change and greenhouse gas emissions could impose significant costs on our operations and on the operations of our customers and suppliers, including increased energy, capital equipment, environmental monitoring, reporting and other compliance costs. The potential costs of "allowances," "offsets" or "credits" that may be part of potential cap-and-trade programs or similar proposed regulatory measures are still uncertain. Any adopted future climate change and greenhouse gas laws or regulations could negatively impact our ability, and that of our customers and suppliers, to compete with companies situated in areas not subject to such laws or regulations. These statutory and regulatory initiatives, if enacted, may impact our operations directly or indirectly through our suppliers or customers. Until the timing, scope and extent of any future law or regulation becomes known, we cannot predict the effect on our business,

financial condition, results of operations or cash flows.

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We depend on key personnel for the success of our business.

Our success depends, to a significant extent, on the continued active participation of our executive officers and other key personnel. In addition, there is significant competition for employees with technical expertise in our industry. In order to succeed we would need to be able to:

- retain our executive officers and key technical personnel;
- attract and retain additional qualified personnel to provide technological depth and support to enhance existing products and develop new products; and
- attract and retain highly skilled operations, marketing and financial personnel.

We cannot make assurances that we will be successful in attracting, integrating, motivating and retaining key personnel. If we are unable to retain our key personnel and attract additional qualified personnel as and when needed, our business may be adversely affected.

We may fail to maintain effective internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act of 2002, which could have a material adverse effect on our operating results, investor confidence in our reported financial information, and the market price of our ordinary shares.

Our efforts to comply with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002, governing internal control and procedures for financial reporting have resulted in increased general and administrative expenses and a diversion of management time and attention, and we expect these efforts to require the continued commitment of significant resources. We may identify material weaknesses or significant deficiencies in our assessments of our internal control over financial reporting. Failure to maintain effective internal control over financial reporting could result in investigations or sanctions by regulatory authorities, and could have a material adverse effect on our operating results, investor confidence in our reported financial information, and the market price of our ordinary shares.

Technological change may adversely affect the market acceptance of our products.

Technological change in the PCB industry is rapid and continual. To satisfy customers' needs for increasingly complex products, PCB manufacturers must continue to develop improved manufacturing processes, provide innovative solutions and invest in new facilities and equipment. To the extent we determine that new technologies and equipment are required to remain competitive, the acquisition and implementation of such technologies and equipment are likely to require significant capital investment. We expect that we will need to invest large amounts in the next few years to replace or refurbish old equipment and to remain competitive in the market. This capital may not be available to us in the future for such purposes and any new manufacturing processes developed by us may not become or remain commercially viable. As a result, we may not be able to maintain our current technological position. Furthermore, the PCB industry may in the future encounter competition from new technologies that may reduce demand for PCBs or may render existing technology less competitive or obsolete. Our future process development efforts may not be successful or the emergence of new technologies, industry standards or customer requirements may render our technology, equipment or processes obsolete or uncompetitive.

We will need to compete with PCB manufacturers in Asia whose manufacturing costs are lower than ours.

In recent years, many electronics manufacturers have moved their commercial production to Asia to take advantage of its exceptionally large, relatively low-cost labor pool. The continued outsourcing of production to the Far-East is likely to result in additional commercial market share potential for PCB manufacturers with a strong presence and

reputation in such markets. Accordingly, we will need to compete with PCB manufacturers whose costs of production may be substantially lower than ours. This competition may limit our ability to price our products profitably, which could significantly harm our financial condition and results of operations.

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The measures we take in order to protect our intellectual property may not be effective or sufficient.

Our success depends in part on our proprietary techniques and manufacturing expertise, particularly in the area of complex multi-layer and flex-rigid PCBs. We currently rely on a combination of trade secrets, copyright and trademark law, together with non-disclosure and invention assignment agreements, to establish and protect the proprietary rights and technology used in our products. Like many companies in the PCB industry, we do not hold any patents. We believe that, because of the rapid pace of technological change in the electronics industry, the legal protections for our products are less significant factors in our success than the knowledge, ability and experience of our employees, the frequency of product enhancements and the timeliness and quality of support services that we provide.

We generally enter into confidentiality agreements with our employees, consultants, customers and potential customers and limit the access to and the distribution of our proprietary information. Despite these precautions, it may be possible for a third party to copy or otherwise obtain and use our technology without authorization, or to develop similar technology independently. Further, the laws of certain countries in which we sell our products do not protect our intellectual property rights to the same extent as do the laws of the United States. Substantial unauthorized use of our products could have a material adverse effect on our business. We cannot make assurances that our means of protecting our proprietary rights will be adequate or that our competitors will not independently develop similar technology.

Claims that our products infringe upon the intellectual property of third parties may require us to incur significant costs.

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

A supplier of one of our software packages requested to conduct an audit of our operation to verify that we do not breach any intellectual property rights he allegedly owns. We believe that we have fully, diligently and timely complied with our obligation toward the supplier. We also believe that the supplier has no right to conduct any audit of our products or services and such audit may cause us to breach confidentiality obligations to other entities. If we are found to be in violation of such supplier's intellectual property rights, we could be liable for compensation and costs of an unknown amount. Such liability could have a material adverse effect on our business, financial condition and results of operations.

Our products and product components need to meet certain industry standards.

Our products and product components need to meet certain standards for the aerospace, defense, and other industries to which we market our products. In addition, new industry standards in the aviation and defense industries could cause some or all of our products and services to become obsolete and unmarketable, which would adversely affect our results of operations. Noncompliance with any of these standards could limit our sales and adversely affect our business, financial condition, and results of operations.

We may be required to make payments to satisfy our indemnification obligations.

We have agreements with our directors and senior officers which may require us, subject to Israeli law and certain limitations in the agreements, to indemnify our directors and senior officers for certain liabilities and expenses that may be imposed on them due to acts performed, or failures to act, in their capacity as office holders as defined in the Israeli Companies Law 5759-1999. These liabilities may include financial liabilities imposed by judgments or settlements in favor of third parties, and reasonable litigation expenses imposed by a court in relation to criminal charges from which the indemnitee was acquitted or criminal proceedings in which the indemnitee was convicted of an offense that does not require proof of criminal intent. In addition, we agreed to exculpate our directors and officers with respect to a breach of their duty of care towards our company.



In addition, as part of the transaction in which Nistec acquired a controlling stake in our company, we agreed to indemnify Nistec for any losses or liabilities occasioned by the breach of any representations or warranties that we made in the investment agreement. If we are found to have breached any of these representations or warranties, we could be required to expend significant amounts of cash to meet our indemnification obligations. Payments made pursuant to such indemnification obligations may materially adversely affect our financial condition

#### Risk Factors Related to Our Ordinary Shares

Our share price has been volatile in the past and may continue to be susceptible to significant market price and volume fluctuations in the future.

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

- quarterly variations in our operating results;
- operating results that vary from the expectations of securities analysts and investors;
- changes in expectations as to our future financial performance, including financial estimates by securities analysts and investors;
- announcements of technological innovations or new products by us or our competitors;
- announcements by us or our competitors of significant contracts, acquisitions, strategic partnerships, joint ventures or capital commitments;
- changes in the status of our intellectual property rights;
- announcements by third parties of significant claims or proceedings against us;
- announcements by governmental or regulatory authorities of significant investigations or proceedings against us;
- additions or departures of key personnel;
- changes in our cost structure due to factors beyond our control, such as new laws or regulations relating to environmental matters and employment;
- future sales of our ordinary shares;
- general stock market price and volume fluctuations; and
- devaluation of the dollar against the NIS.

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



The 50.5% voting interest of Nistec, our controlling shareholder, may conflict with the interests of other shareholders.

As of March 31, 2015, Nistec beneficially owns 50.5% of our outstanding ordinary shares. Accordingly, Nistec has the ability to exercise a significant influence over our business and affairs and generally has the power to determine all matters submitted to a vote of our shareholders where our shares vote together as a single class, including the election of directors and approval of significant corporate transactions. Nistec may make decisions regarding Eltek and our business that are opposed to other shareholders' interests or with which other shareholders may disagree. Nistec's voting power could have the effect of deterring or preventing a change in control of our Company that might otherwise be beneficial to our other shareholders.

If we fail to maintain NASDAQ's continued listing requirement of a minimum bid price of at least \$1.00 per share for a period of 30 consecutive business days, our shares may be delisted from the NASDAQ Capital Market.

Our ordinary shares are listed on the NASDAQ Capital Market under the symbol "ELTK." To continue to be listed on NASDAQ, we need to satisfy a number of requirements, including a minimum bid price for our ordinary shares of \$1.00 per share for a period of 30 consecutive business days. If we fail to comply with such requirement, we would have a period of 180 calendar days to achieve compliance by meeting the applicable standard for a minimum of ten consecutive business days. If we are not deemed in compliance before the expiration of the 180 day compliance period, NASDAQ may afford us an additional 180 day compliance period, provided that on the 180th day of the first compliance period we have demonstrated that we meet all applicable standards for initial listing on the NASDAQ Capital Market (except the bid price requirement) based on our most recent public filings and market information.

Our ordinary shares have experienced significant market price and volume fluctuations in the past and for certain periods have traded below the \$1.00 threshold requirement for continued trading. In 2014, the price of our ordinary shares ranged from \$1.14 to \$2.87 and the closing price of our ordinary shares on December 31, 2014 was \$1.17 per share. If we fail to meet the minimum bid price requirement, our share may be delisted from the NASDAQ Capital Market. If we are delisted from NASDAQ, trading in our ordinary shares would be conducted on a market where an investor would likely find it significantly more difficult to dispose of, or to obtain accurate quotations as to the value of, our ordinary shares.

We do not expect to distribute dividends in the foreseeable future.

We have never declared or paid any cash dividends on our ordinary shares. We currently intend to retain our current and any future earnings to finance operations and expand our business and, therefore, do not expect to pay any dividends in the foreseeable future. According to the Israeli Companies Law, a company may distribute dividends out of its profits (as defined by the Israeli Companies Law), provided that there is no reasonable concern that such dividend distribution will prevent the company from paying all its current and foreseeable obligations, as they become due, or otherwise upon the permission of the court. In the event cash dividends are declared, such dividends will be paid in NIS. The declaration of dividends is subject to the discretion of our board of directors and would depend on various factors, including our operating results, financial condition, future prospects and any other factors deemed relevant by our board of directors. You should not rely on an investment in our company if you require dividend income from your investment.

#### Risks Relating to Our Operations in Israel

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

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

Since its establishment in 1948, Israel has been involved in a number of armed conflicts with its neighbors and a state of hostility, varying from time to time in intensity and degree, has continued into 2014. Since early July 2014, there has been a significant increase in hostilities between Hamas, an Islamist organization governing the Gaza Strip, and Israel, including missiles launched by Hamas from the Gaza Strip into Israel and airstrikes and ground operations conducted by Israel in the Gaza Strip. On July 21, 2014, all U.S. airlines and most major airlines of other nationalities suspended their flights to Israel's Ben-Gurion International Airport for several days after a missile landed approximately 1.5 km away. Also, since 2011, riots and uprisings in several countries in the Middle East and neighboring regions, including Egypt and Syria, have led to severe political instability in several neighboring states and to a decline in the regional security situation. In addition, Iran has threatened to attack Israel and is widely believed to be developing nuclear weapons. Iran is also believed to have a strong influence among extremist groups in areas that neighbor Israel, such as Hamas in Gaza and Hezbollah in Lebanon.

Any armed conflicts, terrorist activities or political instability in the region could adversely affect business conditions and could harm our results of operations and could make it more difficult for us to raise capital. Parties with whom we do business have sometimes declined to travel to Israel during periods of heightened unrest or tension, forcing us to make alternative arrangements when necessary in order to meet our business partners face to face. In addition, the political and security situation in Israel may result in parties with whom we have agreements involving performance in Israel claiming that they are not obligated to perform their commitments under those agreements pursuant to force majeure provisions in such agreements. To date, these matters have not had any material effect on our business and results of operations; however, the regional security situation and worldwide perceptions of it are outside our control and there can be no assurance that these matters will not negatively affect us in the future.

Furthermore, there are a number of countries, primarily in the Middle East, as well as Malaysia and Indonesia, that restrict business with Israel or Israeli companies, and we are precluded from marketing our products to these countries. Restrictive laws or policies directed towards Israel or Israeli businesses may have an adverse impact on our operations, our financial results or the expansion of our business.

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

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

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

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

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



Under current Israeli law, we may not be able to enforce covenants not to compete and therefore may be unable to prevent our competitors from benefiting from the expertise of some of our former employees.

We currently have non-competition clauses in the employment agreements of most of our employees. The provisions of such clauses prohibit our employees, if they cease working for us, from directly competing with us or working for our competitors. Recently, Israeli labor courts have required employers, seeking to enforce non-compete undertakings against former employees, to demonstrate that the competitive activities of the former employee will cause harm to one of a limited number of material interests of the employer recognized by the courts (for example, the confidentiality of certain commercial information or a company's intellectual property). In the event that any of our employees chooses to leave and work for one of our competitors, we may be unable to prevent our competitors from benefiting from the expertise our former employee obtained from us, if we cannot demonstrate to the court that we would be harmed.

There can be no assurance that we will not be classified as a passive foreign investment company (a "PFIC").

For U.S. federal income tax purposes, we may be classified as a passive foreign investment company, or PFIC, for any taxable year in which either: (i) 75% or more of our gross income is passive income or (ii) at least 50% of the average quarterly value of our assets for the taxable year produce or are held for the production of passive income. Based upon our current and projected income, assets and activities, we do not believe that at this time we are a passive foreign investment company for U.S. federal income tax purposes, but there can be no assurance that we will not be classified as such in the future. Such classification may have significant tax consequences for U.S. Holders. One method that a U.S. Holder may use to avoid such tax consequences is making a "mark-to-market" election for each taxable year in which our company is a PFIC. For further explanation, including the definition of U.S. Holder, see Item 10E. "Additional Information - Taxation - United States Federal Income Taxation - Passive Foreign Investment Companies." You are advised to consult with your own tax advisor regarding the particular tax consequences related to the ownership and disposition of our ordinary shares under your own particular factual circumstances.

Provisions of Israeli law may delay, prevent or make difficult an acquisition of us, which could prevent a change of control and therefore impact the price of our shares.

Provisions of Israeli corporate and tax laws may have the effect of delaying, preventing or making more difficult a merger with, or other acquisition of, us or all or a significant portion of our assets. Israeli corporate law regulates acquisitions of shares through tender offers and mergers, requires special approvals for transactions involving significant shareholders and regulates other matters that may be relevant to these types of transactions. These provisions of Israeli law could have the effect of delaying or preventing a change in control and may make it more difficult for a third party to acquire us, even if doing so would be beneficial to our shareholders. These provisions may limit the price that investors may be willing to pay in the future for our ordinary shares. Furthermore, Israeli tax considerations may make potential transactions undesirable to us or to some of our shareholders.

These laws may have the effect of delaying or deterring a change in control of our company, thereby limiting the opportunity for shareholders to receive a premium for their shares and possibly affecting the price that some investors are willing to pay for our company's securities. This could cause our ordinary shares to trade at prices below the price for which third parties might be willing to pay to gain control of us. Third parties who are otherwise willing to pay a premium over prevailing market prices to gain control of us may be unable or unwilling to do so because of these provisions of Israeli law.

The rights and responsibilities of our shareholders are governed by Israeli law and differ in some respects from the rights and responsibilities of shareholders under U.S. law.

We are incorporated under Israeli law. The rights and responsibilities of holders of our ordinary shares are governed by our memorandum of association, articles of association and by Israeli law. These rights and responsibilities differ in some respects from the rights and responsibilities of shareholders in typical U.S. corporations. In particular, each shareholder of an Israeli company has a duty to act in good faith and in a customary manner in exercising his or her rights and fulfilling his or her obligations toward the company and other shareholders and to refrain from abusing his or her power in the company, including, among other things, in voting at the general meeting of shareholders on certain matters. Israeli law provides that these duties are applicable in shareholder votes on, among other things, amendments to a company's articles of association, increases in a company's authorized share capital, mergers and interested party transactions requiring shareholder approval. In addition, a controlling shareholder of an Israeli company, or a shareholder who knows that he or she possesses the power to determine the outcome of a shareholder vote or who has the power to appoint or prevent the appointment of a director or officer in the company, has a duty of fairness toward the company. Currently there is not a clear definition of the duty of fairness under Israeli law. There is limited case law available to assist us in understanding the nature of this duty or the implications of these provisions. These provisions may be interpreted to impose additional obligations and liabilities on holders of our ordinary shares that are not typically imposed on shareholders of U.S. corporations.



As a foreign private issuer whose shares are listed on the NASDAQ Capital Market, we may follow certain home country corporate governance practices instead of certain NASDAQ requirements. We follow Israeli law and practice instead of NASDAQ rules regarding the composition of the board of directors, director nomination process and quorum at shareholders' meetings.

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

#### ITEM 4. INFORMATION ON THE COMPANY

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

We were incorporated under the laws of the State of Israel on January 1, 1970. We are a public limited liability company under the Israeli Companies Law 5759-1999 and operate under that law and associated legislation. Our registered offices and principal place of business are located at 20 Ben Zion Gelis Street, Sgoola Industrial Zone, Petach Tikva 4927920, and our telephone number is +972-3-9395025. Our website is [www.nisteceltek.com](http://www.nisteceltek.com). The information on our website is not incorporated by reference into this annual report.

We manufacture and supply technologically advanced custom made circuitry solutions for use in sophisticated and compact electronic products. We provide specialized services and are a solution provider in the PCB business, mainly in Israel, Europe and North America. PCBs are platforms that conduct an electric current among active and passive microelectronics components, microprocessors, memories, resistors and capacitors and are integral parts of the products produced by high-technology industries. Our focus is on short run quick-turnaround, prototype, pre-production and low to medium volume runs of high-end PCB products for high growth, advanced electronics applications, mainly flex-rigid PCBs.

We design and develop innovative manufacturing solutions pursuant to complex interconnect requirements of original equipment manufacturers, and provide our customers with a wide range of custom designed PCBs, including complex rigid, double-sided and multi-layer PCBs as well as flexible circuitry (flex and flex-rigid boards) made of several types of high-performance base material. To complement our quick-turnaround, prototype, pre-production and low to medium volume production capability and provide our customers with single source service, we also act as an agent for the importation of PCBs from South East Asia when customers require high volume production runs, although such activity was not significant in recent years.

In June 2002, we acquired a majority ownership interest in Kubatronik, a European manufacturing and marketing subsidiary located in Geislingen, Germany. In July 2007, we established Eltek USA Inc., a wholly-owned subsidiary incorporated in Delaware, to manage our sales and marketing in the North American market. In December 2008, we established Eltek Europe GmbH, a wholly-owned subsidiary organized in Germany, to manage our sales and marketing activities for certain European customers.

In November 2013, Nistec acquired 50.5% of our issued share capital and gained control of our company.

During the three years ended December 31, 2014, we invested approximately \$7.6 million in new equipment and the expansion of our facilities and infrastructure. Subject to availability of financial resources, we expect to invest approximately \$2.2 million in capital expenditures in 2015, primarily for our operations in Israel and Germany, mainly for manufacturing equipment to expand our manufacturing capacity and to upgrade our technological capabilities. We intend to finance these expenditures with suppliers' credit, cash flow from operations and bank loans; however, external financing may not be available, or, if available, may not be on terms favorable to us.

## B. Business Overview

### Industry Overview

PCBs are constructed from a variety of base raw materials. PCBs can be double-sided or multi-layered and made of rigid, flexible, flex-rigid or high-frequency materials. In essence, they are platforms that conduct electrical signals among active and passive microelectronics components, microprocessors, memories, resistors and capacitors. Photolithographic type processes transfer the images of the electrical circuit onto the layers, and chemical processes etch these lines on the boards. There are several broad categories of PCBs:

**Rigid PCBs.** Rigid PCBs are the core product of the industry and can be found in virtually every electronics device. The layer count of these products generally ranges from two to 30 layers, although some PCBs are composed of 42 layers.

**Flexible and flex-rigid PCBs.** Flexible boards are thin, light-weight circuits used to interconnect other circuit boards and electronic devices within electronic equipment. Flex-rigid boards are composed of rigid parts and flexible layers. They generally range from two to 30 layers. Flex-rigid boards provide solutions for electronic systems that impose space and shape restrictions and for systems in which reliability of connectivity is crucial. These products are often found in military applications (primarily avionics), medical and measurement equipment and the automotive industry, among other uses.

**Backplanes.** Backplanes are large, high-density circuit boards with design features such as tight tolerance finished hole sizes that require precise process controls. These products are commonly known as "motherboards" on which connectors are mounted to receive and interconnect other PCBs and can be found primarily in telecommunications applications.

PCB manufacturers can generally be classified based on two parameters, product sophistication and service sophistication. Product sophistication is evident in the capability of a PCB manufacturer to offer products with higher layer counts and more complex construction, as well as in the line width and the spacing of lines on the circuit boards. The state-of-the-art HDI technology enables manufacturers to produce PCBs with line width and spaces as narrow as 2-3 mils and hole diameters of 4 to 6 mils.

### Industry Trends

We believe that several trends are impacting the PCB manufacturing industry. These trends include:

Shorter electronic product life cycles. Continual advances in technology have shortened the life cycles of complex commercial electronic products, placing greater pressure on manufacturers to quickly bring new products to market. The accelerated time-to-market and ramp-to-volume needs of manufacturers for high-end commercial equipment create opportunities for PCB manufacturers that can offer engineering support in the prototype stage and manufacturing scalability throughout the production life cycle.

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Increasing complexity of electronic products. Manufacturers continue to design higher performance electronic products which take advantage of advances in semiconductor technology. This in turn requires technologically complex PCBs that can accommodate higher speeds and component densities, including HDI, flexible and substrate PCBs. These complex PCBs can require very high layer counts, miniaturized circuit connections, advanced manufacturing processes and materials, and high-mix production capabilities, which involve processing small lots in a flexible manufacturing environment. Manufacturers increasingly rely upon larger PCB manufacturers, which possess the financial resources necessary to invest in advanced manufacturing process technologies and sophisticated engineering staff, often to the exclusion of smaller PCB manufacturers that do not possess such technologies or resources.

Increasing concentration of global PCB production in Asia. In recent years, many electronics manufacturers have moved their commercial production to Asia to take advantage of its exceptionally large, relatively low-cost labor pool. In particular, the trend has favored China, which according to industry sources had the largest PCB market in terms of both revenue and number of suppliers in 2012. The overall technical capability of suppliers in China has improved dramatically in recent years, and China has emerged as a global production center for cellular phones, smartphones, tablet PCs, computers and computer peripherals, and high-end consumer electronics. According to N.T. Information LTD, approximately 58% of the world's PCB production was forecasted to come from China, Hong Kong and Taiwan in 2013. The continued outsourcing of production to China should result in additional commercial market share potential for PCB manufacturers with a strong presence and reputation in China.

Decreased reliance on multiple PCB manufacturers. Manufacturers traditionally have relied on multiple PCB manufacturers to provide different services as an electronic product moves through its life cycle. The transfer of a product among different PCB manufacturers often results in increased costs and inefficiencies due to incompatible technologies and manufacturing processes and production delays. In addition, manufacturers generally find it easier and less costly to manage fewer PCB manufacturers. As a result, manufacturers are reducing the number of PCB manufacturers and backplane assembly service providers on which they rely, presenting an opportunity for those that can offer one-stop manufacturing capabilities — from prototype to volume production.

Increased requirements for aerospace and defense products. The aerospace and defense market is characterized by increasingly time-consuming and complex certification processes, long product life cycles, and a demand for leading-edge technology with extremely high reliability and durability. While the U.S. Department of Defense (DoD) budget faces increasing scrutiny as part of overall U.S. budget deficit reduction efforts, we anticipate that a continued DoD commitment to new product development and upgrades — incorporating leading-edge PCB technology in products for intelligence, surveillance and reconnaissance, communications and weapon systems — combined with Foreign Military Sales (FMS) programs and a recovering global commercial aerospace industry will support a significant long-term market for these products.

#### Manufacturing and Engineering Processes

Significant investments in equipment are necessary in order to maintain technological competitiveness in the PCB industry. During the three years ended December 31, 2014, we invested approximately \$6.9 million in machinery and equipment for that purpose.

Manufacturing Capabilities. We have the capability to manufacture PCBs having in excess of 36 layers, flex-rigid boards, blind and buried vias and designs using materials as thin as 1 mil. We are able to produce short runs of five to 30 units of simple type PCBs within four to five working days, and a few hundred units within ten working days and are capable of producing such number of boards within five working days when production line scheduling permits. During 2007, we applied new technologies to enable us to manufacture “via-in-pad” multilayer PCBs, microvia filling, through hole via filling and copper overplating. In July 2012, we purchased a new Orbotech Paragon™ Laser Direct Imaging, or LDI, system for increasing capacity and shortening production time and improving product

time-to-market. In 2012, we also acquired and installed a new Hakuto Cut-Sheet-Laminator and the latest Chemplate Indubond model. In 2014 and in the beginning of 2015 we acquired a complete set of two Lauffer hot presses and one cold press, a line for outer layer surface preparation, a laser router and a second Hakuto cut-sheet-laminator (refurbished). These new pieces of equipment are expected to improve our technological capabilities. These machines improve the outer layer accuracy and the registration between the inner-layers, enabling us to offer our customers solutions and participate in bids in which we were not able to participate in the past.

We continue to utilize advanced registration technologies and to improve the copper etching accuracy to comply with new specifications and requirements of our customers and potential customers. We receive orders for production with turnaround times of generally between several days to two months.

Computer Aided Design/Computer Aided Manufacturing (CAD/CAM). We utilize a state-of-the-art CAD system developed by Frontline PCB Solutions Ltd., an Israeli-based company, and can receive CAD data by electronic data transmission. Our CAD workstations perform design rule checks on transmitted designs, incorporate any customer-specific design modifications and perform manufacturability enhancements that increase PCB quality.

Advanced Finishing Capabilities for Dense Packaging Designs. We provide a wide assortment of alternative surface finishes, including hot air solder leveling, electroless gold over nickel, immersion silver, outsource nickel/palladium/gold and immersion tin, for the attachment of components to PCBs.

Other Advanced Process Capabilities. We provide fabrication of dense multi-layer PCBs. We use an advanced inner-layer production line, a laser direct imaging system, mechanical and laser drilling equipment and clean room environments (ISO-7) to produce technologically advanced products.

Quality, Environmental and Safety Standards. Our quality management system has been ISO 9001:2008 certified since July 2002 (and prior to such date, was ISO 9002 certified from January 1995). Such certification is based on successful implementation of quality assurance requirements and includes ongoing monitoring of our business and periodic compliance audits conducted by the Israeli Institute of Standards. We have obtained United States Department of Defense Qualified Product List approval (MIL-PRF-55110G and MIL-P-50884E) for our products. Since 1976, our rigid glass epoxy (FR4 and FR5) and flex-rigid boards have been UL 94V-0 certified by Underwriters Laboratories Inc. (a standards organization that offers product safety testing and certification of product safety). Our environmental management system has been ISO 14001:2004 certified since 2005 (and prior to such date was ISO 14001 certified from 2003). We are OHSAS 18001:2007 certified for occupation health and safety management systems since December 2007. In November 2009, we became certified to the AS 9100B quality management standard for the aerospace industry and in August 2012 we were upgraded to AS 9100C.

Enterprise Resources Planning (ERP) Software. In 2014 we acquired a new ERP system dedicated to the PCB industry from Proms. We expect to install and implement the system in 2015.

#### Sales, Customers and Marketing

Sales. In the years ended December 31, 2014, 2013 and 2012, the primary industries for which we produced PCBs were defense and aerospace equipment (46.4%, 51.8% and 48% of production, respectively), medical equipment (13.4%, 15.8% and 24% of production, respectively), industrial equipment (4.5%, 12.1% and 18% of production, respectively), distributors, contract electronic manufacturers and others (34.3%, 19.2% and 8% of production, respectively).

Customers. During the year ended December 31, 2014, we provided PCBs to approximately 199 customers in Israel and approximately 258 customers outside of Israel. Our customers outside of Israel are located primarily in North America, Germany, the Netherlands, China, Switzerland, Italy and India. Sales to non-Israeli customers were \$21.9 million (47% of revenues) for the year ended December 31, 2014, \$22.2 million (44.3% of revenues) for the year ended December 31, 2013 and \$23.7 million (51.9% of revenues) for the year ended December 31, 2012.

Marketing. We market and sell our products primarily through our direct sales personnel, sales representatives and through PCB trading and manufacturing companies. We currently have eleven persons involved in sales, of which six persons are in Israel, two persons are in the United States employed by our U.S. subsidiary, Eltek USA Inc. and three persons are employed by our German subsidiary, Kubatronik. We also have sales representatives in Germany,

Sweden, Finland, France and Spain. In the Netherlands, Italy, and South Africa, PCB trading and manufacturing companies act as distributors of our products. In North America we market and sell our products through Eltek USA Inc. as well as through independent local sales representatives. In India, we market our products through a local sales representative. We maintain technical support services for our customers world-wide. We also maintain customer service support centers that handle all logistical matters relating to the delivery of our products and receive and handle complaints relating to delivered products. Our customer service personnel currently consist of eleven persons, of which seven persons are in Israel, one person is employed by our U.S. subsidiary, Eltek USA Inc. and three persons are employed by Kubatronik.

Our strategy is to focus on the high end of the PCB market, mainly in flex-rigid PCBs, in which margins are better. We are currently focusing our marketing efforts on the defense and medical industries. To penetrate the U.S. defense market, we applied for ITAR registration from the U.S. Department of State, Bureau of Political-Military Affairs, which we received in January 2009. ITAR regulates the manufacture, export and transfer of defense articles, information and services. ITAR is a set of U.S. government regulations that controls the export and import of certain defense-related articles and services. The regulations restrict sensitive information and technologies only to be shared with U.S. persons, unless special approval is acquired. To qualify for ITAR registration, we met strict requirements for corporate structure, security, record keeping and procedures to allow us to sell our PCBs for use in U.S. defense products. In November 2009, we became certified to the AS 9100B quality management standard for the avionic industry in order to strengthen our position in the avionic and aerospace market in North America and Europe. In January 2014, we received accreditation from Nadcap, a global cooperative accreditation program for aerospace engineering and related industries, for our advanced circuitry solutions, including rigid and flex-rigid printed circuit boards.

We have ongoing programs to upgrade our processes by implementing high-quality standards, employee training and special training activities for clients. Marketing efforts include recruiting independent sales representatives in various geographic areas, the distribution of promotional materials, seminars for engineers, the supply of technical information to business publications and participation in trade shows and industry conferences.

#### Materials and Supplies

The materials used in the manufacture of PCBs are primarily laminates (copper clad, with an isolating core separating them), prepreg composite materials, photo-chemical films, chemicals and inks. The materials we use are manufactured in Europe, North America and South East Asia. Some of the materials are purchased directly from the manufacturer, while others are purchased from local distributors.

During recent years, price negotiations with our suppliers resulted in lower price increases than requested by our suppliers; however we may not continue to be successful in such negotiations in the future. We have also faced pressure to raise our prices for our products to compensate for these price increases and although we have managed to date to maintain our sales prices with moderate price increases, we may not be able to do so in the future. Future price changes for raw materials may materially affect our future profitability.

#### Competition

The global PCB industry is highly fragmented and intensely competitive, trends that we believe will continue. The global PCB industry is characterized by rapidly changing technology, frequent new product introductions and rapidly changing customer requirements. We compete principally in the market for complex, flex-rigid multi-layer PCBs. In the Israeli market we mainly compete with PCB Technologies Ltd. and major PCB exporters, mainly from South East Asia, North America and Europe. In the European market we mainly compete with Advanced Circuit Boards NV (Belgium), AT&S Austria Technologie & Systemtechnik AG (Austria), Dyconex and Cicor (Switzerland), Graphics, Exception PCB and Invotec (United Kingdom), Cistelaier and Somacis (Italy), Schoeller-Electronics GmbH (formerly Ruwel Werke GmbH) (Germany) and certain other German companies. In the North American market we mainly compete with Viasystems North America, Inc. (previously known as DDi Corp), KCA Electronics Inc., Lenthor Engineering, Printed Circuits, Inc., Teledyne and TTM Technologies Inc. Many of these competitors have significantly greater financial, technical and marketing resources than us. Although capital requirements are a significant barrier to entry for manufacturing complex PCBs, the basic interconnect technology is generally not protected by patents or copyrights. Our current competition in the rigid PCB segment is mainly from PCB manufacturers in the Far-East (mainly in China), which have substantially lower production costs than us. Continued competitive pressures could cause us to lose market share and reduce prices.



## Backlog

We estimate that our backlog of unfilled orders as of December 31, 2014, was approximately \$5.7million compared to a backlog of approximately \$10.1 million at December 31, 2013. We include in our backlog all purchase orders scheduled for delivery within the next 12 months. Because unfilled orders may be cancelled prior to delivery, the backlog outstanding at any point in time is not necessarily indicative of the level of business to be expected in the ensuing period.

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## Environmental Matters

Since May 2003, our environmental management system has been ISO 14001 certified. This certification was based on successful implementation of environmental management requirements and includes ongoing monitoring of our processes, raw materials and products. The certification is subject to periodic compliance audits conducted by the Israeli Institute of Standards.

PCB manufacturing requires the use of metals and chemicals classified as hazardous substances. Water used in the manufacturing process must be treated to remove metal particles and other contaminants before it can be discharged into the local sewer systems. We operate and maintain effluent water treatment systems and use approved testing procedures at our manufacturing facilities. There is no assurance, however, that violations will not occur in the future. We are also subject to environmental laws and regulations relating to the storage, use and disposal of chemicals, solid waste and other hazardous materials, as well as air quality regulations. Environmental laws and regulations could become more stringent over time, and the costs of compliance with more stringent laws could be substantial. Environmental regulations enacted in Israel in September 2000 provide that a company that is found to have discharged water containing contaminants will be liable for quadruple the amount normally charged for its water consumption. Over the years, we have undertaken various actions to reduce the use of water in our manufacturing facilities. From 2008 through 2011, we invested in improving our effluent wastewater treatment system to lower the amounts of inorganic salts and copper concentration in the discharged water. All our actions were coordinated with the Israeli Ministry of Environment and in August 2008, we received a waiver for a period of two years that enabled us to increase the amount of minerals disposed of by wastewater. The waiver was subsequently extended until December 2016. During 2014, we entered into an agreement with Elad Technologies, pursuant to which Elad Technologies will build and operate a wastewater treatment facility, which we expect to be operational in the second half of 2015. The facility is expected to reduce the amount of metal concentrations in our wastewater to the permitted levels.

A shortage of water in Israel may reduce the allocation of water available to manufacturing plants, including ours, which could affect the concentrations of pollutants in our wastewater, making it harder to comply with the foregoing regulations, in which event we would be required to invest additional funds to improve our wastewater treatment systems.

For information regarding environmental claims, see Item 8A. “Financial Information – Consolidated and Other Financial Information – Legal Proceedings.”

## Intellectual Property Rights

Our success depends in part on our proprietary techniques and manufacturing expertise, particularly in the area of complex multi-layer and flex-rigid PCBs. Like many companies in the PCB industry, we do not hold any patents and rely principally on trade secret protection of our intellectual property. We believe that, because of the rapid pace of technological change in the electronics industry, the legal protections for our products are less significant factors in our success than the knowledge, ability and experience of our employees, the frequency of product enhancements and the timeliness and quality of support services that we provide.

## C. Organizational Structure

In June 2002, we acquired a 76% interest in Kubatronik, a PCB manufacturer that specializes in short run and prototype boards, including multi-layer, flex-rigid and HDI boards. Its customers include companies engaged in the production of industrial equipment, defense and aerospace equipment, telecom and networking equipment, and computer and data storage equipment as well as contract electronic manufacturers. Mr. Alois Kubat, Kubatronik’s founder, holds the remaining 21% interest in Kubatronik (after we acquired from him an additional 3% of shares of

Kubatronik in May 2012). Mr. Kubat has the right to require us to purchase, and we have the right to require him (or his permitted transferee) to sell to us, his remaining interest in Kubatronik. In May 2012, Mr. Kubat exercised his option with respect to 3% of the shares of Kubatronik for approximately Euro 69,000 and reduced his ownership percentage from 24% to 21%. The price for Mr. Kubat's remaining holdings in Kubatronik under the put option is Euro 483,000, while the price for such holdings under the call option is Euro 513,000. In recent years, Kubatronik has incurred losses, which were partially financed by Eltek Ltd., and we expect that its continued operations will require additional financing by Eltek. As at December 31, 2014 Kubatronik's debt to Eltek was EUR737,000 (\$895,000).

In July 2007, we established Eltek USA Inc., a wholly-owned subsidiary incorporated in Delaware, to manage our sales and marketing activities in the North American market. Eltek USA Inc. commenced operations in 2008.

In December 2008, we established Eltek Europe GmbH, a wholly-owned subsidiary organized in Germany, to manage our sales and marketing activities for certain European customers.

In November 2013, Nistec acquired a controlling 50.5% stake in our company and gained control of our company.

D. Property, Plants and Equipment

Leased Facilities

Our executive offices, as well as our design, production, storage and shipping facilities, aggregating approximately 90,000 square feet, are located in an industrial building in the Sgoola Industrial Zone of Petach Tikva, Israel. The lease for such facilities expires in February 2017 and we have an option to extend the lease for an additional five year term upon six months' prior notice. In the year ended December 31, 2014, we incurred \$849,000 of rent expenses for these premises.

Kubatronik's executive offices as well as its design, production, storage and shipping facilities, aggregating approximately 15,000 square feet, are located in an industrial building in Geislingen, Germany, owned by the wife of the former owner of Kubatronik. The lease for the facilities expires on December 31, 2018. In the year ended December 31, 2014, Kubatronik paid an aggregate of approximately Euro 83,000 (\$111,000) in rent for these premises.

Our U.S. subsidiary, Eltek USA Inc., leases approximately 950 square feet office space in New Hampshire. In the year ended December 31, 2014, we paid \$30,000 in rent for these premises. In February 2015, we signed a new lease agreement for 1,682- square feet in New Hampshire, which expires in February 2020, instead of the current facility.

Leased Equipment

We lease manufacturing equipment under an agreement that obligates us to pay a total of \$667,000 through June 2017. Our monthly lease expense in 2015 under this agreement is \$29,000.

Kubatronik leases manufacturing equipment under ten lease agreements, which as of December 31, 2014 require Kubatronik to pay a total of Euro 99,000 through May 2019. Kubatronik's monthly lease expense under these agreements is approximately Euro 3,000 (\$4,000).

ITEM 4A. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

A. Operating Results

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

Overview

We were incorporated under the laws of the State of Israel in 1970. Since our initial public offering in January 1997, our ordinary shares have been listed on the NASDAQ Stock Market (symbol: ELTK) and are presently listed on the NASDAQ Capital Market. We have production facilities in Israel and Germany and marketing subsidiaries in Germany and the United States.

In November 2013, Nistec acquired 50.5% of our issued share capital and gained control of our company.

We develop, manufacture, market and sell PCBs, including high density interconnect (HDI) multi-layered and flex-rigid boards for the defense and aerospace, medical technology, telecommunications and electronics industries. Our principal customers include manufacturers of medical equipment, defense and aerospace equipment, industrial equipment, and telecom and networking equipment, as well as contract electronic manufacturers.

Our consolidated financial statements appearing in this annual report are prepared in dollars in accordance with U.S. GAAP. Our functional currency is the NIS. The consolidated financial statements appearing in this annual report are translated into dollars at the representative rate of exchange under the current rate method. Under such method, the income statement and cash flows statement items for each year (or period) stated in this report are translated into dollars using the average exchange rates in effect at each period presented, and assets and liabilities for each year (or period) are translated using the exchange rate as of December 31 of each year (as published by the Bank of Israel), except for equity accounts, which are translated using the rates in effect at the date of the transactions. All resulting exchange differences that do not affect our earnings are reported in the accumulated other comprehensive income as a separate component of shareholders' equity.

Critical Accounting Policies

We have identified the policies below as critical to the understanding of our consolidated financial statements. The application of these policies requires management to make estimates and assumptions that affect the valuation of assets and expenses during the reporting period. There can be no assurance that actual results will not differ from these estimates.

The significant accounting policies described in Note 1 of our consolidated financial statements, which we believe to be most important to fully understand and evaluate our financial condition and results of operation under U.S. GAAP, are discussed below.

**Revenue Recognition.** We recognize revenues when products are shipped and the customer takes ownership and assumes risk of loss, collection of the relevant receivable is probable, persuasive evidence of an arrangement exists and the sale price is fixable or determinable.

Inventories. Inventories are recorded at the lower of cost or market value. Cost is determined on the weighted average basis for raw materials. For work in progress and finished goods, the cost is determined based on calculation of accumulated actual direct and indirect costs.

Allowance for doubtful accounts receivable. The allowance for doubtful accounts receivable is calculated on the basis of specific identification of customer balances. The allowance is determined based on management's estimate of the aged receivable balance considered uncollectible, based on historical experience, aging of the receivable and information available about specific customers, including their financial condition and the volume of their operations.

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Fixed assets. Assets are recorded at cost. Depreciation on property and equipment is calculated using the straight-line method over the estimated useful lives of the assets. Machinery and equipment purchased under capital lease arrangements are recorded at the present value of the minimum lease payments at lease inception. Such assets and leasehold improvements are depreciated and amortized respectively, using the straight-line method over the shorter of the lease term or estimated useful life of the asset.

Impairment in Value of Assets. Long-lived assets and certain identifiable intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the asset or asset group to the undiscounted future net cash flows expected to be generated by the asset or the asset group. 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.

Intangible assets. Intangible assets are amortized over their useful lives using a method of amortization that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used up, in accordance with ASC 350, "Intangibles - Goodwill and Other." Intangible assets were amortized based on the straight-line method or acceleration method.

Goodwill. Goodwill represents the excess of the aggregate purchase price over the fair value of the net assets acquired in a purchase business combination. Goodwill is reviewed for impairment at least annually. The goodwill impairment test is a two-step test. Under the first step, the fair value of the reporting unit is compared with its carrying value. An indication of goodwill impairment exists if the fair value of the reporting unit is less than its carrying value, and the enterprise must perform step two of the impairment test (measurement). Under step two, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill. Fair value of the reporting unit is determined using a discounted cash flow analysis. If the fair value of the reporting unit exceeds its carrying value, step two does not need to be performed.

The fair value of an asset is estimated using estimated future cash flows of the asset discounted by a rate commensurate with the risk involved with such asset while incorporating marketplace assumptions. The estimate of future cash flows requires management to make certain assumptions and to apply judgment, including forecasting future sales, PCB market prices, raw material consumption, labor and other manufacturing expenses, and the useful lives of the assets. We exercised our best judgment based on the most current facts and circumstances surrounding our business when applying these impairment rules.

Use of estimates. The preparation of the consolidated financial statements in accordance with U.S. GAAP requires us to make estimates and assumptions relating to the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from these estimates. Significant items subject to such estimates and assumptions include the useful lives of fixed assets, allowance for doubtful accounts, valuation of derivatives, deferred tax assets, inventory, goodwill, put/call option, income tax uncertainties and other contingencies.

Commitments and contingencies. Liabilities for loss contingencies arising from claims, assessments, litigation, fines, and penalties and other sources are recorded when it is probable that a liability has been incurred and the amount can be reasonably estimated. Legal costs incurred in connection with loss contingencies are expensed as incurred. Recoveries of environmental remediation costs from third parties that are probable of realization are separately recorded as assets, and are not offset against the related environmental liability.

Accruals for estimated losses from environmental remediation obligations generally are recognized no later than completion of the remedial feasibility study. Such accruals are adjusted as further information develops or circumstances change. Costs of expected future expenditures for environment remediation obligations are not discounted to their present value.

## Results of Operations

The following table sets forth, for the periods indicated, selected financial information expressed as a percentage of our total revenues:

|                                     | Year Ended December 31, |   |       |   |       |   |
|-------------------------------------|-------------------------|---|-------|---|-------|---|
|                                     | 2014                    |   | 2013  |   | 2012  |   |
| Revenues                            | 100                     | % | 100   | % | 100   | % |
| Cost of revenues                    | (87.1                   | ) | (84.1 | ) | (82.9 | ) |
| Gross profit                        | 12.9                    |   | 15.9  |   | 17.1  |   |
| R&D expenses                        | (0.1                    | ) | -     |   | -     |   |
| Selling, general and administrative | (14.5                   | ) | (13.4 | ) | (13.2 | ) |



|   |        |        |        |
|---|--------|--------|--------|
| expenses  |        |        |        |
| Impairment loss on goodwill                                   | (0.2 ) | -      | (1 )   |
| Operating profit  | (1.9 ) | 2.5    | 2.8    |
| Financial expenses, net                                       | (0.8 ) | (0.9 ) | (1.2 ) |
| Other income, net   | 0.1    | *      | *      |
| Profit before income tax expense and non-controlling interest | (2.6 ) | 1.6    | 1.6    |
| Income tax (expense) benefit                                  | (3.5 ) | 6.0    | (0.1 ) |
| Net profit  | (6.1 ) | 7.6    | 1.5    |
| Net profit (loss) attributable to non-controlling interest    | (0.4 ) | *      | *      |
| Net profit (loss) attributed to shareholders                  | (5.7 ) | 7.6    | 1.5    |

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\* Less than 0.1%

Year Ended December 31, 2014 Compared with Year Ended December 31, 2013

**Revenues.** Revenues decreased by 7.2% to \$46.6 million in the year ended December 31, 2014, from \$50.2 million in the year ended December 31, 2013. The decrease in revenues is primarily attributable to decreased demand for our products, mainly from military customers.

**Cost of Revenues.** Cost of revenues decreased by 3.9% to \$40.6 for the year ended December 31, 2014, from \$42.2 million for the year ended December 31, 2013. The decrease in cost of revenues is primarily attributable to decreased revenues and to savings in manufacturing costs. Cost of revenues as a percentage of revenues increased to 87.1% for the year ended December 31, 2014, from 84.1% for the year ended December 31, 2013. The increase in cost of revenues as a percentage of revenues is primarily attributable to the decrease in revenues which was at a greater percentage than the reduction in costs.

**Gross Profit.** Gross profit decreased by 24.7% to \$6 million for the year ended December 31, 2014, from \$8 million for the year ended December 31, 2013. The decrease in gross profit is primarily due to the decrease in revenues and the increase in cost of sales as a percentage of sales. Gross profit as a percentage of revenues decreased to 12.9% for the year ended December 31, 2014, from 15.9% for the year ended December 31, 2013. The decrease in gross profit as a percentage of revenues is primarily attributable to the decrease in revenues and the increase in cost of sales as a percentage of sales.

**Selling, General and Administrative Expenses.** Selling, general and administrative expenses increased by 0.8% to \$6.8 million in the year ended December 31, 2014, from \$6.7 million in the year ended December 31, 2013.

**R&D expenses.** In 2014 we recorded R&D expenses of \$72,000 in connection with our participation in the Printel program, a consortium within the framework of the MAGNET program of the Office of the Chief Scientist of the Ministry of Industry and Trade of the State of Israel, or the OCS. We did not record R&D expenses in 2013.

**Impairment loss on goodwill.** In 2014 we recorded a goodwill impairment loss of \$80,000. We did not record a goodwill impairment loss in 2013.

**Operating Profit (Loss).** As a result of the foregoing, we recorded operating loss of \$903,000 in the year ended December 31, 2014, compared to operating profit of \$1.3 million in the year ended December 31, 2013.

**Financial Expenses, Net.** Financial expenses, net decreased by 18.9% to \$356,000 in the year ended December 31, 2014, from \$439,000 in the year ended December 31, 2013. Our financial expenses in 2014 were primarily attributable to interest paid on short-term and long-term debt and the impact of the NIS exchange rate on outstanding dollar and Euro denominated balances of our receivables from customers and debt to our suppliers. The decrease in financial expenses in 2014 compared to 2013 is primarily attributable to the decrease in our financial liabilities and to a lower interest rate we paid on our loans.

**Other Income (Loss), Net.** We had other income, net of \$38,000 in the year ended December 31, 2014, compared to other loss, net of \$26,000 in the year ended December 31, 2013, primarily as a result of sale and disposal of fixed assets.

**Income Tax (Expense) Benefit.** During the year ended December 31, 2014 we recorded a tax expense of \$1.6 million compared to a tax benefit of \$3 million in 2013. In 2014 we reduced certain of our deferred tax assets due to changes in the market conditions affecting the PCB markets and increased uncertainty about our ability to utilize these tax assets in the foreseeable future. Such uncertainty results from a reduced demand for our products, a change in the PCB buying patterns of our domestic military customers, which shifted some PCB acquisitions overseas, increased competition coupled with reduced prices in the local market, on-going manufacturing challenges, and possible devaluation of the U.S. dollar against the NIS, all of which may adversely affect our future profitability. Other tax expenses in 2014 were attributable to our subsidiaries in the United States and Germany. In 2013 we determined that certain of our deferred tax assets were more likely than not to be realized in future years, based on three years of consistent profits. Accordingly, we reversed the valuation allowances, in the amount of \$2.5 million. The amount of the deferred tax assets considered realizable could be further reduced in the near term if estimates of future taxable income during the carryforward period are reduced. For the years ended December 31, 2014 and 2013, we did not record a deferred tax asset and related tax benefit with respect to the net operating losses of Kubatronik due to uncertainty about its ability to utilize such losses in the foreseeable future.

**Non-controlling interest.** Non-controlling interest of \$190,000 reflects the other shareholder's proportionate share in Kubatronik's net loss for the year ended December 31, 2014, as compared to \$42,000 in Kubatronik's net profit for the year ended December 31, 2013.

#### Year Ended December 31, 2013 Compared with Year Ended December 31, 2012

**Revenues.** Revenues increased by 10.0% to \$50.2 million in the year ended December 31, 2013, from \$45.6 million in the year ended December 31, 2012. The increase in revenues is primarily attributable to increased demand for our products, mainly from military customers.

**Cost of Revenues.** Cost of revenues increased by 11.6% to \$42.2 million for the year ended December 31, 2013, from \$37.8 million for the year ended December 31, 2012. The increase in cost of revenues is primarily attributable to increased revenues and devaluation of the dollar compared to the NIS, which increased the dollar value of our NIS denominated costs. Cost of revenues as a percentage of revenues increased to 84.1% for the year ended December 31, 2013, from 82.9% for the year ended December 31, 2012. The increase in cost of revenues as a percentage of revenues is primarily attributable to devaluation of the dollar compared to the NIS, which increased the dollar value of our NIS denominated costs.

**Gross Profit.** Gross profit increased by 2.3% to \$8 million for the year ended December 31, 2013, from \$7.8 million for the year ended December 31, 2012. The increase in gross profit is primarily due to the increase in revenues which was partly offset by the increase in cost of sales. Gross profit as a percentage of revenues decrease to 15.9% for the year ended December 31, 2013, from 17.1% for the year ended December 31, 2012. The decrease in gross profit as a percentage of revenues is primarily attributable to the increase in revenues which was partly offset by the increase in cost of sales.

**Selling, General and Administrative Expenses.** Selling, general and administrative expenses increased by 11.3% to \$6.7 million in the year ended December 31, 2013, from \$6 million in the year ended December 31, 2012. The increase in selling, general and administrative expenses is mainly attributable to the devaluation of the U.S. dollar compared to the NIS, which increased the dollar value of the NIS denominated expenses (mainly salaries) and directors' fees for meetings in connection with the Nistec investment in our company.

**Impairment loss on goodwill.** We did not record a goodwill impairment loss in 2013. We recorded a goodwill impairment loss of \$481,000 in 2012 following our annual impairment test of goodwill, in which we determined that the value of our investment in Kubatronik had decreased by that amount.

**Operating Profit.** As a result of the foregoing, we recorded operating profit of \$1.3 million in the year ended December 31, 2013, compared to operating profit of \$1.3 million in the year ended December 31, 2012.

**Financial Expenses, Net.** Financial expenses, net decreased by 19.2% to \$439,000 in the year ended December 31, 2013, from \$543,000 in the year ended December 31, 2012. Our financial expenses in 2013 were primarily attributable to interest paid on short-term and long-term debt and the impact of the NIS exchange rate on outstanding dollar and Euro denominated balances of our receivables from customers and debt to our suppliers. The decrease in financial expenses compared to 2012 is primarily attributable to the decrease in our financial liabilities.

Other Income, Net. We had other loss, net of \$26,000 in the year ended December 31, 2013, compared to other income, net of \$2,000 in the year ended December 31, 2012, primarily as a result of the loss recorded on the disposal of fixed assets.

Income Tax (Expense) Benefit. During the year ended December 31, 2013 we recorded a tax benefit of \$3 million compared to tax expense of \$52,000 in 2012. In 2013 we determined that certain of our deferred tax assets were more likely than not to be realized in future years, based on three years of consistent profits. Accordingly, we reversed the valuation allowances, in the amount of \$2.5 million. Nevertheless, the amount of the deferred tax asset considered realizable could be reduced in the near term if estimates of future taxable income during the carryforward period are reduced. The tax expense in 2012 was attributable to our subsidiaries in the United States and Germany. During the year ended December 31, 2012, we did not record a deferred tax asset and related tax benefit with respect to our net operating losses generated in Israel due to uncertainty about our ability to utilize such losses in the foreseeable future. For the years ended December 31, 2013 and 2012, we did not record a deferred tax asset and related tax benefit with respect to the net operating losses of Kubatronik due to uncertainty about its ability to utilize such losses in the foreseeable future.

Non-controlling interest. Non-controlling interest of \$42,000 reflects the other shareholder's proportionate share in Kubatronik's net loss for the year ended December 31, 2013, as compared to \$6,000 in Kubatronik's net profit for the year ended December 31, 2012.

#### Impact of Currency Fluctuations and Inflation

Our revenues and expenses are denominated in the NIS, dollars and Euros. Due to the different proportions of currencies our revenues and expenses are denominated in, fluctuations in rates of exchange between NIS and other currencies may affect our operating results and financial condition. In addition, the NIS value of our dollar or Euro denominated revenues are negatively impacted by the depreciation of the dollar and the Euro against the NIS. The average exchange rate for the NIS against the dollar was 1.3% lower in 2014 than 2013 and the average exchange rate for the NIS against the Euro was 1.1% lower in 2014 than 2013, and in total, these changes had a negative impact on our operating results in 2014. The average exchange rate for the NIS against the dollar was 6.4% lower in 2013 than 2012 and the average exchange rate for the NIS against the Euro was 3.2% lower in 2013 than 2012, and in total, these changes had a negative impact on our operating results in 2013.

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

|             | Year Ended December 31, |    |      |    |      |    |      |   |       |    |
|-------------|-------------------------|----|------|----|------|----|------|---|-------|----|
|             | 2014                    |    | 2013 |    | 2012 |    | 2011 |   | 2010  |    |
| Dollar      | 12                      | %  | (7   | )% | (2.3 | )% | 7.7  | % | (6.0  | )% |
| Euro        | (1.2                    | )% | (2.8 | )% | (0.4 | )% | 4.2  | % | (12.9 | )% |
| Israeli CPI | (0.2                    | )% | 1.8  | %  | 1.6  | %  | 2.2  | % | 2.7   | %  |

From time to time in the past we have used currency hedging instruments in order to partially protect ourselves from currency fluctuation and may use hedging instruments from time to time in the future.

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



## Conditions in Israel

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

## Trade Relations

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

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

## Effective Corporate Tax Rate

Israeli companies are generally subject to income tax on their taxable income under the Income Tax Ordinance. The applicable rate for 2014 was 26.5%. However, one of our production facilities qualifies as a “benefited enterprise” under the Law for the Encouragement of Capital Investments, 1959, as amended. Subject to certain time limitations, a certain portion of our income derived from such benefited enterprise will be subject to a zero tax rate, while the remainder will be taxed at a rate of up to 26.5%. Alternatively we may select a “preferred enterprise” status, which will allow us to be taxed at a rate of 16% on all of our income. For additional information see Item 10E. “Additional Information – Taxation - Tax Benefits Under the Law for the Encouragement of Capital Investments, 1959” and Note 14 to our consolidated financial statements.

As of December 31, 2014, we had approximately \$14.1 million in tax operating losses and \$4.2 million in capital losses carry forwards in Israel, which can be offset against future income in Israel without time limitation. In Israel, we have received final tax assessments through the 1995 tax year and the tax assessments we received for the 1996-2008 tax years are considered final due to the statute of limitations. Our European subsidiaries, Kubatronik and Eltek Europe, have received final tax assessments through the 2010 tax year. As of December 31, 2014, Kubatronik had approximately Euro 1.5 million (\$1.8 million) in tax loss carry forwards in Germany for corporate tax and Euro 1.5 million (\$1.8 million) for municipal corporate tax. Our U.S. subsidiary has not yet received any final tax assessments since its incorporation.

During 2013, we determined that a portion of our deferred tax assets were more likely than not to be realized in future years, based on three years of consistent profits. Accordingly, we reversed the valuation allowance in the amount of \$2.5 million. The amount of the deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carryforward period are reduced. The ultimate realization of deferred tax assets depends on the generation of future taxable income during the periods in which those temporary differences are deductible. Management considers the scheduled reversal of deferred tax liabilities, projected taxable income, and tax-planning strategies in making this assessment.



## Recently Issued Accounting Standards

In July 2013, the FASB issued ASU 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. ASU 2013-11 requires an unrecognized tax benefit, or a portion of an unrecognized tax benefit, to be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. ASU 2013-11 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The new standard is to be applied prospectively but retrospective application is permitted. We implemented the provisions of ASU 2013-11 as of January 1, 2014.

In August 2014, the FASB issued Accounting Standards Update No. 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 ("ASU 2014-15"). ASU 2014-15 requires management to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a period of one year after the date that the financial statements are issued. If such conditions or events exist, an entity should disclose that there is substantial doubt about the entity's ability to continue as a going concern for a period of one year after the date that the financial statements are issued. Disclosure should include the principal conditions or events that raise substantial doubt, management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations, and management's plans that are intended to mitigate those conditions or events. ASU 2014-15 will be effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter.

## B. Liquidity and Capital Resources

Historically, we have financed our operations through cash generated by operations, shareholder loans, long-term and short-term bank loans, borrowings under available credit facilities and the proceeds from our initial public offering in 1997 (approximately \$5.8 million).

As of December 31, 2014, we had \$1.1 million in cash and cash equivalents and working capital of \$3,000 compared to \$2.5 million in cash and cash equivalents and working capital of \$2.5 million at December 31, 2013.

## Cash Flows

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

| Year ended December 31,                              | (\$ in thousands) |        |          |
|--|-------------------|--------|----------|
|  | 2014              | 2013   | 2012     |
| Net cash provided by operating activities            | 79                | 1,618  | 4,772    |
| Net cash used in investing activities                | (2,643 )          | (950 ) | (1,234 ) |
| Net cash used in financing activities                | 1,248             | (113 ) | (2,390 ) |
| Effect of translation adjustments                    | (69 )             | 24     | (105 )   |
| Net increase (decrease) in cash and cash equivalents | (1,385 )          | 579    | 1,043    |
| Cash and cash equivalents at beginning of year       | 2,514             | 1,935  | 892      |
| Cash and cash equivalents at end of year             | 1,129             | 2,514  | 1,935    |

The changes in assets and liabilities reflected in the cash flow statement do not correspond exactly to the respective amounts in the balance sheets included with this annual report, mainly because our functional currency is the NIS and our reporting currency is the dollar.



Net cash provided by operating activities was \$79,000 in the year ended December 31, 2014. This amount was primarily attributable to our net loss of \$2.9 million, adjustments for non-cash item of depreciation and amortization of \$1.9 million, a \$101,000 capital loss with respect to fixed assets, an increase in other liabilities and accrued expenses of \$445,000, a decrease in deferred tax benefits of \$1.5 million, and a \$848,000 decrease in inventories (mainly work in process). This amount was offset in part by an increase of other receivables and prepaid expenses of \$319,000, a decrease in trade payables of \$1.4 million, a change in the severance benefits of \$59,000 and an increase in trade receivables of \$78,000.

Net cash provided by operating activities was \$1.6 million in the year ended December 31, 2013. This amount was primarily attributable to our net income of \$3.8 million, adjustments for non-cash item of depreciation and amortization of \$1.7 million, an increase in trade payables of \$655,000, an increase in other liabilities and accrued expenses of \$147,000, decrease of other receivables and prepaid expenses of \$46,000 and a change in employee severance benefits, net of \$217,000. This amount was offset in part by an increase in deferred tax benefits of \$3 million, an increase in trade receivables of \$1.5 million, and a \$451,000 increase in inventories (mainly finished goods and work in process).

Net cash provided by operating activities was \$4.8 million for the year ended December 31, 2012. This amount was primarily attributable to our net income of \$696,000, adjustments for non-cash items (consisting of depreciation and amortization) of \$2.3 million, a decrease in trade receivables of \$2.3 million resulting from payments of \$1.3 million from two large customers, a decrease in other liabilities and accrued expenses of \$281,000, a decrease in employee severance benefits, net of \$53,000 and a revaluation of long term loans of \$25,000. This amount was offset in part by a \$670,000 increase in inventories, a decrease in trade payables of \$147,000 and an increase in other receivables and prepaid expenses of \$58,000.

Net cash used in investing activities was \$2.6 million in the year ended December 31, 2014 compared to \$950,000 in the year ended December 31, 2013 and \$1.2 million in the year ended December 31, 2012. Net cash used in investing activities in the years ended December 31, 2014, 2013, and 2012 was primarily for the purchase of fixed assets for our production lines, expansion of our manufacturing facilities, including leasehold improvements, and the purchase of information technology software and hardware.

Net cash used in financing activities was \$1.2 million in the year ended December 31, 2014, which was primarily attributable to a decrease in short-term credit of \$ 1.4 million, repayment of long term loans of \$806,000, and the repayment of credit from fixed assets payable of \$477,000. These amounts were partially offset by proceeds from a long term loan of \$1.2 million. Net cash used in financing activities was \$113,000 in the year ended December 31, 2013, which was primarily attributable to our major shareholder's \$3.5 million investment in our company, which was offset by a decrease in short-term credit of \$2.6 million, repayment of long term loans of \$564,000, and repayment of credit from fixed assets payable of \$515,000. Net cash used in financing activities was \$2.4 million in the year ended December 31, 2012, which was primarily attributable to repayments of long-term loans, net of \$1.1 million, repayment of credit from fixed assets payable of \$1.0 million and a decrease of \$192,000 in short term credit.

As of December 31, 2014, we had a revolving line of credit of approximately \$360,000 with Bank Hapoalim B.M., a revolving line of credit of approximately \$2.3 million with Bank Leumi B.M. and a long-term loan from Bank Hapoalim B.M. of \$1.2 million.

As of December 31, 2014, we also had long-term loans from suppliers of fixed assets in the aggregate amount of \$1.2 million. Of such amount, \$659,000 is linked to the Euro, \$403,000 is linked to the dollar and \$128,000 is not linked.

Our credit lines and short-term loans bear annual interest at Prime+ 0.9%.

Our long-term bank loans and loan from fixed asset suppliers bear annual interest as follows:

- linked to the dollar - from LIBOR+4% to LIBOR+4.5%
- linked to the Prime rate - Prime+0.9%

- linked to the Euro – from 2.17% to 3.86%.
- NIS not linked 6%
- linked to the dollar - from 5.89% to 8.56%.

The borrowings from our banks are secured by specific liens on certain assets, by a first priority charge on the rest of our now-owned or after-acquired assets and by a fixed lien on goodwill (intangible assets) and insurance rights (rights to proceeds on insured assets in the event of damage). In addition, the agreements with our banks prohibit us from selling or otherwise transferring any assets except in the ordinary course of business or from placing a lien on our assets without the banks' consent.

Bank Hapoalim and Bank Leumi require us to maintain a specific set of covenants each fiscal year. We are required to meet all of the following financial covenants: (i) maintaining adjusted shareholders' equity equal to the greater of \$4.5 million or 17% of our consolidated total assets; and (ii) a debt service ratio of 1.5. For this purpose, adjusted shareholders' equity excludes certain intangible and other assets. Debt service ratio is defined as the ratio of EBITDA to current maturities of long-term debt plus interest expenses. As of December 31, 2014, we were in compliance with these covenants.

Capital expenditures on a cash flow basis for the years ended December 31, 2014 and 2013 were approximately \$2.6 million and \$950,000, respectively. In addition, purchases of fixed assets not yet paid as at December 31, 2014 amounted to \$523,000. Our capital expenditures in such periods mainly related to our investments in production and manufacturing equipment, and in leasehold improvements. As of December 31, 2014 we had existing commitments to purchase \$113,000 of equipment. We intend to finance our 2015 capital expenditures mainly with bank loans, suppliers' credit and operational cash flow; however, such financing may not be available, or, if available, may not be on terms favorable to us. Our principal commitments consist of obligations outstanding under our bank loans and credit facilities, suppliers' credit and operating leases.

We expect to finance our 2015 budget from operational cash flow, revolving bank credit lines and long-term bank loans, and supplier financing. Although we anticipate that these capital resources will be adequate to satisfy our liquidity requirements through 2015, our liquidity could be negatively affected by a decrease in demand for our products, including the impact of changes in customer buying that may result from the general economic downturn, the stability of the dollar/NIS exchange rate, our results of operations, our suppliers' payment terms, our customers' demand for extending their payment terms and other factors detailed in Item 3D. "Key Information - Risk Factors." If available liquidity is not sufficient to meet our operating and debt service obligations as they come due, we would need to pursue alternative financing arrangements or reduce expenditures to meet our cash requirements through 2015. Such additional financing may not be available to us or, if available, may not be obtained on terms favorable to us, and there is no assurance that we would be able to reduce discretionary spending to provide the required liquidity.

#### C. Research and Development, Patents and Licenses

We generally do not engage in research and development. In 2014, we were granted membership in Printel, a consortium within the framework of the MAGNET program of the Office of the Chief Scientist of the Ministry of Industry and Trade of the State of Israel, or the OCS. Printel was created specifically to develop printed electronic technologies that are an alternative innovative technology for the electronics industry. Under the terms of the consortium, each member of the consortium received an advance for its research and development costs for a specific research and development project assigned to it by the consortium. The Office of the Chief Scientist reimburses 66% of the approved research and development expenses, less certain consortium expenses. These reimbursements are contingent upon our submitting periodic reports prepared in accordance with the requirements of the OCS. We are not

required to pay the OCS royalties with respect to this grant.

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## D. Trend Information

Following a decline in revenues caused by the global financial crisis in 2008 and 2009, our revenues began to increase in 2010 and 2011, slightly declined in 2012, increased in 2013 and declined again in 2014, primarily due to a reduced demand for our products, mainly by the defense sector.

Our backlog at December 31, 2014 was approximately \$5.7 million compared to a backlog of approximately \$10.1 million at December 31, 2013. We include in our backlog all purchase orders scheduled for delivery within the next 12 months. The decline in our backlog was primarily due to the decline in demand for our products, mainly from military customers. For a variety of reasons, including the timing of orders, delivery intervals, customer and product mix and the possibility of customer changes in delivery schedules, backlog as of any particular date may not be a reliable measure of sales for any succeeding period. Cancellation charges generally vary depending upon the time of cancellation and, therefore, substantially all of our backlog may be subject to cancellation without penalty.

## E. Off-Balance Sheet Arrangements

We are not a party to any material off-balance sheet arrangements. In addition, we have no unconsolidated special purpose financing or partnership entities that are likely to create material contingent obligations.

## F. Tabular Disclosure of Contractual Obligations

The following table summarizes our minimum contractual obligations as of December 31, 2014.

| Contractual Obligations  | Total         | Payments due by period<br>(\$ in thousands) |              |            |                      |
|--|---------------|---|--------------|------------|----------------------|
|  |               | less than 1<br>year                         | 2-3 years    | 4-5 years  | more than<br>5 years |
| Short-term bank credit<br>(1)  | 2,722         | 2,722                                       | -            | -          | -                    |
| Long-term debt obligations (1)   | 2,347         | 509   | 1,134        | 704        | -                    |
| Operating lease  | 2,567         | 1,016                                       | 1,281        | 270        | -                    |
| Other contractual obligations  | 1,258         | 639   | 614          | 5          | -                    |
| Purchase obligations   | 445           | 445   | -            | -          | -                    |
| Other short-term liabilities reflected on the<br>company's balance sheet (2) | 5,156         | 5,156                                       | -            | -          | -                    |
| Other long-term liabilities reflected on the<br>company's balance sheet      | 249           | -   | -            | -          | 249                  |
| Estimate of interest payments on long-term<br>debt obligations (3)           | 139           | 48  | 72           | 19         | -                    |
| <b>Total</b>   | <b>14,883</b> | <b>10,535</b>                               | <b>3,101</b> | <b>998</b> | <b>249</b>           |

(1) For information on the interest rates of our short-term bank credit and long-term debt obligations, see Item 5B. "Operating and Financial Review and Prospects - Liquidity and Capital Resources."

(2) Includes the estimated net value of our liability attributable to Mr. Kubat's put option relating to his 21% ownership interest in Kubatronik under the agreement relating to the acquisition of our 76% ownership interest in Kubatronik in June 2002, which increased to 79% in May 2012. Under U.S. GAAP, such an arrangement gives rise to a derivative instrument, which must be marked to market every reporting period.

(3)

The estimate of interest payments on long-term debt obligations is based on current interest rates as of December 31, 2014 (including current variable rates on the existing long-term debt obligations) and on the current volume of debt obligations, assuming loan repayment in future years as disclosed in Note 8 to the consolidated financial statements.



## ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

## A. Directors and Senior Management

## Directors

Set forth below are the name, age, principal position and a biographical description of each of our directors:

| Name                              | Age | Position                                   |
|-----------------------------------|-----|--|
| Yitzhak Nissan (3)                | 65  | Chairman of the Board of Directors and CEO |
| Mordechai Marmorstein (1)(2)      | 68  | Director                                   |
| Gavriel David Meron               | 62  | Director                                   |
| David Rubner                      | 74  | Director                                   |
| Erez Meltzer                      | 57  | Director                                   |
| Gad                               |     | External Director                          |
| Dovev(1)(2)                       | 68  |  |
| Ophira Rosolio-Aharonson(1)(2)(3) | 65  | External Director                          |

(1) Member of the Audit Committee

(2) Member of the Compensation Committee

(3) Member of the Banking Committee (established in March 2014)

Ms. Ophira Rosolio-Aharonson was elected to serve as an external director at our 2012 annual general meeting of shareholders for a third three-year term, pursuant to the provisions of the Israeli Companies Law. Mr. Gad Dovev was elected to serve as an external director at our 2014 annual general meeting of shareholders for a three-year term. Yitzhak Nissan, Mordechai Marmorstein, Gavriel David Meron, David Rubner and Erez Meltzer were re-elected to serve as a directors at our 2014 annual general meeting of shareholders on October 7, 2014 until our the next annual general meeting of shareholders.

Yitzhak Nissan was elected to serve on our Board of Directors and was appointed Chairman in November 2013 and as of October 2014, serves also as our Chief Executive Officer. Mr. Nissan is the founder of Nistec Group and has served as its chief executive officer since 1985. Mr. Nissan served as a Presiding Member of ILTAM (Israeli Users' Association of Advanced Technologies in Hi-Tech Integrated Systems) between 2008 and 2009, and as a Presiding Member of the Israeli Association of Electronics and Software Industries since 2012. Mr. Nissan also established the VPs Operations Forum, which brings thought leadership to 200 VPs of operations from diverse hi-tech companies in Israel. In 2008, Mr. Nissan received the Distinguished Industry Award from the mayor of Petach Tikva Municipality. Mr. Nissan holds a BSc. degree in Electronic Engineering from the University of Buffalo, New York.

Dr. Mordechai Marmorstein was elected to serve on our Board of Directors in October 2013 and is a member of our audit and compensation committees. From 1992 to 2001, Dr. Marmorstein was the chief financial officer of Pazchim Co. Ltd. Dr. Marmorstein was also an internal auditor and accountant at Negev Phosphate Works. Dr. Marmorstein served as the chairman of Teshet (Tourist Enterprises and Aviation Services Co. Ltd.), a subsidiary of El-Al, the Israeli national airline, from 1999 to 2000. Dr. Marmorstein holds a B.A. degree in Economics, an M.A. degree in Contemporary Jewry Studies and a Ph.D. in Jewish History Studies, all from Bar-Ilan University.

Gavriel David Meron was elected to serve on our Board of Directors in October 2013. Mr. Meron currently serves as the chairman and the chief executive officer of hygieacare Inc., and has served as the chairman and chief executive

officer of M.G.D. Management Services & Investments Ltd. since November 2006. Mr. Meron was the founder, president and chief executive officer of Given Imaging Ltd. from 1998 to 2006. Mr. Meron holds a B.A. degree in Economics and Statistics from the Hebrew University of Jerusalem and an MBA degree in International Business from Tel Aviv University.

David Rubner was elected to serve on our Board of Directors in October 2013. Mr. Rubner has served as the Chairman and Chief Executive Officer of Rubner Technology Ventures Ltd. and as a Partner in Hyperion Israel Advisors Ltd., a venture capital firm since 2000. During the years 1991 to 2000, he was the President and Chief Executive Officer of ECI Telecom Ltd. Mr. Rubner serves on the board of directors of Check Point Software Ltd., Radware Ltd., Telemessage International Ltd. and several private companies. He also serves on the boards of trustees and executive council of Shaare Zedek Hospital. Mr. Rubner holds a B.Sc. degree in engineering from Queen Mary College, University of London and an M.S. degree from Carnegie Mellon University.

Erez Meltzer has served as the Chairman of our Board of Directors from 2011 to 2013 and has served as a director since 2009. Mr. Meltzer is the Executive Chairman of Hadassah Medical Center and the chairman of MIS Implants Technologies Ltd. Mr. Meltzer also serves as a director of Ericom Software Ltd. From 2008 to 2013, Mr. Meltzer has served as the Chief Executive Officer of Gadot Chemical Tankers & Terminals Ltd. From 2006 to 2007, Mr. Meltzer served as the Chief Executive Officer of Africa Israel Group. From 2002 to 2006, Mr. Meltzer served as the President and Chief Executive Officer of Netafim Ltd. From 1999 to 2001, Mr. Meltzer served as the President and Chief Executive Officer of CreoScitex. Mr. Meltzer served is a colonel in the Israeli Defense Forces – Armored Corps (reserve). Mr. Meltzer serves as the Chairman of the Lowenstein Hospital Friends Association since 1999 and is the honorary chairman of the Israeli Chapter of YPO (the Young Presidents Organization). Mr. Meltzer studied Economics and Business at the Hebrew University of Jerusalem and Boston University, and is a graduate of the Advanced Management Program at Harvard Business School.

Ophira Rosolio-Aharonson was elected to serve as an external director (within the meaning of the Israeli Companies Law) in December 2006 and is a member of our audit, compensation and banking committees. Ms. Rosolio-Aharonson is a co-founder of Seagull Tech Inc. and KeyScan Inc. In addition, Ms. Rosolio-Aharonson serves as an executive director of several private and publicly traded companies, a strategic business consultant to high-technology companies and an advisor to venture capital firms in Israel and the United States. Among others, Ms. Rosolio-Aharonson served as a director of Cimatron Ltd and Scailex Corp. From 1992 through 1999, Ms. Rosolio-Aharonson served as the chief executive officer of Terra Computers, Inc. in the United States. From 1980 to 1989, Ms. Rosolio-Aharonson served as a senior executive, holding managerial positions, at Clal Ltd., an Israeli company publicly traded on the Tel Aviv Stock Exchange, including director, chief executive officer, chief operations officer and vice president of sales and marketing of certain of Clal Ltd.’s subsidiaries. Ms. Rosolio-Aharonson holds a B.Sc. degree in applied mathematics and physics, and has completed courses required for a M.Sc. degree in bio-medical engineering, both from the Technion – Israel Institute of Technology and is a graduate of the executive business and management program of Tel Aviv University.

Gad Dovev was elected to serve as an external director (within the meaning of the Israeli Companies Law) in October 2014 and is a member of our audit and compensation committees. Mr. Dovev retired from the Israeli Ministry of Defense in August 2012. Mr. Dovev served as head of the Israeli Ministry of Defense Mission to the United States from August 2008 to August 2011. From August 2005 to August 2008, Mr. Dovev served as head of the Israeli Ministry of Defense Mission to Germany. Prior to that, from 2001 to 2005, Mr. Dovev acted as Deputy General Manager of the Israeli Ministry of Defense and Head of the Rehabilitation Department. From 1993 to 2001, Mr. Dovev served as Director of the Finance Department and the Financial Comptroller of the Israeli Ministry of Defense. Mr. Dovev served as member of the Board of Directors of Bank Otsar Ha-Hayal Ltd., IMI-Israel Military Industries Ltd., Shekem Ltd. and Gapim Ltd. Mr. Dovev holds a BSc in Financial and Agricultural Administration from the Hebrew University of Jerusalem.

#### Executive Officers

Set forth below are the name, age, principal position and a biographical description of each of our executive officers:

| Name              | Age | Position  |
|-------------------|-----|---|
| Yitzhak Nissan(1) | 65  | Chief Executive Officer   |
| Roberto Tulman    | 56  | Deputy CEO, and Chief Technology Officer  |
| Amnon Shemer      | 55  | Vice President, Finance and Chief Financial Officer                             |
| Eliyahu Dvora     | 58  | Vice President, Operations  |
| Avraham Gal       | 51  | Vice President, 5S and Chief Information Officer, General Manager of Kubatronik |

|               |    |                               |
|---------------|----|-------------------------------|
| James Barry   | 56 | President of Eltek USA Inc.   |
| Axel Herrmann | 56 | General Manager, Eltek Europe |

(1) Mr. Arie Reichart's engagement as our Chief Executive Officer was terminated on July 29, 2014. Mr. Roberto Tulman served as interim Chief Executive Officer until October 7, 2014, when our shareholders approved the appointment of our Chairman, Mr. Yitzhak Nissan, also as Chief Executive Officer.

Roberto Tulman joined us in August 2005 as vice president, technologies and chief technology officer, and was appointed as our Deputy CEO in October 2014. During the 22 years prior to joining our company, Mr. Tulman served in the electronic research department of the Israel Defense Forces, where he held various research and development and management positions, and managed the printed circuits division during his last eight years of service. Mr. Tulman holds a B.Sc. degree (Cum Laude) in Chemistry, an M.Sc degree in Chemistry (Electrochemistry) and an M.B.A. degree, all from Tel-Aviv University.

Amnon Shemer joined us in February 2004 as vice president-finance and chief financial officer. From January 2003 until November 2003, Mr. Shemer served as managing director of Mea Control Transfer Ltd., a company that provides investment banking services. From June 1995 until August 2002, Mr. Shemer was vice president of finance for Mentergy Ltd., a publicly-traded company that provides e-learning solutions and satellite communications services. Mr. Shemer holds a B.A. degree in Economics and Business Administration and M.A. degree in Economics, both from Bar-Ilan University, and complementing accounting courses at Seneca College in Toronto, Canada.

Eli Dvora joined us in 1993 after our merger with TPC Ltd. and served as our comptroller until August 1997. From September 1997 until February 1998, Mr. Dvora was self-employed. In March 1998, Mr. Dvora rejoined our company and in September 1999, was appointed as our vice president - operations. Mr. Dvora holds a B.A. degree in Economics and an M.B.A. degree, both from Bar Ilan University.

Avi Gal was appointed as our vice president, IS and chief information officer in December 2009 and was appointed as General Manager of Kubatronik in July 2013. Mr. Gal joined us in August 1986 as an industrial engineer in our shop floor control department. In 1988, Mr. Gal established our IT department and led the adaptation of a generic ERP system to the PCB sector. Between 1994 and 2005, Mr. Gal managed his own business, mainly in developing and implementing an ERP System for maintenance, repair and overhaul for the aviation sector. In 2005, Mr. Gal returned to our company as chief information officer. Mr. Gal holds a B.Sc. degree in Management and Industrial Engineering from the Technion - Israel Institute of Technology.

James Barry joined us in September 2008 as the president of Eltek USA Inc. Prior to that and from May 2003, Mr. Barry served as a consultant to us in a sales, marketing and applications engineering role. Mr. Barry has over 30 years' experience within the PCB industry. Mr. Barry has held management positions within engineering, sales and operations for some major PCB producers. Mr. Barry attended Northern Essex Community College.

Axel Herrmann joined us in March 2006 as commercial manager of Kubatronik, our German subsidiary and was appointed as general manager, Eltek Europe in August 2009. From July 2003 until February 2006, Mr. Herrmann served as commercial manager for Heinrich Heiland GmbH, a supplier for the automotive industry. From October 2000 until June 2003, Mr. Herrmann worked as commercial manager for Helukabel GmbH, a company that produces and sells cables and wires. From July 1989 until September 2000, Mr. Herrmann worked at Pfisterer, a producer of electrical devices for power plants, initially as a department head in bookkeeping, advanced to commercial manager and his last position was managing director. Mr. Herrmann holds a B.A. degree in economics from Hohenheim University in Stuttgart, Germany.

There are no family relationships between any of our directors and executive officers.

## B. Compensation

The following table sets forth all compensation we paid with respect to all of our directors and executive officers as a group for the year ended December 31, 2014.

|  | Salaries, fees,<br>commissions<br>and bonuses | Pension, retirement<br>and similar benefits |
|--|---|---|
| All directors and executive officers as a group ( then consisting of 19 persons) | 2.7<br>\$million(1)(2)(3)                     | \$ 221,000                                  |

- (1)The compensation amount does not include \$530,000 recorded as a provision in respect of future settlements with officers whose employment terms ended in 2014.
- (2)During the year ended December 31, 2014, we paid each of our external and independent directors an annual fee of \$13,894 and an attendance fee of \$695 per meeting. These fees are included in the above amount.
- (3)The salaries amount includes expenses for automobiles and other benefits that we provide to certain of our executive officers.

For as long as we qualify as a foreign private issuer, we are not required to comply with the proxy rules applicable to U.S. domestic companies, including the requirement to disclose information concerning the amount and type of compensation paid to the chief executive officer, chief financial officer and the three other most highly compensated executive officers, rather than on an aggregate basis. Nevertheless, a recent amendment to the regulations promulgated under the Israeli Companies Law requires us to disclose the annual compensation of our five most highly compensated officers (or all the named executive officers if there are less than five) on an individual basis, rather than on an aggregate basis, as was previously permitted for Israeli public companies listed overseas. Under the Companies Law regulations, this disclosure is required to be included in the notice of our annual meeting of shareholders each year or in a public document that accompanies such notice, which we furnish to the SEC under cover of a Report of Foreign Private Issuer on Form 6-K. The Companies Law regulations permit us to refer to a report filed pursuant to the laws of the country in which our shares are listed for trading that includes the required information in lieu of its inclusion in the notice of annual meeting. Because of that disclosure requirement under Israeli law, we are including such information in this annual report, pursuant to the disclosure requirements of Form 20-F.

The table below reflects the compensation granted to our five most highly compensated office holders during or with respect to the year ended December 31, 2014. All amounts reported in the table reflect the cost to the company, as recognized in our financial statements for the year ended December 31, 2014.

| Name of Officer | Position of Officer        | Holdings | Compensation for services (USD)(1) |             |              |              |                    |
|-----------------|----------------------------|----------|------------------------------------|-------------|--------------|--------------|--------------------|
|                 |                            |          | Base salary                        | Benefits(2) | Cash bonuses | Equity-based | Total compensation |
| Yitzhak Nissan  | Chief Executive Officer    | 50.5 %   | 303,271                            | -           | -            | -            | 303,271            |
| Arieh Reichart  | Former CEO                 | -        | 256,069                            | 102,252     | -            | -            | 358,321            |
| James Barry     | President of Eltek USA Inc | -        | 211,234                            | 28,777      | -            | -            | 238,459            |
| Shay Shahar     | Former Vice President,     | -        | 179,586                            | 54,698      | -            | -            | 234,284            |

|              |   |   |         |        |   |   |         |
|--------------|---|---|---------|--------|---|---|---------|
|              | Sales and Marketing                                 |   |         |        |   |   |         |
| Amnon Shemer | Vice President, Finance and Chief Financial Officer | - | 166,670 | 65,890 | - | - | 232,560 |

(1) Cash compensation amounts denominated in NIS were converted into U.S.dollars at the rate of NIS 3.5612 per \$1 (the average exchange rate in 2014).

(2) Benefits include car related expenses, managers' insurance and pension funds, payments to the National Insurance Institute, advanced education funds, vacation allowance and other customary benefits.

C. Board Practices

Introduction

According to the Israeli Companies Law, the role of the board of directors is to formulate a company's policy and to supervise the chief executive officer's exercise of his roles and operations. According to our articles of association, our chief executive officer has the power to appoint our other executive officers who, together with our chief executive officer, are responsible for our day-to-day management. The board of directors may exercise any power of the company which was not assigned to another organ of the company by law or by the articles of association. The executive officers have individual duties as determined by our chief executive officer and board of directors.

Election of Directors

Our articles of association provide for a board of directors consisting of no less than three and no more than nine members or such other number as may be determined from time to time at a general meeting of shareholders. Our board of directors is currently composed of seven directors.

Generally, at each annual meeting of shareholders, directors are elected by a vote of the holders of a majority of the voting power represented and voting at such meeting. All the members of our board of directors (except the external directors as detailed below) may be reelected upon completion of their term of office. Directors (other than external directors) may be removed earlier from office by a resolution passed at a general meeting of our shareholders. Our board of directors may temporarily fill vacancies in the board or add to their body until the next annual meeting of shareholders, provided that the total number of directors will not exceed the maximum number permitted under our articles of association.

The board of directors of an Israeli public company is required to determine that at least one or more directors will have "accounting and financial expertise," as defined by regulations promulgated under the Israeli Companies Law. Our board of directors determined, accordingly, that at least one director must have "accounting and financial expertise." Our board of directors has further determined that Mr. Gad Dovev (an external director within the meaning of the Israeli Companies Law) has the requisite "accounting and financial expertise."

We do not follow the requirements of the NASDAQ Stock Market Rules with regard to the nomination process of directors, and instead, we follow Israeli law and practice, in accordance with which our board of directors is authorized to recommend to our shareholders director nominees for election. See Item 16G. "Corporate Governance."

External and Independent Directors

External directors. Under the Israeli Companies Law, Israeli companies whose shares have been offered to the public are required to appoint at least two external directors. The Israeli Companies Law provides that a person may not be appointed as an external director if (i) the person is a relative of a controlling shareholder; (ii) the person, or the person's relative, partner, employer or an entity under that person's control, has or had during the two years preceding the date of appointment any affiliation with the company, or the controlling shareholder or its relative; (iii) in a company that does not have a controlling shareholder, such person has an affiliation (as such term is defined in the Israeli Companies Law), at the time of his appointment, to the chairman of the board of directors, chief executive officer, a shareholder holding at least 5% of the share capital of the company or the chief financial officer; (iv) such person is an employee of the Israeli securities authority or an Israeli stock exchange; and (v) such person's relative, partner, employer, supervisor, or an entity he controls, has other than negligible business or professional relations with any of the persons mentioned in subsection (ii) above, even if such relations are not maintained on a regular basis. The term "relative" means a spouse, sibling, parent, grandparent, child or child, sibling or parent of spouse or spouse of any



of the above. The term “affiliation” includes an employment relationship, a material business or professional relationship maintained on a regular and continuous basis, control and service as an office holder excluding service as an external director of a company that is offering its shares to the public for the first time. In addition, no person may serve as an external director if the person’s position or other activities create or may create a conflict of interest with the person’s responsibilities as director or may otherwise interfere with the person’s ability to serve as director. If, at the time an external director is appointed all members of the board of directors who are not the controlling shareholders or their relatives, are of the same gender, then that external director must be of the other gender. A director of one company may not be appointed as an external director of another company if a director of the other company is acting as an external director of the first company at such time.

At least one of the external directors elected must have “accounting and financial expertise” and any other external director must have “accounting and financial expertise” or “professional qualification,” as such terms are defined by regulations promulgated under the Israeli Companies Law. Our external director, Mr. Gad Dovev, has “accounting and financial expertise” and our other external director, Ms. Ophira Rosolio-Aharonson, has “professional qualification,” as such terms are defined by regulations promulgated under the Israeli Companies Law.

External directors are elected by shareholders. The shareholders voting in favor of their election must include at least a majority of the shares of the non-controlling shareholders (and those who do not have a personal interest in the matter as a result of their relationship with the controlling shareholders) of the company voting on the matter (not including abstaining votes). This majority approval requirement need not be met if the total shareholdings of those non-controlling shareholders (and those who do not have a personal interest in the matter as a result of their relationship with the controlling shareholders) voting against their election represent 2% or less of all of the voting rights in the company.

External directors serve for a three-year term, which may be renewed for two additional three year periods through one of the following mechanisms:

- (i) the board of directors proposed the nominee and his appointment was approved by the shareholders in the manner required to appoint external directors for their initial term;
- (ii) a shareholder holding 1% or more of the voting rights proposed the nominee, and the nominee is approved by a majority of the votes cast by the shareholders of the company on the matter, excluding the votes of controlling shareholders and those who have a personal interest in the matter as a result of their relationship with any controlling shareholder and excluding abstentions, provided that the aggregate votes cast by shareholders who are not controlling shareholders and do not have a personal interest in the matter as a result of their relationship with the controlling shareholders voted in favor of the reelection of the nominee constitute more than 2% of the voting rights in the company, and provided further that at the time of such nomination or in the two years preceding such nomination, such external director or his relative are neither the shareholder who proposed such nomination, or a shareholder holding 5% or more of the company's issued share capital or voting power, in each case who, or whose controlling shareholder or any entity controlled by them (i) has business relations with the company, or (ii) is a competitor of the company; or
- (iii) such external director nominates himself or herself for each such additional term and his or her election is approved at a shareholders meeting by the same disinterested majority as required for the election of an external director nominated by a 1% or more shareholder (as described above).

External directors cannot be dismissed from office unless: (i) the board of directors determines that the external director no longer meets the statutory requirements for holding the office, or that the external director has breached the external director's fiduciary duties and the shareholders vote, by the same majority required for the appointment, to remove the external director after the external director has been given the opportunity to present his or her position; (ii) a court determines, upon a request of a director or a shareholder, that the external director no longer meets the statutory requirements of an external director or that the external director has breached his or her fiduciary duties to the company; or (iii) a court determines, upon a request of the company or a director, shareholder or creditor of the company, that the external director is unable to fulfill his or her duty or has been convicted of specified crimes. Each committee that is authorized to exercise powers that are usually vested in the board of directors must include at least one external director and the audit committee and compensation committee must each include all of the external directors. An external director is entitled to compensation as provided in regulations promulgated under the Israeli Companies Law and is otherwise prohibited from receiving any other compensation, directly or indirectly, in connection with such service.

Ms. Ophira Rosolio-Aharonson was elected to serve as an external director at our 2012 annual general meeting of shareholders for a third three-year term, and Mr. Gad Dovev was elected to serve as an external director at our 2014 annual general meeting for a three-year term.

**Independent Directors.** In general, NASDAQ Stock Market Rules require that the board of directors of a NASDAQ-listed company have a majority of independent directors and its audit committee must have at least three members and be comprised only of independent directors, each of whom satisfies the respective "independence" requirements of NASDAQ and the SEC. However, on June 9, 2005, we provided NASDAQ with a notice of non-compliance with respect to (among other things) the requirement to maintain a majority of independent directors, as defined under NASDAQ Stock Market Rules. Instead, we follow Israeli law and practice which requires that we appoint at least two external directors, within the meaning of the Israeli Companies Law, as previously discussed. In addition, in accordance with the rules of the SEC and NASDAQ, we have the mandated three independent directors, as defined by the rules of the SEC and NASDAQ, on our audit committee.

Also, pursuant to the Israeli Companies Law, a director may be qualified as an independent director if such director is either (i) an external director; or (ii) a director who complies with the following requirements: (y) he or she is eligible for nomination as an external director and the audit committee has approved such eligibility; and (z) he or she has not acted as a director of the company for a period exceeding nine consecutive years. For this purpose, a hiatus of less than two years of service will not be deemed to be an interruption in the continuation of service.

Our Audit Committee is comprised only of directors who are independent under the requirements of the Israeli Companies Law and also meet the independence requirements under the NASDAQ and the SEC rules.

#### Chairman of the Board

Our articles of association provide that the chairman of the board is appointed by the members of the board of directors. Under the Israeli Companies Law, the chief executive officer (referred to as a "general manager" under the Companies Law) or a relative of the chief executive officer may not serve as the chairman of the board of directors of a public company, and the chairman or a relative of the chairman may not be vested with authorities of the Chief Executive Officer without shareholder approval consisting of a majority vote of the shares present and voting at a shareholders meeting, provided that either (i) such majority includes at least two-thirds of the shares held by all shareholders who are not controlling shareholders and do not have a personal interest in such appointment, present and voting at such meeting; or (ii) the total number of shares of non-controlling shareholders and shareholders who do not have a personal interest in such appointment voting against such appointment does not exceed two percent of the aggregate voting rights in the company.

In addition, a person subordinated, directly or indirectly, to the Chief Executive Officer may not serve as the chairman of the board of directors; the chairman of the board may not be vested with authorities that are granted to those subordinated to the Chief Executive Officer; and the chairman of the board may not serve in any other position in the company or a controlled company, but he may serve as a director or chairman of a subsidiary.

On October 7, 2014, our shareholders approved the appointment of our chairman of the board to also serve as our Chief Executive Officer. This dual office term will be for three years and can be extended for additional three-year terms, subject to shareholder approval.

## Committees of the Board of Directors

### Audit Committee

Under the Israeli Companies Law, the board of directors of any public company must establish an audit committee. The audit committee must consist of at least three directors, must include all of the external directors and must have a majority of independent directors.

The audit committee may not include the chairman of the board of directors, the controlling shareholder (or any of the controlling shareholder's relatives), any director employed by the company or by its controlling shareholder or by an entity controlled by the controlling shareholder, any director who regularly provides services to the company or to its controlling shareholder or to an entity controlled by the controlling shareholder, and any director who derives most of his or her income from the controlling shareholder. The chairman of the audit committee must be an external director. A majority of the members of the audit committee constitutes a quorum, provided that the majority of the members present at the meeting are independent directors (within the meaning of the Israeli Companies Law) and at least one external director is present at the meeting.

In addition, the NASDAQ Stock Market Rules require us to establish an audit committee comprised of at least three members, all of whom must be independent directors, each of whom is financially literate and satisfies the respective "independence" requirements of the SEC and NASDAQ and one of whom has accounting or related financial management expertise at senior levels within a company.

Our audit committee meets at least once each quarter. Under the Israeli Companies Law, the roles of the audit committee are (i) to identify deficiencies in the management of our business, including in consultation with the internal auditor and our independent auditors, and to suggest appropriate courses of action to amend such deficiencies; (ii) to define whether certain acts and transactions that involve conflicts of interest are material or and to define whether transactions that involve interested parties are extraordinary or not, and to approve such transactions (which may be approved according to certain criteria set out by our audit committee on an annual basis); (iii) to establish procedures to be followed in respect of related party transactions with a controlling shareholder (where such are not extraordinary transactions), which may include, where applicable, the establishment of a competitive process for such transaction, under the supervision of the audit committee, or individual, or other committee or body selected by the audit committee, in accordance with criteria determined by the audit committee; (iv) to determine procedures for approving certain related party transactions with a controlling shareholder, which having been determined by the audit committee not to be extraordinary transactions, were also determined by the audit committee not to be negligible transactions; (v) to examine the performance of our internal auditor and whether he is provided with the required resources and tools necessary for him to fulfill his role, considering, among others, the company's size and special needs, and to review his annual plan and approve it should the company's articles of association require the approval of the Board for such plan; and (vi) to oversee and approve the retention, performance and compensation of our independent auditors and to establish and oversee the implementation of procedures concerning our systems of internal accounting and auditing control and (vi) to set procedures for handling of complaints made by company's employees in connection with management deficiencies and the protection to be provided to such employees.

The audit committee may consult from time to time with our independent auditors and internal auditor with respect to matters involving financial reporting and internal accounting controls.

In the event the audit committee has discovered a material deficiency in the company's business operations, it must hold at least one meeting regarding such deficiency, at which the internal auditor or the independent accountants must be present and in which office holders who are not members of the audit committee may not participate, except for the presentation of their position.

Our audit committee consists of three members of our board of directors who satisfy the respective requirements of the SEC, NASDAQ and Israeli law for the composition of the audit committee. Our audit committee is currently composed of Messrs. Dovev and Marmorstein and Ms. Rosolio-Aharonson.

## Compensation Committee

Effective December 2012, Israeli law requires our Board of Directors to appoint a compensation committee which must be comprised of at least three directors, including all of the external directors, which shall be a majority of the members of the compensation committee and one of whom must serve as chairman of the committee. However, subject to certain exceptions, Israeli companies whose securities are traded on stock exchanges such as NASDAQ, and who do not have a controlling party, do not have to meet this majority requirement; provided, however, that the compensation committee meets other Companies Law composition requirements, as well as the requirements of the non-Israeli jurisdiction where the company's securities are traded. Other than the external directors, the rest of the members of the compensation committee shall be directors who will compensation for their role as directors only in accordance with Israeli Companies Law regulations applicable to the compensation of external directors, or amounts paid pursuant to indemnification and/or exculpation contracts or commitments and insurance coverage.

On January 9, 2014, our shareholders approved a compensation policy for our company. The compensation policy must be approved every three years by our compensation committee, board of directors and shareholders, voting with a special majority (in that order). The compensation policy is based on and references certain matters and provisions set forth in the Israeli Companies Law, which include: (i) promoting our company's goals, work plan and policy with a long-term view; (ii) creating appropriate incentives for our company's office holders, considering, among other things, our company's risk management policy; (iii) our company's size and nature of operations; and (iv) with respect to variable elements of compensation (such as annual cash bonuses), the office holder's contribution to achieving company objectives and maximization of our company's profits, with a long-term view and in accordance with his or her position. For further details, see our proxy statement for a special general meeting held on January 9, 2014, which we furnished to the SEC on December 5, 2013 under Form 6-K.

Our compensation committee is currently composed of Ms. Rosolio-Aharonson (Chairman of the committee) and Messrs. Marmorstein and Dovev.

## Banking Committee

In March 2014, our Board of Directors established a banking committee, which was authorized to adopt resolutions on behalf of the Board in respect of banking activities, including opening of new accounts and signing credit agreements of up to \$9 million. Our banking committee is currently composed of Mr. Nissan and Ms. Rosolio-Aharonson.

## Internal Audit

The Israeli Companies Law also requires the board of directors of a public company to appoint an internal auditor nominated by the audit committee. The internal auditor must meet certain statutory requirements of independence. The role of the internal auditor is to examine, among other things, the compliance of the company's conduct with applicable law and orderly business practice. Mr. Gali Gana, Certified Public Accountant (Israel), serves as our internal auditor.

## Directors' Service Contracts

There are no arrangements or understandings between us and any of our subsidiaries, on the one hand, and any of our directors, on the other hand, providing for benefits upon termination of their employment or service as directors of our company or any of our subsidiaries.

## Exculpation, Indemnification and Insurance of Directors and Officers

## Exculpation of Office Holders

The Israeli Companies Law provides that an Israeli company cannot exculpate an office holder from liability with respect to a breach of his or her duty of loyalty. If permitted by its articles of association, a company may exculpate in advance an office holder from his or her liability to the company, in whole or in part, with respect to a breach of his or her duty of care. However, a company may not exculpate in advance a director from his or her liability to the company with respect to a breach of his duty of care with respect to distributions.



Our articles of association allow us to exculpate any office holder from his or her liability to us for breach of duty of care, to the maximum extent permitted by law, before or after the occurrence giving rise to such liability. We provided an exemption letter to each of our directors and officers, and agreed to provide the same to our future office holders.

#### Insurance of Office Holders

The Israeli Companies Law provides that a company may, if permitted by its articles of association, enter into a contract to insure office holders in respect of liabilities incurred by the office holder with respect to an act or omission performed in his or her capacity as an office holder, as a result of: (i) a breach of the office holder's duty of care to the company or to another person; (ii) a breach of the office holder's duty of loyalty to the company, provided that the office holder acted in good faith and had reasonable grounds to assume that his or her act would not prejudice the company's interests; or (iii) a monetary liability imposed upon the office holder in favor of another person.

Our articles of association provide that, subject to any restrictions imposed by applicable law, we may procure, and/or undertake to procure, insurance covering any past or present or future office holder against any liability which he or she may incur in such capacity, including insurance covering us for indemnifying such office holder, to the maximum extent permitted by law.

Without derogating from the above, we may enter into a contract to insure the liability of an office holder for an obligation imposed on such office holder in consequence of an act or omission done in such office holder's capacity as an office holder, in the following case: expenses, including reasonable litigation expenses and legal fees, incurred by the office holder as a result of a proceeding instituted against such office holder in relation to (A) infringements that may result in imposition of financial sanction pursuant to the provisions of Chapter H'3 under the Israeli Securities Law of 1968 (as amended), or the "Securities Law", or (B) administrative infringements pursuant to the provisions of Chapter H'4 under the Securities Law or (C) infringements pursuant to the provisions of Chapter I'1 under the Securities Law and (ii) payments made to the injured parties of such infringement under Section 52ND(a)(1)(a) of the Securities Law.

#### Indemnification of Office Holders

The Israeli Companies Law provides that a company may, if permitted by its articles of association, indemnify an office holder for liabilities or expenses imposed on him or her, or incurred by him or her concerning acts or omissions performed by the office holder in such capacity for: (i) a monetary liability imposed on the office holder in favor of another person by any judgment, including a settlement or an arbitrator's award approved by a court; (ii) reasonable litigation expenses, including attorney's fees, incurred by the office holder as a result of an investigation or proceeding instituted against him or her by a competent authority, provided that such investigation or proceeding concluded without the filing of an indictment against the office holder or the imposition of any monetary liability in lieu of criminal proceedings, or concluded without an indictment against the office holder but with the imposition of a monetary liability on the office holder in lieu of criminal proceedings with respect to a criminal offense that does not require proof of criminal intent; and (iii) reasonable litigation expenses, including attorneys' fees, incurred by the office holder or which were imposed on him or her by a court, in an action instituted by the company or on the company's behalf, or by another person, against the office holder, or in a criminal charge from which the office holder was acquitted, or in a criminal proceeding in which the office holder was convicted of a criminal offense which does not require proof of criminal intent.

The Israeli Companies Law provides that a company's articles of association may permit the company to indemnify an office holder following a determination to this effect made by the company after the occurrence of the event in respect of which the office holder will be indemnified. It also provides that a company's articles of association may permit the company to undertake in advance to indemnify an office holder, except that with respect to a monetary liability imposed on the office holder by any judgment, settlement or court-approved arbitration award, the undertaking must

be limited to types of events which the company's board of directors deems foreseeable considering the company's actual operations at the time of the undertaking, and to an amount or standard that the board of directors has determined as reasonable under the circumstances.

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Our articles of association provide that we may indemnify an office holder retroactively for certain obligations or expenses imposed on such office holder in consequence of an act or omission done in such office holder's capacity as an officer in our company. These obligations and expenses include:

- i. a monetary obligation imposed on the office holder in favor of another person pursuant to a judgment, including a judgment given in settlement or an arbitrator's award that has been approved by a court;
- ii. reasonable litigation expenses, including advocates' professional fees, incurred by the office holder pursuant to an investigation or a proceeding commenced against the office holder by a competent authority and that was terminated without an indictment and without having a monetary charge imposed on the office holder in exchange for a criminal procedure (as such terms are defined in the Companies Law), or that was terminated without an indictment but with a monetary charge imposed on the office holder in exchange for a criminal procedure in a crime that does not require proof of criminal intent or in connection with a financial sanction;
- iii. reasonable litigation expenses, including advocates' professional fees, incurred by the office holder or which the office holder is ordered to pay by a court, in proceedings filed against the office holder by the company or on its behalf or by another person, or in a criminal indictment in which the office holder is acquitted, or in a criminal indictment in which the office holder is convicted of an offence that does not require proof of criminal intent;
- iv. expenses, including reasonable litigation expenses and legal fees, incurred by an office holder as a result of a proceeding instituted against such office holder in relation to (A) infringements that may result in imposition of financial sanction pursuant to the provisions of Chapter H'3 under the Securities Law or (B) administrative infringements pursuant to the provisions of Chapter H'4 under the Securities Law or (C) infringements pursuant to the provisions of Chapter I'1 under the Securities Law; and
- v. payments to an injured party of infringement under Section 52ND(a)(1)(a) of the Securities Law.

Our articles of association also provide that we may undertake to indemnify in advance an office holder, in accordance with the conditions set under applicable law, in respect of the obligations or expenses specified in (i)-(v) above, provided that such undertaking is limited to types of events which in the board of directors' opinion may be anticipated, in light of our company's activities, at the time of granting the indemnity undertaking, and to an amount or criteria which the board of directors determines is reasonable in the circumstances of the case, both of which are to be specified in the indemnification undertaking.

According to our compensation policy, the total amount of indemnification that our company undertakes towards all persons whom it has resolved to indemnify, jointly and in the aggregate, shall not exceed an amount equal to \$2 million but in no event more than twenty five percent (25%) of the net equity of our company.

#### Limitations on Exculpation, Insurance and Indemnification

The Israeli Companies Law provides that neither a provision of the articles of association permitting the company to enter into a contract to insure the liability of an office holder, nor a provision in the articles of association or a resolution of the board of directors permitting the indemnification of an office holder, nor a provision in the articles of association exempting an office holder from duty to the company shall be valid, where such insurance, indemnification or exemption relates to any of the following: (i) a breach by the office holder of his duty of loyalty, except with respect to insurance coverage or indemnification if the office holder acted in good faith and had reasonable grounds to assume that the act would not prejudice the company; (ii) a breach by the office holder of his duty of care if such breach was committed intentionally or recklessly, unless the breach was committed only negligently; (iii) any act or omission committed with intent to derive an unlawful personal gain; and (iv) any fine or forfeiture imposed on the office holder.



Under the Israeli Companies Law, exculpation of, procurement of insurance coverage for, and an undertaking to indemnify or indemnification of, an office holder (other than the chief executive officer) must be approved by the company's compensation committee and board of directors and, if such office holder is a director, also by the company's shareholders. Exculpation of, procurement of insurance coverage for, and an undertaking to indemnify or indemnification of, the chief executive officer must be approved by the company's compensation committee, board of directors and by a special majority of the shareholders.

We have agreed to indemnify our office holders for certain liabilities and expenses that may be imposed on them due to acts performed, or failures to act, in their capacity as office holders as defined in the Israeli Companies Law 5759-1999, including financial liabilities imposed by judgments or settlements in favor of third parties, and reasonable litigation expenses imposed by a court in relation to criminal charges from which the indemnitee was acquitted or criminal proceedings in which the indemnitee was convicted of an offense that does not require proof of criminal intent, all subject to Israeli law and certain limitations in the agreements. The aggregate amount we may pay our office holders pursuant to our indemnification undertaking may not exceed, jointly and in the aggregate, \$2 million but in any event not more than 25% of our company's net equity. We currently maintain directors and officers liability insurance with a per claim and aggregate coverage limit of \$10 million. Under our current directors and officers liability insurance policy, losses will be paid in accordance with the following order of priority: first, on behalf of officers and directors, for all loss that they will be obligated to pay as a result of a claim made against them; thereafter, on our behalf, for all loss that an officer or director will be obligated to pay as a result of a claim made against them, to the extent that we are required or permitted by law to indemnify our officers and directors; and thereafter, on our behalf, for all loss that we will be obligated to pay as a result of a securities claim made against us.

D. Employees

As of December 31, 2014, we employed 325 full-time employees in Israel, of which 208 were employed in manufacturing services, 39 in process and product engineering, 43 in quality assurance and control, 13 in sales and marketing and 22 in finance, accounting, information service and administration. As of December 31, 2013, we employed 345 full-time employees in Israel, of which 220 were employed in manufacturing services, 40 in process and product engineering, 46 in quality assurance and control, 15 in sales and marketing and 24 in finance, accounting, information service and administration. As of December 31, 2012, we employed 343 full-time employees in Israel, of which 221 were employed in manufacturing services, 39 in process and product engineering, 43 in quality assurance and control, 15 in sales and marketing and 25 in finance, accounting, information service and administration.

In addition, Kubatronik, our subsidiary in Germany, employed 38 full-time employees and 2 part-time employees as of December 31, 2014, 44 full-time employees and five part-time employees as of December 31, 2013, and 45 full-time employees and five part-time employees as of December 31, 2012.

Eltek USA, a wholly-owned Delaware subsidiary, employed three full-time employees as of December 31, 2013 and 2014 and four employees as of December 31, 2012.

Our relationships with our employees in Israel are governed by Israeli labor law, extension orders of the Israeli Ministry of Labor and personal employment agreements. We are subject to various Israeli labor laws, general collective bargaining agreements entered into, from time to time, between the Histadrut and the Manufacturers Association, as well as specific and local agreements and arrangements. Such laws, agreements, and arrangements cover the wages and employment conditions of our employees, including length of the workday, minimum daily wages for professional workers, contribution to pension fund, insurance for work related accidents, procedures for dismissing employees, determination of severance pay, benefit programs and annual leave. We generally provide our Israeli employees with benefits and working conditions beyond the minimums required by law.

In November 2011, we were notified by the Histadrut that more than one-third of our employees in Israel had decided to join the Histadrut and that they have established an employees' union committee. In 2012, a significant portion of our employees decided to resign their membership in the Histadrut, which then ceased to represent our employees.

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In addition, certain of our officers, key employees and other employees are party to individual employment agreements. We have entered into a non-disclosure and non-competition agreement with some of our executive officers. All of our officers and employees are subject to confidential and proprietary information provisions set forth in our Code of Business Conduct and Ethics.

Pursuant to Israeli law, we are legally required to pay severance benefits upon certain circumstances, including the retirement or death of an employee or the termination of employment of an employee without due cause, equivalent to a one month salary for each year of employment with the company. Most of our employees are covered by pension plans providing customary benefits including retirement and severance benefits. Some of our employees are covered by life and pension insurance policies providing similar benefits. We contribute 8.33% of base salaries to the employees' pension funds or life pension insurance policies to cover our liability for severance pay. Pursuant to Section 14 of the Israeli Severance Pay Law, if a company contributes to an employee's pension fund or severance fund, then the employee is entitled only to the severance amounts accumulated in such fund(s) upon resignation from the company or termination by the company, and the company is not obligated to make additional payments to the employee upon termination of employment with the company.

With respect to pension benefits, we contribute between 6.0% to 7.5% of base salaries to the employees' pension plans and between 6.2% to 6.8% to those employees who have life insurance policies. The employees who have pension plans contribute between 5.5% to 7.0% of base salaries to their pension plans, and the employees who have life insurance policies contribute 5.0% of their base salaries to their policies. In addition, we contribute between 6% to 8.33% for severance pay into the employees' life insurance policies, pension plans or similar funds of their choice.

We also contribute between 1% to 7.5% of base salaries to certain "professional advancement" funds for managers, engineers and certain others and such employees have to match such contribution, up to 2.5% of their base salaries.

Israeli employers and employees are required to pay predetermined sums to the National Insurance Institute, which is similar to the United States Social Security Administration. Subject to minimum thresholds, the employer contribution to the National Insurance Institute is at the rate of 7.25% of the salary (6.75% in 2014) and the employee contribution to the National Insurance Institute is at the rate of 12.0% of the salary (of which 5% relates to payments for national health insurance), both of which are limited to a maximum salary of NIS 43,240 (approximately \$12,350) in 2015, the same as in 2014 and 2013. In the year ended December 31, 2014, our aggregate payments as an employer to the National Insurance Institute amounted to approximately 4.4% of the salaries.

#### E. Share Ownership

##### Beneficial Ownership of Executive Officers and Directors

The following table sets forth certain information as of March 31, 2015 regarding the beneficial ownership of our ordinary shares by our directors and executive officers and all of our executive officers and directors as a group:

| Name  | Number of Ordinary Shares Beneficially Owned | Percentage of Outstanding Ordinary Shares |   |
|---|--|---|---|
| Yitzhak Nissan*   | 5,122,095                                    | 50.5                                      | % |
| All executive officers and directors as a group (19 persons)* | 5,122,095                                    | 50.5                                      | % |

\* Except for Mr. Nissan, none of our directors or executive officers held any ordinary shares or options.





## ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

## A. Major Shareholders

The following table sets forth certain information as of March 31, 2015 regarding the beneficial ownership by all shareholders known to us to own beneficially 5% or more of our ordinary shares:

| Name               | Number of Ordinary Shares Beneficially Owned (1) | Percentage of Ownership (2) |   |
|--------------------|--|-----------------------------|---|
| Nistec Ltd. (3)    | 5,122,095  | 50.5                        | % |
| Yitzhak Nissan (3) | 5,122,095  | 50.5                        | % |

(1) Beneficial ownership is determined in accordance with the rules of the SEC and generally includes voting or investment power with respect to securities. Ordinary shares relating to options or convertible notes currently exercisable or exercisable within 60 days of the date of this table are deemed outstanding for computing the percentage of the person holding such securities but are not deemed outstanding for computing the percentage of any other person. Except as indicated by footnote, and subject to community property laws where applicable, the persons named in the table above have sole voting and investment power with respect to all shares shown as beneficially owned by them.

(2) The percentages shown are based on 10,142,762 ordinary shares issued and outstanding as of March 31, 2015.

(3) Nistec Ltd. is an Israeli private company controlled by Yitzhak Nissan. Accordingly, Mr. Nissan may be deemed to be the beneficial owner of the ordinary shares held directly by Nistec.

## Significant Changes in the Ownership of Major Shareholders

On August 19, 2013, we entered into an agreement to issue and sell 3,532,655 ordinary shares of our company, nominal value NIS 0.6 each, to Nistec for \$4.2 million. Nistec is controlled by Yitzhak Nissan, who beneficially owns all of the shares owned by Nistec. Also on August 19, 2013, Nistec purchased 1,589,440 of our ordinary shares from Merhav M.N.F. Ltd., which at the time held 24.1% of our outstanding ordinary shares. The total consideration paid by Nistec in the two transactions was \$6.5 million. Nistec obtained a portion of those funds from a loan extended by Bank Leumi Le'Israel, and the shares that Nistec acquired constitute collateral for the loan.

As a result of these transactions, which were closed on November 1, 2013, Nistec acquired 50.5% of our ordinary shares, which constitute 50.5% of our issued share capital on a fully diluted basis, and Nistec gained control of our company. Several of our directors resigned, and four new directors were nominated and elected, including Yitzhak Nissan, who was elected Chairman of our Board of Directors. We also approved compensation terms for the directors, indemnification agreements between our company and our new directors, granted exculpation letters to our directors and officers, granted waiver and release letters to our then-current directors and officers, and purchased a run-off insurance policy for our then-current directors and officers. We also amended our Articles of Association along with our issuance of the shares to Nistec. Nistec and Yitzhak Nissan have the shared power to vote, dispose of, direct the vote of, and direct the disposition of the 5,122,095 ordinary shares of our company beneficially owned by Nistec.

## Major Shareholders Voting Rights

Our principal shareholders do not have different voting rights attached to their ordinary shares.

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## Record Holders

Based on the information provided to us by our transfer agent, as of March 30, 2015, there were 13 holders of record of our ordinary shares, of which 8 record holders holding approximately 0.2% of our ordinary shares had registered addresses in the United States. These numbers are not representative of the number of beneficial holders of our shares nor are they representative of where such beneficial holders reside, since many of our ordinary shares were held of record by brokers or other nominees (including one U.S. nominee company, CEDE & Co., which held approximately 48.8% of our outstanding ordinary shares as of such date).

## B. Related Party Transactions

Until November 2013, our former principal shareholder Mr. Josef Maiman (through entities under his control) owned Gadot, one of our major raw material suppliers. For the periods ended October 31, 2013 and December 31, 2012 and 2011, we purchased raw materials from Gadot in the aggregate amount of \$3.4 million, \$3.3 million, and \$2.7 million, respectively. As of December 31, 2012 and 2011, our accounts payable to Gadot amounted to \$1.3 million, and \$1.0 million, respectively. As of December 31, 2013, Gadot was no longer a related party.. Our transactions with Gadot are carried out on an arm's-length basis. The nature of our business relationship with Gadot did not change following the acquisition of Gadot by Mr. Maiman in 2008, nor did the scope of our annual purchases of alternative raw materials, other than to the extent that the amount of our purchases has increased as our use of raw materials has increased. According to the Israeli Companies Law, we were required to present the transaction for the approval of our shareholders, and it was approved in our 2011 annual general meeting of shareholders.

In connection with our investment agreement signed in August 2013 with Nistec for Nistec's acquisition of a controlling stake in our company, we entered into several transactions with Nistec and undertook several undertakings in favor of Mr. Yitzhak Nissan, who is the owner of Nistec, and other directors who were elected pursuant to Nistec's acquisition of a controlling interest in our company. These transactions and undertakings included, among others:

- A registration rights agreement with Nistec;
- A management agreement with Nistec;
- A finder's fee paid to Merhav M.N.F. Ltd.; and
- Approvals of compensation, indemnification, exculpation, waiver and release, run-off insurance, and directors' and officers' insurance policies, in favor of directors and officers of our company.

For details regarding these transactions, see the proxy statement we furnished to the SEC under Form 6-K on September 12, 2013.

On April 27, 2014 our Audit Committee and Board of Directors approved: (i) our engagement with Nistec in a shared insurance purchase transaction; and (ii) the distribution of costs of a shared insurance consultant. For details regarding these transactions, see the notice regarding purchase of joint insurance with Nistec furnished to the SEC under Form 6-K on May 27, 2014.

The Israeli Companies Law requires that extraordinary transactions of a company with its controlling shareholders shall be subject to shareholder approval at a special majority. Under a recent amendment to the Israeli Companies Law, the Audit Committee is required to classify a related party transaction as extraordinary, ordinary or negligible. The classification can be based on pre-set parameters that shall apply for a one year term. On June 30, 2014 and on July 3, 2014, the Audit Committee and the Board of Directors, respectively, approved such parameters that shall be used for the classifications of transactions of our company with Nistec, as ordinary or negligible transactions.



C. Interests of Experts and Counsel

Not applicable.

ITEM 8. FINANCIAL INFORMATION

A. Consolidated Statements and Other Financial Information

See the consolidated financial statements, including the notes thereto, and the exhibits listed in Item 18 hereof.

Legal Proceedings

From time to time we are involved in legal proceedings arising from the operation of our business. Based on the advice of our legal counsel, management believes that except for the proceedings discussed below, such current proceedings, if any, will not have a material adverse effect on our financial position or results of operations.

Environmental Related Matters

On August 25, 2009, we received a notice from the Petach Tikva Municipality claiming that random automatic wastewater sampling in proximity of our plant indicates high levels of metal concentrations which exceed the amounts permitted by law. The Municipality requested our explanations to such alleged violation and further informed us that its environmental department has determined to initiate procedures against any plant that is not in compliance with the permitted concentrations. On September 16, 2009, we sent a letter to the Municipality explaining that we have invested extensive funds and resources each year in order to comply with all environmental legal requirements. We further indicated that we have been and are still engaged in several projects to reduce salt and metal concentrations in our plant wastewater and that we constantly update our procedures with respect to environmental matters. In addition, we proposed to collaborate with the Municipality and conduct mutual tests to ensure maximum protection of the environment. To date, we have not received any response from the Municipality to our letter dated September 16, 2009.

In January 2014 and in July 2014, we received notices from Meitav, the water company of the Petach Tikva municipality, requiring payment of fees totaling NIS 1.4 million (\$390,000) excluding VAT, for discharges of industrial wastewater allegedly not meeting the applicable standards into the municipal sewage system. The payment demands were made on the basis of four samplings conducted by Meitav in our premises during 2013. We presented to Meitav our plans for a new wastewater treatment facility, in an effort to have Meitav rescind or reduce its demand for payment. Management believes that that we have good arguments against such demand for payment and that we will not be required to pay to Meitav any amounts exceeding the amounts provided for in our financial statements. In July 2014, we entered into an agreement with Elad Technologies (L.S) Ltd., pursuant to which Elad Technologies will build and operate a wastewater treatment facility for our company. We expect the facility to become operational in the second half of 2015.

If we are found to be in violation of environmental laws, then in addition to fees, we could be liable for damages, costs of remedial actions and a range of potential penalties, and could also be subject to revocation of permits necessary to conduct our business or any part thereof. Any such liability or revocation could have a material adverse effect on our business, financial condition and results of operations.

In connection with the change of control of our company that resulted from Nistec's acquisition of a controlling stake in our company, Israeli law requires us to obtain a new business permit in order to continue operating our business. We have submitted an application for this permit, but we have not yet received the new permit. The new permit is

expected to be subject to certain conditions, especially certain conditions imposed by the Israeli Ministry for Environmental Protection. Compliance with these conditions may be costly.

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## Employee Related Matters

Three lawsuits were filed against us in May 2008, in March 2012 and in December 2014 by three employees alleging that they had suffered personal injuries during their employment with us and are seeking aggregate financial compensation of approximately \$200,000 for past damages and additional amounts for future lost income, pain and suffering as the court may determine.

Four other employees notified us between January 2011 and July 2013 that they allegedly suffered personal injuries during their employment with us. Of these four employees, one is seeking compensation of \$170,000 and the others did not state their claim amount. We submitted the claims to our insurance company, which informed us that it is reviewing the statements of claim without prejudicing its rights to deny coverage.

In January 2015 and February 2015 two former employees demanded additional payments in connection with their employment with the company and subsequent termination. The aggregate amount claimed is approximately \$380,000.

On April 1, 2015 a former employee submitted to the Company a demand letter for additional payments in connection with his employment with the company and subsequent termination. The total amount claimed is approximately \$212,000.

## Software License

A supplier of one of our software packages asked to conduct an audit of our operation to verify that we are not in breach of any intellectual property rights he allegedly owns. We believe that we have fully, diligently and timely complied with our obligation toward the supplier. We also believe that the supplier has no right to conduct any audit of our products or services and such audit may cause us to breach confidentiality obligations to other entities. If a claim is made and we are found to be in violation of such supplier's intellectual property rights, we could be liable for compensation and costs of an unknown amount. Such liability could have a material adverse effect on our business, financial condition and results of operations.

## Dividend Distribution Policy

We have never declared or paid any cash dividends to our shareholders. We currently intend to retain future earnings for use in our business and do not anticipate paying cash dividends on our ordinary shares in the foreseeable future. Any future dividend policy will be determined by our board of directors and will be based upon conditions then existing, including our results of operations, financial condition, current and anticipated cash needs, contractual restrictions and other conditions.

According to the Israeli Companies Law, a company may distribute dividends out of its profits provided that there is no reasonable concern that such dividend distribution will prevent the company from paying all its current and foreseeable obligations, as they become due. Notwithstanding the foregoing, dividends may be paid even if not out of profits, with the approval of a court, provided that there is no reasonable concern that such dividend distribution will prevent the company from satisfying its current and foreseeable obligations, as they become due. Profits, for purposes of the Israeli Companies Law, means the greater of retained earnings or earnings accumulated during the preceding two years, after deducting previous distributions that were not deducted from the surpluses. In the event cash dividends are declared, such dividends will be paid in NIS.

## B. Significant Changes

None.





## ITEM 9. THE OFFER AND LISTING

## A. Offer and Listing Details

## Annual Stock Information

The following table sets forth, for each of the years indicated, the high and low market prices of our ordinary shares on the NASDAQ Capital Market:

| Year | High    | Low     |
|------|---------|---------|
| 2010 | \$ 1.82 | \$ 0.84 |
| 2011 | \$ 1.85 | \$ 0.91 |
| 2012 | \$ 1.69 | \$ 0.87 |
| 2013 | \$ 3.95 | \$ 1.07 |
| 2014 | \$ 2.87 | \$ 1.14 |

## Quarterly Stock Information

The following table sets forth, for each of the full financial quarters in the two most recent full financial years and any subsequent period, the high and low market prices of our ordinary shares on the NASDAQ Capital Market:

|  | High    | Low     |
|--|---------|---------|
| 2013                                   |         |         |
| First Quarter .                        | \$ 1.40 | \$ 1.09 |
| Second Quarter                         | \$ 1.40 | \$ 1.07 |
| Third Quarter .                        | \$ 1.80 | \$ 1.08 |
| Fourth Quarter                         | \$ 3.95 | \$ 1.23 |
| 2014                                   |         |         |
| First Quarter .                        | \$ 2.87 | \$ 2.18 |
| Second Quarter                         | \$ 2.44 | \$ 1.26 |
| Third Quarter .                        | \$ 1.78 | \$ 1.40 |
| Fourth Quarter                         | \$ 2.35 | \$ 1.14 |
| 2015                                   |         |         |
| First Quarter (through March 31, 2015) | \$ 1.30 | 1.02    |

## Monthly Stock Information

The following table sets forth, for each of the most recent six months, the high and low market prices of our ordinary shares on the NASDAQ Capital Market:

| Month          | High    | Low     |
|----------------|---------|---------|
| September 2014 | \$ 1.78 | \$ 1.45 |
| October 2014   | \$ 2.35 | \$ 1.45 |
| November 2014  | \$ 1.68 | \$ 1.38 |
| December 2014  | \$ 1.53 | \$ 1.14 |

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|                                     |         |         |
|-------------------------------------|---------|---------|
| January 2015                        | \$ 1.23 | \$ 1.02 |
| February 2015                       | \$ 1.30 | \$ 1.13 |
| March 2015 (through March 31, 2015) | \$ 1.29 | \$ 1.12 |

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B. Plan of Distribution

Not applicable.

C. Markets

Our ordinary shares were listed on the NASDAQ National Market from our initial public offering on January 22, 1997 until May 19, 1999, at which date the listing of our ordinary shares was transferred to the NASDAQ Capital Market (symbol: ELTK).

D. Selling Shareholders

Not applicable.

E. Dilution

Not applicable.

F. Expense of the Issue

Not applicable.

ITEM 10. ADDITIONAL INFORMATION

A. Share Capital

Not applicable.

B. Memorandum and Articles of Association

Set out below is a description of certain provisions of our memorandum of association and articles of association and of the Israeli Companies Law related to such provisions. This description is only a summary and does not purport to be complete and is qualified by reference to the full text of the memorandum of association and articles of association, which are incorporated by reference as exhibits to this Annual Report, and to Israeli law.

Purposes and Objects of the Company

We are registered with the Israeli Registrar of Companies and have been assigned company number 52-004295-3. Section 2 of our memorandum of association provides that we were established for the purpose of engaging in the business of developing, manufacturing, producing, vending, importing, exporting, supplying, distributing and dealing in printed, multi-layer, flexible, thick film, hybrid and integrated circuits, components or portions thereof, processes for making the same and related products. In addition, the purpose of our company is to perform various corporate activities permissible under Israeli law.

The Powers of the Directors

Under the provisions of the Israeli Companies Law and our articles of association, a director cannot vote on a proposal, arrangement or contract in which he or she has personal interest in, nor be present in the discussion relating to such transaction is considered. In addition, our directors' compensation is approved through special

procedures prescribed in the Israeli Companies Law. In general, with respect to a director's compensation, approval is required by the (i) compensation committee, (ii) board of directors and (iii) company's shareholders with a regular majority (in that order).

The authority of our directors to enter into borrowing arrangements on our behalf is not limited, except in the same manner as any other transaction by us.

Under our articles of association, the service of directors in office is not subject to any age limitation and our directors are not required to own shares in our company in order to qualify to serve as directors.

#### Rights Attached to Shares

Our authorized share capital consists of NIS 30,000,000 divided into 50,000,000 ordinary shares, nominal value of NIS 0.6 each. All outstanding ordinary shares are validly issued, fully paid and non-assessable. The rights attached to the ordinary shares are as follows:

**Dividend rights.** Holders of our ordinary shares are entitled to the full amount of any cash or share dividend subsequently declared. The board of directors may declare interim dividends and propose the final dividend with respect to any fiscal year only out of its profits, as defined under the Israeli Companies Law. See Item 8A. “Financial Information – Consolidated and Other Financial Information – Dividend Distributions Policy.” If after 30 days a dividend has been declared and it is still unclaimed, the dividend may be invested or otherwise used by us for our own account, as we deem fit, until such dividend is claimed; and we will not be deemed a trustee in respect thereof. We are not obliged to pay, and may not pay interest on declared but unpaid dividends if the shareholders entitled to such dividends fails to collect the same or to provide us the necessary information for the payment thereof, or if we are for any other reason unable to pay the dividend to such shareholder.

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

Unless otherwise required by law or our articles of association, all resolutions require approval of no less than a majority of the voting rights represented at the meeting in person or by proxy and voting thereon.

Generally, at each annual meeting of shareholders, directors are elected by a vote of the holders of a majority of the voting power represented and voting on the matter. All the members of our board of directors (except our external directors) may be reelected upon completion of their term of office. For information regarding the election of our external directors, see Item 6C. “Directors, Senior Management and Employees – Board Practices – External and Independent Directors.”

**Rights to share in our profits.** Our shareholders have the right to share in our profits distributed as a dividend and any other permitted distribution. See this Item 10B. “Additional Information – Memorandum and Articles of Association – Rights Attached to Shares – Dividend Rights.”

**Rights to share in surplus in the event of liquidation.** In the event of our liquidation, after satisfaction of liabilities to creditors, our assets will be distributed to the holders of ordinary shares in proportion to the nominal value of their holdings. This right may be affected by the grant of preferential dividend or distribution rights to the holders of a class of shares with preferential rights that may be authorized in the future.

#### Changing Rights Attached to Shares

According to our articles of association, in order to change the rights attached to any class of shares, such change must be adopted by a resolution in writing by the holders of the majority of the issued shares of such class or by an ordinary resolution at a separate general meeting of the holders of the affected class.

Annual and Extraordinary Meetings of Shareholders

The board of directors must convene an annual general meeting of shareholders at least once every calendar year, within 15 months of the last annual meeting. Depending on the matter to be voted upon, notice of at least 21 days or 35 days prior to the date of the meeting is required. In addition, the board of directors must convene a special general meeting of the shareholders upon the demand of any of: two of the directors; 25% of the nominated directors; one or more shareholders holding at least 5% of our company's issued and outstanding share capital and at least 1% of the voting power in the company; or, one or more shareholders holding at least 5% of the voting power in our company. See this Item 10B. "Additional Information - Memorandum and Articles of Association- Rights Attached to Shares-Voting Rights."

The quorum required for a shareholders meeting consists of at least two shareholders present in person or represented by proxy who hold or represent, in the aggregate, at least one third of the voting rights of the issued share capital. A meeting adjourned for lack of a quorum is adjourned by seven business days, at the same time and place, or any later time and place as the board of directors designate in a notice to the shareholders. The requisite quorum at an adjourned general meeting will be: (i) if the original meeting was convened upon requisition by shareholders pursuant to the Israeli Companies Law - the number of shareholders holding the minimum number of voting shares necessary to make such requisition, present in person or by proxy; and (ii) in any other event - one or more shareholders, present in person or by proxy, holding at least one share. We do not follow the requirements of the NASDAQ Stock Market Rules regarding the quorum at shareholder meetings. See Item 16G. "Corporate Governance."

#### Limitations on the Rights to Own Securities in Our Company

Neither our memorandum of association nor our articles of association nor the laws of the State of Israel restrict in any way the ownership or voting of shares by non-residents, except with respect to subjects of countries that are in a state of war with Israel.

#### Provisions Restricting Change in Control of Our Company

**Full Tender Offer.** A person wishing to acquire shares of a publicly traded Israeli company who would as a result hold over 90% of the company's issued and outstanding share capital, or of a certain class of shares, is required by the Israeli Companies Law to make a full tender offer to all of the company's shareholders for the purchase of all of the remaining issued and outstanding shares of the company, or the class of shares, as the case may be. If (i) the shareholders who do not accept the offer hold less than 5% of the issued share capital of the company, or of the relevant class of shares, and the majority of shareholders having no personal interest in the offer accepted it; or (ii) shareholders who do not accept the offer hold less than 2% of the issued share capital of the company; then all of the shares that the acquirer offered to purchase will be transferred to the acquirer by operation of law. However, the shareholders may petition the court to determine the consideration for the acquisition if the consideration is less than the shares' fair value (unless the acquirer has specified in the tender offer that any shareholder tendering his shares will not be entitled to such appraisal rights). If the dissenting shareholders hold more than 5% of the issued and outstanding share capital of the company, or of the relevant class of shares, as the case may be, the acquirer may not acquire additional shares of the company from shareholders who accepted the tender offer if following such acquisition the acquirer would own over 90% of the company's issued and outstanding share capital, or of the relevant class of shares.

**Special Tender Offer.** The Israeli Companies Law provides that an acquisition of control bloc of shares in a public Israeli company must be made by means of a special tender offer if as a result of the transaction the acquirer could become a holder of 25% or more of the voting rights in the company, unless one of the exemptions in the Israeli Companies Law (as described below) is met. This rule does not apply if there is already another holder of at least 25% of the voting rights in the company. Similarly, the Israeli Companies Law provides that an acquisition of shares in a public company must be made by means of a tender offer if as a result of the acquisition the purchaser could become a holder of more than 45% of the voting rights in the company, if there is no other shareholder of the company who holds more than 45% of the voting rights in the company, unless one of the exemptions in the Israeli Companies Law is met. Such exemptions include: (a) acquisition of shares issued pursuant to a private placement approved by a general meeting of the company as a private placement intended to provide the purchaser with holdings of 25% or more of the voting rights in the company, if there is no other shareholder of the company who holds more than 25% of the voting rights in the company, or with holdings of more than 45% of the voting rights in the company, if there is no other shareholder of the company who holds more than 45% of the voting rights in the company, (b) acquisition of shares from a holder of 25% or more of the voting rights in the company following which the purchaser will hold 25% or more of the voting rights in the company, or (c) acquisition of shares from a holder of 45% or more of the voting rights in the company following which the purchaser will hold 45% or more of the voting rights in the company.





A special tender offer must be extended to all shareholders of a company, but the offeror is not required to purchase shares representing more than 5% of the voting power attached to the company's outstanding shares, regardless of how many shares are tendered by shareholders. A special tender offer may be consummated only if (1) at least 5% of the voting power attached to the company's outstanding shares will be acquired by the offeror and (2) the number of shares tendered in the offer exceeds the number of shares whose holders objected to the offer (disregarding holders who control the offeror or have a personal interest in the acceptance of the offer or holders of 25% or more of the voting rights of the company, any of their relatives, or corporations controlled by any of the above).

If a special tender offer is accepted, then the purchaser, any corporation controlled by it, or any person or entity controlling it or under common control with the purchaser may not make a subsequent tender offer for the purchase of shares of the target company and may not enter into a merger with the target company for a period of one year from the date of the offer, unless the purchaser or such person or entity undertook to effect such an offer or merger in the initial special tender offer.

**Merger.** The Israeli Companies Law permits merger transactions between Israeli companies, if approved by each party's board of directors and, unless certain requirements described under the Israeli Companies Law are met, the majority of each party's shares voted on the proposed merger at a shareholders meeting convened with prior notice of at least 35 days. A merger is defined as the transfer of all assets and liabilities, including conditional, future, known and unknown debts of the target company to the surviving company, as a result of which the target company is liquidated, and stricken out of the Companies Register.

Since our company was incorporated prior to the entry into effect of the Companies Law, a merger transaction requires the approval of a special majority of 75% or more of the shareholders voting on the matter (disregarding abstentions. For purposes of the shareholder vote, unless a court rules otherwise, the merger will not be deemed approved if a majority of the votes of shares represented at the shareholders meeting (disregarding abstentions) that are held by any of (1) parties other than the other party to the merger, (2) parties who hold 25% or more of the voting rights or any means of control or the right to appoint 25% or more of the directors of the other party, or (3) anyone on such parties' behalf, including relatives of such parties and corporations controlled them, vote against the merger. If, however, the merger involves a merger with a company's own controlling party or if the controlling party has a personal interest in the merger, then the merger is instead subject to the same special majority approval that governs all extraordinary transactions with controlling parties.

If the transaction would have been approved by the shareholders of a merging company but for the separate approval of each class or the exclusion of the votes of certain shareholders as provided above, a court may still approve the merger upon the request of holders of at least 25% of the voting rights of a company, if the court holds that the merger is fair and reasonable, taking into account the appraisal of the value of the parties to the merger and the consideration offered to the shareholders of the company.

Upon the request of a creditor of either party to the proposed merger, the court may delay or prevent the merger if it concludes that there exists a reasonable concern that, as a result of the merger, the surviving company will be unable to satisfy the obligations of any of the parties to the merger, and may further give instructions to secure the rights of creditors.

In addition, a merger may not be consummated until at least 50 days have passed from the date on which a proposal for approval of the merger was filed by each party with the Israeli Registrar of Companies and at least 30 days have passed from the date on which the merger was approved by the shareholders of each party.

Notwithstanding the foregoing, a merger is not subject to the approval of the shareholders of the target company if the target company is a wholly-owned subsidiary of the acquiring company. A merger is not subject to the approval of the shareholders of the acquiring company in any of the following events:

- the merger does not require the alteration of the memorandum or articles of association of the acquiring company;
- the acquiring company would not issue more than 20% of the voting rights thereof to the shareholders of the target company in the course of the merger and no person will become, as a result of the merger, a controlling shareholder of the acquiring company, on a fully diluted basis;
- neither the target company, nor any shareholder that holds 25% of the means of control of the target company is a shareholder of the acquiring company and there is no person that holds 25% or more of the means of control in both companies.

#### Disclosure of Shareholders Ownership

The Israeli Securities Law and regulations promulgated thereunder do not require a company whose shares are publicly traded solely on a stock exchange outside of Israel, as in the case of our company, to disclose its share ownership in the records of the Israeli Companies Registrar.

#### Changes in Our Capital

Changes in our capital are subject to the approval of a simple majority of shareholders present and voting at any shareholders meeting.

#### C. Material Contracts

**August 2013 Investment Agreement.** On August 19, 2013, we entered into an agreement to issue and sell 3,532,655 ordinary shares of our company, nominal value NIS 0.6 each, to Nistec for \$4.2 million. Nistec is controlled by Yitzhak Nissan, who beneficially owns all of the shares owned by Nistec. Also on August 19, 2013, Nistec purchased 1,589,440 of our ordinary shares from Merhav M.N.F. Ltd, which at the time held 24.1% of our outstanding ordinary shares. The total consideration paid by Nistec in the two transactions was \$6,500,000. Nistec obtained a portion of those funds from a loan extended by Bank Leumi Le'Israel in the amount of approximately \$4,755,165 (based on the exchange rate between the NIS and the dollar published by the Bank of Israel on the date of the transactions), and the shares that Nistec acquired constitute collateral for the loan. As a result of these transactions, Nistec acquired 50.5% of our ordinary shares, which constitute 50.5% of our issued share capital on a fully diluted basis, and Nistec gained control of our company. Several of our directors resigned, and four new directors were nominated and elected, including Yitzhak Nissan, who was elected Chairman of our Board of Directors. We also amended our Articles of Association along with our issuance of the shares to Nistec. Nistec and Yitzhak Nissan have the shared power to vote, dispose of, direct the vote of, and direct the disposition of the 5,122,095 ordinary shares of our company beneficially owned by Nistec.

**Registration Rights Agreement.** In connection with our investment agreement with Nistec, on August 19, 2013 we entered into a registration rights agreement with Nistec, pursuant to which we agreed to register under the Securities Act of 1933 some or all of the ordinary shares sold to Nistec upon its "demand," at any time after one year following the consummation of the sale. Nistec is entitled to an aggregate of four demand registrations, subject to certain conditions. We also agreed to grant Nistec "piggyback" registration rights that allow it to include its ordinary shares in any public offering of equity securities initiated by us. We may postpone or withdraw the filing or the effectiveness of a piggyback registration at any time in our sole discretion. Under the registration rights agreement, we also agreed to indemnify Nistec against any losses or damages resulting from any untrue statement or omission of material fact in

any registration statement or prospectus pursuant to which they sell ordinary shares, unless such liability arose in reliance upon information furnished in writing by Nistec. We will pay all expenses incurred by our company in connection with any such registrations in addition to reasonable fees and disbursements of counsel to Nistec. The selling expenses relating to the ordinary shares owned by Nistec will be borne and paid by Nistec.

Management Agreement. Under the terms of the investment agreement with Nistec and as a condition thereof, and since Nistec has significant experience and skills in the markets in which we operate, on August 19, 2013 we entered into a management agreement with Nistec which became effective as of the closing of the investment agreement. Under the management agreement, Mr. Yitzhak Nissan, the owner of Nistec, will serve as the chairman of our Board of Directors. As such, Mr. Nissan will provide us with the following services: (a) coordination of the activities of our Board of Directors with respect to the development of the long term strategy for our company; (b) guidance to our Board of Directors with respect to the implementation by management of its strategy, work plans and budget, as shall be determined from time to time by our Board of Directors; (c) coordination of the activities of our Board of Directors with respect to the regulation and implementation of proper corporate governance practices; (d) coordination of the activities of our Board of Directors for the purpose of the approval of quarterly and annual financial statements and reports; (e) development and retention of relations with current and future strategic investors; (f) general guidance and management of the activities of our Board of Directors; (g) advancement of our company's efforts with respect to the realization of its business development strategy, including the pursuit of mergers and acquisition opportunities in cooperation with the chief executive officer of our company; (h) coordination of the activities of our Board of Directors with respect to the definition of strategic financial targets and in attaining said targets; and (i) guidance in the optimization and steps to be taken to increase the efficiency of our company's production and operation systems. In consideration for performing the above services, we agreed to pay Nistec a monthly fixed fee of NIS 90,000, plus applicable VAT. Reimbursement of expenses will be subject to our company's policy approved in advance by the Audit Committee and shall not exceed an aggregate amount of NIS 10,000 per calendar quarter. The management agreement will be in force for a term of three years, subject to any applicable law.

Finder's Fee. Also in connection with our investment agreement with Nistec, on August 19, 2013 we agreed to pay a one-time finder's fee of \$200,000 (plus applicable VAT) to Merhav, for introducing Nistec to us and facilitating the transaction contemplated by the investment agreement.

D. Exchange Controls

Israeli law and regulations do not impose any material foreign exchange restrictions on non-Israeli holders of our ordinary shares. Non-residents of Israel who purchase our ordinary shares will be able to convert dividends, if any, thereon, and any amounts payable upon our dissolution, liquidation or winding up, as well as the proceeds of any sale in Israel of our ordinary shares to an Israeli resident, into freely repatriable dollars, at the exchange rate prevailing at the time of conversion, provided that the Israeli income tax has been withheld (or paid) with respect to such amounts or an exemption has been obtained.

E. Taxation

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

Holders of our ordinary shares should consult their own tax advisors as to the United States, Israeli or other tax consequences of the purchase, ownership and disposition of ordinary shares, including, in particular, the effect of any foreign, state or local taxes.

Israeli Tax Considerations

General Corporate Tax Structure

Israeli companies are generally subject to income tax on their taxable income. The regular corporate tax rate in Israel for 2013 was 25% and was increased to 26.5% in 2014 and onwards. However, the effective rate of tax payable by a company which is qualified under Israeli law as an “Industrial Company” and/or which derives income from an “approved enterprise” or a “benefited enterprise” (as further discussed below) may be lower. See this Item 10E. “Additional Information – Taxation - Tax Benefits Under the Law for the Encouragement of Capital Investments, 1959.”

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

Pursuant to the Law for the Encouragement of Industry (Taxes), 1969, or the Industry Law, a company qualifies as an “Industrial Company” if it resides in Israel and at least 90% of its income in any tax year, determined in Israeli currency (exclusive of income from defense loans, capital gains, interest and dividends) is derived from an “Industrial Enterprise” it owns. An “Industrial Enterprise” is defined for purposes of the Industry Law as an enterprise whose majority activity in a given tax year is industrial production.

We believe that we are currently an Industrial Company. An Industrial Company is entitled to certain tax benefits, including a deduction of the purchase price of patents or certain other intangible property rights at the rate of 12.5% per annum.

Prior to January 1, 2011, the tax laws and regulations dealing with the adjustment of taxable income for local inflation provided that Industrial Enterprises, such as us, were eligible for special rates of depreciation deductions. These rates vary in the case of plant and machinery according to the number of shifts in which the equipment is being operated and generally range from 20% to 40% on a straight-line basis, a 30% to 50% on a declining balance basis for equipment first put into operation on or after June 1, 1989 (instead of the regular rates which are applied on a straight-line basis). The applicable regulations are valid for machinery whose first operation was not later than December 31, 2013.

Moreover, Industrial Enterprises that are approved enterprises or benefited enterprises (see below) can choose between (a) the special depreciation rates referred to above or (b) accelerated regular rates of depreciation applied on a straight-line basis in respect of property and equipment, generally ranging from 200% (for equipment) to 400% (for buildings) of the ordinary depreciation rates during the first five years of service of these assets, provided that the depreciation on a building may not exceed 20% per annum.

Eligibility for benefits under the Industry Law is not contingent upon the prior approval of any Government agency. There can be no assurance that we will continue to so qualify, or will be able to avail ourselves of any benefits under the Industry Law in the future.

#### Tax Benefits under the Law for the Encouragement of Capital Investments, 1959

##### General

One of our production facilities qualifies as a “benefited enterprise” under the Law for the Encouragement of Capital Investments, 1959, as amended in 2005, or the Investment Law, which provides certain tax benefits to investment programs of an “approved enterprise” or “benefited enterprise.” Our benefited enterprise was converted from a previously approved enterprise program pursuant to the approval of the Israel Tax Authority that we received in September 2006. The period of tax benefits for the benefited enterprise has not yet commenced and will expire no later than 2016 (as further discussed below). We have elected 2012 as the base year for the second benefited period.

The Investment Law stipulates criteria for investment programs qualified to receive tax benefits, which, if qualified, are referred to as a “benefited enterprise.” Companies that meet those criteria may claim the tax benefits (as further discussed below) offered by the Investment Law directly in its tax returns (and there is no need to obtain prior approval to qualify for the benefits). There is no requirement to file reports with the Investment Center. Audits are the responsibility of the Israeli Income Tax Authorities as part of their tax audits. Companies may also approach the Israeli Tax Authority for a pre-ruling regarding their eligibility for benefits under the Investment Law.

A company that owns an approved enterprise is eligible for governmental grants, but may elect to receive an alternative package comprised of tax benefits, referred to as the “alternative benefits track.” The tax benefits of a benefited enterprise include lower tax rates or no tax depending on the area and the track chosen, lower tax rates on dividends and accelerated depreciation. In order to receive benefits in the grant track or the alternative benefit track, the industrial enterprise must contribute to the economic independence of the Israeli economy, be competitive and contribute to the gross local product in one of the manners stipulated in the Investment Law. Tax benefits would be available, subject to certain conditions (described below), to production facilities that generally derive more than 25% of their annual revenue from export, or that do not derive 75% or more of their annual revenue in a single market.



On September 20, 2006, we received a pre-ruling from the Israeli Tax Authority confirming that our most recent investment program will be deemed a “benefited enterprise” instead of its former “approved enterprise” status. Pursuant to such pre-ruling, the former approved enterprise status of that investment plan was terminated by the Investment Center. The benefited enterprise status granted to our investment program provides for a tax exemption on undistributed earnings derived from the program for two years and a reduced tax rate for the remainder of the benefit period (see below). The benefit period with respect to such program has not yet commenced, and will expire no later than 2016. The second benefited period with a respect to such program has not yet commenced, and will expire no later than 2023.

If, (i) only a part of a company’s taxable income is derived from an approved enterprise or a benefited enterprise, as in our case; or (ii) a company owns more than one approved enterprise or benefited enterprise, the resulting effective corporate tax rate of the company represents the weighted combination of the various applicable rates. A company owning a “mixed enterprise” (which is a company that derives income from one or more sources in addition to an approved enterprise or benefited enterprise) generally may not distribute a dividend that is attributable only to the approved enterprise or benefited enterprise.

Subject to certain provisions concerning income subject to the alternative benefits track (see below), any distributed dividends are deemed attributable to the entire enterprise, and the effective tax rate represents the weighted combination of the various applicable tax rates. A company may elect to attribute dividends distributed by it only to income not subject to the alternative benefits track.

#### Tax Benefits

The tax benefits available to benefited enterprises are: (1) benefited enterprise situated in zone A may choose between (a) limited corporate tax rate of 11.5%; and (b) tax exemption from corporate tax on undistributed income; (2) benefited enterprises situated in zone B or elsewhere (“zone C”) are entitled to tax exemption on undistributed income for six or two years, respectively, and to beneficial tax rate (25% or less in the case of a qualified foreign investor’s company that is at least 49% owned by non-Israeli residents) for the remainder of the applicable period of benefits. Our plant is located in zone C.

Dividends paid out of income derived from an approved enterprise or benefited enterprise (or out of dividends received from a company whose income is derived from an approved enterprise or benefited enterprise) are generally subject to withholding tax at the rate of 15% (deductible at source). The rate of 15% is limited to dividends and distributions out of income derived during the benefits period and actually paid at any time up to 12 years thereafter. A company which elects the alternative benefits track will be subject to corporate tax at the otherwise applicable rate of not more than 25% (or lower in the case of a qualified foreign investor’s company which is at least 49% owned by non-Israeli residents) in respect of the gross amount of the dividend if it pays a dividend out of income derived from its approved enterprise or benefited enterprise during the tax exemption period. Dividends paid to a qualifying non-resident out of the profits of a benefited enterprise subject to 11.5% corporate tax are subject to withholding tax at the rate of 4%.

The tax benefits available to a benefited enterprise relate only to taxable income attributable to that specific enterprise and are contingent upon the fulfillment of the conditions stipulated by the Investment Law and its regulations and the terms of the pre-ruling that we received from the Israeli Tax Authority. If we fail to comply with these conditions, the tax and other benefits may be discontinued, in whole or in part, and we might be required to pay the monetary equivalent of the tax benefits we received, plus CPI linkage differences and interest

A company that qualifies as a foreign investor’s company is entitled to further tax benefits relating to its benefited enterprises. Subject to certain conditions, a foreign investor company is a company more than 25% of whose share capital (in terms of shares, rights to profits, voting and appointment of directors), and of whose combined share and



loan capital, is owned, directly or indirectly, by persons who are not residents of Israel. Such a company with a foreign investment of over 25% will be eligible for an extension of the period of tax benefits for its approved and benefited enterprises (up to a total period of ten years, compared to a normal period of seven years) and further tax benefits (a reduced corporate tax rate of 10%-20%) should the foreign investment reach or exceed 49%. The rate of 15% applicable to dividends is effective for an unlimited period. No assurance can be given that we currently qualify or will qualify in the future as a foreign investor's company.

## Amendment to Investment Law

In December 2010, the Israeli Parliament passed the Law for Economic Efficiency for 2011 and 2012 (Amended Legislation), 2011, which prescribes, among other things, amendments to the Investment Law, effective as of January 1, 2011. The amendment introduced new benefits for income generated by a “Preferred Company” through its Preferred Enterprise (as such terms are defined in the Investment Law). The new tax benefits (described below) would be available, subject to certain conditions, to production facilities that generally derive more than 25% of their annual revenue from export, or that do not derive 75% or more of their annual revenue in a single market. A “Preferred Company” is defined in the amendment as either (i) a company incorporated in Israel and not wholly-owned by the government or (ii) a partnership (a) that was registered under the Israeli Partnerships Ordinance and (b) all of its partners are companies incorporated in Israel, but not all of them are fully owned by the government and such companies or partnerships have, among other conditions, Preferred Enterprise status and are controlled and managed from Israel.

In accordance with the amendment and a further amendment made during 2013, a Preferred Enterprise is entitled to a reduced corporate tax rate of 15% with respect to income derived by its Preferred Enterprise in 2011-2012, unless it is located in a certain development zone, in which case the rate will be 10%. Such corporate tax rate was reduced to 12.5% and 7%, respectively, in 2013 and was raised to 16% and 9% in 2014 and thereafter, respectively.

Under the amendments, dividends distributed out of income attributed to a Preferred Enterprise are subject to withholding tax at source at the rate of 20% (or lower, under an applicable tax treaty). However, upon the distribution of a dividend to an Israeli company, no withholding tax will be remitted.

The 2010 amendment applies to income generated as of January 1, 2011. Under the transitional provisions of the amendment, we may decide to irrevocably implement the amendment to the Investment Law while waiving benefits provided under the Investment Law as in effect prior to the amendment or to remain subject to the Investment Law as in effect prior to the amendment. We may elect to implement the amendment by May 31 of any year, with regard to that tax year and the following tax years. Electing to implement the amendment is irreversible.

We comply with the conditions provided in the amendment to the Law for the Encouragement of Capital Investments for inclusion in the scope of the tax benefits track. We intend to implement the Amendment in future tax year. Therefore, the deferred tax balance as of December 31, 2014 was calculated based on the rate provided by the Amendment.

The termination or substantial reduction of any of the benefits available under the Investment Law could have a material adverse effect on our future investments in Israel, and could adversely affect our results of operations and financial condition.

## Taxation Under Inflationary Conditions

The Income Tax (Inflationary Adjustments) Law, 1985, or the Inflationary Adjustments Law, is intended to neutralize the erosion of capital investments in business and to prevent tax benefits resulting from deduction of inflationary expenses. This law applies a supplementary set of inflationary adjustments to the nominal taxable profits computed under regular historical cost principles.

The Inflationary Adjustments Law introduced a special tax adjustment for the preservation of equity based on changes in the CPI, whereby certain corporate assets are classified broadly into fixed (inflation-resistant) assets and non-fixed assets. Where shareholders' equity, as defined in the Inflationary Adjustments Law, exceeds the depreciated cost of fixed assets (as defined in the Inflationary Adjustment Law), a tax deduction which takes into account the effect of the annual rate of inflation on such excess is allowed (up to a ceiling of 70% of taxable income for companies in any

single year, with the unused portion carried forward on a linked basis, without limit). If the depreciated cost of such fixed assets exceeds shareholders' equity, then such excess, multiplied by the annual inflation rate, is added to taxable income. In addition, subject to certain limitations, depreciation of fixed assets and losses carried forward are adjusted for inflation on the basis of changes in the CPI.

Pursuant to the Inflationary Adjustments Law to which we are subject, results for tax purposes are measured in real terms in accordance with the changes in the CPI.

On February 26, 2008, the Israeli Income Tax Law (Inflationary Adjustments) (Amendment No. 20) (Restriction of Period of Application) – 2008 was passed by the Israeli parliament. According to the amendment, the inflationary adjustments law will no longer be applicable subsequent to the 2007 tax year except for the transitional provisions whose objectives are to prevent distortion of the income tax calculations.

In addition, according to the amendment commencing in the 2008 tax year, the adjustment of the income for the effects of inflation for tax purposes will no longer be calculated. Additionally, depreciation on the protected assets and tax loss carryforward will no longer be linked to the CPI, subsequent to the 2007 tax year, and the balances that have been linked to the CPI through the end of 2007 tax year, will be used going forward. As a result, our carryforward tax loss will no longer be linked to the Israeli CPI.

#### Taxation of Gains Upon Disposition of, and Dividends Paid on, our Ordinary Shares

##### Taxation of Israeli Resident Shareholders

Israeli law imposes a capital gains tax on the sale of capital assets. The law distinguishes between real gain and inflationary surplus. The inflationary surplus is a portion of the total capital gain that is equivalent to the increase of the relevant asset's purchase price which is attributable to the increase in the CPI between the date of purchase and the date of sale. Foreign residents who purchased an asset in foreign currency may request that the inflationary surplus will be computed on the basis of the devaluation of the NIS against such foreign currency. The real gain is the excess of the total capital gain over the inflationary surplus. The inflationary surplus accumulated from and after December 31, 1993, is exempt from any capital gains tax in Israel while the real gain is taxed at the applicable rate discussed below.

Dealers in securities in Israel are taxed at regular tax rates applicable to business income.

Subject to certain transitional provisions relating to capital gains derived from the sale of assets, including our shares, purchased prior to January 1, 2003, the tax rate on capital gains, including capital gain from the sale of securities listed on a stock exchange and on dividends, is generally a uniform rate of 25% for individuals (and 26.5% for corporate bodies) and 30% for substantial individual shareholders (who are, generally, shareholders of 10% or more of the shares of the company on the date of the sale of the shares or at any date during the 12 months before the sale). Dividends paid to an Israeli company by another Israeli company are not subject to tax, unless received out of income derived from a benefited enterprise or stems from income derived or accrued outside of Israel.

Under the convention between the United States and Israel concerning taxes on income, Israeli capital gains tax will generally not apply to the sale, exchange or disposition of ordinary shares by a person who qualifies as a resident of the United States within the meaning of the U.S.-Israel tax treaty. However, this exemption will not apply, among other cases, if the gain is attributable to a permanent establishment of such person in Israel, or if the qualified U.S. resident holds, directly or indirectly, shares representing 10% or more of our voting power during any part of the 12-month period preceding the sale, exchange or disposition, subject to specified conditions. In this case, the sale, exchange or disposition would be subject to Israeli tax, to the extent applicable. However, under the U.S.-Israel tax treaty, a U.S. resident generally would be permitted to claim a credit for the taxes against the U.S. federal income tax imposed on the sale, exchange or disposition, subject to the limitations in U.S. laws applicable to foreign tax credits. The U.S.-Israel tax treaty does not relate to U.S. state or local taxes.

For residents of other countries, the purchaser of the shares may be required to withhold capital gains tax on all amounts received for the sale of our ordinary shares, for so long as the capital gain from such a sale is not exempt

from Israeli capital gains tax, and unless a different rate is provided in a treaty between Israel and the stockholder's country of residence.

The capital gain from the sale of our shares by non-Israeli residents would be tax exempt as long as our shares are listed on the NASDAQ Capital Market or any other stock exchange recognized by the Israeli Ministry of Finance, and provided certain other conditions are met, the most relevant of which are: (i) the capital gain is not attributed to the foreign resident's permanent establishment in Israel, and (ii) the shares were acquired by the foreign resident after the company's shares had been listed for trading on the foreign Exchange.

If the shares were sold by Israeli residents, then (i) for the period ending December 31, 2002 their sale would be tax exempt so long as (1) the shares were listed on a stock exchange, such as, in our case, the NASDAQ Capital Market, which is recognized by the Israeli Ministry of Finance on December 31, 2002, and (2) we qualified as an Industrial Company or Industrial Holding Company under the law for Encouragement of Industry (Taxes) 1969, at the relevant times as provided by the Income Tax Ordinance [New Version], 1961, which we believe we so qualified and (ii) for the period commencing January 1, 2003, the sale of the shares would be, generally, subject to a 25% tax if sold by non-substantial individual shareholders and corporate bodies and 30% tax if sold by a substantial individual shareholders. We cannot provide any assurance that the Israeli tax authorities will agree with the determination that we qualified as an Industrial Company at the relevant times.

On the distribution of dividends other than bonus shares (stock dividends) to individual Israeli residents shareholders or to non-Israeli shareholders, income tax applies at the rate of 25% or 30%, as described above, but is generally withheld at source at the rate of 20% (for as long as we are listed) or the lower rate payable with respect to dividends received out of income derived from a benefited enterprise (see “Law for the Encouragement of Capital Investments, 1959”), unless a double taxation treaty is in effect between Israel and the shareholder's country of residence which provides for a lower tax rate in Israel on dividends. The Convention between the State of Israel and the Government of the United States relating to relief from double taxation provides for a maximum tax of 25% on dividends paid to a resident of the United States. Dividends paid to an Israeli company by another Israeli company are not subject to corporate tax, unless received out of income derived from a benefited enterprise or unless the dividend stems from income produced or accrued abroad.

#### Taxation of Non-Israeli Resident Shareholders

Non-residents of Israel are subject to income tax on income accrued or derived from sources in Israel. Such sources of income include passive income such as dividends, royalties and interest, as well as non-passive income from services rendered in Israel. On distributions of dividends other than bonus shares or stock dividends, income tax at the rate of 25% or 30% as described above), 12.5% for dividends not generated by a benefited enterprise if the non-resident is a U.S. corporation and holds 10% of our voting power for a designated period, and 15% for dividends generated by a benefited enterprise applies, unless a different rate is provided, based on a treaty between Israel and the shareholder's country of residence. Under the U.S.-Israel Tax Treaty, the maximum tax on dividends paid to a holder of ordinary shares who is a Treaty U.S. Resident will be 25%. However, under the Investment Law, dividends generated by an approved enterprise (which approved plan was approved before January 1, 2014) or benefited enterprise are, generally, taxed at the rate of 15%.

Subject to certain conditions, non-Israeli residents will be tax exempt on capital gain derived from investments in Israeli companies without derogating from any other capital gain tax exemption applying to non-Israeli resident under Israeli law or under any applicable double tax treaty.

#### Foreign Exchange Regulation and Withholding Taxes

Non-residents of Israel who purchase ordinary shares and receive dividends, if any are declared, or any amounts payable upon the dissolution, liquidation or winding up of our affairs will be able to freely repatriate such amounts in non-Israeli currencies, pursuant to the general permit issued by the Controller of Foreign Currency at the Bank of Israel under the Currency Control Law, 1978, provided that we have withheld Israeli income tax with respect to such amounts, as may be applicable.

Under the general permit issued by the Controller of Foreign Currency, Israeli residents, including corporations, may generally purchase securities, including the ordinary shares, outside of Israel.



United States Federal Income Taxation

The following is a summary of certain material U.S. federal income tax consequences of the acquisition, ownership and disposition of our ordinary shares. This description addresses only the U.S. federal income tax considerations that are relevant to U.S. Holders (as defined below) who hold our ordinary shares as capital assets. This summary is based on the U.S. Internal Revenue Code of 1986, as amended, or the Code, Treasury regulations promulgated thereunder, judicial and administrative interpretations thereof, and the U.S.-Israel Tax Treaty, or the Treaty, all as in effect on the date hereof and all of which are subject to change either prospectively or retroactively. There can be no assurance that the U.S. Internal Revenue Service, or the IRS, will not take a different position concerning the tax consequences of the acquisition, ownership and disposition of our ordinary shares or that such a position would not be sustained. This description does not address all tax considerations that may be relevant with respect to an investment in our ordinary shares. This summary does not account for the specific circumstances of any particular investor, such as:

- broker-dealers,
- financial institutions,
- certain insurance companies,
- regulated investment companies or real estate investment trusts,
- investors liable for alternative minimum tax,
- tax-exempt organizations,
- taxpayers whose functional currency is not the dollar,
- persons who hold the ordinary shares through partnerships or other pass-through entities,
- persons who acquire their ordinary shares through the exercise of employee stock options or otherwise as compensation for services,
  - investors who actually or constructively own, or have owned, 10 percent or more of our voting shares, and
- investors holding ordinary shares as part of a straddle, appreciated financial position, a hedging transaction or a conversion transaction.

If a partnership or an entity treated as a partnership for U.S. federal income tax purposes owns ordinary shares, the U.S. federal income tax treatment of a partner in such a partnership will generally depend upon the status of the partner and the activities of the partnership. A partnership that owns ordinary shares and the partners in such partnership should consult their tax advisors about the U.S. federal income tax consequences of holding and disposing of ordinary shares.

This summary does not address the effect of any U.S. federal taxation (such as estate and gift tax) other than U.S. federal income taxation. In addition, this summary does not include any discussion of state, local or foreign taxation. You are urged to consult your tax advisors regarding the foreign and U.S. federal, state and local tax consequences of an investment in ordinary shares.

For purposes of this summary, a U.S. Holder is:



- an individual who is a citizen or, for U.S. federal income tax purposes, a resident of the United States;
- a corporation, or other entity treated for tax purposes as a corporation, created or organized in or under the laws of the United States or any political subdivision thereof;

- an estate whose income is subject to U.S. federal income tax regardless of its source; or
- a trust that (a) is subject to the primary supervision of a court within the United States and the control of one or more U.S. persons or (b) has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person.

#### Taxation of Distributions

Subject to limitations, including the discussion, below, under the heading “—Passive Foreign Investment Companies,” the gross amount of any distributions received with respect to our ordinary shares, including the amount of any Israeli taxes withheld therefrom, will constitute dividends for U.S. federal income tax purposes to the extent of our current and accumulated earnings and profits, as determined for U.S. federal income tax purposes. Because we do not expect to maintain calculations of our earnings and profits under U.S. federal income tax principles, it is expected that the entire amount of any distribution will generally be reported as dividend income to you. Dividends are included in gross income as ordinary income. Distributions in excess of our current and accumulated earnings and profits will be treated as a non-taxable return of capital to the extent of your tax basis in our ordinary shares and any amount in excess of your tax basis will be treated as capital gain from the sale of ordinary shares. See “—Disposition of Ordinary Shares” below for a discussion of the taxation of capital gains. Our dividends will not qualify for the dividends-received deduction generally available to corporations under section 243 of the Code.

Dividends that we pay in NIS, including the amount of any Israeli taxes withheld therefrom, will be included in your income in a dollar amount calculated by reference to the exchange rate in effect on the day such dividends are distributed, regardless of whether the payment is in fact converted into dollars. A U.S. Holder who receives payment in NIS and converts NIS into dollars at an exchange rate other than the rate in effect on such day may have a foreign currency exchange gain or loss that would generally be treated as U.S.-source ordinary income or loss. U.S. Holders should consult their own tax advisors concerning the U.S. tax consequences of acquiring, holding and disposing of NIS and converting NIS into dollars.

Subject to complex limitations, some of which vary depending upon the U.S. Holder’s circumstances, any Israeli withholding tax imposed on dividends paid with respect to our ordinary shares will be a foreign income tax that is eligible for credit against a U.S. Holder's U.S. federal income tax liability (or, alternatively, for deduction against U.S. income tax in determining such tax liability). The limitation on foreign income taxes eligible for credit is calculated separately with respect to specific classes of income. Dividends generally are treated as foreign-source passive category income or, in the case of certain U.S. Holders, general category income for purposes of computing the U.S. foreign tax credit. Further, there are special rules for computing the foreign tax credit limitation of a taxpayer who receives dividends subject to a reduced tax rate (see discussion below). The U.S. rules relating to the foreign tax credit are complex, and you should consult with your own tax advisors to determine whether and to what extent you would be entitled to this credit.

Subject to certain limitations, “qualified dividend income” received by a non-corporate U.S. Holder will be subject to tax at the lower long-term capital gain rates (currently a maximum of 20%). Distributions taxable as dividends paid on our ordinary shares should qualify for a reduced rate provided that either: (i) we are entitled to benefits under the Treaty or (ii) our ordinary shares are readily tradable on an established securities market in the United States and certain other requirements are met. We believe that we are entitled to benefits under the Treaty and that our ordinary shares currently are readily tradable on an established securities market in the United States. However, no assurance can be given that our ordinary shares will remain readily tradable. The reduced rate does not apply unless certain holding period requirements are satisfied. With respect to the ordinary shares, the U.S. Holder must have held such shares for at least 61 days during the 121-day period beginning 60 days before the ex-dividend date. The reduced rate also does not apply to dividends received from a passive foreign investment company (see discussion below), in respect of certain hedged positions, or in certain other situations. The legislation enacting the reduced tax rate on

qualified dividend income contains special rules for computing the foreign tax credit limitation of a taxpayer who receives dividends subject to the reduced tax rate. U.S. Holders of our ordinary shares should consult their own tax advisors regarding the effect of these rules in their particular circumstances.

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## Disposition of Ordinary Shares

If you sell or otherwise dispose of our ordinary shares, you will generally recognize gain or loss for U.S. federal income tax purposes in an amount equal to the difference between the amounts realized on the sale or other disposition and your adjusted tax basis in our ordinary shares. Subject to the discussion below under the heading “Passive Foreign Investment Companies,” such gain or loss will generally be capital gain or loss and will be long-term capital gain or loss if you have held the ordinary shares for more than one year at the time of the sale or other disposition. Long-term capital gain realized by a non-corporate U.S. Holder is generally eligible for a preferential tax rate (currently a maximum of 20%). In general, any gain that you recognize on the sale or other disposition of ordinary shares will be U.S.-source for purposes of the foreign tax credit limitation; losses will generally be allocated against U.S. source income. Deduction of capital losses is subject to certain limitations under the Code.

In the case of a cash basis U.S. Holder who receives NIS in connection with the sale or disposition of our ordinary shares, the amount realized will be based on the dollar value of the NIS received with respect to the ordinary shares as determined on the settlement date of such sale or other disposition. A cash basis U.S. Holder who receives payment in NIS and converts NIS into dollars at a conversion rate other than the rate in effect on the settlement date may have a foreign currency exchange gain or loss, which would generally be treated as ordinary income or loss.

An accrual basis U.S. Holder may elect the same treatment required of cash basis taxpayers with respect to foreign currency gain or loss realized on a sale or disposition of our ordinary shares that are traded on an established securities market, provided that the election is applied consistently from year to year. Such election may not be changed without the consent of the IRS. In the event that an accrual basis U.S. Holder does not elect to be treated as a cash basis taxpayer for this purpose (pursuant to the Treasury regulations applicable to foreign currency transactions), such U.S. Holder may have a foreign currency gain or loss for U.S. federal income tax purposes because of differences between the dollar value of the currency received prevailing on the trade date and the settlement date. Any such currency gain or loss would be treated as ordinary income or loss and would be in addition to the gain or loss, if any, recognized by such U.S. Holder on the sale or disposition of our ordinary shares. Any foreign currency gain or loss a U.S. Holder realizes will generally be U.S. source ordinary income or loss.

The U.S. rules relating to foreign currency gains and losses are complex, and you should consult with your tax advisor to determine whether and to what extent you would have to recognize such foreign currency gains or losses.

## Passive Foreign Investment Companies

If we were to be classified as a “passive foreign investment company”, or a PFIC, in any taxable year, a U.S. Holder would be subject to special rules intended to reduce or eliminate any benefits from the deferral of U.S. federal income tax that a U.S. Holder could otherwise derive from investing in a non-U.S. company that does not distribute all of its earnings on a current basis. We will be treated as a PFIC for any taxable year in which either (i) 75% or more of our gross income is passive income, or (ii) at least 50% of the average value of all of our assets for the taxable year produce or are held for the production of passive income. For this purpose, passive income generally includes dividends, interest, royalties, rents, annuities and the excess of gains over losses from the disposition of assets that produce passive income. Included in the calculation of our income and assets is our proportionate share of the income and assets of each corporation in which we own, directly or indirectly, at least a 25% interest, by value. If we were determined to be a PFIC for U.S. federal income tax purposes, unfavorable and highly complex rules would apply to you as a U.S. Holder of ordinary shares, whether you own your ordinary shares directly or indirectly. Accordingly, you are urged to consult your own tax advisors regarding the application of such rules.

Based on our current and projected income, assets and activities, we believe that we are not currently a PFIC. However, because the determination of whether we are a PFIC is based upon the composition of our income and assets from time to time, there can be no assurances that we will not become a PFIC in any future taxable year.



If we are treated as a PFIC for any taxable year, dividends on our ordinary shares would not qualify for the reduced tax rate on qualified dividend income, discussed above, and, unless you elect to "mark to market" your ordinary shares, as described below:

- you would be required to allocate income recognized upon receiving certain dividends or gain recognized upon the disposition of ordinary shares ratably over your holding period for such ordinary shares,
- the amount allocated to the current taxable year, and to any taxable years in your holding period prior to the first day in which we were treated as a PFIC will be treated as ordinary income in the current year, and
- the amount allocated to each prior taxable year during which we are considered a PFIC would be subject to tax at the highest individual or corporate tax rate, as the case may be, and an interest charge would be imposed with respect to the resulting tax liability allocated to each such year.

If we are a PFIC and any of our non-U.S. subsidiaries is also a PFIC, you will generally be treated as owning a proportionate amount (by value) of the underlying shares of each such subsidiary PFIC.

A U.S. Holder may make a mark-to-market election only if our ordinary shares are "regularly traded" on a "qualified exchange". In general, our ordinary shares will be treated as "regularly traded" for a given calendar year if more than a de minimis quantity of our ordinary shares is traded on a qualified exchange on at least 15 days during each calendar quarter of such calendar year. Our ordinary shares are listed on the NASDAQ. However, no assurance can be given that our ordinary shares will be regularly traded for purposes of the mark-to-market election. In addition, because a mark-to-market election cannot be made for a subsidiary PFIC, if you make a mark-to-market election you may continue to be subject to the PFIC rules with respect to your indirect interest in any PFICs we own.

If you elect to mark to market your ordinary shares, you will generally include in income, in each year in which we are considered a PFIC, any excess of the fair market value of your ordinary shares at the close of each tax year over your adjusted basis in the ordinary shares. If the fair market value of the ordinary shares had depreciated below your adjusted basis at the close of the tax year, you may generally deduct the excess of the adjusted basis of the ordinary shares over its fair market value at that time. However, such deductions would generally be limited to the net mark-to-market gains, if any, that you included in income with respect to such ordinary shares in prior years. Your adjusted tax basis in your ordinary shares would be increased by the amount of any income inclusion and decreased by the amount of any deductions under the mark-to-market rules. Income recognized and deductions allowed under the mark-to-market provisions, as well as any gain or loss on the disposition of ordinary shares with respect to which the mark-to-market election has been made, in a year in which we are classified as a PFIC, would be treated as ordinary income or loss (except that loss on a disposition of ordinary shares is treated as capital loss to the extent the loss exceeds the net mark-to-market gains, if any, that you included in income with respect to such ordinary shares in prior years), and the source of such gain or loss will be U.S.-source for purposes of the foreign tax credit limitation. Gain or loss from the disposition of ordinary shares (as to which a mark-to-market election was made) in a year in which we are no longer classified as a PFIC, would be capital gain or loss.

If you own our ordinary shares during any year in which we are a PFIC, you may be required file an IRS Form 8621 with respect to our company, typically with your federal income tax return for that year. U.S. Holders should consult their own tax advisors regarding whether we are a PFIC and the potential application of the PFIC rules to them, including the application of the mark-to-market election.

#### Net Investment Income Tax

In addition to the income taxes described above, U.S. Holders that are individuals, estates or trusts and whose income exceeds certain thresholds will be subject to a 3.8% Medicare contribution tax on net investment income, which

includes dividends and capital gains.

#### Backup Withholding and Information Reporting

Payments in respect of our ordinary shares may be subject to information reporting to the IRS and to U.S. backup withholding tax at the rate (currently) of 28%. Backup withholding will not apply, however, if you (i) are a corporation or fall within certain exempt categories, and demonstrate the fact when so required, or (ii) furnish a correct taxpayer identification number and make any other required certification.

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Backup withholding is not an additional tax. Amounts withheld under the backup withholding rules may be credited against your U.S. tax liability. You may obtain a refund of any excess amounts withheld under the backup withholding rules by filing the appropriate claim for refund with the IRS.

U.S. individuals that hold certain specified foreign financial assets, including stock in a foreign corporation, with values in excess of certain thresholds are required to file with their U.S. federal income tax return Form 8938, on which information about the assets, including their value, is provided. Taxpayers who fail to file the form when required are subject to penalties. An exemption from reporting applies to foreign assets held through a financial institution. Investors are encouraged to consult with their own tax advisors regarding the possible application of this disclosure requirement to their investment in our ordinary shares.

F. Dividends and Paying Agents

Not applicable.

G. Statement by Experts

Not applicable.

H. Documents on Display

We are subject to certain of the reporting requirements of the Exchange Act as applicable to “foreign private issuers” as defined in Rule 3b-4 under the Exchange Act. As a foreign private issuer, we are exempt from certain provisions of the Exchange Act. Accordingly, our proxy solicitations are not subject to the disclosure and procedural requirements of Regulation 14A under the Exchange Act, and transactions in our equity securities by our officers and directors are exempt from reporting and the “short-swing” profit recovery provisions contained in Section 16 of the Exchange Act. In addition, we are not required under the Exchange Act to file quarterly reports and financial statements. However, we file with the SEC an annual report on Form 20-F containing financial statements audited by an independent accounting firm. We also submit to the SEC reports on Form 6-K containing (among other things) press releases and unaudited financial information. We post our annual report on Form 20-F on our website ([www.nisteceltek.com](http://www.nisteceltek.com)) promptly following the filing of our annual report with the SEC. The information on our website is not incorporated by reference into this annual report.

This annual report and the exhibits thereto and any other document we file pursuant to the Exchange Act may be inspected without charge and copied at prescribed rates at the SEC public reference room at 100 F Street, N.E., Room 1580, Washington, D.C. 20549. You may obtain information on the operation of the SEC’s public reference room in Washington, D.C. by calling the SEC at 1-800-SEC-0330. The Exchange Act file number for our SEC filings is 0-28884.

The SEC maintains a website at [www.sec.gov](http://www.sec.gov) that contains reports, proxy and information statements, and other information regarding registrants that make electronic filings with the SEC using its EDGAR (Electronic Data Gathering, Analysis, and Retrieval) system.

The documents concerning our company that are referred to in this annual report may also be inspected at our offices located at Sgoola Industrial Zone, Petach Tikva 4910101, Israel.

I. Subsidiary Information

Not applicable.





ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

We are exposed to a variety of market risks, including foreign currency fluctuations and changes in interest rates affecting primarily the interest on short-term credit lines and long-term loans.

Foreign Currency Exchange Risk

Our reporting currency is the dollar. Our revenues are primarily denominated in the dollar, NIS and Euros, while our expenses are primarily denominated in NIS, dollars and Euros. As a result, the NIS value of our dollar and Euro denominated revenues are negatively impacted by the depreciation of the dollar and the Euro against the NIS. In addition, fluctuations in rates of exchange between NIS and other currencies may affect our operating results and financial condition. The average exchange rate for the NIS against the dollar was 1.3% lower in 2014 than 2013 and the average exchange rate for the NIS against the Euro was 1.1% lower in 2014 than 2013, which had a negative impact on our operating results in 2014. The average exchange rate for the NIS against the dollar was 6.4% lower in 2013 than 2012 and the average exchange rate for the NIS against the Euro was 3.2% lower in 2013 than 2012, which had a negative impact on our operating results in 2013.

We estimate that a devaluation of 1% of the dollar against the NIS would result in a decrease of approximately \$200,000 in our operating income. As of December 31, 2014, we estimate that a devaluation of 1% of the Euro against the NIS would not have a material impact on our operating and financial results.

We have engaged external consultants to assist us to manage our foreign exchange risk. From time to time in the past we have engaged in hedging transactions in order to partially protect ourselves from currency fluctuation risks and may use hedging instruments from time to time in the future. We have recently encountered difficulties in obtaining lines of credits from our banks to perform hedging transactions in order to protect ourselves from currency fluctuations. If we were to determine that it is in our best interests to enter into any other hedging transactions in the future in order to protect ourselves in part from currency fluctuations, we may not be able to do so, or such transactions, if entered into, may not materially reduce the effect of fluctuations in foreign currency exchange rates on our results of operations and may result in additional expenses.

Commodity Price Risk

Cost of raw materials is a significant component of our cost of revenues. In 2014, the cost of raw materials used in production was \$13.0 million compared to \$16.3 million in 2013. A 1% increase or decrease in the cost of raw materials used in production would increase or decrease our cost of raw materials by approximately \$130,000.

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to our short-term credit lines, short-term loans and long-term loans. For information on the interest rates of our short-term credit lines, short-term loans and long-term loans, see Item 5B. "Operating and Financial Review and Prospects - Liquidity and Capital Resources." For purposes of specific risk analysis, we use sensitivity analysis to determine the impact that market risk exposure may have on the financial expenses derived from our short-term credit lines and long-term loans. Based on our loans balance at December 31, 2014, a hypothetical increase of 1% in the interest rates would result in an increase of approximately \$44,000 in our financial expenses. A hypothetical increase of 1% in the CPI would not have a material impact on our financial and operational expenses.

Credit Risk

We may be subject to significant concentrations of credit risk consisting principally of cash and cash equivalents and trade accounts receivable. Cash and cash equivalents are deposited with major financial institutions in Israel, Europe and the United States.

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We perform ongoing credit evaluations of the financial condition of our customers, if such information is available to us. The risk of collection associated with trade receivables is reduced by the geographical dispersion of our customer base, and our policy of obtaining credit evaluations of the financial condition of certain customers, purchase of insurance for certain receivables, or requiring collateral or security with respect to certain other receivables. However, our business involves selling products to customers for whose credit we do not have full insurance coverage, and we are exposed to risk with respect to our receivables from them.

ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

Not applicable.

PART II

ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

None.

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

None.

ITEM 15. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our chief executive officer and chief financial officer to allow timely decisions regarding required disclosure. Our management, including our chief executive officer and chief financial officer, conducted an evaluation of our disclosure controls and procedures, as defined under Exchange Act Rule 13a-15(e), as of the end of the period covered by this Annual Report on Form 20-F. Based upon that evaluation, our chief executive officer and chief financial officer have concluded that, as of such date, our disclosure controls and procedures were effective.

Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over our financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) or 15d-15(f) promulgated under the Securities Exchange Act of 1934 as a process designed by, or under the supervision of, our company's principal executive and principal financial officers and effected by our company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of our company;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of our

company are being made only in accordance with authorizations of management and directors of our company; and

- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our company's assets that could have a material effect on our financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2014. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Based on that assessment, our management concluded that as of December 31, 2014, our internal control over financial reporting is effective.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the period covered by this annual report that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

ITEM 16. [RESERVED]

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Our board of directors has determined that Mr. Gad Dovey, an external director, meets the definition of an audit committee financial expert, as defined by rules of the SEC. For a brief listing of Mr. Dovey’s relevant experience, see Item 6A. “Directors, Senior Management and Employees - Directors and Senior Management.”

ITEM 16B.CODE OF ETHICS

We have adopted a code of ethics that applies to our chief executive officer and all senior financial employees of our company, including the chief financial officer and the comptroller. The code of ethics is publicly available on our website at [www.nisteceltek.com](http://www.nisteceltek.com). Written copies are available upon request. If we make any substantive amendment to the code of ethics or grant any waivers, including any implicit waiver, from a provision of the codes of ethics, we will disclose the nature of such amendment or waiver on our website.

ITEM 16C.PRINCIPAL ACCOUNTANT FEES AND SERVICES

Independent Registered Public Accounting Firm Fees

The following table sets forth, for each of the years indicated, the fees billed by our independent registered public accountants. Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global, serve as our principal independent registered public accounting firm since October 2014. Somekh Chaikin, a member firm of KPMG International, has served as our independent registered public accounting firm prior to the appointment of Kost Forer Gabbay & Kasierer.

All of such fees were pre-approved by our Audit Committee.

| Services Rendered. | 2014      | 2013       |
|--------------------|-----------|------------|
| Audit (1)          | \$ 70,000 | \$ 108,000 |
| Audit Related Fees | -         | -          |
| Tax (2)            | \$ 3,000  | \$ 5,000   |
| All other Fees (3) | \$ 12,000 |            |
| Total              | \$ 85,000 | \$ 113,000 |

(1) Audit fees relate to audit services provided for each of the years shown in the table, including fees associated with the annual audit, consultations on various accounting issues and audit services provided in connection with

statutory or regulatory filings.

- (2) Tax fees relate to services performed regarding tax compliance.
- (3) Other fees are fees for professional services other than audit or tax related fees.

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Pre-Approval Policies and Procedures

Our audit committee has adopted a policy and procedures for the pre-approval of audit and non-audit services rendered by our independent registered public accounting firm, Kost Forer Gabbay and Kasierer, a member of Ernst and Young Global. Pre-approval of an audit or non-audit service may be given as a general pre-approval, as part of the audit committee's approval of the scope of the engagement of our independent auditor, or on an individual basis. Any proposed services exceeding general pre-approved levels also require specific pre-approval by our audit committee. The policy prohibits retention of the independent registered public accounting firm to perform the prohibited non-audit functions defined in Section 201 of the Sarbanes-Oxley Act or the rules of the SEC, and also requires the audit committee to consider whether proposed services are compatible with the independence of the registered public accountants.

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

Not applicable.

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

Neither we nor any affiliated purchaser has purchased any of our securities during 2014.

ITEM 16F. CHANGES IN REGISTRANT'S CERTIFYING ACCOUNTANT

(a) Previous independent registered public accounting firm.

On October 7, 2014, our shareholders elected Kost Forer Gabbay & Kasierer, a member of Ernst and Young Global, as our independent registered public accounting firm, replacing Somekh Chaikin, a member of KPMG International. This action was approved by our shareholders following the recommendation of our Board of Directors and Audit Committee.

The reports of Somekh Chaikin on the Company's consolidated financial statements for the fiscal years ended December 31, 2013 and December 31, 2012 did not contain any adverse opinion or a disclaimer of opinion, nor were the reports qualified or modified as to uncertainty, audit scope or accounting principles.

During the Company's fiscal years ended December 31, 2013 and December 31, 2013 and through October 7, 2014, there were no disagreements with Somekh Chaikin on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of Somekh Chaikin, would have caused it to make reference thereto in its reports on the Company's financial statements for such fiscal years.

During the Company's fiscal years ended December 31, 2013 and December 31, 2012 and through October 7, 2014, there were no reportable events as described in Item 16F(a)(1)(V) of Form 20-F.

A letter from Somekh Chaikin is attached as Exhibit 15.1 to this Form 20-F.

(b) New independent registered public accounting firm.

On October 7, 2014, Kost Forer Gabbay & Kasierer, a Member of Ernst and Young Global, was engaged as the independent registered public accounting firm for the Company. The engagement of Kost Forer Gabbay & Kasierer was approved by our shareholders following the recommendation by the Board of Directors and the Audit



Committee. During the Company's fiscal years ended December 31, 2013 and December 31, 2012 and through October 7, 2014, the Company did not consult with Kost Forer Gabbay & Kasierer regarding any of the matters or events set forth in Item 16F(a)(1)(V) of Form 20-F.

ITEM 16G.CORPORATE GOVERNANCE

Under NASDAQ Stock Market Rule 5615(a)(3), foreign private issuers, such as our company, are permitted to follow certain home country corporate governance practices instead of certain provisions of the NASDAQ Stock Market Rules. A foreign private issuer that elects to follow a home country practice instead of any of such NASDAQ rules must submit to NASDAQ, in advance, a written statement from an independent counsel in such issuer's home country certifying that the issuer's practices are not prohibited by the home country's laws.

We have notified NASDAQ that we do not comply with the following NASDAQ requirements, and instead follow Israeli law and practice in respect of such requirements:

- The requirement to maintain a majority of independent directors, as defined under the NASDAQ Stock Market Rules. Instead, we follow Israeli law and practice which requires that we appoint at least two external directors, within the meaning of the Israeli Companies Law, to our board of directors. We do have the mandated three independent directors, within the meaning of the rules of the SEC and NASDAQ, on our audit committee. See Item 6C. “Directors, Senior Management and Employees - Board Practices - External and Independent Directors.”
- The requirements regarding the directors’ nominations process. Under Israeli law and practice our board of directors is authorized to recommend to our shareholders director nominees for election. See Item 6C. – “Directors, Senior Management and Employees - Board Practices - Election of Directors.”
- The requirement regarding the quorum for any meeting of shareholders. Instead, we follow Israeli law and practice which provides that, unless otherwise provided by a company’s articles of association, the quorum required for a general meeting of shareholders is at least two shareholders present who hold, in the aggregate, 25% of the company’s voting rights. Our articles of association provide that the quorum required for a shareholder meeting consists of at least two shareholders present in person or represented by proxy who hold or represent, in the aggregate, at least 33% of the voting rights of the issued share capital. See Item 10A. “Additional Information - Share Capital - Annual and Extraordinary Meetings of Shareholders.”

ITEM 16H. MINE SAFETY DISCLOSURE

Not applicable.

ITEM 17. FINANCIAL STATEMENTS

Not applicable.

ITEM 18. FINANCIAL STATEMENTS

Consolidated Financial Statements

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ITEM 19.EXHIBITS

Index to Exhibits

|      | Exhibit | Description   |
|------|---------|---|
| 1.1  |         | Memorandum of Association of the Registrant(1)  |
| 1.2  |         | Articles of Association of the Registrant, as amended (2)   |
|      | 2.1     | Specimen of Share Certificate(1)  |
| 4.1  |         | Share Purchase Agreement, dated June 10, 2002, by and among En-Eltek Netherlands 2000 B.V., Kubatronik-Leiterplatten GmbH, Mr. Alois Kubat, Mr. Thomas Kubat and Ms. Heike Heidenreich (4)  |
| 4.2  |         | Extension of Put/Call Option Agreement, dated May 4, 2005, by and between En-Eltek Netherlands 2000 B.V. and Mr. Alois Kubat (5)  |
| 4.3  |         | Second Extension of Put/Call Option Agreement Provisions under the Share Purchase Agreement, dated December 28, 2007, by and between En-Eltek Netherlands 2000 B.V. and Mr. Alois Kubat (6) |
| 4.4  |         | English Translation of Lease Agreement dated June 26, 2002, by and between the Registrant and A.Z. Baranovitz – Assets and Rental Ltd. (7)  |
| 4.5  |         | Addendum to Lease Agreement dated May 13, 2007, by and between the Registrant and A.Z. Baranovitz – Assets and Rental Ltd. (8)  |
| 4.6  |         | Amendment and Supplement to a Lease Agreement dated June 7, 2002, by and between Kubatronik Leiterplatten GmbH and Ms. Karin Kubat. (9)   |
| 4.7  |         | English Translation of Letter of Extension dated December 18, 2007 to Lease Agreement dated June 7, 2002, by and between Kubatronik Leiterplatten GmbH and Ms. Karin Kubat. (10)            |
|      | 4.8     | Compensation Policy dated November 28, 2013, approved on January 9, 2014.(11)   |
|      | 4.9     | Form of Director and Officer Indemnity Agreement (2)  |
|      | 4.10    | Investment Agreement, dated August 19, 2013, by and between the Registrant and Nistec Ltd. (2)  |
| 4.11 |         | Bank Hapoalim B.M. Agreement dated April 27, 2014: Summary of Economic Terms; Irrevocable Undertakings (12)   |
| 4.12 |         | Bank Leumi B.M. Agreement dated May 27, 2014: Summary of Economic Terms; Irrevocable Undertakings (12)  |
| 4.13 |         | English summary of terms of Wasterwater Treatment Facility Building and Operation Agreement, dated July 3, 2014, by and between the Registrant and Elad Technologies (L.S.) (12)            |
|      | 8.1     | List of Subsidiaries of the Registrant(12)  |

12.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended. (12)

12.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended. (12)

13.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (12)

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13.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (12)

15.1 Letter of Somekh Chaikin, former independent registered public accounting firm (12)

101.INS\*XBRL Instance Document.

101.SCH\*XBRL Taxonomy Extension Schema Document.

101.PRE\*XBRL Taxonomy Presentation Linkbase Document.

101.CAL\*XBRL Taxonomy Calculation Linkbase Document.

101.LAB\*XBRL Taxonomy Label Linkbase Document.

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\*Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for the purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

- (1) Filed as an exhibit to our registration statement on Form F-1, registration number 333-5770, as amended, and incorporated herein by reference.
- (2) Included in Exhibit 99.1 to our Report of Foreign Issuer on Form 6-K filed on September 12, 2013 and incorporated herein by reference.
- (3) Filed as Exhibit 4.1 to our Annual Report on Form 20-F for the year ended December 31, 2008 and incorporated herein by reference.
- (4) Filed as Exhibit 4.5 to our Annual Report on Form 20-F for the year ended December 31, 2004 and incorporated herein by reference.
- (5) Filed as Exhibit 4.6 to our Annual Report on Form 20-F for the year ended December 31, 2004 and incorporated herein by reference.
- (6) Filed as Exhibit 4.7 to our Annual Report on Form 20-F for the year ended December 31, 2007 and incorporated herein by reference.
- (7) Filed as Exhibit 4.6 to our Annual Report on Form 20-F for the year ended December 31, 2008 and incorporated herein by reference.
- (8) Filed as Exhibit 4.7 to our Annual Report on Form 20-F for the year ended December 31, 2008 and incorporated herein by reference.
- (9) Filed as Exhibit 4.8 to our Annual Report on Form 20-F for the year ended December 31, 2009 and incorporated herein by reference.
- (10)

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Filed as Exhibit 4.9 to our Annual Report on Form 20-F for the year ended December 31, 2009 and incorporated herein by reference.

(11)Included as Exhibit A to Exhibit 99.1 to our Report of Foreign Issuer on Form 6-K filed on December 5, 2013 and incorporated herein by reference.

(12)Filed herewith.

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ELTEK LTD. AND ITS SUBSIDIARIES  
CONSOLIDATED FINANCIAL STATEMENTS  
AS OF DECEMBER 31, 2014  
US DOLLARS IN THOUSANDS

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AUDITORS' REPORT  
TO THE SHAREHOLDERS OF  
ELTEK LTD.

We have audited the accompanying consolidated balance sheets of Eltek Ltd. and its Subsidiaries (the "Company") as of December 31, 2014 and the related consolidated statements of comprehensive income, changes in shareholders' equity and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2014, and the results of its operations and its cash flows for the year ended December 31, 2014, in conformity with U.S. generally accepted accounting principles.

Tel-Aviv, Israel  
April 1, 2015

KOST FORER GABBAY & KASIERER  
A Member of Ernst & Young Global



Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders of  
Eltek Ltd.

We have audited the accompanying consolidated balance sheet of Eltek Ltd. and its Subsidiaries (the “Company”) as of December 31, 2013 and the related consolidated statements of comprehensive income, changes in shareholders' equity and cash flows for each of the years in the two-year period ended December 31, 2013. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audit 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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2013, and the results of its operations and its cash flows for each of the years in the two-year period ended December 31, 2013, in conformity with U.S. generally accepted accounting principles.

Somekh Chaikin  
Certified Public Accountants (Isr.)  
Member firm of KPMG International

April 27, 2014

## ELTEK LTD. AND ITS SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

|   | Note | December 31,            |        |
|---|------|-------------------------|--------|
|   |      | 2014                    | 2013   |
|   |      | US Dollars in thousands |        |
| <b>ASSETS</b>   |      |                         |        |
| <b>Current Assets</b>   |      |                         |        |
| Cash  | 2    | 1,129                   | 2,514  |
| Trade accounts receivable, net of allowance for doubtful accounts | 1h   | 8,227                   | 9,127  |
| Inventories   | 3    | 4,670                   | 6,109  |
| Prepaid expenses and other current assets                         |      | 857                     | 605    |
| Total current assets  |      | 14,883                  | 18,355 |
| Assets held for employees' severance benefits                     | 9    | 49                      | 53     |
| Fixed assets, net   | 4    | 10,070                  | 10,108 |
| Deferred tax assets, long-term                                    | 14   | 1,056                   | 2,863  |
| Intangible asset  |      | 208                     | -      |
| Goodwill  | 5    | -                       | 75     |
| Total assets  |      | 26,266                  | 31,454 |

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

## ELTEK LTD. AND ITS SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

|  |           | December 31,            |               |
|--|-----------|-------------------------|---------------|
|  | Note      | 2014                    | 2013          |
|  |           | US Dollars in thousands |               |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |           |                         |               |
| <b>Current liabilities</b>   |           |                         |               |
| Short-term credit and current maturities of long-term debt   | 6         | 2,722                   | 1,818         |
| Accounts payable:  |           |                         |               |
| Trade  |           | 7,077                   | 9,229         |
| Other current liabilities  | 7         | 5,156                   | 5,311         |
| <b>Total Current liabilities</b>   |           | <b>14,955</b>           | <b>16,358</b> |
| <b>Long-term liabilities</b>   |           |                         |               |
| Long-term debt, excluding current maturities   | 8         | 1,838                   | 1,412         |
| Employees' severance benefits  | 9         | 249                     | 337           |
| <b>Total long-term liabilities</b>   |           | <b>2,087</b>            | <b>1,749</b>  |
| <b>COMMITMENTS AND CONTINGENT LIABILITIES</b>  | <b>10</b> |                         |               |
| <b>SHAREHOLDERS' EQUITY</b>  | <b>11</b> |                         |               |
| Ordinary shares, NIS 0.6 par value<br>Authorized 50,000,000 shares, issued and<br>outstanding 10,142,762 shares as of<br>December 31, 2014 and 10,142,762 as of<br>December 31, 2013 |           | 1,985                   | 1,985         |
| Additional paid-in capital   |           | 17,270                  | 17,270        |
| Cumulative foreign currency translation<br>adjustments   |           | 1,907                   | 3,186         |
| Capital reserves   |           | 695                     | 695           |
| Accumulated deficit  |           | (12,550 )               | (9,885 )      |
| <b>Total Eltek Ltd. shareholders' equity</b>   |           | <b>9,307</b>            | <b>13,251</b> |
| Non-controlling interest   |           | (83 )                   | 96            |

|   |        |        |
|---|--------|--------|
| Total equity  | 9,224  | 13,347 |
| Total liabilities, shareholders' equity and non- controlling interest | 26,266 | 31,454 |

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

|  |   |   |
|--|---|---|
| April 1, 2015                                | /s/ Amnon Shemer  | /s/ Yitzhak Nissan  |
| Date of approval of the financial statements | Amnon Shemer<br>Vice President, Finance<br>and Chief Financial<br>Officer | Yitzhak Nissan<br>Chairman of the<br>Board of Directors<br>and Chief<br>Executive Officer |

## ELTEK LTD. AND ITS SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

|   |      | 2014  | Year ended<br>December 31,<br>2013 | 2012      |
|---|------|---|------------------------------------|-----------|
|   | Note | US Dollars in thousands<br>(except profit per share data) |                                    |           |
| REVENUES  | 12   | 46,626  | 50,235                             | 45,646    |
| Cost of revenues  | 16B  | (40,604 )   | (42,242 )                          | (37,836 ) |
| Gross profit  |      | 6,022   | 7,993                              | 7,810     |
| Operating expenses  |      |   |                                    |           |
| R&D expenses  |      | (72 )   | -                                  | -         |
| Selling, general and<br>administrative expenses                   |      | (6,773 )  | (6,722 )                           | (6,040 )  |
| Impairment of goodwill  |      | (80 )   | -                                  | (481 )    |
| Operating profit (loss)   |      | (903 )  | 1,271                              | 1,289     |
| Financial expenses, net   | 13   | (356 )  | (439 )                             | (543 )    |
| Other income (loss), net  |      | 38  | (26 )                              | 2         |
| Profit (loss) before income tax<br>(expense) benefit              |      | (1,221 )  | 806                                | 748       |
| Income tax (expense) benefit                                      | 14   | (1,634 )  | 2,975                              | (52 )     |
| Net profit (loss)   |      | (2,855 )  | 3,781                              | 696       |
| Net (profit) loss attributable to<br>non-controlling interest     |      | 190   | 42                                 | (6 )      |
| Net profit (loss) attributable to<br>Eltek Ltd.                   |      | (2,665 )  | 3,823                              | 690       |
| Other comprehensive income<br>(loss):                             |      |   |                                    |           |
| Foreign currency translation<br>adjustments                       |      | (1,268 )  | 487                                | 78        |
| Comprehensive income (loss)                                       |      | (4,123 )  | 4,268                              | 774       |
| Comprehensive loss<br>attributable to non-controlling<br>interest |      | (179 )  | (28 )                              | (7 )      |
| Comprehensive income(loss)<br>attributable to Eltek Ltd.          |      | (3,944 )  | 4,296                              | 781       |

|   |            |           |           |
|---|------------|-----------|-----------|
| Basic and diluted net profit (loss) per ordinary share attributable to Eltek Ltd. shareholders  | (0.26 )    | 0.53      | 0.1       |
| Weighted average number of ordinary shares used to compute basic and diluted net profit (loss) per ordinary share attributable to Eltek Ltd. shareholders | 10,142,762 | 7,198,883 | 6,610,107 |

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

## ELTEK LTD. AND ITS SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

|   | Company's shareholders                                 |        |                                  |   |                     |                        |  |                                | Total  |
|---|--|--------|----------------------------------|---|---------------------|------------------------|--|--------------------------------|--------|
|   | Ordinary<br>shares                                     | Amount | Additional<br>paid-in<br>capital | Accumulated<br>other<br>comprehensive<br>income | Capital<br>reserves | Accumulated<br>deficit | Equity<br>attributed<br>to Eltek<br>Ltd. and<br>subsidiaries | Non<br>controlling<br>interest |        |
|   | US Dollars in thousands (except profit per share data) |        |                                  |   |                     |                        |  |                                |        |
| Balance as of<br>January 1, 2012                  | 6,610,107  | 1,384  | 14,328                           | 2,622   | 695                 | (14,398)               | 4,631  | 131                            | 4,762  |
| Changes during<br>the year                        |  |        |                                  |   |                     |                        |  |                                |        |
| Foreign<br>currency<br>translation<br>adjustments | -  | -      | -                                | 91  | -                   | -                      | 91   | (13 )                          | 78     |
| Net profit  | -  | -      | -                                | -   | -                   | 690                    | 690  | 6                              | 696    |
| Comprehensive<br>income ( loss)                   | -  | -      | -                                | -   | -                   | -                      | 781  | (7 )                           | 774    |
| Balance as of<br>December 31,<br>2012             | 6,610,107  | 1,384  | 14,328                           | 2,713   | 695                 | (13,708)               | 5,412  | 124                            | 5,536  |
| Changes during<br>the year                        |  |        |                                  |   |                     |                        |  |                                |        |
| Foreign<br>currency<br>translation<br>adjustments | -  | -      | -                                | 473   | -                   | -                      | 473  | 14                             | 487    |
| Net profit (loss)                                 | -  | -      | -                                | -   | -                   | 3,823                  | 3,823  | (42 )                          | 3,781  |
| Comprehensive<br>income (loss)                    | -  | -      | -                                | -   | -                   | -                      | 4,296  | (28 )                          | 4,268  |
| Issuance of<br>shares, net of<br>costs            | 3,532,655  | 601    | 2,942                            | -   | -                   | -                      | 3,543  | -                              | 3,543  |
| Balance as of<br>December 31,<br>2013             | 10,142,762   | 1,985  | 17,270                           | 3,186   | 695                 | (9,885 )               | 13,251   | 96                             | 13,347 |

Changes during  
the year

|   |   |   |   |          |   |          |          |        |          |
|---|---|---|---|----------|---|----------|----------|--------|----------|
| Foreign<br>currency<br>translation<br>adjustments | - | - | - | (1,279 ) | - | -        | (1,279 ) | 11     | (1,268 ) |
| Net loss  | - | - | - | -        | - | (2,665 ) | (2,665 ) | (190 ) | (2,855 ) |
| Comprehensive<br>loss                             | - | - | - | (1,279 ) | - | (2,665 ) | (3,944 ) | (179 ) | (4,123 ) |

Balance as of  
December 31,

|      |            |       |        |       |     |          |       |       |       |
|------|------------|-------|--------|-------|-----|----------|-------|-------|-------|
| 2014 | 10,142,762 | 1,985 | 17,270 | 1,907 | 695 | (12,550) | 9,307 | (83 ) | 9,224 |
|------|------------|-------|--------|-------|-----|----------|-------|-------|-------|

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

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## ELTEK LTD. AND ITS SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

|   | Year ended<br>December 31, |          |          |
|---|----------------------------|----------|----------|
|   | 2014                       | 2013     | 2012     |
|   | US Dollars in thousands    |          |          |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>  |                            |          |          |
| Net profit (loss)   | (2,855 )                   | 3,781    | 696      |
| Adjustments to reconcile net profit to net cash flows provided by operating activities: |                            |          |          |
| Depreciation and goodwill amortization  | 1,893                      | 1,739    | 2,253    |
| Capital loss on disposal of fixed assets  | 101                        | 26       | -        |
| Revaluation of long term loans  | 16                         | 1        | 25       |
| Increase (decrease) in deferred tax benefit   | 1,528                      | (3,012 ) | -        |
| Changes in employee severance benefits, net   | (59 )                      | 217      | 53       |
| Decrease (increase) in trade receivables  | (78 )                      | (1,531 ) | 2,339    |
| Decrease (increase) in other receivables and prepaid expenses                           | (319 )                     | 46       | (58 )    |
| Decrease (increase) in inventories  | 848                        | (451 )   | (670 )   |
| Increase (decrease) in trade payables   | (1,441 )                   | 655      | (147 )   |
| Increase in other liabilities and accrued expenses                                      | 445                        | 147      | 281      |
| Net cash provided by operating activities   | 79                         | 1,618    | 4,772    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>  |                            |          |          |
| Purchase of intangible assets   | (212 )                     | -        | -        |
| Purchase of fixed assets, net   | (2,431 )                   | (950 )   | (1,234 ) |
| Net cash used in investing activities   | (2,643 )                   | (950 )   | (1,234 ) |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>  |                            |          |          |
| Increase (decrease) in short- term credit   | 1,352                      | (2,577 ) | (192 )   |
| Repayment of long-term loans  | (806 )                     | (564 )   | (1,149 ) |
| Proceeds from long-term loans   | 1,179                      | -        | -        |
| Proceeds from issuance of shares  | -                          | 3,543    | -        |
| Repayment of credit from fixed asset payables   | (477 )                     | (515 )   | (1,049 ) |
| Net cash provided by (used in) financing activities                                     | 1,248                      | (113 )   | (2,390 ) |
| Effect of exchange rate on cash and cash equivalents                                    | (69 )                      | 24       | (105 )   |
| Net increase (decrease) in cash   | (1,385 )                   | 579      | 1,043    |
| Cash at beginning of the year   | 2,514                      | 1,935    | 892      |
| Cash at end of the year   | 1,129                      | 2,514    | 1,935    |

## SUPPLEMENTAL CASH FLOW INFORMATION:

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|                                       |     |     |       |
|---------------------------------------|-----|-----|-------|
| Income tax paid                       | 40  | 110 | 43    |
| Interest paid                         | 146 | 356 | 386   |
| Non-cash activities:                  |     |     |       |
| Purchase of fixed assets not yet paid | 523 | 514 | 1,212 |

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

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Notes to the Consolidated Financial Statements

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## NOTE 1:- ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

## a. General:

Eltek Ltd. ("the Parent") was organized in Israel in 1970, and the Parent's shares have been publicly traded on the NASDAQ Capital Market since 1997. Eltek Ltd. and its subsidiaries (see below) are collectively referred to as "the Company".

The Company manufactures, markets and sells custom made printed circuit boards ("PCBs"), including high density interconnect, flex-rigid and multi-layered boards. The principal markets of the Company are in Israel, Europe and North America.

The Company markets its product mainly to the medical technology, defense and aerospace, industrial, telecom and networking equipment, as well as to contract electronic manufacturers, among other industries, and its business is subject to numerous risks. The major risks include, but are not limited to, (1) the impact of currency exchange rates (mainly NIS/US\$ ), (2) the Company's success in implementing its sales and manufacturing plans, (3) the impact of competition from other companies, (4) the Company's ability to receive regulatory clearance or approval to market its products, (5) changes in regulatory environment, (6) domestic and global economic conditions and industry conditions, and (7) compliance with environmental laws and regulations. Further, the Company's liquidity position, as well as its operating performance, may be negatively affected by other financial and business factors, many of which are beyond its control.

On August 19, 2013, the Parent entered into an agreement to issue and sell 3,532,655 of its ordinary shares, par value NIS 0.6 each, to Nistec Ltd. ("Nistec"), a private company organized under the laws of the State of Israel, for \$ 4.2 million. Nistec is controlled by Yitzhak Nissan, who owns all of the shares of Nistec. Also, on August 19, 2013, Nistec purchased 1,589,440 of the Parent's ordinary shares from Merhav M.N.F. Ltd., a company owned by Mr. Yosef Maiman, which at the time held 24.1% of the Parent's outstanding ordinary shares. The total consideration paid by Nistec in the two transactions was \$ 6.5 million, \$ 2.3 directly to Merhav M.N.F Ltd. and \$ 4.2 million to the Parent. Nistec financed a portion of those funds from a loan extended by Bank Leumi Le'Israel, and the shares that Nistec acquired constitute collateral for the loan.

As a result of these transactions, which closed on November 1, 2013, Nistec acquired 50.5% of the Parent's ordinary shares on a fully diluted basis, and Nistec gained control of the Parent.

**Kubatronik Leiterplatten GmbH**

In June 2002, the Parent established a wholly-owned subsidiary, EN-Eltek Netherlands 2002 B.V. ("EN-Eltek"), for the purpose of the acquisition of Kubatronik Leiterplatten GmbH ("Kubatronik").

Notes to the Consolidated Financial Statements

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## NOTE 1:- ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont.)

On June 10, 2002, the Parent acquired 76% of the shares of Kubatronik for € 2.6 million (\$ 2.4 million as of the date of acquisition). The acquisition resulted in the recognition of goodwill in the amount of € 1.1 million (\$ 1 million as of the date of acquisition) see Note 5.

The Parent subsequently incurred a goodwill impairment of approximately \$ 1 million and the goodwill balance was nil as of December 31, 2014 and \$75 as of December 31, 2013.

Pursuant to the Kubatronik acquisition agreement, the seller had until December 31, 2014, (at which time the period is automatically extended for additional consecutive two-year periods unless otherwise notified in writing by either party upon at least six months prior notice) the right to require the Parent to purchase ("Put Option"), and the Parent has the right to require the seller to sell to the Parent ("Call Option") the seller's remaining 24% interest in Kubatronik. In May 2012, the seller exercised his option with respect to 3% of his remaining shares of Kubatronik for approximately Euro 69 (\$ 89) and reduced his share in Kubatronik from 24% to 21%. The exercise price for the seller's 21% interest in Kubatronik under the Put Option is Euro 483 (\$ 587), and the exercise price for the seller's remaining holdings in Kubatronik under the Call Option is Euro 513 (\$ 623). As of December 31, 2014 the option is presented at the maximum exercise price in the amount of \$587 in the short term liabilities. Changes in fair value are recorded in the Consolidated Statement of Comprehensive income. See Note 15.

**Eltek USA Inc.**

In 2007, the Parent established a wholly-owned subsidiary, Eltek USA Inc. for the purpose of sales, promotion and marketing in the North American market. Eltek USA Inc. commenced operations in 2008.

**Eltek Europe GmbH**

In 2008, the Parent established a wholly-owned subsidiary, Eltek Europe GmbH for the purpose of sales, promotion and marketing to certain customers in Europe. Eltek Europe GmbH commenced operations in 2009.

**b. Basis of presentation:**

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP").

The consolidated financial statements include the accounts of the Parent and its subsidiaries.

The Parent sells goods through its subsidiaries that function as distributors.

All intercompany transactions and balances were eliminated in consolidation.

The consolidated financial statements include the accounts of the Parent Company and its subsidiaries. Intercompany transactions and balances including profits from intercompany sales not yet realized outside the Company, have been eliminated upon consolidation.

Changes in the Parent Company's ownership interest with no change of control are treated as equity transactions, rather than step acquisitions or dilution gains or losses.

Non-controlling interests in subsidiaries represent the equity in subsidiaries not attributable, directly or indirectly, to a parent. Non-controlling interests are presented in equity separately from the equity attributable to the equity holders of the Company. Profit or loss and components of other comprehensive income are attributed to the Company and to non-controlling interests. Losses are attributed to non-controlling interests even if they result in a negative balance of non-controlling interests in the consolidated statement of financial position.

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Notes to the Consolidated Financial Statements

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## NOTE 1:- ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont.)

## c. Functional and reporting currency:

The Parent's functional currency is the New Israeli Shekel ("NIS"). Transactions denominated in foreign currencies are translated into NIS using the prevailing exchange rates at the date of the transaction. Gains and losses from the translation of foreign currency transactions are recorded in financial income or expenses.

The Company's reporting currency is the U.S. dollar. Assets and liabilities are translated to the reporting currency using the exchange rate at the end of the year. Revenues and expenses are translated into the reporting currency using the average exchange rate for each quarter. Translation adjustments are reported separately as a component of accumulated other comprehensive income.

## d. Translation of foreign entity operations:

The financial statements of foreign subsidiaries are translated into the Parent's functional currency as follows:

1. Assets and liabilities are translated according to the exchange rate on the consolidated balance sheet date including goodwill arising from the acquisition of the subsidiary.
2. Income and expense items are translated according to the weighted average exchange rate on a quarterly basis.
3. The resulting exchange rate differences are classified as a separate item in shareholders' equity.

## e. Exchange rates and linkage bases:

1. Balances linked to the Israeli Consumer Price Index ("CPI") are recorded pursuant to contractual linkage terms of the specific assets and liabilities.

## Notes to the Consolidated Financial Statements

## NOTE 1:- ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont.)

## 2. Details of the CPI and the representative exchange rates are as follows:

|                   | Israeli CPI<br>Points | Exchange<br>rate<br>of one US<br>dollar<br>NIS | Exchange<br>rate<br>of one Euro<br>NIS |
|-------------------|-----------------------|--|--|
| December 31, 2014 | 219.80                | 3.889  | 4.7246                                 |
| December 31, 2013 | 220.20                | 3.471  | 4.7819                                 |
| December 31, 2012 | 219.80                | 3.733  | 4.9206                                 |
|                   |                       | %  |  |
| December 31, 2014 | (0.2 )                | 12.2   | (1.2 )                                 |
| December 31, 2013 | 1.8                   | (7.02 )  | (2.82 )                                |
| December 31, 2012 | 1.6                   | (2.30 )  | (0.35 )                                |

## f. Use of estimates:

The preparation of the consolidated financial statements in accordance with U.S. GAAP requires the management of the Company to make estimates and assumptions relating to the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from these estimates. Significant items subject to such estimates and assumptions include the useful lives of fixed assets, allowance for doubtful accounts, valuation of derivatives, deferred tax assets, inventory, goodwill, put/call options, income tax uncertainties and other contingencies.

## g. Cash and cash equivalents:

Cash and cash equivalents are highly-liquid investments which include short-term bank deposits with an original maturity of three months or less from deposit date and which are not restricted by a lien.

## h. Trade accounts receivable:

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. Amounts collected on trade accounts receivable are included in net cash provided by operating activities in the consolidated statements of cash flows. The Company maintains an allowance for doubtful accounts for estimated losses inherent in its accounts receivable portfolio.

The allowance for doubtful accounts receivable is calculated on the basis of specific identification of customer balances. The allowance is determined based on management's estimate of the aged receivable balance considered uncollectible, based on historical experience, aging of the receivable and information available about specific

customers, including their financial condition and volume of their operations.

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## Notes to the Consolidated Financial Statements

## NOTE 1:- ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The activity in the allowance for doubtful accounts for the three years ended December 31, 2014 is as follows:

|  | 2014                    | Year ended<br>December 31,<br>2013 | 2012 |
|--|-------------------------|------------------------------------|------|
|  | US Dollars in thousands |                                    |      |
| Opening balance                          | 82                      | 95                                 | 93   |
| Additions during the year                | 21                      | -                                  | 1    |
| Write off of allowance                   | (32 )                   | (9 )                               | -    |
| Foreign currency translation adjustments | (9 )                    | (4 )                               | 1    |
| Closing balance                          | 62                      | 82                                 | 95   |

## i. Inventories:

Inventories are recorded at the lower of cost or market value. Cost is determined on the weighted average basis for raw materials. For work in progress and finished goods, the cost is determined pursuant to calculation of accumulated actual direct and indirect costs.

## j. Assets held for employees' severance payments:

Assets held for employees' severance payments represent contributions to insurance policies and deposits to a central severance pay fund, and are recorded at their current redemption value.

## k. Fixed assets:

Fixed assets are stated at cost. Depreciation is computed by the straight-line method over the estimated useful lives of the assets at the following annual rates:

%

Machinery and equipment 5-33

Leasehold improvements 6-14

Motor vehicles 15

Office furniture and equipment 6-33

Machinery and equipment purchased under capital lease arrangements are recorded at the present value of the minimum lease payments at lease inception. Such assets and leasehold improvements are depreciated and amortized respectively, using the straight-line method over the shorter of the lease term or estimated useful life of the asset.

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Notes to the Consolidated Financial Statements

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## NOTE 1:- ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Long-lived assets, such as property, plant, and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If circumstances require a long-lived asset or asset group be tested for possible impairment, the Company first compares undiscounted cash flows expected to be generated by that asset or asset group to its carrying value. If the carrying value of the long-lived asset or asset group is not recoverable on an undiscounted cash flow basis, impairment is recognized to the extent that the carrying value exceeds its fair value. Fair value is determined through various valuation techniques including discounted cash flow models, quoted market values and third-party independent appraisals, as considered necessary.

## l. intangible assets:

Intangible assets are amortized over their useful lives using a method of amortization that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used up, in accordance with ASC 350, "Intangibles - Goodwill and Other." Intangible assets were amortized based on the straight-line method or acceleration method.

The Parent acquired software technology which will be amortized during 2015.

Intangible assets are stated at cost. Depreciation is computed by the straight-line method over the estimated useful life of 10 years.

## m. Goodwill:

Goodwill is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized. Goodwill is reviewed for impairment at least annually. In September 2011, the Financial Accounting Standards Board ("FASB") issued ASU 2011-08, Testing Goodwill for Impairment, which provides an entity the option to perform a qualitative assessment to determine whether it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount prior to performing the two-step goodwill impairment test. If this is the case, the two-step goodwill impairment test is required. If it is more-likely-than-not that the fair value of a reporting unit is greater than its carrying amount, the two-step goodwill impairment test is not required. The Company adopted this guidance in 2011.

If the two-step goodwill impairment test is required, first, the fair value of the reporting unit is compared with its carrying amount (including goodwill). If the fair value of the reporting unit is less than its carrying amount, an indication of goodwill impairment exists for the reporting unit and the entity must perform step two of the impairment test (measurement). Under step two, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation and the residual fair value after this allocation is the implied fair value of the reporting unit goodwill. Fair value of the reporting unit is determined using a discounted cash flow analysis. If the fair value of the reporting unit exceeds its carrying amount, step two does not need to be performed.

The Company performs an annual impairment review of goodwill at the beginning of the following year, and when a triggering event occurs between annual impairment tests. Due to ongoing losses of Kubatronik, the Company recorded

impairment losses of \$80 in 2014 and \$481 in 2012. See Note 5. For 2013, the Company performed a qualitative assessment of goodwill and determined that it is not more-likely-than-not that the fair values of its reporting units are less than the carrying amounts. Accordingly, no impairment loss was recorded in 2013.

As of December 31, 2014, the Company had no goodwill balance. See Note 5.

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Notes to the Consolidated Financial Statements

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## NOTE 1:- ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont.)

## n. Income taxes:

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. The Company recognizes the effect of income tax positions only if those positions are more-likely-than- not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs.

## o. Revenue recognition:

The Company recognizes revenue upon shipment of the product and after the customer takes ownership and assumes risk of loss, collection of the corresponding receivable is probable, persuasive evidence of an arrangement exists, and the sales price is fixed or determinable. -

## p. Earnings per ordinary share:

Diluted earnings per ordinary share calculation is similar to basic earnings per share except that the weighted average of ordinary shares outstanding is increased to include the number of additional ordinary shares that would have been outstanding if the outstanding options had been exercised, to the extent that these options had a diluted effect. The Company does not presently have such dilutive instruments.

## q. Derivative financial instruments:

The Company may utilize derivative financial instruments principally to manage its exposure resulting from fluctuations in foreign currency exchange rates. The Company holds put/call options with the minority shareholder of Kubatronik for the purchase/sale of the minority holding in Kubatronik (see Note 15).

Changes in fair value are recognized in the consolidated statements of comprehensive income as a financing item.

The fair value of derivative financial instruments is determined on the basis of their market values or the quotations of financial institutions. In the absence of a market value or financial institution quotation the fair value is determined on the basis of a valuation model.

Notes to the Consolidated Financial Statements

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## NOTE 1:- ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont.)

## r. Concentration of credit risk:

Financial instruments that may subject the Company to significant concentrations of credit risk consist principally of cash and trade accounts receivable. Cash is deposited with major financial institutions in Israel, Europe and the United States.

The Company performs ongoing credit evaluations of the financial condition of its customers. The risk of collection associated with trade receivables is reduced by the large number and geographical dispersion of the Company's customer base, and the Company's policy of obtaining credit evaluations of the financial condition of certain customers, requiring collateral or security with respect to certain receivables, or purchase of insurance for certain other receivables.

## s. Research and development costs:

Research and development costs incurred in the process of developing product improvements or new products, are charged to expenses as incurred.

## t. Commitments and contingencies:

Liabilities for loss contingencies arising from claims, assessments, litigation, fines, and penalties and other sources are recorded when it is probable that a liability has been incurred and the amount can be reasonably estimated. Legal costs incurred in connection with loss contingencies are expensed as incurred.

## u. Fair value measurements:

The Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible. The Company determines fair value on assumptions that market participants would use in pricing an asset or liability in the principal or most advantageous market. When considering market participant assumptions in fair value measurements, the following fair value hierarchy distinguishes between observable and unobservable inputs, which are categorized in one of the following levels:

- Level 1 Inputs: Unadjusted quoted prices in active markets for identical assets or liabilities accessible to the reporting entity at the measurement date.
- Level 2 Inputs: Other than quoted prices included in Level 1 inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability.
- Level 3 Inputs: Unobservable inputs for the asset or liability used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at measurement date.

See Note 15.



## Notes to the Consolidated Financial Statements

## NOTE 1:- ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont.)

## v. Recently issued accounting standards:

In August 2014, the FASB issued Accounting Standards Update No. 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 ("ASU 2014-15"). ASU 2014-15 requires management to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a period of one year after the date that the financial statements are issued. If such conditions or events exist, an entity should disclose that there is substantial doubt about the entity's ability to continue as a going concern for a period of one year after the date that the financial statements are issued. Disclosure should include the principal conditions or events that raise substantial doubt, management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations, and management's plans that are intended to mitigate those conditions or events. ASU 2014-15 will be effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)", a comprehensive new revenue recognition standard that will supersede existing revenue guidance under US GAAP and IFRS ("ASU 2014-09"). ASU 2014-09's core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. ASU 2014-09 is effective for annual periods beginning after December 15, 2016, including interim periods within that period. Early adoption is not permitted under US GAAP.

## NOTE 2:- CASH AND CASH EQUIVALENTS

|                             | December 31,            |       |
|-----------------------------|-------------------------|-------|
|                             | 2014                    | 2013  |
|                             | US Dollars in thousands |       |
| Denominated in U.S. dollars | 773                     | 886   |
| Denominated in NIS          | 150                     | 1,304 |
| Denominated in Euro         | 206                     | 324   |
|                             | 1,129                   | 2,514 |

## NOTE 3:- INVENTORIES

|                   | December 31,            |       |
|-------------------|-------------------------|-------|
|                   | 2014                    | 2013  |
|                   | US Dollars in thousands |       |
| Raw materials     | 1,954                   | 2,168 |
| Work-in-process   | 1,686                   | 2,616 |
| Finished products | 1,030                   | 1,325 |



4,670

6,109

Raw materials inventory is net of \$59 and \$87 of obsolete items as of December 31, 2014, and 2013, respectively.

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## ELTEK LTD. AND ITS SUBSIDIARIES

## Notes to the Consolidated Financial Statements

## NOTE 4:-

## FIXED ASSETS, NET

|                                | December 31,            |           |
|--------------------------------|-------------------------|-----------|
|                                | 2014                    | 2013      |
|                                | US Dollars in thousands |           |
| Cost:                          |                         |           |
| Machinery and equipment        | 36,735                  | 40,347    |
| Leasehold improvements         | 8,542                   | 9,321     |
| Motor vehicles                 | 45                      | 114       |
| Office furniture and equipment | 1,472                   | 1,653     |
|                                | 46,794                  | 51,435    |
| Accumulated depreciation:      |                         |           |
| Machinery and equipment        | (28,896 )               | (32,897 ) |
| Leasehold improvements         | (6,469 )                | (6,842 )  |
| Motor vehicles                 | (33 )                   | (98 )     |
| Office furniture and equipment | (1,326 )                | (1,490 )  |
|                                | (36,724 )               | (41,327 ) |
| Depreciated cost               | 10,070                  | 10,108    |

Depreciation expense for the years ended December 31, 2014, 2013 and 2012 were \$ 1,813, \$ 1,827 and \$ 1,772, respectively.

## NOTE 5:-

## GOODWILL

Changes in the carrying amount of goodwill for the years ended December 31, 2014 and 2013 are as follows:

|                                      | December 31,            |      |
|--------------------------------------|-------------------------|------|
|                                      | 2014                    | 2013 |
|                                      | US Dollars in thousands |      |
| Balance at the beginning of the year | 75                      | 69   |
| Impairment on goodwill               | (80 )                   | -    |
| Effect of translation adjustments    | 5                       | 6    |
|                                      | -                       | 75   |

## NOTE 6:-

## SHORT-TERM CREDIT AND CURRENT MATURITIES OF LONG-TERM DEBT

## Banks:

Annual  
interest

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|  | rate at<br>December<br>31<br>2014<br>% | December 31,<br>2014 | December 31,<br>2013<br>US Dollars in thousands |
|--|--|----------------------|---|
| In NIS (linked to the Prime rate)                        | 3.5 - 6.75                             | 2,674                | 1,469   |
| In U.S. dollars  | 3.81 -<br>4.41                         | -                    | 110   |
| Current maturities of long-term debt from banks (Note 8) |  | 48                   | 239   |
|  |  | 2,722                | 1,818   |

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## ELTEK LTD. AND ITS SUBSIDIARIES

## Notes to the Consolidated Financial Statements

## NOTE 7:-

## OTHER CURRENT LIABILITIES

|  | December 31,            |       |
|--|-------------------------|-------|
|  | 2014                    | 2013  |
|  | US Dollars in thousands |       |
| Accrued payroll and related benefits               | 1,129                   | 1,134 |
| Provision for vacation and other employee benefits | 1,416                   | 1,973 |
| Net written put option (Note 1A)                   | 587                     | 554   |
| Accrued expenses                                   | 871                     | 812   |
| Employees' severance benefits (Note 9D)            | 401                     | 115   |
| Provision for contingent liabilities (Note 10D)    | 298                     | 202   |
| Other liabilities                                  | 454                     | 521   |
|  | 5,156                   | 5,311 |

## NOTE 8:-

## LONG-TERM DEBT, EXCLUDING CURRENT MATURITIES

## Banks and others

|  | Annual<br>interest<br>rate at<br>December<br>31<br>2014<br>% | December 31,            |        |
|--|--|-------------------------|--------|
|  |  | 2014                    | 2013   |
|  |  | US Dollars in thousands |        |
| Linkage terms                                |  |                         |        |
| U.S. dollar                                  | 5.89 -<br>8.56   | 403                     | 615    |
| NIS - not linked                             | 6  | 128                     | 225    |
| Euro   | 2.17 -<br>3.86   | 659                     | 454    |
| NIS - linked to the Prime rate               | P+0.9  | 1,157                   | 68     |
| U.S. dollar linked to Libor                  | 4-4.5  | -                       | 720    |
|  |  | 2,347                   | 2,082  |
| Less - current maturities (banks and others) |  | (509 )                  | (670 ) |
|  |  | 1,838                   | 1,412  |

Minimum future payments at December 31, 2014 due under the long-term (including capital lease) debt are as follows:

|                           | Long-term<br>loan |
|---------------------------|-------------------|
| First year                | 509               |
| Second year               | 674               |
| Third year                | 460               |
| Forth year                | 420               |
| Fifth year and thereafter | 284               |
|                           | 2,347             |

Long-term debt (excluding current maturities) includes capital leases in the amounts of \$308 and \$ 892 for the years ended December 31, 2014 and 2013, respectively.

Notes to the Consolidated Financial Statements

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## NOTE 8:- LONG-TERM DEBT, EXCLUDING CURRENT MATURITIES (Cont.)

For the year ended December 31, 2013 and onward, the Company's banks require the Company to maintain certain financial covenants. In April 2014, the Company signed a new financial undertakings letter, with one of the banks and in May 2014 with the other bank effective for the financial statements for the year ended December 31, 2013 and onward, pursuant to which it is required to maintain: (i) adjusted shareholders' equity equal to the greater of \$ 4.5 million or 17% of its consolidated total assets; and (ii) a debt service ratio of 1.5. For this purpose, adjusted shareholders' equity excludes certain intangible and other assets. Debt service ratio is defined as the ratio of EBITDA to current maturities of long-term debt plus interest expenses. As of December 31, 2014, the Company was in compliance with such covenants.

As to pledges securing the loans, see Note 10a.

## NOTE 9:- EMPLOYEE SEVERANCE BENEFITS

Under Israeli law and labor agreements, the Parent is required to make severance and pension payments to retired or dismissed employees and to employees leaving employment in certain other circumstances.

- a. The Parent has an approval from the Israeli Ministry of Labor and Social Welfare, pursuant to the terms of Section 14 of the Israeli Severance Pay Law, 1963, according to which the current deposits in the pension fund and/or with the insurance company exempt it from any additional severance obligations to the employees for whom such depository payments were made.
- b. The Parent's employees participate in a pension plan or individual insurance policies are purchased for them. The Parent's liability for severance obligations for the employees employed for one year or more is discharged by making regular deposits with a pension fund or the insurance policies. Under Israeli law, there is no liability for severance pay in respect of employees who have not completed one year of employment. The amount deposited with the pension fund or the insurance policies is based on salary components as prescribed in the employment agreement. The custody and management of the amounts so deposited are independent of the Parent and accordingly, such amounts funded and related liabilities are not reflected in the balance sheet.

Notes to the Consolidated Financial Statements

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## NOTE 9:- EMPLOYEE SEVERANCE BENEFITS (Cont.)

For the non-management employees, the Parent deposits 72% of its liability for severance obligations with a pension fund for such employees, and upon completion of one year of employment with the Parent, it makes a one-time deposit with the pension fund for the remaining balance.

In 2011, the Parent made a transfer of funds from a central severance fund to individual funds in the name of the employees for the unfunded liability in respect of the employees, which pursuant to Section 14 of the Israeli Severance Pay Law, it discharged its liability in respect of such employees' severance pay. As a result, the balance of assets held for employees severance pay was reduced, and the liability was reduced accordingly.

c. Kubatronik owns an insurance policy and makes regular deposits with an insurance company for securing pension rights on behalf of one of its former employees. Such amounts deposited and the related liabilities are reflected in the consolidated balance sheet.

In respect of its other employees, Kubatronik does not make any deposits for pension or retirement rights, since such deposits are not required under German law.

d. Total liability for employees' severance benefits as at December 31, 2014 amounted to \$ 617. The current portion amounting to \$ (84) is recorded in the short-term liabilities.

Expenses recorded in respect of the unfunded liability for employee severance payments for the years ended December 31, 2014, 2013, and 2012 were \$ 284, \$ 231 and \$ 57, respectively.

## NOTE 10:- COMMITMENTS AND CONTINGENT LIABILITIES

## a. Pledges:

1. The Company has pledged certain items of its equipment and the rights to any insurance claims on such items to secure its indebtedness to banks, as well as placed floating liens on all of its remaining assets in favor of the banks.
2. The Company has pledged certain items of its equipment as a guarantee for the implementation of its benefited enterprise for tax purposes. The Company has determined that it is in compliance with the conditions of the approval (see Note 14a).
3. The Company has also pledged machines to secure its indebtedness to certain suppliers that provided financing for such equipment.

## Notes to the Consolidated Financial Statements

## NOTE 10:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

## b. Operating leases and other agreements:

1. The premises occupied by the Parent and Kubatronik are leased under two operating agreements that expire in February 2017 and May 2019, respectively.
2. The Parent has signed several lease and maintenance agreements for production equipment with suppliers of equipment and software. Of such agreements, the main principal agreement expires in June 2017.
3. Several production machines are leased by Kubatronik under operating agreements which will expire in May 2019.
4. The Parent's motor vehicles are leased under operating lease agreements, mainly for three-year terms.
5. Minimum future payments at December 31, 2014 due under the above agreements over the next five years and thereafter are as follows:

|                           | Premises<br>leases<br>US Dollars in thousands | Other<br>agreements |
|---------------------------|---|---------------------|
| First year                | 1,016   | 639                 |
| Second year               | 1,016   | 436                 |
| Third year                | 265   | 178                 |
| Fourth year               | 115   | 2                   |
| Fifth year and thereafter | 155   | 3                   |
|                           | 2,567   | 1,258               |

Payments required under these agreements are charged to expense by the straight-line method over the periods of the respective leases.

Expenses recorded under these agreements for the years ended December 31, 2014, 2013, and 2012 were \$1,480, \$ 1,471 and \$ 1,183, respectively.

## c. Indemnification agreement:

The Parent entered into an indemnification agreement with its directors and officers and undertook to enter into the same agreement with future directors and officers, for losses incurred by a director or officer. Such indemnification amount is limited to the lesser of \$ 2,000 or 25% of the Parent's shareholders' equity.



Notes to the Consolidated Financial Statements

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## NOTE 10:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

The Israeli Companies Law provides that an Israeli company cannot exculpate an officer from liability with respect to a breach of his or her duty of loyalty. If permitted by its articles of association, a company may exculpate in advance an officer from his or her liability to the company, in whole or in part, with respect to a breach of his or her duty of care. However, a company may not exculpate in advance a director from his or her liability to the company with respect to a breach of his duty of care with respect to distributions.

The Company's articles of association allow it to exculpate any officer from his or her liability for breach of duty of care, to the maximum extent permitted by law, before or after the occurrence giving rise to such liability. The Parent provided an exculpation letter to each of its directors and officers, and agreed to provide the same to future officers.

## d. Contingent Liabilities:

## Environmental Related Matters

In January, 2014 and in July 2014, the Company received notices from Meitav, the water company of the Petach Tikva municipality, requiring payment of fees totaling NIS 1.4 million (\$390,000) excluding VAT, for discharges of industrial wastewater allegedly not meeting the applicable standards into the municipal sewage system. The payment demands were made on the basis of four samplings conducted by Meitav on Eltek's premises during 2013. The Company presented to Meitav its plans for a new wastewater treatment facility, in order to revoke or reduce the demand for payment. The Company believes that we have good arguments against such demand for payment and that it will not be liable to pay to Meitav any amounts exceeding the amounts provided for in its financial statements. In July 2014, the Company entered into an agreement with Elad Technologies (L.S) Ltd., pursuant to which, Elad Technologies will build and operate a wastewater treatment facility for the Company. The Company expects the facility to become operational in the second half of 2015.

If the Company is found to be in violation of environmental laws, then in addition to fees, it could be liable for damages, costs of remedial actions and a range of potential penalties, and could also be subject to revocation of permits necessary to conduct our business or any part thereof. Any such liability or revocation could have a material adverse effect on its business, financial condition and results of operations.

In connection with the change of control of our company that resulted from Nistec's acquisition of a controlling stake in the Company, Israeli law requires it to obtain a new business permit in order to continue operating its business. The Company submitted an application for this permit, but has not yet received the new permit. The new permit is expected to be subject to certain conditions, especially certain conditions imposed by the Israeli Ministry for Environmental Protection. The cost of complying with such conditions may be significant.

Notes to the Consolidated Financial Statements

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NOTE 10:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

Employee Related Matters

Three lawsuits were filed against the Company in May 2008, in March 2012 and in December 2014 by three employees alleging that they had suffered personal injuries during their employment with the Company. The employees are seeking aggregate financial compensation of approximately \$200,000 for past damages and additional amounts for future lost income, pain and suffering as the court may determine.

Four other employees notified the Company between January 2011 and July 2013 that they allegedly suffered personal injuries during their employment with the Company. Of these four employees, one is seeking compensation of \$170,000 and the others did not state their claim amount.

The Company submitted all these claims to its insurance company, which informed the Company that it is reviewing the statements of claim without prejudicing its rights to deny coverage.

In January 2015 and February 2015 two former employees informed the Company that they demand additional payments in connection with their employment with the Company and their termination. Their aggregate amount claimed is approximately \$380,000.

## Notes to the Consolidated Financial Statements

## NOTE 11:- SHAREHOLDERS' EQUITY

Authorized, issued and outstanding share capital in historical terms is as follows:

|   | Authorized<br>December 31<br>2014 and 2013 | Issued and outstanding<br>December 31,<br>2014 | 2013       |
|---|--|--|------------|
|   |  | Number of shares                               |            |
| Ordinary shares of par value NIS 0.6 each | 50,000,000                                 | 10,142,762                                     | 10,142,762 |
| <b>Amount in US\$</b>                     |  |  |            |
| Ordinary shares of par value NIS 0.6 each |  | 1,985,280                                      | 1,985,280  |

## NOTE 12:- REVENUES

a. Customers who accounted for over 10% of the total consolidated revenues:

|   | 2014                    | Year ended<br>December 31,<br>2013 | 2012   |
|---|-------------------------|------------------------------------|--------|
|   | US Dollars in thousands |                                    |        |
| Customer A - Sales of manufactured products | 20.6 %                  | 18.4 %                             | 17.2 % |

b. Revenues by geographic areas:

|                   | 2014                    | Year ended<br>December 31,<br>2013 | 2012   |
|-------------------|-------------------------|------------------------------------|--------|
|                   | US Dollars in thousands |                                    |        |
| Israel            | 24,807                  | 27,992                             | 21,965 |
| Europe            | 9,383                   | 10,623                             | 11,583 |
| North America     | 5,892                   | 6,227                              | 7,664  |
| India             | 5,240                   | 3,294                              | 1,280  |
| Rest of the world | 1,304                   | 2,099                              | 3,154  |
|                   | 46,626                  | 50,235                             | 45,646 |

c. Fixed assets, net by geographic areas:

|  | 2014                    | Year ended<br>December 31,<br>2013 | 2012 |
|--|-------------------------|------------------------------------|------|
|  | US Dollars in thousands |                                    |      |

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|               |        |        |       |
|---------------|--------|--------|-------|
| Israel        | 9,161  | 9,534  | 8,617 |
| Europe        | 901    | 561    | 445   |
| North America | 8      | 13     | 13    |
|               | 10,070 | 10,108 | 9,075 |

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## Notes to the Consolidated Financial Statements

## NOTE 13:-

## FINANCIAL EXPENSES, NET

|  | 2014                    | Year ended<br>December 31,<br>2013 | 2012 |
|--|-------------------------|------------------------------------|------|
|  | US Dollars in thousands |                                    |      |
| Interest and exchange rate expenses on long-term loans   | 95                      | 106                                | 126  |
| Expenses on short-term credit and bank charges   | 54                      | 284                                | 281  |
| Effect of exchange rate differences on other expenses and net loss from derivative instruments | 117                     | 19                                 | 137  |
| Other financing expenses (income), net   | 90                      | 30                                 | (1)  |
|  | 356                     | 439                                | 543  |

The Company uses forward contracts and options to manage some of its foreign exchange rate exposures. Such transactions were not designated as hedging instruments for accounting purposes.

## NOTE 14:-

## TAXES ON INCOME

- a. Tax benefits under the Israeli Law for the Encouragement of Capital Investments, 1959 (the "Law"):

## 1. Beneficiary enterprise:

The Parent has production facilities in Israel qualified as "Beneficiary Enterprises" in accordance with the Law, as amended in 2005, which provides certain tax benefits to investment programs of an "Approved Enterprise" or "Beneficiary Enterprise." The Parent's first Beneficiary Enterprise was converted from a previously "Approved Enterprise" program pursuant to the approval of the Israel Tax Authority that the Parent received in September 2006. In the past, certain of the Parent's production facilities were granted approved enterprise status pursuant to the Law; however, the benefit periods for such approved enterprises expired in 2005. Additionally, the Parent has elected 2012 as the year of election.

The income generated by the "Beneficiary Enterprise" is exempt from tax over a period of two years, beginning with the year in which the Parent first had taxable income. The period of tax benefit of the first Beneficiary Enterprise has not yet commenced and will expire not later than 2016. The period of tax benefit of the second beneficiary enterprise has not yet commenced and will expire not later than 2023. The benefits are contingent upon compliance with the terms of the Encouragement Law (export rate, etc.). The Parent is currently in compliance with these terms.

Notes to the Consolidated Financial Statements

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NOTE 14:-

## TAXES ON INCOME (Cont.)

A company having a Beneficiary Enterprise that distributes a dividend from exempt income, will be required in the tax year of the dividend distribution to pay company tax on the amount of the dividend distributed (including the company tax required as a result of the distribution) at the tax rate that would have been applicable to it in the year the income was produced if it had not been exempt from tax. The Parent did not have exempt income from the above "Beneficiary Enterprise".

## 2.Amendment to the Law:

On December 29, 2010 the Knesset approved the Economic Policy Law for 2011-2012, which includes an amendment to the Law for the Encouragement of Capital Investments – 1959 (hereinafter – "the Amendment"). The Amendment is effective from January 1, 2011 and its provisions apply to preferred income derived or accrued in 2011 and thereafter by a preferred company, per the definition of these terms in the Amendment.

Companies can choose not to be included in the scope of the amendment to the Encouragement Law and to stay in the scope of the law before its amendment until the end of the benefits period of its approved/beneficiary enterprise. The 2012 tax year was the last year companies could have chosen as the year of election, providing that the minimum qualifying investment began in 2010.

The Amendment provides that only companies in Development Area A will be entitled to the grants track and that they will be entitled to receive benefits under this track and under the tax benefits track at the same time. In addition, the existing tax benefit tracks were eliminated (the tax exempt track, the "Ireland" track and the "Strategic" track) and two new tax tracks were introduced in their place, a preferred enterprise and a special preferred enterprise, which mainly provide a uniform and reduced tax rate for all the company's income entitled to benefits, such as: for a preferred enterprise – in the 2011-2012 tax years – a tax rate of 10% for Development Area A and of 15% for the rest of the country, in the 2013-2014 tax years – a tax rate of 7% for Development Area A and of 12.5% for the rest of the country, and as from the 2015 tax year – 6% for Development Area A and 12% for the rest of the country. On August 5, 2013 the Knesset passed the Law for the Change in National Priorities (Legislative Amendments for Achieving Budget Objectives in the Years 2013 and 2014) – 2013, which cancelled the planned tax reduction so that as from the 2014 tax year the tax rate on preferred income will be 9% for Development Area A and 16% for the rest of the country.

The Amendment also provides that no income tax will apply to a dividend distributed out of preferred income to a shareholder that is a company, for both the distributing company and the shareholder. A tax rate of 15% shall apply to a dividend distributed out of preferred income to an individual shareholder or foreign resident, subject to double taxation prevention treaties. The Law for the Change in National Priorities (Legislative Amendments for Achieving Budget Objectives in the Years 2013 and 2014) – 2013 raised to 20% the tax rate on a dividend distributed to an individual and foreign resident out of preferred income as from January 1, 2014.

## Notes to the Consolidated Financial Statements

## NOTE 14:- TAXES ON INCOME (Cont.)

Furthermore, the Amendment provides relief with respect to the non-payment of tax on a dividend received by an Israeli company from profits of an approved/alternative/beneficiary enterprise that accrued in the benefits period according to the version of the law before its amendment, if the company distributing the dividend notifies the tax authorities by June 30, 2015 that it is applying the provisions of the Amendment and the dividend is distributed after the date of the notice (hereinafter – "the relief"). Furthermore, a distribution from profits of the exempt enterprise will be subject to tax by the distributing company.

The Parent complies with the conditions provided in the amendment to the Law for the Encouragement of Capital Investments for inclusion in the scope of the tax benefits track. The Parent intends to implement the Amendment in future tax years. Therefore, the deferred tax balance as of December 31, 2013 was calculated based on the rate provided by the Amendment.

## b. Corporate tax rate:

Presented hereunder are the tax rates relevant to the Parent in the years 2012-2014:  
2013 and 2012 - 25%, 2014 - 26.5%.

On August 5, 2013, the Knesset passed the Law for the Change in National Priorities (Legislative Amendments for Achieving Budget Objectives in the Years 2013 and 2014) - 2013, by which, inter alia, the corporate tax rate would be raised by 1.5% to a rate of 26.5% as from 2014.

Current taxes for the reported periods are calculated according to the tax rates presented above.

## c. Tax losses and tax credits carryforwards:

As of December 31, 2014, the Parent's tax loss carryforwards were approximately \$ 14.1 million of operating losses and \$ 4.2 million of capital losses and Kubatronik's tax loss carryforwards were Euro 1.5 million (\$ 1.8 million) for corporate tax and Euro 1.5 million (\$ 1.8 million) for municipal corporate tax. Additionally, the Parent's tax credits carryforward was \$ 869.

The Parent's tax loss carryforward and tax credits carryforward do not have expiration dates. Kubatronik's tax loss carryforward may be subject to restrictions if a change of control in Kubatronik occurs.

## d. Income tax assessments:

The Parent files its income tax return in Israel. Kubatronik and Eltek Europe file their income tax returns in Germany and Eltek USA files its income tax return in the United States.

## Notes to the Consolidated Financial Statements

## NOTE 14:- TAXES ON INCOME (Cont.)

In Israel, the Parent has received final tax assessments through the 1995 tax year. Assessments through the 2009 tax year are considered final due to statute of limitations. The Israeli tax returns of the Parent may be audited by the Israeli Tax Authorities for the tax years beginning in 2010.

Kubatronik and Eltek Europe have received final tax assessments through the 2010 tax year. The tax returns of Kubatronik and Eltek Europe remain subject to audit for the tax years beginning in 2011. The tax returns of Eltek USA remain subject to audit for the tax years beginning in 2009.

The Parent's other foreign subsidiaries have not yet received any final tax assessments since their incorporation.

e. Profit before tax and income tax expense (benefit) included in the consolidated statements of comprehensive income:

|  | 2014                    | Year ended<br>December 31,<br>2013 | 2012 |
|--|-------------------------|------------------------------------|------|
|  | US Dollars in thousands |                                    |      |
| Profit (loss) before income tax expense: |                         |                                    |      |
| Israel                                   | (483 )                  | 782                                | 495  |
| Foreign jurisdictions                    | (738 )                  | 24                                 | 253  |
|  | (1,221 )                | 806                                | 748  |
| Current tax expense (benefit):           |                         |                                    |      |
| Israel                                   | -                       | (41 )                              | -    |
| Foreign jurisdictions                    | 19                      | 78                                 | 52   |
|  | 19                      | 37                                 | 52   |
| Deferred taxes:                          |                         |                                    |      |
| Israel                                   | 1,581                   | (3,079 )                           | -    |
| Foreign jurisdictions                    | 34                      | 67                                 | -    |
|  | 1,615                   | (3,012 )                           | -    |
| Income tax expense (benefit)             | 1,634                   | (2,975 )                           | 52   |

The deferred tax assets utilized in 2013 and 2012 were \$ 299,000 and \$ 1.1 million respectively.



## Notes to the Consolidated Financial Statements

## NOTE 14:- TAXES ON INCOME (Cont.)

- f. Reconciliation of the theoretical income tax expense (benefit) to the actual income tax expense:

A reconciliation of the theoretical income tax expense (benefit), assuming all income is taxable at the statutory rates applicable in Israel, and the actual income tax expense, is as follows:

|  | 2014                    | Year ended<br>December 31,<br>2013 |  | 2012     |
|--|-------------------------|------------------------------------|--|----------|
|  | US Dollars in thousands |                                    |  |          |
| Profit (loss) before income tax expense (benefit) as reported in the consolidated statements of comprehensive income | (1,221 )                | 806                                |  | 748      |
| Statutory tax rates  | 26.5 %                  | 25 %                               |  | 25 %     |
| Theoretical tax expense calculated   | (324 )                  | 202                                |  | 187      |
| Other  | 182                     | (118 )                             |  | 15       |
| Changed in liability for undistributed income of subsidiaries  | 29                      | 132                                |  | -        |
| Change in valuation allowance  | 1,724                   | (2,540 )                           |  | 1,095    |
| Loss on investment in subsidiaries   | -                       | -                                  |  | (1,098 ) |
| Adjustment to net loss carryforward  | -                       | 142                                |  |          |
| Change in effective corporate tax rates  | -                       | (757 )                             |  | -        |
| Tax benefit arising from "Beneficiating and Preferred enterprises" (*)   | 40                      | (70 )                              |  | (146 )   |
| Foreign tax rate differential in subsidiaries  | (17 )                   | 34                                 |  | (1 )     |
| Total  | 1,958                   | (3,177 )                           |  | (135 )   |
| Income tax expense (benefit)   | 1,634                   | (2,975 )                           |  | 52       |

(\*)Net earnings per share - amounts of the benefit resulting from the Approved and Preferred Enterprises: 2014 - \$0.01 2013- \$ 0.01, 2012- \$ 0.02.

## Notes to the Consolidated Financial Statements

## NOTE 14:- TAXES ON INCOME (Cont.)

## g. Deferred tax assets and liabilities:

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

|   | December 31,            |               |
|---|-------------------------|---------------|
|   | 2014                    | 2013          |
|   | US Dollars in thousands |               |
| <b>Deferred tax assets:</b>                               |                         |               |
| Net operating loss carryforwards (in Israel)              | 2,532                   | 2,543         |
| Net operating loss carryforwards (outside Israel)         | 530                     | 343           |
| Capital loss carryforwards (in Israel)                    | 1,113                   | 1,252         |
| Severance benefits  | 29                      | 32            |
| Provision for vacation pay                                | 199                     | 280           |
| Tax credit carryforward                                   | 869                     | 952           |
| Allowance for doubtful accounts                           | 10                      | 13            |
| <b>Total gross deferred tax assets</b>                    | <b>5,282</b>            | <b>5,415</b>  |
| Less valuation allowance                                  | (3,319 )                | (1,595 )      |
| <b>Net deferred tax assets</b>                            | <b>1,963</b>            | <b>3,820</b>  |
| <b>Deferred tax liabilities:</b>                          |                         |               |
| Undistributed income of subsidiaries                      | (29 )                   | (134 )        |
| Fixed assets - differences in depreciation                | (721 )                  | (635 )        |
| <b>Total gross deferred tax liabilities</b>               | <b>(750 )</b>           | <b>(769 )</b> |
| <b>Net deferred tax assets</b>                            | <b>1,213</b>            | <b>3,051</b>  |
| Deferred tax assets, short-term (in other current assets) | 157                     | 188           |
| Deferred tax assets, long-term                            | 1,056                   | 2,863         |

Despite the Company's accumulated profits in Israel during the years ended December 31, 2014 and 2013, the Company recorded a full valuation allowance for deferred tax assets with respect to its deferred tax assets in Israel due to uncertainty about its ability to utilize such losses in the future.

During the year ended December 31, 2014 the Company recorded a tax expense of \$1.6 million compared to a tax benefit of \$3 million in 2013. In 2014, the Company reduced certain of its deferred tax assets due to changes in the PCB market conditions and increased uncertainty about its ability to utilize these tax assets in the foreseeable future. Such uncertainty results from a reduced demand for the Company's products, a change in the PCB buying patterns by domestic military customers, which shifted some PCB acquisitions overseas, increased competition coupled with reduced prices in the local market, on-going manufacturing challenges, and the possible devaluation of the US Dollar against the NIS, all of which may adversely affect the Company's future profitability. Other tax expenses in 2014 were attributable to subsidiaries in the United States and Germany.

In 2013, the Parent determined that the deferred tax assets were more-likely-than-not to be realized in future years, based on three years of consistent profits. Accordingly, the Company reversed the valuation allowance, in the amount of \$ 2.5 million. The amount of the deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carryforward period are reduced. The ultimate realization of deferred tax assets depends on the generation of future taxable income during the periods in which those temporary differences are deductible. Management considers the scheduled reversal of deferred tax liabilities, projected taxable income, and tax-planning strategies in making this assessment. The valuation allowance for deferred tax assets as of December 31, 2014 and 2013, was \$3,319 and \$ 1,595 respectively. The net change in the total valuation allowance for each of the years ended December 31, 2014, 2013 and 2012, was an increase (decrease) of \$1,724, \$(2,540) and \$1,095, respectively.

Certain comparative figures in Note 14F and 14G have been changed to reflect changes in the deferred tax assets and liabilities and related valuation allowance.

Notes to the Consolidated Financial Statements

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## NOTE 14:- TAXES ON INCOME (Cont.)

## h. Accounting for uncertainty in income taxes:

For the twelve-month periods ended December 31, 2014, 2013 and 2012, the Company did not have any unrecognized tax benefits and thus, no interest and penalties related to unrecognized tax benefits were recorded. In addition, the Company does not expect that the amount of unrecognized tax benefits will change significantly within the next twelve months.

## NOTE 15:- FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The Company measures its long-term bank loans and net written put option (see Note 1A) at fair value. In accordance with ASC 820-10, the Company's long-term bank loans and foreign currency derivative contracts are classified within Level 2, because they are valued utilizing market observable inputs. The net written put option is classified within Level 3 because it is valued using a Binomial model which utilizes significant inputs that are unobservable in the market such as expected stock price volatility, risk-free interest rate and the dividend yield, and remaining period of time the options will be outstanding before they expire.

The Company's outstanding loan as of December 31, 2014 was received at the year-end and accordingly is presented at its fair value.

In addition to the above, the Company's financial instruments at December 31, 2014 and 2013, consisted of cash and cash equivalents, bank deposits, trade and other accounts receivable, other current assets, short-term credit provided by financial institutions, and trade and other payables. The carrying amounts of all the aforementioned financial instruments, at face value or cost plus accrued interest, approximate fair value due to the short maturity of these instruments.

The changes in the Company's liabilities measured at fair value using significant unobservable inputs (Level 3), during the years ended December 31, 2014 and 2013 were changes in the fair value of the net written put option charged to financial expense in the Consolidated Statement of Comprehensive Income of \$ 93 and \$ 35 and, respectively, and translation adjustments included in financial income in the Consolidated Statement of Comprehensive Income \$ 60 and \$ (15), respectively.

These Consolidated Financial Statements do not include any nonrecurring fair value measurements relating to assets and liabilities for which the Company has adopted the provisions of ASC Topic 820.

## ELTEK LTD. AND ITS SUBSIDIARIES

## Notes to the Consolidated Financial Statements

## NOTE 16:- RELATED PARTY BALANCES AND TRANSACTIONS

The Company carries out transactions with related parties as detailed below. Until November 2013, the Company's principal shareholder was also the principal shareholder of an affiliated supplier.

One of the Company's customers, Nistec, became a related party in November 2013. The Company sells products to Nistec and pays management fees to Nistec. The Company's transactions with its related parties were carried out on an arm's-length basis.

## a. Balances with related parties:

|                           | December 31,            |      |
|---------------------------|-------------------------|------|
|                           | 2014                    | 2013 |
|                           | US Dollars in thousands |      |
| Trade accounts receivable | 74                      | 26   |
| Trade accounts payable    | 32                      | -    |

## b. Transactions with related parties:

|  | Year ended<br>December 31, |       |       |
|--|----------------------------|-------|-------|
|  | 2014                       | 2013  | 2012  |
|  | US Dollars in thousands    |       |       |
| Cost of revenues (*)                         | -                          | 3,402 | 3,287 |
| Selling, general and administrative expenses | 302                        | 52    | -     |

(\*)The Company's purchases from such supplier accounted for 23.1% and 24.5% of its raw material costs in 2013 and 2012, respectively.

## NOTE 17:- SUBSEQUENT EVENTS

On April 1, 2015 a former employee submitted to the Company a demand for additional payments related to his employment with the Company and his termination. The total amount claimed is approximately \$212,000. Due to the early stage of this claim, the Company has not yet assessed the chances of its success.

SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

ELTEK LTD.

By: /s/ Yitzhak Nissan  
Name: Yitzhak Nissan  
Title: Chairman and Chief  
Executive Officer

By: /s/ Amnon Shemer  
Name: Amnon Shemer  
Title: Vice President, Finance and  
Chief Financial Officer

Dated: April 2, 2015

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