

BOS BETTER ONLINE SOLUTIONS LTD  
Form 20-F  
April 30, 2013

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As filed with the Securities and Exchange Commission on April 30, 2013

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, 2012

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: 001-14184

B.O.S. BETTER ONLINE SOLUTIONS LTD.

(Exact name of Registrant as specified in its charter)

ISRAEL

(Jurisdiction of incorporation or organization)

20 Freiman Street, Rishon LeZion, 75100, Israel  
(Address of principal executive offices)

Eyal Cohen, 972-3-9542070, eyalc@boscom.com, 20 Freiman Street, Rishon LeZion, 75100, Israel

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(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, nominal value NIS 80.00 per share	NASDAQ Capital Market

Securities registered or to be registered pursuant of 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 at the close of the period covered by the annual report:

1,132,685 ordinary shares, nominal value NIS 80.00 per share, as of December 31, 2012 and  
1,154,633 ordinary shares, nominal value NIS 80.00 per share, as of March 31, 2013.

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

This report on Form 20-F is being incorporated by reference into all effective Registration Statements filed by us under the Securities Act of 1933, to the extent not superseded by documents or reports subsequently filed or furnished.

#### Forward Looking Statements

This Annual Report on Form 20-F contains forward-looking statements that are intended to be, and are hereby identified as, forward looking statements for the purposes of the safe harbor provisions of the Private Securities Reform Act of 1995. These statements address, among other things: our strategy; the anticipated development of our products; the results of completed acquisitions and our ability to make future acquisitions; our projected capital expenditures and liquidity; our development of additional revenue sources; our development and expansion of relationships; the market acceptance of our products; and our technological advancement. Actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including all the risks discussed below and elsewhere in this report.

We urge you to consider that statements that use the terms "believe", "do not believe", "expect", "plan", "intend", "estimate", "anticipate", "projections", "forecast" and similar expressions are intended to identify forward-looking statements. These statements reflect our current views with respect to future events. These statements are based on assumptions and are subject to risks and uncertainties. These risk factors and uncertainties include, amongst others, the dependency of sales being generated from one or few major customers, the uncertainty of BOS being able to maintain current gross profit margins, inability to keep up or ahead of technology and to succeed in a highly competitive industry, inability to maintain marketing and distribution arrangements and to expand our overseas markets, uncertainty with respect to the prospects of legal claims against BOS, the effect of exchange rate fluctuations, general worldwide economic conditions and continued availability of financing for working capital purposes and to refinance outstanding indebtedness; and additional risks and uncertainties set forth in this Annual Report, including under the heading "Risk Factors." Except as required by applicable law, including the federal securities laws of the United States, we do not intend to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Market data and forecasts used in this report have been obtained from independent industry sources. We have not independently verified the data obtained from these sources and we cannot assure you of the accuracy or completeness of the data. Forecasts and other forward-looking information obtained from these sources are subject to the same

qualifications and additional uncertainties accompanying any estimates of future market size.

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PART I

Item 1: Identity of Directors, Senior Management and Advisors

Not applicable.

Item 2: Offer Statistics and Expected Timetable

Not applicable.

Item 3: Key Information Regarding BOS

Unless the context in which such terms are used would require a different meaning, all references to “BOS”, “we”, “our” or the “Company” refer to B.O.S. Better Online Solutions Ltd. and its subsidiaries.

3A. Selected Consolidated Financial Data

The selected consolidated statement of operations data for B.O.S. Better Online Solutions Ltd. set forth below with respect to the years ended December 31, 2012, 2011 and 2010, and the selected consolidated balance sheet data as of December 31, 2012 and 2011, have been derived from our audited Consolidated Financial Statements listed in Item 18, which have been prepared in accordance with generally accepted accounting principles in the United States (“U.S. GAAP”). The selected consolidated statement of operations data set forth below with respect to the years ended December 31, 2009 and 2008, and the consolidated balance sheet data as of December 31, 2010, 2009 and 2008, are derived from other consolidated financial statements not included herein and have been prepared in accordance with U.S. GAAP. The financial statements for the years ended December 31, 2012, 2011, 2010, 2009 and 2008 were audited by Kost Forer Gabbay & Kasierer, an independent registered public accounting firm and a member of Ernst & Young Global. The financial statements of BOS - Supply Chain Solutions (Lynk) Inc. (“Lynk”, formerly, Lynk, USA Inc.) and its subsidiaries for the years ended December 31, 2009 and 2008 were audited by Arik Eshel, CPA & Assoc., PC an independent registered public accounting firm. The selected consolidated financial data presented below should be read in conjunction with and is qualified entirely by reference to Item 5: “Operating and Financial Review and Prospects” and the Notes to the Financial Statements included in this Annual Report on Form 20-F.

The Company has accounted for discontinued operations, in accordance with ASC 205-20, Discontinued operations of the Financial Accounting Standards Board. As such, the results of discontinued operations, including revenues, cost of revenues, operating expenses, and other income and expenses, related to the prior periods of the discontinued operation have been reclassified in the accompanying statements of operations (see Note 1e to the Consolidated Financial Statements for the year ended December 31, 2012).

On December 14, 2012 the Company announced the completion of a 1-for-4 reverse stock split of its Ordinary shares. Pursuant to the reverse stock split, each 4 Ordinary Shares, NIS 20.00 nominal value per share, were converted into one Ordinary Share, NIS 80.00 nominal value per share. No fractional shares were issued as a result of the reverse-split. Instead, all fractional shares were rounded up to the next higher whole number of shares. As of December 13, 2012, there were 4,472,298 Ordinary Shares outstanding and after the reverse stock split there were 1,118,081 Ordinary Shares outstanding. Unless explicitly stated otherwise, all share prices and amounts are adjusted to account for the reverse stock split.



Statement of Operations Data: (In U.S. thousands of dollars with the exception of per share data)

	Year Ended December 31,				
	2008	2009	2010	2011	2012
Revenues	34,066	25,467	30,187	33,434	24,503
Cost of revenues	26,893	19,741	22,668	26,481	19,050
Inventory write offs	339	2,235	36	443	385
Gross profit	6,834	3,491	7,483	6,510	5,068
Operating expenses:					
Research and development, net	844	360	372	403	125
Sales and marketing	6,408	5,426	4,068	4,273	3,058
General and administrative	2,029	2,004	1,786	2,252	1,693
Impairment of goodwill and other intangible assets	568	383	-	555	-
Total operating expenses	9,849	8,173	6,226	7,483	4,876
Operating Profit (loss)	(3,015 )	(4,682 )	1,257	(973 )	192
Financial expense, net	(431 )	(606 )	(961 )	(2,241 )	(781 )
Other expenses, net	(1,448 )	(409 )	(120 )	(172 )	(147 )
Income (loss) before tax on income	(4,894 )	(5,697 )	176	(3,386 )	(736 )
Tax benefit (taxes on income)	241	(329 )	(5 )	172	187
Income (loss) from continuing operations	(4,653 )	(6,026 )	171	(3,214 )	(549 )
Net income (loss) from discontinued operations	(1,747 )	(3,075 )	(806 )	-	-
Net loss	(6,400 )	(9,101 )	(635 )	(3,214 )	(549 )
Basic and diluted net income (loss) per share from continuing operations	\$(7.76 )	\$(9.28 )	\$0.28	\$(4.56 )	\$(0.49 )
Basic and diluted net income (loss) per share from discontinued operations	\$(2.92 )	\$(4.72 )	\$(1.24 )	\$-	\$-
Basic and diluted net loss per share	\$(10.68 )	\$(14 )	\$(0.96 )	\$(4.56 )	\$(0.49 )
Weighted average number of shares used in computing basic net earnings (loss) per share	599	652	656	705	1,118
Weighted average number of shares used in computing diluted net earnings (loss) per share	599	652	656	705	1,118

Consolidated Balance Sheet Data:	As of December 31,				
	2008	2009	2010	2011	2012
Cash and Cash Equivalents	1,247	564	703	411	354
Working Capital (*)	3,491	237	386	(349 )	(739 )
Total Assets	37,345	27,362	22,130	20,069	18,049
Short-term banks loan and current maturities of long-term bank loans	6,879	7,983	7,778	7,496	6,383
Long-term liabilities	4,564	4,274	4,073	2,440	2,017
Share Capital	13,159	13,225	13,959	23,065	23,374
Additional paid in Capital	55,830	57,042	56,805	51,093	50,891
Shareholders' equity	11,244	3,643	3,713	3,598	3,156
(*)Working capital comprises of:					
Current assets	19,644	19,682	14,730	13,682	12,137
Less: current liabilities	16,153	19,445	14,344	14,031	12,876
	3,491	237	386	(349 )	(739 )

3B. Capitalization and Indebtedness

Not applicable.

3C. Reasons for the Offer and Use of proceeds

Not applicable.

3D. Risk Factors

The following factors, in addition to other information contained or incorporated by reference in this Form 20-F, should be considered carefully. Our business, financial condition or results of operations could be materially adversely affected by any of these risks. The risks described below are not the only risks facing our Company. Additional risks and uncertainties that we are not aware of or that we currently believe are immaterial may also adversely affect our business, financial condition, results of operation and liquidity. The trading price of our ordinary shares could decline due to any of these risks, and you may lose all or part of your investment.

Risks relating to our financial results and capital structure:

We require a significant amount of cash to satisfy our debt obligations. If we fail to generate sufficient cash flow from operations, we may need to renegotiate or refinance our debt, obtain additional financing, postpone capital expenditures or sell assets.

As of December 31, 2012 we had \$846,000 in long-term debt to Dimex Systems Ltd. (includes current maturities of \$136,000) and \$1,612,000 in long-term bank loans (includes current maturities of \$424,000). In addition, at December 31, 2012, we had \$5.96 million of short term bank loans drawn under a revolving credit facility. We depend mainly on cash generated by continuing operating activities to make payments on our debt. We cannot assure that we will generate sufficient cash flow from operations to make the scheduled payments on our debt. Our ability to meet our debt obligations will depend on whether we can successfully implement our business strategy, as well as on economic, financial, competitive and technical factors (See "Item 5B. Liquidity and Capital Resources").

Some of the factors are beyond our control, such as economic conditions in the markets where we operate or intend to operate, changes in our customers' demand for our products, and pressure from existing and new competitors. Also, because part of our loans bear interest at floating rates, we are susceptible to an increase in interest rates (See "Item 11. Quantitative and Qualitative Disclosures about Market Risk").

If we cannot generate sufficient cash flow from operations to make scheduled payments on our debt obligations, we may need to renegotiate the terms of our debt, refinance our debt, obtain additional financing, delay planned capital expenditures or sell assets.

If our lenders decline to renegotiate the terms of our debt in these circumstances, the lenders could declare all amounts borrowed and all amounts due to them under the agreements due and payable.

We have had a history of losses and our future levels of sales and ability to achieve profitability are unpredictable.

As of December 31, 2012, we had an accumulated deficit of \$71 million. In 2012, we had a net loss of \$0.55 million. The Company's revenues in 2012 were lower by 26.7% as compared to 2011. Our ability to maintain and improve future levels of sales and achieve profitability depends on many factors, which include:

- developing and selling new Radio Frequency Identification ("RFID") and Mobile Solutions products to meet market needs;
  - having access to sufficient working capital financing to support our operations.
  - delivering our products in a timely manner;
  - successfully implementing our business strategy;
  - increased demand for our existing products; and
- controlling costs.

There can be no assurance that we will be able to meet our challenges and experience any growth in sales or achieve profitability in the future, that the level of historic sales will continue in the future or that our net losses will not increase in the future.

We may be unable to maintain our gross profit margins.

Our sales and profitability may vary in any given year, and from quarter to quarter. In order to increase sales or to enter into new markets with new products or due to competition we may find it necessary to decrease prices in order to be competitive. Additionally, our gross profit margin tends to fluctuate mainly due to variety and mix of products. We may not be able to maintain current gross profit margins in the future, which would have a material adverse effect on our business.

We depend on two banks which provide our short and long term loans.

We rely on Bank Leumi le-Israel Ltd. ("Bank Leumi") and on Bank Hapoalim, to provide credit facilities to our subsidiaries. As of December 31, 2012 we had \$5.96 million drawn under a Bank Leumi short term revolving credit facility. In addition, as of December 31, 2012 we had \$403,000 current maturities of long term loans and \$1.12 million of long terms bank loans with Bank HaPoalim. The Bank HaPoalim loans contain several covenants that require the Company's Israeli subsidiaries to maintain certain financial ratios and levels of profitability. As of December 31, 2012 the Company was not in compliance with Bank HaPoalim's covenants. Nonetheless, Bank HaPoalim agreed under certain conditions, including compliance by the Company with its covenants for the year 2013, to waive this failure of the Company to meet its financial covenants in 2012. Failure to meet our bank covenants may lead to a default under the loan agreements.



Our assets are subject to security interests in favor of our bank lenders. Our failure to repay the bank loans, if required, could result in legal action against us, which could require the sale of all of our assets.

The repayment of our debt to Bank Leumi is secured by a first priority floating charge on all of our Company's assets, present and future as they may be changing from time to time, and by a first priority fixed charge on all of the Company's issued and unpaid-for share capital, its goodwill and its shares of our Israeli subsidiaries, BOS - Dimex Ltd. ("Dimex") and BOS - Odem Ltd. ("Odem"). In addition, the Company and its Israeli subsidiaries entered into a series of intercompany guarantees in favor of Bank Leumi.

The repayment of the Company's debt to Bank HaPoalim is secured by long term bank deposits in the amount of \$438,000.

If we are unable to repay the bank loans when due, our bank lender could foreclose on our assets in order to recover the amounts due. Any such action would require us to curtail or cease operations (See "Item 5B. Liquidity and Capital Resources").

Our debt obligations may hinder our growth and put us at a competitive disadvantage.

Our debt obligations require us to use a substantial portion of our operating cash flow to repay the principal and interest on our loans. This reduces funds available to grow and expand our business, limits our ability to pursue business opportunities and makes us more vulnerable to economic and industry downturns. The existence of debt obligations and covenants also limits our ability to obtain additional financing on favorable terms.

Due to restrictions in our loan agreements, we may not be able to operate our business as we desire.

Our loan agreements contain a number of conditions and limitations on the way in which we can operate our business, including limitations on our ability to raise debt, sell or acquire assets and pay dividends. Our loan agreements also contain various covenants, which require that we maintain certain financial ratios related to shareholder's equity, operating results and certain levels of profitability. These limitations and covenants may force us to pursue less than optimal business strategies or forgo business arrangements which could have been financially advantageous to our shareholders and us. Our failure to comply with the covenants and restrictions contained in our loan agreements could lead to a default under the terms of these agreements (See "Item 5B. Liquidity and Capital Resources").

Risks related to our business:

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 the executive officers and key technical personnel who have been involved in the development of our two divisions;
- 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 computer operating, 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 be unable to effectively manage our growth and expansion, and as a result, our business results may be adversely affected.

Our goal is to grow over the next few years. The management of our growth, if any, will require the continued expansion of our operational and financial control systems, as well as a significant increase in our financial resources and in our delivery and service capabilities. These factors could place a significant strain on our resources.

Our growth increases the complexity of our operations, places significant demands on our management and our operational, financial and marketing resources and involves a number of challenges, including:

- managing geographically dispersed operations;
- retaining and motivating key personnel of the acquired businesses;
- assimilating different corporate cultures;
- preserving the business relationships with existing key customers and suppliers;
- maintaining uniform standards, controls, procedures and policies; and
- introducing joint products and service offerings.

In recent years, the Company has made several acquisitions, such as the acquisition of Dimex Systems' business in March 2008, and the acquisition of BOS Supply Chain Solutions (Summit) Inc. ("Summit"), a New Jersey based company, in October 2007 (Summit filed for Chapter 7 bankruptcy relief on November 23, 2010). There can be no assurance that we will be able to successfully integrate and manage future acquisitions, if they further occur, in order to maintain and grow the combined business and maximize the potential synergies.





Further, once integrated, acquisitions may not achieve comparable levels of revenues, profitability or productivity as were prior to the acquisitions or otherwise perform as expected. The occurrence of any of these events could harm our business, financial condition or results of operations.

Our inability to meet our delivery commitments in a timely manner (as a result of unexpected increases in orders, for example) could result in losses of sales, exposure to contractual penalties, costs or expenses, as well as damage to our reputation in the marketplace.

Our inability to manage growth effectively could have a material adverse effect on our business, financial condition and results of operations.

The continued growth of our RFID and Mobile Solutions division depends on our ability to expand sales abroad.

Our RFID and Mobile Solutions was unable to significantly expand sales abroad. Due to limitations in the size of the Israeli RFID and Mobile Solutions markets, continued growth of this division depends on our ability to increase our sales abroad. There can be no assurance that we will be successful in generating revenues from sales outside of Israel.

We do not have collateral or credit insurance for all of our customers' debt, and our allowance for bad debts may increase.

Our customers' debt is derived from sales to customers located primarily in Israel, the Far East and Europe. The Company does not generally require collateral; however most of the Company's debt of customers outside of Israel is insured against customer nonpayment through the Israeli Credit Insurance Company Ltd. or through letters of credit.

The balance of allowance for bad debt as of December 31, 2012 amounted to \$127,000, which was determined by the Company's management to be sufficient. In face of a global economic slowdown or if a local or global recession reoccurs, we may be required to record additional and significant allowances for bad debts.

Certain customers of our Supply Chain Solutions division may cancel purchase orders they placed before the delivery.

Supply chain programs for the sale of electronic components, including the programs offered by our Supply Chain Solutions division, are designed to accommodate the preference of customers to work with a limited number of suppliers that are able to provide a wide range of electronic components under one order. In the event we are not able to provide all of the components required by a customer, they could elect to terminate the entire order before its delivery. In addition, certain of our individual product orders provide a right of termination prior to delivery.

In the event substantial orders are so cancelled, there is no assurance that we will be able to sell the pre-purchased inventory at a profit, or at all. This could result in excess and obsolete inventory and could have a material adverse effect on our results of operations.

The electronic components provided by our Supply Chain Solutions division need to meet certain industry standards and for some customers we need to be the manufacturers' authorized distributors.

The main business of our Supply Chain Solutions division is the provision of electronic components to the aerospace and defense industry. These components need to be in compliance with Aviation Standard number 9120, which was adopted by the International Aerospace Quality Group. Non compliance with these standards could limit our sales.

In addition, in face of an increased number of refurbished or non-original components offered in the marketplace, certain customers have begun to insist on purchasing components only directly from authorized distributors of the manufacturers. This could impair our ability to sell components of manufacturers for which we do not serve as authorized dealers and have a substantial adverse effect on our business.

The Supply Chain Solutions division engages in a number of business activities governed by U.S. Government Laws and Regulations, which if violated, could subject the Company to civil or criminal fines and penalties.

The Supply Chain Solutions division engages in a number of business activities governed by U.S. Government procurement laws and regulations which change frequently, including regulations relating to import-export control and technology transfer restrictions. In addition, the U.S. Foreign Corrupt Practices Act, or the FCPA, and similar anti-corruption laws in other jurisdictions, include anti-bribery provisions. If we or our sales representatives fail to comply with these laws and regulations, we could be subject to administrative, civil, or criminal liabilities that could have a material adverse effect on our business and results of operations. We may not always be protected in cases of violation of the FCPA or other anti-corruption laws by our employees or third-parties acting on our behalf. A violation of anti-corruption laws by our employees or third-parties during the performance of their obligations for us may have a material adverse effect on our reputation operating results and financial condition.

We rely on certain key suppliers.

Most of our sales rely on products of certain key suppliers, which we represent. 41% of our first quarter of 2013 Supply Chain Solutions division purchases were sourced from five key suppliers and 48% of our first quarter of 2013 RFID and Mobile Solutions division purchases were sourced from another five key suppliers. In the year 2012, 14% of our Supply Chain Solutions division purchases were sourced from five key suppliers and 52% of our RFID and Mobile Solutions purchases were sourced from five key suppliers.

In the event that any of our key suppliers becomes unable to fulfill our requirements in a timely manner or if we cease our business relationship with these suppliers, we may experience an interruption in delivery and a decrease in our business until an alternative source of supply can be obtained.

Future changes in industry standards may have an adverse effect on our business.

New industry standards in the aviation and defense industry could cause a portion of our Supply Chain Solutions division's inventory to become obsolete and unmarketable which would adversely affect our results of operations.

If revenue levels for any quarter fall below our expectations, our results of operations will be adversely affected.

Our revenues in any quarter are substantially dependent on orders received and delivered in that quarter. We base our decisions regarding our operating expenses on anticipated revenue trends, and our expenses levels are relatively fixed, or require some time for adjustment. As a result, revenue levels below our expectations will adversely affect our results of operations.

The rate of inflation in Israel may negatively impact our costs if it exceeds the rate of devaluation of the NIS against the U.S. dollar. Similarly, the U.S. dollar cost of our operations in Israel will increase to the extent increases in the rate of inflation in Israel are not offset by a devaluation of the NIS in relation to the U.S. dollar.

A substantial amount of our revenues is denominated in U.S. dollars ("U.S. dollars" or "dollars") or is U.S. dollar-linked, but we incur a significant portion of our expenses, principally salaries and related personnel expenses in Israel and rent for our facilities in Israel, in NIS. As a result, we are exposed to the risk that the rate of inflation in Israel will exceed the rate of devaluation of the NIS in relation to the U.S. dollar or that the timing of this devaluation lags behind inflation in Israel. In that event, the U.S. dollar cost of our operations in Israel will increase and our U.S. dollar-measured results of operations will be adversely affected.

Similarly, we are exposed to the risk that the NIS, after adjustment for inflation in Israel, will appreciate in relation to the U.S. dollar. In that event, the dollar-measured cost of our operations in Israel will increase and our dollar-measured results of operations will be adversely affected. In 2012 and 2010, the NIS appreciated by approximately 2.3% and 0.7% respectively, against the U.S. dollar and in 2011 the NIS devaluated by approximately 7.7% against the U.S. dollar. In 2010, 2011 and 2012, the annual inflation rate in Israel was approximately 2.7%, 2.17% and 1.63%, respectively, and therefore the U.S. dollar cost of our Israeli operations increased in 2012 and 2010 and decreased in 2011. We cannot predict whether in the future the NIS will appreciate against the U.S. dollar or vice versa. Any increase in the rate of inflation in Israel, unless the increase is offset on a timely basis by a devaluation of the NIS in relation to the U.S. dollar, will increase our labor and other costs, which will increase the U.S. dollar cost of our operations in Israel and harm our results of operations (see "Item 5A. Results of Operation - Impact of Inflation and Currency Fluctuations.")

If we are unsuccessful in developing and introducing new products, we may be unable to expand our business.

The market for some of our products is characterized by rapidly changing technology and evolving industry standards. The introduction of products embodying new technology and the emergence of new industry standards can render existing products obsolete and unmarketable and can exert price pressures on existing products.

Our ability to anticipate changes in technology and industry standards and successfully develop and introduce new and enhanced products as well as additional applications for existing products, in each case on a timely basis, will be critical in our ability to grow and remain competitive. Although these products are related to, and even incorporate our existing products, there can be no assurance that we will be able to successfully develop and market any such new products. If we are unable, for technological or other reasons, to develop products that are competitive in technology and price and responsive to customer needs, our business will be materially adversely affected.

Our Supply Chain division has significant sales worldwide and could encounter problems if conditions change in the places where we market our products.

We have sold and intend to continue to sell our products in Europe and the Far East.

A number of risks are inherent in engaging in international transactions, including:

- possible problems in collecting receivables;
- imposition of governmental controls, or export license requirements;
- political and economic instability in foreign companies;
- trade restrictions or changes in tariffs being imposed; and
- laws and legal issues concerning foreign countries.

If we should encounter such difficulties in conducting our international operations, it may adversely affect our business condition and results of operations.

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

The financial and economic downturn in the United States and in European countries may cause revenues of our customers to decrease. This may result in reductions in sales of our products and services in some markets, longer sales cycles, slower adoption of new technologies and increased price competition. In addition, weakness in the end-user market could negatively affect the cash flow of our customers who could, in turn, delay paying their obligations to us. This could increase our credit risk exposure and cause delays in our recognition of revenues on future sales to these customers. If global economic and market conditions do not improve, or weaken further, it may have a material adverse effect on our business, operating results and financial condition.

We may be obligated to indemnify our directors and officers.

The Company has agreements with its directors and senior officers which provide, subject to Israeli law, indemnification by the Company of directors and senior officers for: (a) monetary liability imposed upon them in favor of a third party by a judgment, including a settlement or an arbitral award confirmed by the court, as a result of an act or omission of such person in its capacity as a director or officer of the Company, (b) reasonable litigation expenses, including attorney's fees, incurred by them pursuant to an investigation or a proceeding commenced against them by a competent authority if it was terminated without an indictment and without having a monetary charge imposed on them in exchange for a criminal procedure (as such terms are defined in the Israeli Companies Law 1999 – 5759 (the "Israeli Companies Law")), or that was terminated without an indictment but with a monetary charge imposed on them in exchange for a criminal procedure in a crime that does not require proof of criminal intent, or in connection with a financial sanction, as a result of an act or omission of such person in its capacity as a director or officer of the Company, (c) reasonable litigation expenses, including attorney's fees, incurred by such a director or officer or imposed on him by a court, in a proceeding brought against him by or on behalf of the Company or by a third party, or in a criminal action in which he was acquitted, or in a criminal action which does not require criminal intent in which he was convicted, in each case relating to acts or omissions of such person in its capacity as a director or officer of the Company, (d) expenses, including reasonable litigation expenses and legal fees, incurred by such a director or officer as a result of a proceeding instituted against him 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 or (B) administrative infringements pursuant to the provisions of Chapter H'4 under the Israeli Securities Law or (C) infringements pursuant to the provisions of Chapter I'1 under the Israeli Securities Law; and (e) payments to an injured party of infringement under Section 52ND(a)(1)(a) of the Israeli Securities Law. Payment pursuant to such indemnification may materially adversely affect our financial condition.

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

Our success is dependent upon our proprietary rights and technology. 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. 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. We do not believe that our products and proprietary rights infringe upon the proprietary rights of others. However, there can be no assurance that any other party will not argue otherwise. The cost of responding and adequately protecting ourselves against any such assertion may be material, whether or not the assertion is valid. 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. Additionally, there are risks that arise from the use of intranet networks and the Internet. Although we utilize firewalls and protection software, we cannot be sure that our proprietary information is secured against penetration. Such penetration, if occurs, could have an adverse effect on our business.

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

Based upon our current and projected income, assets and activities, we do not believe that at this time BOS is 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 grave tax consequences for U.S. shareholders. One method of avoiding such tax consequences is by making a “qualified electing fund” election for the first taxable year in which the Company is a PFIC. However, such an election is conditioned upon our furnishing U.S. shareholders annually with certain tax information. We do not presently prepare or provide such information, and such information may not be available to U.S. shareholders if we are subsequently determined to be a PFIC. 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.

A decline in the value of our market capitalization could require us to write-down the value of our goodwill, which could have a material adverse effect on our results of operations.

Our balance sheet contains a significant amount of goodwill and other amortizable intangible assets in long-term assets, totaling about \$4.5 million at December 31, 2012. We review goodwill annually for impairment, or more frequently when indications for potential impairment exist. We review other amortizable intangible assets for impairment when indicators for impairment exist. The volatility of our share price can cause significant changes to our market capitalization. If the value of our market capitalization falls below the value of our stockholders’ equity, it might indicate that impairment is required. An impairment of goodwill may be required if the carrying amount of a reporting unit exceeds its fair value.

If our market capitalization experiences a significant decline and is below the value of our stockholders' equity, or if any other quantitative or qualitative indication of impairment of goodwill arises in the future, we may be required to record impairment charges for our goodwill. Any such write-downs, if required, could result in a significant non-economic expense on our income statement, which could have a material adverse effect on our results of operations.

Risks related to our ordinary shares:

Our share price has been and may continue to be volatile, which could result in substantial losses for individual shareholders.

The market price of our ordinary shares has been and may continue to be highly volatile and subject to wide fluctuations. From January 2012 through March 2013, the daily closing price of our ordinary shares in NASDAQ has ranged from \$1.64 to \$8.19 per share. We believe that these fluctuations have been in response to a number of factors including the following, some of which are beyond our control:

- variations between actual results and projections;
- the limited trading volume in our stock;
- changes in our bank debts;
- Nasdaq Capital Market Listing Standards non-compliance notices; and
- the 1-for 4 reverse stock split that we completed on December 14, 2012.

In addition, the stock market in general, and stocks of technology companies in particular, have from time to time experienced extreme price and volume fluctuations. This volatility is often unrelated or disproportionate to the operating performance of these companies. These broad market fluctuations may adversely affect the market price of our ordinary shares, regardless of our actual operating performance.

The Company's shares may be delisted from the NASDAQ Capital Market if it does not meet NASDAQ's continued listing requirements.

Over the years, the Company has received several notices from the NASDAQ Stock Market advising it of non-compliance of its shares for continued listing on this market.

On January 17, 2012, the Company received a notice from the Listing Qualifications Department of Nasdaq advising us that the Company has failed to comply with Nasdaq's requirement that listed securities maintain a minimum bid price of \$1.00 per share as set forth in Nasdaq Listing Rules.

On July 19, 2012, the Company requested a hearing with the Nasdaq Hearings Panel, and a hearing was held on August 30, 2012. The Panel determined that the continued listing of the Company's securities on Nasdaq was contingent on the Company effecting a reverse stock split in the ratio of 1 for 4 by not later than December 15, 2012, which it did.

On January 2, 2013 the Company received a notice from the NASDAQ Office of General Counsel-Hearings, advising that the Company has regained compliance with the applicable minimum bid price rule and is in compliance with all other applicable requirements for listing on The NASDAQ Capital Market.

There can be no assurance that the Company will continue to qualify for listing on the Nasdaq Capital Market. If the Company's ordinary shares are delisted from the Nasdaq Capital Market, trading in its ordinary shares could be conducted on the over-the-counter market. In addition, if the Company's ordinary shares were delisted from the Nasdaq Capital Market, it would be subject to the so-called penny stock rules that impose restrictive sales practice requirements on broker-dealers who sell those securities. Consequently, de-listing, if it occurred, could affect the

ability of the shareholders to sell their ordinary shares in the secondary market. The restrictions applicable to shares that are de-listed, as well as the lack of liquidity for shares that are traded on an electronic bulletin board, may adversely affect the market price of such shares.

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Risks related to our location in Israel:

Political, economic, and security conditions in Israel affect our operations and may limit our ability to produce and sell our products or provide our services.

We are incorporated under the laws of the State of Israel, where we also maintain our headquarters and our principal research and development and sales and marketing facilities.

Since its establishment in 1948, Israel has been involved in a number of armed conflicts with its Arab neighbors and a state of hostility, varying from time to time in intensity and degree, has continued into 2013. In recent years, there was an escalation in violence among Israel, Hamas, the Palestinian Authority and other groups. Also, since 2011, riots and uprisings in several countries in the Middle East and neighboring regions have led to severe political instability in several neighboring states and to a decline in the regional security situation. Such instability may affect the local and global economy, could negatively affect business conditions and, therefore, could adversely affect our operations. 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.

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, several countries, principally those in the Middle East, as well as Malaysia and Indonesia, still restrict business with Israel and Israeli companies. 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.

A number of our key personnel in Israel have standing obligations to perform periodic reserve duty in the Israel Defense Forces and are subject to be called for active military duty at any time. If our key personnel are absent from our business for a significant period of time, we may experience disruptions in our business that could affect the development, sales or technical support of our products. As a result, we might not be able to compete in the market and our results of operations could be harmed.

The anti-takeover effects of Israeli laws may delay or deter a change of control of the Company.

Provisions of Israeli law may delay, prevent or make undesirable a merger or an acquisition of all or a significant portion of our shares or 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 the 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 the Company's securities.

All of our directors and officers are non-U.S. residents and enforceability of civil liabilities against them is uncertain.

All of our directors and officers reside outside of the United States. Service of process upon them may be difficult to effect within the United States. Furthermore, because the majority of our assets are located in Israel, any judgment obtained in the United States against us or any of our directors and non-U.S. officers may not be collectible within the United States.

Your rights and responsibilities as our shareholder will be governed by Israeli law, which differ in some respects from the rights and responsibilities of shareholders of United States corporations.

Since we are incorporated under Israeli law, the rights and responsibilities of our shareholders are governed by our articles of association and Israeli law. These rights and responsibilities differ in some respects from the rights and responsibilities of shareholders in United States-based corporations. In particular, a shareholder of an Israeli company has a duty to act in good faith towards the company and other shareholders and to refrain from abusing its power in the company, including, among other things, in voting at the general meeting of shareholders on certain matters, such as an amendment to the company's articles of association, an increase of the company's authorized share capital, a merger and approval of related party transactions that require shareholder approval. In addition, a shareholder who knows that it possesses the power to determine the outcome of a shareholders' vote or to appoint or prevent the appointment of a director or executive officer in the company has a duty of fairness towards the company. These provisions may be interpreted to impose additional obligations and liabilities on our shareholders 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 in the future elect to follow certain home country corporate governance practices instead of certain Nasdaq requirements.

We are a foreign private issuer as such term is defined under U.S. federal securities laws. As a foreign private issuer, we may elect to follow certain home country corporate governance practices instead of certain requirements of the Marketplace Rules of The Nasdaq Capital Market, or the Nasdaq Marketplace Rules. We may in the future elect to follow Israeli corporate governance practices with regard to, among other things, the composition of our board of directors, compensation of officers, director nomination procedures and quorum requirements at shareholders' meetings. In addition, we may elect to follow Israeli corporate governance practices instead of the Nasdaq requirements to obtain shareholder approval for certain dilutive events (such as for the establishment or amendment of certain equity-based compensation plans, issuances 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). Accordingly, our shareholders may not be afforded the same protection as provided under Nasdaq's corporate governance rules. Following our home country governance practices as opposed to the requirements that would otherwise apply to a U.S. company listed on The Nasdaq Capital Market may provide less protection than is accorded to investors of domestic issuers.

In addition, as a foreign private issuer, we are exempt from the rules and regulations under the United States Securities Exchange Act of 1934, as amended, or the Exchange Act, related to the furnishing and content of proxy statements, and our officers, directors, and principal shareholders are exempt from the reporting and 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 annual, quarterly and current reports and financial statements with the Securities and Exchange Commission as frequently or as promptly as domestic companies whose securities are registered under the Exchange Act.

If we were to lose our foreign private issuer status under U.S. federal securities laws, we would incur additional expenses associated with compliance with the U.S. securities laws applicable to U.S. domestic issuers.

As a foreign private issuer, we are not required to comply with all of the periodic disclosure and current reporting requirements applicable to U.S. domestic issuers, as explained above. The regulatory and compliance costs to us under U.S. securities laws, if we are required to comply with the reporting requirements applicable to a U.S. domestic issuer, may be significantly higher than the cost we currently incur as a foreign private issuer.

#### Item 4: Information on the Company

##### 4A. History and Development of the Company

We were incorporated in Israel in 1990 and are subject to the Israeli Companies Law. Our executive offices, shipping and service operations are located in Israel. Our address in Israel is 20 Freiman Street, Rishon LeZion, 75100, Israel.

Our address in the United States is B.O.S Better Online Solutions Ltd. c/o Ruby-tech, Inc. 147-20 184th St., Jamaica NY 11413, USA.

Our telephone number is 972-3-954-2000 and our website address is [www.boscom.com](http://www.boscom.com). Our subsidiaries' websites are: Odem - [www.odem.co.il](http://www.odem.co.il); and Dimex – [www.dimex.co.il](http://www.dimex.co.il). The information contained on, or linked from, our websites is not a part of this report.

We operate our business through two divisions:

- Supply Chain Solutions – conducted through our wholly owned subsidiary, Odem. Our Supply Chain Solutions business offers a wide range of electronic components to customers in the aviation, aerospace and high technology industry that prefer to consolidate their component acquisitions through a supplier that is able to provide a comprehensive solution to their components-supply needs.
- RFID and Mobile Solutions – conducted through our wholly owned subsidiary, Dimex. Our RFID and Mobile Solutions offerings form a comprehensive turn-key solution for Automatic Identification and Data Collection, combining mobile infrastructure of manufacturers that we represent, middleware software and a software application.

In March 2008, Dimex and its subsidiary, Dimex Hagalil Projects (2008) Ltd. (“Dimex Hagalil 2008”), purchased the assets and activities of Dimex Systems, which was an integrator of AIDC (Automatic Identification and Data Collection) solutions based on RFID and barcode technology. The consideration was NIS 44.6 million (approximately \$12.4 million). The consideration was comprised of cash, payable over a 24-month period and of 25,011 BOS shares (equal to approximately 4.4% of the then outstanding shares of BOS).

In the year 2009 through 2012, the Company entered into several amendments to the purchase agreement for the purchase of the assets and activities of Dimex Systems, or the Dimex Systems Asset Purchase Agreement. The amendments revised the payment schedule of the consideration payable to Dimex Systems. The remaining debt, as of December 31, 2012, amounts to \$846,000.

For further details regarding the Dimex Systems Asset Purchase Agreement, see “Item 5B. Liquidity and Capital Resources” and Notes 12 and 14 to our Consolidated Financial Statements s attached to this annual report.

In addition, we have an interest in two companies:

(a) Surf Communication Solutions Ltd. (“Surf”), in which, as of December 31, 2012, we held 5.1% of the issued and outstanding share capital. Established in 1996, Surf is an Israeli privately held company. Surf develops a suite of hardware and software products that drives a wide variety of applications whose common goal is high-capacity distribution of voice and video. During 2011 and 2010, impairment losses due to other-than-temporary declines in fair value of \$39,000 and \$111,000, respectively, have been recorded and presented in Other expenses, net in the consolidated statements of operations. As of December 31, 2012, the Company's investment in Surf (a cost method investee) was fully impaired.

(b) New World Brands Inc. (PINK:NWBD) (“New World” or “NWB”), a U.S. public corporation. On February 26, 2010, the Company sold all of its holdings in NWB to P&S Spirit LLC. and recorded a capital loss of \$7,000. The Company sold 61,441,827 shares of common stock of NWB and 1,430,178 warrants to purchase common stock of NWB at an exercise price of \$ 0.2098 per share expiring on December 31, 2010. The consideration for the NWB shares and warrants was \$ 300,000 of which \$ 150,000 was paid in March 2010 and the remaining \$ 150,000 plus annual interest of 4% were to be paid in twelve monthly installments commencing March 2011. The shares and warrants were delivered to an escrow agent to be released to the buyer upon full payment of the remaining debt. In May 2011, the buyer notified the Company that it will not pay the remaining debt, and the shares and warrants were released back to the Company. As of December 31, 2011 the Company recognized other-than-temporary loss of \$156,000, reflecting that the investment in NWB was fully impaired.

Following the Company's request, on May 12, 2009 the Company's ordinary shares were delisted from trading on the Tel Aviv Stock Exchange (the “TASE”). The delisting of the ordinary shares from the TASE did not affect the continued listing of the ordinary shares on the NASDAQ Capital Market under the symbol BOSCO. As a result of the delisting of the Company's ordinary shares from the TASE, the Company is no longer subject to reporting requirements in Israel, under the Israeli Securities Law.

On November 23, 2010 the Company's two U.S. subsidiaries that are part of its Supply Chain Solutions division, Lynk and its subsidiary Summit, have filed with the US Bankruptcy Court a Chapter 7 petition. In March 2011, the Lynk case was closed. The proceedings in respect of Summit are continuing but they have no impact on the financial statements of the Company. The results of operations, including revenues, cost of revenues, operating expenses, and other income and expenses related to the prior periods of the discontinued operations, have been reclassified in the accompanying statements of operations as discontinued operations.

4B.

#### Business Overview

BOS's vision is to be a worldwide provider of turnkey AIDC (Automatic ID Data Capture) mobility solutions, focusing on RFID technologies, and a leading distributor of electronic components for the civil aircraft industry and for the defense industry.

The Company's products and services assist customers worldwide in improving the efficiency of their enterprise logistics, enhancing and automating their data collection processes, improving asset tracking, and managing real-time business data.

BOS manages its business in two reportable divisions: RFID and Mobile Solutions (through its subsidiary Dimex), and Supply Chain Solutions (through its subsidiary Odem).

The Company's customers represent a cross-section of multinational industry leaders, from the avionics, defense, retail, government, utilities, and livestock markets around the world. Our Supply Chain Solutions customers include, among others, Bombardier, Elbit system, Refael and Israeli Aircraft Industry. Our RFID and Mobile Solutions customers include, among others, IKEA, Blue Square, Shufersal and Teva.

In its Supply Chain Solutions division, the Company has expanded its penetration to global, top-tier aircraft manufacturers (such as Bombardier) and has begun expansion to international markets (e.g., India, and China).

In its RFID and Mobile Solutions division, the Company continues to invest in efforts to expand its product offering and in sales to markets outside of Israel.

In February 2012, the Company successfully completed a traceability project in Spain at Barcelonesa de Metales, S.A. (BAMESA) corporation. BAMESA is a steel service center organization for automotive, home appliances and metal engineering industries, among others. The project included tagging, tracking and managing inventory for metal pallets, inside and outside of the warehouse. The project was executed in cooperation with the Supply Chain Excellence Centre of Everis, a multi-national Spanish consulting company.

In 2011, the Company was recognized with the Entrepreneurial Company of the Year Award in the field of Automatic Identification Data Capture (AIDC) for the Europe, Middle East and Africa region, by Frost & Sullivan, a leading global research organization.

BOS continues to execute a growth strategy in order to strengthen its product offerings and distribution channels worldwide.

#### BOS Product Offerings

##### RFID and Mobile Solutions

RFID (Radio Frequency Identification) refers to the use of an automatic identification method to remotely retrieve data using devices called RFID tags. An RFID tag is an object such as a pendant, bead, nail, label, micro wire or fiber, which can be applied to or incorporated into a product, animal, or person for the purpose of identification using radio waves.

BOS' RFID and Mobile Solutions division offers turnkey solutions as well as stand-alone products, including best-of-breed RFID and Automatic Identification Data Capture (AIDC) hardware and communications equipment, software platform, and industry-specific software applications. Customers can opt for a full solution comprised of hardware, middleware and software, or for any item as a stand-alone product or service.

Our RFID and Mobile Solutions division represents leading global manufacturers of AIDC equipment based on RFID and barcode technology. Among the manufacturers we represent are Motorola Inc., Intermec Technologies and Corporation, Zebra Technologies Corp., Texas Instruments, Alien Technology, Cisco Systems Inc., M3, DLog GmbH, Microscan Systems Inc., Seagull Scientific Inc., Feig and HID Global.

Specifically, our RFID and Mobile Solutions division offers the following products and services:

- Hardware, including:
  - o Thermal and barcode printers
  - o RFID and barcode scanners and readers
  - o Wireless, mobile and forklift terminals
  - o Wireless infrastructure
  - o Active and passive RFID tags (HF & UHF)
  - o Consumables (ribbons, labels, tags)
- Applications:

BOS has developed the following set of vertical applications:

- o BOS LIVESTOCK is a software application that enables livestock operations to manage, track, support and plan all day-to- day tasks.
- o BOS CarID is a turnkey solution to identify and track vehicles for a variety of transportation-related settings, such as auto vehicle testing centers, public and company parking lots, industrial factories, and automobile dealers, importers, or distributors. By using RFID tags on the vehicles, BOS CarID enables companies, government transportation agencies, and law enforcement officials in the transportation field to effectively manage, track, support and plan all day-to- day vehicle-related activities.

oBOS STOCK is an optimized data collection solution for logistics management in stores and warehouses. The solution may be based on RFID tags or bar codes, and is intended to provide customers with greater visibility into a retailer's stock management and warehouse/logistics operations. BOS Stock enables storeroom managers to receive advanced delivery notifications and system alerts for delivery discrepancies, and gives them the ability to locate inventory in the stockroom. BOS Stock provides inventory managers with a direct communication link to the sales floor, and assists in minimizing inventory loss or theft. BOS Stock also enables sales floor representatives to instantly check on the availability of a product, offer alternatives if the product is out of stock, and provide the customer with up-to-date product information.

oBOS Mfgr. is a production line tracking solution whereby manufacturing companies can track the progress and status of items on a production line. The solution may be based on RFID tags or bar codes, and is intended to provide greater visibility into a customer's manufacturing process, as well as traceability for critical parts. With BOS Mfgr., items entering the manufacturing plant are labeled with RFID tags or bar codes, and fixed readers that are located along the production line, record the product's progress through the production line stations. Mobile readers may also be used to collect data from the parts labeled with RFID tags or bar codes.

BOS' RFID and Mobile Solutions division provides also complementary services such as:

oIntegration Services, that include site surveys, business requirements analyses, system design and configuration, and implementation, testing and deployment.

oService lab, that lab offers maintenance and repair services to data collection equipment, as well as warehouse and on-site service plans.

In August 2012, the Company entered into a cooperation agreement with an independent software development company for the maintenance, development and support to its software solutions. The selling and marketing of the software solutions continues to be performed by our RFID and Mobile Solutions division. In 2012, 36% of our revenues were attributed to sales generated from our RFID and Mobile Solutions division.

#### Supply Chain Solutions

Our Supply Chain Solutions division provides electronic components, networking and telecommunications equipment, and components consolidation services to the aerospace, defense, medical and telecommunications industries and enterprise customers worldwide.



These services include:

- o Representation of global manufacturers and distribution of their electronics components, communications and networking products (see below);
- o Kitting (electronics components consolidation) services for aerospace, defense, medical, and telecommunications industries and enterprise customers;
  - o Inventory and quality control management of components entering production lines; and
- o Warehouse management for ongoing projects, including all warehouse functions such as storage, operations and inventory management.

Our Supply Chain Solutions division represents on a non-exclusive basis, among others, Corsair Electrical Connectors, Holtek Semiconductor Inc., Sensata Technologies Inc., Integrated Power Designs, Inc. Adam Technologies Inc., Positronic Global Connector Solutions, Babcock International Group, Bluegiga, Switchcraft Inc., first Sensor A.G., Microelectronics Inc., Winchester Electronics Corporation, Fema Electronics Corporation, SGC Technologies Inc., Stroco Manufacturing Inc., Jamicon Electronic Corporation USA, Civue Optotech Inc., ACON Inc. and Alien Technology Corporation.

The electronic components from these suppliers fall into four main categories:

- 1) Active Components - semiconductors, transistors, detectors, diodes, integrated circuits, hybrid modems, cellular components, communication ICs, memories, displays and LEDs;
- 2) Passive Components - capacitors, thermistors, varistors, oscillators, crystals, resistors, C-DC converters, and power supplies;
- 3) Electro-Mechanical Components - relays, connectors, circuit breakers, filters, transformers, plugs, thermostats and switches; and
- 4) Microwave components such as repeaters and filters.

In 2012, 64% of our revenues were attributed to sales of the Supply Chain Solutions division.

#### Marketing, Distribution and Sales

We market our RFID and Mobile Solutions primarily to medium and large sized corporations through a combination of direct sales, sales agents and integrators.

#### RFID and Mobile Solutions

We market our solutions directly to customers or through distributors and system integrators. We intend to increase our international sales force with new distributors, system integrators, sales representatives and direct salespersons who specialize in the RFID and Mobile Solutions sector.

In Europe, we are targeting system integrators as the main channel through which to sell our software products.

#### Supply Chain Solutions

We market our Supply Chain Solutions directly to customers or through distributors. Our sales force is comprised of direct sales teams.

#### Seasonality

Our sales fluctuate seasonally, with the third quarter sales typically reduced by summer vacations in Europe and new years' holidays in Israel, and the December and January sales typically reduced by the Christmas season.

The following tables set forth our revenues (in thousands of \$), by major geographic areas and by divisions, for the periods indicated below:

#### Sales by major geographic areas:

	2012	%	2011	%	2010	%
America	493	2	1,514	5	2,596	9
Far East	1,985	8	3,943	12	2,228	7
Europe	1,178	5	976	3	811	3
Israel and others	20,847	85	27,001	80	24,552	81
Total Revenues	24,503	100	33,434	100	30,187	100

#### Sales by divisions:

RFID and Mobile Solutions	8,894	36	13,128	39	12,463	41
Supply Chain Solutions	15,915	65	21,332	64	17,724	59
Intercompany	(306 )	(1 )	(1,026 )	(3 )	-	-
Total Revenues	24,503	100	33,434	100	30,187	100

## Intellectual Property

We currently rely on a combination of trade secrets, copyright and trademark law, together with non-disclosure agreements and technical measures, to establish and protect proprietary rights in our products.

We believe that the improvement of existing products and solutions, reliance upon trade secrets and proprietary know-how and the development of new products are generally as important as patent protection in establishing and maintaining a competitive advantage. We believe that the value of our products is dependent upon our proprietary software and hardware remaining “trade secrets” or subject to copyright protection.

Generally, we enter into non-disclosure and invention assignment agreements with our employees, partners and subcontractors. However, there can be no assurance that our proprietary technology will remain a trade secret, or that others will not develop similar technology or use such technology in products competitive with those offered by us.

While our competitive position may be affected by our inability to protect our proprietary information, we believe that because of the rapid pace of technological change in the industry, factors such as the technical expertise and the knowledge and innovative skill of our management and technical personnel, name recognition, the timeliness and quality of our support services and our ability to rapidly develop, produce, enhance and market software products may be more significant in maintaining our competitive position.

As the number of software products in the industry increases and the functionality of these products further overlaps, we believe that software programs will increasingly become subject to infringement claims. The cost of responding to any such assertion may be material, whether or not the assertion is valid.

## Competition

### RFID and Mobile Solutions

The RFID and Mobile Solutions market is subject to rapidly changing technology and evolving standards incorporated into mobile equipment, Enterprise Resource Planning systems, computer networks and host computers. As the market grows, so does the number of competitors. Some of the competitors have substantially greater financial, marketing and technological resources as well as stronger name recognition than BOS.

In Israel, our main competitors in the RFID and Mobile Solutions market are Soft Solutions Ltd., eWave Ltd., Dangot Computers Ltd., Danner Advanced Technologies Ltd., LogiTag Systems Ltd. and Galbital RFID Solutions Ltd. In the global market, the competitors are system integrators that provide turnkey solutions that include both hardware and software such as GlobeRanger Corp., Mobile Frame LLC, Decision Point systems Inc. OATSystems, a division of Checkpoint Systems, Inc., RF-iT Solutions GmbH and InSync Software, Inc.

#### Supply Chain Solutions

We hold several representation agreements with major suppliers and manufacturers. Most of our representation agreements are not on an exclusive basis.

Our Israeli competitors in distribution to the electronic industry include the publicly traded Telsys Ltd., Nisco Projects Ltd. and STG International Electronics (1981) Ltd., as well as Eastronics Ltd. and C.M.S. Compucenter Ltd.

In the international market, our competitors are mainly Arrow Electronics International Inc., Avnet Electronics Marketing, TTI Inc., PEI-Genesis Inc., Marine Air Supply Co. Inc., Airtechnics Inc., Flame Enterprise Inc., Norstan Electronics Inc., Peerless Electronics Inc., Hansair Logistic Inc., Aviall, API Delevan, Cooper and Avio Innovative Propulsion.

#### Strategy

The Company's vision is to become a worldwide provider in the field of RFID and Mobile Solutions and Supply Chain Solutions for enterprise logistics and organizational processes.

The key elements of our strategy are as follows:

- Expand the Mobile and RFID Solutions division product offerings to our existing customer base. This will include the sale and integration of new complementary hardware and software to customers that already use our RFID solutions;
- Increase our international sales by new partnerships with distributors, system integrators, and hardware vendors specialized in RFID and Mobile Solutions;
- Secure several reference-able customers in Europe, potentially leveraging our position as a trusted supplier in the aerospace Supply Chain Solutions market;
  - Further expand sales of our Supply Chain Solutions division to our client base, in and outside of Israel;
    - Increase partnerships with manufacturers for our Supply Chain Solutions division.

#### Exchange Controls

See “Item 10D. Exchange Controls”.

For other government regulations affecting the Company’s business, see “Item 5A. Results of Operations - Grants and Participation”.

#### 4C. Organizational Structure

The Company’s wholly owned subsidiaries include:

In Israel:

- (1) Dimex, representing the RFID and Mobile Solutions division; Dimex Hagalil Projects (2008), a wholly owned subsidiary of BOS-Dimex which has been inactive since 2009 and is in the final process of liquidation.
- (2) Odem, representing the Supply Chain Solutions division;

In the United States:

- (1) Ruby-Tech, a New York corporation, is a wholly owned subsidiary of Odem and a part of the Supply Chain Solutions division.
- (2) On November 23, 2010 the Company's two U.S. subsidiaries that are part of its Supply Chain Solutions division, Lynk and its subsidiary Summit, have filed with the US Bankruptcy Court a Chapter 7 petition. In March 2011, the Lynk case was closed.

## 4D. Property, Plants and Equipment

Our executive offices and engineering, development, testing, shipping and service operations are located in the following facilities in Israel:

Location	Size (square meters)	End of lease period	Extension Option
R i s h o n Lezion*	1,515	May 31, 2012 through – January 31, 2016	July 7, 2016 -
Kibutz Dafna	578	On a month-to-month basis	

\*Includes 302 square meters in the same building owned by Odem.

Our average monthly rental fee in 2013 (up until March 31, 2013), for the year 2012 and for the year 2011 amounted to \$9,637, \$9,500 and \$13,000, respectively.

## Item 4A: Unresolved Staff Comments

Not Applicable.

## Item 5: Operating and Financial Review and Prospects

The following management's discussion and analysis of financial condition and results of operations should be read in conjunction with our financial statements and notes thereto. Certain matters discussed below and throughout this Annual Report are forward-looking statements that are based on our beliefs and assumptions as well as information currently available to us. Such forward-looking statements may be identified by the use of the words "anticipate", "believe", "estimate", "expect", "plan" and similar expressions. Such statements reflect our current views with respect to future events and are subject to certain risks and uncertainties. While we believe such forward-looking statements are based on reasonable assumptions, should one or more of the underlying assumptions prove incorrect, or these risks or uncertainties materialize, our actual results may differ materially from those described herein.

Critical accounting policies

Our discussion and analysis of our financial condition and results of operations is based on our consolidated financial statements which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of our financial statements in conformity with generally accepted accounting principles in the United States requires our management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. These amounts and disclosures could potentially be materially different under other assumptions and conditions. These are our management's best estimates based on experience and historical data, however, actual results could differ materially from these estimates. Our significant accounting principles are presented within Note 2 to our Consolidated Financial Statements attached to this annual report. While all the accounting policies impact the financial statements, certain policies may be viewed to be critical. Management believes that the following policies are those that are most important to the portrayal of our financial condition and results of operations and for fully understanding and evaluating our reported results:

- inventories
- impairment of long-lived assets and goodwill
- revenue recognition

a. Inventories:

Inventories are valued at the lower of cost or market value. Cost is determined using the moving average cost method.

Inventory write-offs and write-downs are provided to cover risks arising from slow-moving items or technological obsolescence.

b. Impairment of Long-Lived Assets and Goodwill

Impairment of long-lived assets:

The Company's long-lived assets are reviewed for impairment in accordance with ASC 360-10, Accounting for the Impairment or Disposal of Long-Lived Asset, whenever events or changes in circumstances indicate that the carrying amount of an asset (or asset group) may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset (or asset group) to the future undiscounted cash flows expected to be generated by the assets (or asset group). If such assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the assets exceeds their fair value. During 2012, no impairment losses have been identified. The fair value of the brand name and customer list related intangibles was determined by the income approach method. Assumptions in the fair value assessment included: the impact of changes in economic conditions, revenue and cash flow forecasts for the remaining lives of the intangibles and the Company's weighted average cost of capital ("WACC").

During 2011, the Company recognized an impairment loss \$555,000 related to a brand name and customer list of which \$470,000 was attributed to the Supply Chain Solutions division and \$85,000 were attributed to the RFID and Mobile Solutions division. During 2012 and 2010, no impairment losses have been identified.

**Goodwill:**

Goodwill represents excess of the costs over the net assets of businesses acquired. Under ASC 350, Intangibles - Goodwill and Other ("ASC 350"), goodwill is not amortized but instead is tested for impairment at least annually or between annual tests in certain circumstances, and written-down when impaired.

Goodwill as of December 31, 2012 and December 31, 2011 amounted to \$4,122,000. The translation impact on goodwill during the year ended December 31, 2011 was (\$316,000), and \$0 during the year ended December 31, 2012 due to the reporting division's change in functional currency from the NIS to the US Dollar.

**Testing Methodology:**

The Company performs its annual impairment analysis of goodwill as of December 31 of each year, or more often if there are indicators of impairment present. The provisions of ASC 350 requires that a two-step impairment test be performed on goodwill at the level of the reporting units. In the first step, or Step 1, the Company compares the fair value of each reporting unit to its carrying value. If the fair value exceeds the carrying value of the net assets, goodwill is considered not impaired, and the Company is not required to perform further testing. If the carrying value of the net assets exceeds the fair value, then the Company must perform the second step, or Step 2, of the impairment test in order to determine the implied fair value of goodwill. To determine the fair value used in Step 1, the Company uses discounted cash flows. If and when the Company is required to perform a Step 2 analysis, determining the fair value of its net assets and its off-balance sheet intangibles would require it to make judgments that involve the use of significant estimates and assumptions.

The reporting unit of the Company for purposes of the impairment test is the Company's RFID and Mobile Solutions division. Discrete financial information is available for this component of the business. Management regularly reviews the operating results of this component.

The Company determined the fair value of the reporting unit using the Income Approach, which utilizes a discounted cash flow model, as it believes that this approach best approximates the reporting unit's fair value at this time. Judgments and assumptions related to revenue, operating income, future short-term and long-term growth rates, weighted average cost of capital, interest, capital expenditures, cash flows, and market conditions are inherent in developing the discounted cash flow model. The material assumptions used for the Income Approach for 2012 were five years of projected net cash flows, WACC of 16.06% and a long-term growth rate of 3%. The Company considered historical rates and current market conditions when determining the discount and growth rates to use in its analyses. The Company performed a sensitivity analysis for the two key assumptions used in our annual goodwill impairment test and determined that an increase in the long-term growth rate of 1% to 2% and in the estimated weighted average cost of capital of 1% would not result in the estimated fair value of the reporting unit falling below its carrying value. If these estimates or their related assumptions change in the future, the Company may be required to record impairment charges for its goodwill.



The aggregate fair value of the Company depends on various factors, some of which are qualitative and involve management judgment, including stable backlog coverage and experience in meeting operating cash flow targets.

Testing Results:

During 2012, 2011 and 2010 no impairment losses have been identified.

c. Revenue recognition:

The Company derives its revenues mainly from the sale of products and support services.

Revenues from product sales, related to both the Supply Chain Solutions and RFID and Mobile Solutions divisions, are recognized in accordance with SAB 104, Revenue Recognition ("ASC 605") when delivery has occurred, persuasive evidence of an arrangement exists, the vendor's fee is fixed or determinable, no further obligation exists, and collectability is reasonably assured.

Legal Contingencies

The Company has been a party to various legal proceedings in the normal course of its business. The results of legal proceedings are difficult to predict and an unfavorable resolution of a lawsuit or proceeding may occur. Management believes that the prospects of these proceedings to prevail and recover a significant amount, seem remote, and a corresponding provision was recorded in this respect. For additional information, see "Item 13A. Consolidated Statements and Other Financial Information - Legal Proceedings". As additional information becomes available, Company's management will reassess the potential liability related to these legal proceedings and may revise its estimate of the probable cost of these proceedings. Such revisions in the estimates of the probable cost could have a material adverse effect on the Company's future results of operations and financial position.

5A. Operating Results

All share and per share data in this report is reported after giving effect to the 1 for 4 reverse stock split that occurred on December 14, 2012.

### Comparison of 2012 and 2011

Revenues for 2012 were \$24.5 million, compared to \$33.4 million in 2011. The decrease in revenues was in both our Mobile and RFID and Supply Chain Solutions divisions. See note 17a to the Consolidated Financial Statements for the year ended December 31, 2012. The decrease in revenues in 2012 was due mainly to the global economic slowdown and to intensified competition. In addition, we closed-down a non profitable product line.

Gross profit for 2012 was \$5.1 million (gross margin of 20.7%), compared to \$6.5 million (gross margin of 19.5%) for 2011.

Research and development expenses for 2012 decreased to \$125,000, compared to \$403,000 in 2011.

In August 2012, the Company entered into a cooperation agreement for the maintenance, development and support to its software solutions. The selling and marketing of the software solutions continues to be performed by our RFID and Mobile Solutions division.

Selling and marketing expenses for 2012 decreased by 28% to \$3.1 million from \$4.3 million in 2011. The reduction in expenses of 28% was equivalent to reduction in revenues by 27% to \$24.5 million in year 2012 from \$33.4 million in year 2011. The reduction in expenses was attributed mainly to reduction in workforce and commissions related payroll.

General and administrative expenses for 2012 decreased to \$1.7 million, compared to \$2.3 million in 2011, due, partly, to a reduction in workforce, salaries and consulting fees.

During 2011, the Company recognized an impairment loss of \$555,000 related to customer list and a brand name, of which \$470,000 related to the Supply Chain Solutions division and \$85,000 related to the RFID and Mobile Solutions division. During 2012, no impairment losses were identified.

As a result of the above, operating profit in 2012 amounted to \$192,000, compared to an operating loss of \$973,000 in 2011.

Financial expenses for 2012 were \$ 781,000, compared to \$2.24 million in 2011. Of the decrease in the financial expenses in 2012, \$1.3 million was due to the conversion of a convertible loan. Most of the convertible loan was converted in the fourth quarter of year 2011 (see Note 14 to the Consolidated Financial Statements for the year ended December 31, 2012).

Other expenses in 2012 and 2011, which amounted to \$147,000 and \$172,000, respectively, were mainly due to disposal of property, plant and equipment and the decrease in the value of the Company investments in NWB and Surf.

Tax benefit in 2012 amounted to \$187,000, compared to \$172,000 in 2011. Tax benefit in 2012 and 2011 is mainly related to uncertain tax positions accounted for in accordance with ASC 740 (see Notes 21 and 15i to the Consolidated Financial Statements for the year ended December 31, 2012).

Loss from continuing operations in 2012 amounted to \$549,000 compared to \$3.2 million in 2011. On a per share basis, the basic and diluted net loss per share from continuing operations in 2012 was \$0.49, compared to \$4.56 in 2011.

#### Comparison of 2011 and 2010

Revenues for 2011 were \$33.4 million, compared to \$30.2 million in 2010. The growth in revenues was in both our Mobile and RFID and Supply Chain Solutions divisions. See note 18a to the Consolidated Financial Statements for the year ended December 31.

Gross profit for 2011 was \$6.5 million (gross margin of 19.5%), compared to \$7.5 million (gross margin of 24.8%) for 2010. The decrease in the gross profit in 2011 was due mainly to: (a) an inventory write-off in 2011 in the amount of \$443,000, compared to a \$36,000 inventory write-off in 2010 (inventory write-offs are executed in view of slow-moving items or as a result of technological obsolescence); (b) a gross loss in the software product line (related to the RFID division) in the amount of \$37,000 in 2011, compared to a gross profit of \$470,000 in 2010; and (c) a decrease in gross margins due to increased competition.

During the fourth quarter of 2011, we have successfully completed a restructuring of our software activity which yielded a positive gross profit in the fourth quarter of 2011.

Research and development expenses for 2011 increased to \$403,000, compared to \$372,000 in 2010. The increase reflects our continuing efforts to enhance our products offering. See "Item 5B. Liquidity and Capital Resources".

Selling and marketing expenses for 2011 increased to \$4.3 million from \$4.1 million in 2010, mainly due to: (a) a 10.7% growth in 2011 revenues as compared to 2010 revenues, and (b) marketing expenses related to the acquisition of new international customers in both divisions.

General and administrative expenses for 2011 increased to \$2.3 million, compared to \$1.8 million in 2010. The increase was mainly due to: (a) expenses related to allowance for doubtful accounts which amounted to \$82,000 in 2011, compared to income of \$89,000 in 2010 resulting from a reverse of allowance for doubtful accounts and (b) an increase of approximately \$185,000 in management salary and directors fees. See Note 19 to the Consolidated Financial Statements for the year ended December 31, 2011.

During 2011, the Company recognized an impairment loss of \$555,000 related to customer list and a brand name, of which \$470,000 related to the Supply Chain Solutions division and \$85,000 related to the RFID and Mobile Solutions division. The fair value of the brand name and customer list related intangibles was determined by the income approach method. Assumptions in the fair value assessment included: the impact of changes in revenues from major customers, economic conditions, revenue and cash flow forecasts for the remaining lives of the intangibles and the Company's weighted average cost of capital. During 2010, no impairment losses were identified.

As a result of the above, operating loss in 2011 amounted to \$973,000, compared to an operating profit of \$1.26 million in 2010.

Financial expenses for 2011 were \$ 2.24 million, compared to \$961,000 in 2010. The increase in the financial expenses in 2011 was due mainly to: (a) expenses of \$860,000 related to the conversion of convertible loans pursuant to amended agreements (see Note 13 to the Consolidated Financial Statements for the year ended December 31, 2011); and (b) expenses related to changes in fair value of forward contracts in the amount of \$44,000 in 2011, compared to income of \$141,000 in 2010 (See Notes 2o and 17 to the Consolidated Financial Statements for the year ended December 31, 2011).

Other expenses in 2011 and 2010, which amounted to \$172,000 and \$120,000, respectively, were mainly due to the decrease in the value of the Company investments in NWB and Surf.

Tax benefit in 2011 amounted to \$172,000, compared to a tax on income of \$5,000 in 2010. Tax benefit in 2011 is mainly related to uncertain tax positions accounted for in accordance with ASC 740 (see Notes 2m and 16i to the Consolidated Financial Statements for the year ended December 31, 2011).

Loss from continuing operations in 2011 amounted to \$3.2 million compared to income of \$171,000 million in 2010. On a per share basis, the basic and diluted net loss per share from continuing operations in 2011 was \$1.14, compared to net earnings per share of \$0.07 in 2010.

Loss from discontinuing operations in 2010 of \$806,000 was due to the closing of the operation of Lynk and its subsidiary Summit in November, 2010. Both companies belong to the Supply Chain Solutions division. There was no similar loss in 2011. On a per share basis, the basic and diluted net loss per share from discontinuing operations in 2010 was \$0.31.

#### Variability of Quarterly Operating Results

Our revenues and profitability may vary in any given year, and from quarter to quarter, depending on the mix of products sold. In addition, due to potential competition, uncertain market acceptance and other factors, we may be required to reduce prices for our products in the future.

Our future results will be affected by a number of factors including our ability to:

- establish effective distribution channels and manage them;
- introduce and deliver new products on a timely basis;
- anticipate accurately customer demand patterns;
- manage future inventory levels in line with anticipated demand; and
- reduce level of debts to banks and others lenders.

These results may also be affected by currency exchange rate fluctuations and interest rate and economic conditions in the geographical areas in which we operate. There can be no assurance that our historical trends will continue, or that revenues, gross profit and net income in any particular quarter will not be lower than those of the preceding quarters, including comparable quarters.

#### Impact of Inflation and Currency Fluctuations

The U.S. dollar cost of our operations in Israel is influenced by the differential between the rate of inflation in Israel and any change in the value of the NIS relative to the U.S. dollar.

A devaluation of the NIS in relation to the U.S. dollar will have the effect of decreasing the U.S. dollar costs in any of our NIS expenses and a converse effect in case of devaluation of the U.S. dollar in relation to the NIS.

A devaluation of the NIS in relation to the U.S. dollar will also have the effect of decreasing the U.S. dollar value of any of our NIS assets (unless such asset is linked to the U.S. dollar). Such a devaluation would further have the effect of reducing the U.S. dollar amount of any of our liabilities and expenses which are payable in NIS (unless such payables are linked to the U.S. dollar). Conversely, any increase in the value of the NIS in relation to the U.S. dollar will have the effect of increasing the U.S. dollar value of our NIS assets (unless such asset is linked to the U.S. dollar). Such an increase would also have the effect of increasing the U.S. dollar amount of any of our liabilities and expenses which are payable in NIS (unless such payables are linked to the U.S. dollar).

In the years ended December 31, 2012, 2011, 2010, 2009, 2008 the inflation rate in Israel, as adjusted for the depreciation or appreciation of the NIS against the U.S. dollar, was 3.94%, (5.49)% , 8.6 % , 4.6%, and 4.9%, respectively. The closing representative exchange rate of the U.S. dollar at the end of each such period, as reported by the Bank of Israel, was NIS 3.733, 3.821, 3.549, NIS 3.775 and NIS 3.802, respectively.

#### Effective Corporate Tax Rate

The Israeli corporate tax rate was 25% in 2010, 24% in 2011 and 25% in 2012. In 2013, the corporate tax rate is 25%.

#### Grants and Participation

Under the Law for the Encouragement of Industrial Research and Development, 1984 (the "Research Law"), research and development programs approved by a research committee of the Office of the Chief Scientist of Israel's Ministry of Industry, Trade and Labor, are eligible for grants in exchange for payment to the Government of royalties from the sale of products developed in accordance with the program. In order to be eligible, the applicant must be an Israeli company that proposes to invest in the development of industrial know-how, the development of new products, the development of new processing or manufacturing procedures or the development of significant improvements to an existing process or product. A committee of the OCS reviews the applications, evaluates the feasibility of the proposal, determines whether or not to approve a grant, and also determines the extent of Chief Scientist funding (within a range specified by the law) for approved projects. Depending on the nature of the project, the OCS grants generally amount to up to 50% of the approved research expenses.

Under the Company's research and development agreements with the OCS and pursuant to applicable laws, the Company is required to pay royalties at the rate of 3.5% of sales of products developed with funds provided by the OCS, up to an amount equal to 100% of the research and development grants (U.S. dollar-linked) received from the OCS. The obligation to pay these royalties is contingent upon actual sales of the products. Royalties payable with respect to grants received under programs approved by the OCS after January 1, 1999, are subject to interest on the U.S. dollar-linked value of the total grants received at the annual rate of LIBOR applicable to U.S. dollar deposits at the time the grants were received.

The Research Law requires that the manufacture of any product developed as a result of research and development funded by the Israeli Government take place in Israel. If any of the manufacturing is performed outside of Israel, the Company would ordinarily be required to first receive OCS' approval, as well as to pay royalties at an increased rate and to increase the aggregate repayment amount to between 120% and 300% of the grant amount, depending on the manufacturing volume that is performed outside Israel, except in special cases that receive the prior approval of the research committee, and subject to certain payments to be made to the Israeli Government (generally an amount no less than the aggregate grants plus interest less royalties paid).

The Research Law also provides that know-how from the research may not be transferred to third parties in Israel without prior approval of the research committee. This approval, however, is not required for the sale or export of any products resulting from such research and development. Approval of such transfer of know-how may be granted in specific circumstances, only if the recipient abides by the provisions of the Research Law and related regulations, including the restrictions on the transfer of know-how and the obligation to pay royalties in an amount that may be increased. The Research Law further provides that the know-how developed under an approved research and development program may not be transferred to any third parties outside Israel, except with the approval of the OCS and subject to particular payments.

The Research Law imposes reporting requirements with respect to certain changes in the ownership of a grant recipient. The law requires the grant recipient and its controlling shareholders and interested parties to notify the Office of the Chief Scientist of any change in control of the recipient or a change in the holdings of the significant shareholders of the recipient that results in a non-Israeli becoming an interested party directly in the recipient, and requires the new interested party to undertake to the Office of the Chief Scientist to comply with the Research Law. In addition, the rules of the Office of the Chief Scientist may require prior approval of the Office of the Chief Scientist or additional information or representations in respect of certain of such events.

The funds available for Office of the Chief Scientist grants out of the annual budget of the State of Israel have been reduced, and the Israeli authorities have indicated that the government may further reduce or abolish Office of the Chief Scientist grants in the future.

Since 2006, we have not participated in research and development programs supported by the OCS.

As of December 31, 2012, the Company has an outstanding contingent obligation to pay royalties to the OCS, including interest, in the amount of approximately \$ 3.3 million, in respect of previous grants. Commencing in year 2012, there are no sales of products that were developed using funds provided by the OCS. Additionally, the developed software for which the grant was received is no longer being sold.

We are also committed to paying royalties to the Fund for the Encouragement of Exports for its participation, by way of grants, in our marketing expenses outside of Israel. Royalties payable are 3% of the growth in exports, from the year we received the grant, up to 100% of the U.S. dollar-linked amount of the grant received at the date the grants received.

Since 1996, we have not participated in Fund for the Encouragement of Exports programs. As of December 31, 2012, the Company has an outstanding contingent obligation to pay royalties including interest of \$ 107,000 with respect to export grants. No expenses were incurred on account of such royalties during 2012, 2011 and 2010.

## Conditions in Israel

We are incorporated under the laws of the State of Israel, where we also maintain our headquarters and our research and development and manufacturing facilities. See Item 3D. "Risk Factors – Risks Relating to Our Location in Israel" for a description of governmental, economic, fiscal, monetary or political policies or factors that have materially affected or could materially affect our operations.

## 5B. Liquidity and Capital Resources

In the years ended December 31, 2012, 2011, and 2010 the Company incurred losses of \$ 549,000, \$3,214,000 and profit of 635,000 respectively. In the years ended December 31, 2012, 2011, and 2010 the Company generated positive cash flow from operating activities from continuing operations amounting to \$1,709,000 in 2012, negative cash flow of \$365,000 in 2011, and positive cash flow of \$1,460,000 in 2010. Due to the above, the Company's cash and cash equivalents decreased from \$411,000 as of December 31, 2011 to \$354,000 as of December 31, 2012. The Company had negative working capital of \$739,000 as of December 31, 2012 and \$349,000 as of December 31, 2011.

As of December 31, 2012, we had \$846,000 in long-term debt to Dimex Systems Ltd. (including current maturities of \$136,000) and \$1.6 million in long-term bank loans (including current maturities of \$424,000). In addition, at December 31, 2012, we had \$5.9 million of short term bank loans drawn under a revolving credit facility.

In August 2009, the Company closed a \$2.4 million Convertible Loan Financing with several lenders including Catalyst Private Equity Partners (Israel) II L.P., Telegraph Hill Capital Fund I, LLC, certain existing shareholders and members of its management (the "Lenders"). The financing consisted of loans with a term of three years that bear interest at a rate equal to 8% per annum, compounded annually. The Company was to repay the loan principal amount and the accrued interest in one payment at the end of the term, unless converted earlier into ordinary shares at the discretion of the lender. The loan conversion rate is \$13 per ordinary share. The Company granted the lenders warrants to purchase 100% of the number of ordinary shares into which the loan is convertible. The warrants are exercisable, in whole or in part, from 18 months to 36 months from grant, at an exercise price per ordinary share of \$11. In addition, the lenders received certain registration rights. A total of \$675,000 of the loan was extended to the Company by conversion into the debt financing of a payment otherwise due to Dimex Systems by April 2010, pursuant to the Asset Purchase Agreement the Company had entered into with Dimex Systems.

In April 2013, the Company has requested its Lenders to defer registration of the shares underlying the warrants issued to them. In connection with such deferral, the warrants' exercise period shall be extended by an additional one year. The Lenders have agreed to this arrangement, and it was approved by the Company's Audit Committee and Board of Directors. The extension of warrants held by Telegraph Hill Capital is subject to shareholders' approval.

In March 2009, the Company entered into an amendment to the 2008 Dimex Systems Asset Purchase Agreement that revised the payment schedule of the approximately NIS 10 million payable in three semi-annual installments through June 2010. The amendment provided for a NIS 3.5 million payment in March 2009, NIS 4 million to be paid in 6 equal monthly installments each, starting on January 15, 2010, and the remaining approximately NIS 2.5 million was converted into the same type of convertible debentures subsequently issued by the Company in July 2009.



On February 4, 2010, the Company entered into an additional amendment to the Dimex Systems Asset Purchase Agreement, further revising the schedule of remaining payments in the amount of NIS 4 million, to Dimex Systems. The amendment provided for payment of:

(a) NIS 300,000 in February 2010 and NIS 3.1 million plus 8% interest per annum, to be paid in monthly installments commencing July 2010 through December 2013; and

(b) NIS 600,000 were converted into the same long-term convertible debentures, into which NIS 2.5 million were previously converted.

In addition, the Company issued to Dimex Systems a warrant to purchase 17,274 ordinary shares at an exercise price of \$13 per ordinary shares during the first 18 months commencing August 3, 2011 and \$16.00 per ordinary share thereafter.

On October 5, 2010 the Company entered into a Share Purchase Agreement with Telegraph Hill Capital Fund I, LLC for the issuance of an aggregate of 24,091 Ordinary Shares at a price per share of \$12.44, or approximately \$300,000 in total.

In December 2011, Company's shareholders approved and the Company effected amendments to the terms of the Convertible Loan Financing agreements (the "Conversion Amendments"). The Conversion Amendments provided that approximately \$2.5 million of the outstanding convertible debt (consisting of \$2,093,000 principal and \$430,000 accrued interest) shall be converted into 420,491 ordinary shares (at a reduced conversion price of \$6 per ordinary share, instead of the original \$13 price). In addition, the warrants to purchase 160,996 shares that had been issued to the Lenders were extended by two years until July 2014 and February 2015, with no change to the exercise price of \$11 per ordinary share.

The balance of the loan of \$501,000 that was extended by Dimex Systems remained outstanding, and will bear a reduced interest rate of 4%, instead of the original rate of 8%, and will no longer be convertible. This amount will be repaid to Dimex Systems in 24 equal monthly installments commencing January 10, 2014. The balance of aforementioned amount as of December 31, 2012 is \$527,000.

On December 31, 2012, the Company entered into an additional amendment to the Dimex Systems Asset Purchase Agreement, further revising the schedule of remaining payments in the amount of approximately NIS 1.2 million (\$319,000), to Dimex Systems and the outstanding debt shall bear interest at an annual rate of 4% instead of the original rate of 8%.

The Company's loans from Bank Leumi are secured by:

- first ranking fixed charges on the goodwill of the Company and its Israeli subsidiaries, on our shareholdings in the Israeli subsidiaries and on certain Bank Leumi accounts of Odem; and
- floating charges on all of the assets of the Company and its Israeli subsidiaries, owned now or in the future; and

The Company also guarantees the liabilities of its Israeli subsidiaries to Bank Leumi and each of its Israeli subsidiaries guarantee the Company's liabilities to Bank Leumi.

The Bank Leumi loan agreements signed by the Company and its Israeli subsidiaries contain various financial covenants, which require that the Company and the Israeli subsidiaries maintain certain financial ratios related to shareholders' equity, EBITDA and operating results. On February 8, 2010, the Company and its Israeli subsidiaries executed revised loan documents governing their credit line from Bank Leumi, in which they undertook revised covenants for year 2010. There were no Bank Leumi covenants applicable for the fiscal year 2011 and 2012.

The Company's loan from Bank HaPoalim is secured by long term bank deposits in the amount of \$438,000. Bank HaPoalim's loan agreements contain various financial covenants which require that the Company's Israeli subsidiaries maintain certain financial ratios and levels of profitability.

As of December 31, 2012, the Company failed to meet Bank HaPoalim's covenants. Nonetheless, Bank HaPoalim agreed, under certain conditions, including compliance by the Company with its warrants for the year 2013, to waive this failure of the Company to meet its financial covenants in 2012, until the earlier of May 1, 2014, or the submission of the Company's 2013 financial statements to Bank HaPoalim.

We finance our activities by different means, including short and long-term loans, and income from operating activities.

Working capital requirements will vary from time-to-time and will depend on numerous factors, including but not limited to, the operating results, scope of sales, supplier and customer credit terms, the level of resources devoted to research and development, new product introductions, and marketing and acquisition activities.

We have in-balance sheet financial instruments and off-balance sheet contingent commitments. Our in-balance sheet financial instruments consist of our assets and liabilities. Our cash is invested in short-term (less than 3 months) U.S. dollars and NIS interest bearing deposits with banks. As of December 31, 2012, our trade receivables' and trade payables' aging days were 118 and 92 days, respectively. The fair value of our financial instruments is similar to their book value. Our off-balance sheet contingent commitments consist of: (a) royalty commitments that are directly related to our future revenues, (b) lease commitments of our premises and vehicles, (c) directors and officers' indemnities, in excess of the proceeds received from liability insurance which we obtain, and (d) legal proceedings.

The Company had negative working capital of \$739,000 as of December 31, 2012. As of December 31, 2012, the Company was not in compliance with certain financial covenants in its Bank Hapoalim loan. The Company received a waiver from Bank Hapoalim with respect to the covenants as of December 31, 2012.

It is the Company's opinion that current working capital is sufficient for the Company's present requirements.

#### Cash Flows

Net cash provided by operating activities of continuing operations in 2012 was \$1,709,000, compared to net cash used in operating activities of \$365,000 in 2011. The difference in cash flows was due to the decrease of net loss from continued operations from \$3.2 million net loss in year 2011 to \$550,000 net loss in year 2012.

Net cash used in investing activities from continuing operations in 2012 decreased to \$311,000, compared to \$1.04 million in 2011. The decrease was due to: (a) a decrease in investment in fixed assets from \$357,000 in 2011 to \$82,000 in 2012. (b) investment of \$427,000 in a bank deposit in 2011, which was part of the loan proceeds we received from Bank Hapoalim in year 2011.

Net cash used in financing activities from continuing operations in 2012 amounted to \$1.45 million, compared to net cash provided by financing activities of \$1.1 million in 2011.

#### 5C. Research and Development

In August 2012, the Company entered into a cooperation agreement for the maintenance, development and support of its software solutions. The selling and marketing of the software solutions continues to be performed by our RFID and Mobile Solutions division.

#### 5D. Trend Information

BOS' vision is to become a worldwide provider in the field of RFID and Mobile solutions for enterprise logistics and organizational processes. Committed to this vision, we plan to expand our suite of solutions and anticipate that the portion of the RFID and Mobile Solutions division revenues will increase gradually going forward.

Growth of the RFID and Mobile Solutions division depend on sales outside of Israel.

In addition, we are working towards an increase of our Supply Chain Solution to the international markets.

Interest rate on our short term loan that is quoted in NIS was 6.7% on December 31, 2012, compared to 7.25% on December 31, 2011. Interest NIS rate on our U.S. short term loan that is quoted in US\$ was 4.80% on December 31, 2012, compared to 5.49% on December 31, 2011. A significant increase in interest rates could have an adverse effect on our results of operation and financial condition. We cannot predict any future trends in the rate of interest.

#### 5E. Off-Balance Sheet Arrangements

Not applicable.

#### 5F. Tabular Disclosure of Contractual Obligations

The following table of our material contractual obligations as of December 31, 2012, summarizes the aggregate effect that these obligations are expected to have on our cash flow in the periods indicated:

	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-term loans (1)	\$ 1,612,553	\$ 424,039	\$ 1,188,514	-	-
Accrued severance pay (2)	119,164	-	-	-	119,164
Liability to Dimex system	846,319	135,721	710,598	-	-
Uncertain tax position	30,982	-	-	-	30,982
Operating lease - cars	410,063	218,179	191,884	-	-
Purchase obligation for service and inventory	3,183,807	3,183,807	-	-	-
Facilities lease	237,460	105,501	131,959	-	-
Total	\$ 6,440,348	\$ 4,067,247	\$ 2,222,955	\$ -	\$ 150,146

(1) Does not include interest. For information on interest rate on long terms loans. See Note 11 to the Consolidated Financial Statements for the year ended December 31, 2012.

(2) The time for payment of the severance cannot be predicted.

The above table does not include: (i) contingent obligations to pay royalties to the Office of the Chief Scientist and to the Fund for the Encouragement of Export, since the total amount to be paid under the terms of those agreements is a function of future sales, and (ii) contingent legal claims (see "Item 8A. Consolidated Statements and Other Financial Information - Legal Proceedings").

#### Item 6: Directors, Senior Management and Employees

##### 6A. Directors and Senior Management

Set forth below is information regarding our directors and senior management.

Name	Age	Position
Mr. Edouard Cukierman	48	Chairman of the Board of Directors
Mr. Yuval Viner	50	Chief Executive Officer
Mr. Aviad Zelicovsky	43	President
Mr. Eyal Cohen	44	Chief Financial Officer
Mr. Joel Adler	59	Director
Mr. Ronen Zavlik	52	Director
(*) Mr. Luis Gutierrez Roy	42	Director
Ms. Orit Nir Schwartz (*)	41	External Director
Mr. David Golan	72	External Director
(*)		

(\*) Member of our Audit Committee and Compensation Committee.

Mr. Edouard Cukierman has been a director of BOS since May 2003 and Chairman of the Company since June 2003. He is the Founder and Managing Partner of Catalyst Funds and serves as Chairman of Cukierman & Co. Investment House. Since its establishment in 1993, Cukierman & Co. Investment House has advised in more than € 4 billion worth of corporate finance transactions. Prior to managing Catalyst Fund in 2000, he was the President and CEO of Astra Technological Investments, a Venture Capital Fund established in 1993, which was the first Israeli company to go public in Continental Europe. He is also the Founder of the Go4Europe annual conference. He is a board member of Lamina Technologies which is based in Switzerland, Dorimedia Group as well as Harmon.ie in Israel. Edouard Cukierman is the Chairman of the European Committee of the "High-Tech Industry Association" in Israel since May 2011. He serves as the Vice President of the Fondation France Israël. Mr. Cukierman is a board member of "Alliance Israelite Universelle en Israel" and a board member of Sar-El (Association that brings volunteers from across the world to the IDF in Israel). In the past, he was also the President of the Supervisory Board of Citec Environment SA in Paris. He was a Board member of Orex, MTI Wireless and other portfolio companies of Catalyst and served as a Board member of Otto Capital, a Singapore based VC fund. He now serves as a Reserve officer in the Crisis & Hostage Negotiation Team and in the Spokesman Unit of the IDF. Mr. Cukierman holds an MBA from INSEAD,

France and a B.Sc. from the Technion - Israel Institute of Technology.

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1 Mr. Cukierman and Mr. Zelicovsky are first cousins. There are no other family relationships among the officers and directors.

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Mr. Yuval Viner was appointed as the Company acting CEO on October 20, 2009 and as CEO on March 17, 2010. From March 2008, following the acquisition of Dimex System's assets, he served as the Head of RFID and Mobile Solutions division. Mr. Viner joined Dimex Systems (1988) Ltd. in 1993 and was appointed as Dimex System's CEO in 2000. Mr. Viner joined the Company as part of the acquisition of Dimex Systems assets. Mr. Viner is a graduate of the Practical Engineering Academy of Tel Aviv.

Mr. Avidan Zelicovsky was appointed as the Company acting president in October 20, 2009 and as president on March 17, 2010. From November 2004, following the acquisition of Odem by BOS, Mr. Zelicovsky served as the Head of Supply Chain Solutions division. Mr. Zelicovsky first joined the Company's subsidiary Odem in 1996. Mr. Zelicovsky holds a B.A. in Business Administration from the Tel Aviv College of Management and an LL.M. from the Bar-Ilan University.

Mr. Eyal Cohen was appointed as the Company's Chief Financial Officer in January 2007. From 2004 through 2006, Mr. Cohen served as the Company's controller, and prior to that held the position of Chief Financial Officer at Cellact Ltd. From 1998 to 2001, Mr. Cohen was the controller of e-SIM Ltd. (NASDAQ:ESIMF) and in the years 1995-1997 held an audit manager position in PricewaterhouseCoopers. Mr. Cohen holds a B.A. in Accounting and Business Administration from the College of Management in Tel-Aviv and is a certified public accountant in Israel and in the United States, in the state of Maine.

Mr. Joel Adler has been a director of the Company since June 2005. Mr. Adler is a partner in Mishcon de Reya a leading law firm in London. He specializes in mergers & acquisitions and corporate finance work, in particular international corporate transactions. Mr. Adler advises a number of major Israel based companies on their business activities in the UK and Europe and on IPO of foreign companies on the London Stock Exchange (AIM). Mr. Adler joined Mishcon de Reya as a partner in 2006, from the London law firm of Speechly Bircham, where he was a partner from 1999. Previously, Mr. Adler was head of the corporate department of Rakisons (now part of U.S. law firm Steptoe & Johnson). He gained his experience with other leading law firms in London Herbert Oppenheimer Nathan & Vandyck (now Denton Wilde Sapte) and DJ Freeman. He is a member of the Israeli Bar and worked for the well-known Israeli law firm Caspi & Co. for two years. Mr. Adler holds a Law degree from Bar Ilan University in Israel, and an LLM from London University. He was born and educated in Vienna.

Mr. Ronen Zavlik has been a director of the Company since May 2003. He is a partner in the CPA firm of Grinberg-Zavlik, which he founded in 1987. His firm provides a wide range of audit, tax consultancy and CFO services to a wide variety of companies. Mr. Zavlik provides internal auditing services to a number of large companies whose shares are traded on the Tel-Aviv Stock Exchange, Mr. Zavlik holds a B.A. in Accountancy and Business Management from the College of Management in Tel-Aviv. Mr. Zavlik holds an accounting license in Israel, is a certified internal auditor in the United States and a member of the Institute of Certified Public Accountants in Israel.

Mr. Luis Gutierrez Roy has been a director of the Company since October 2010. Mr. Gutierrez Roy co-founded and has been a managing partner at Telegraph Hill Capital Fund I, LLC (THCapital) since 2008. He was a managing director of Corporate Finance and co-head of the Technology, Media and Telecom Group at Ernst & Young (E&Y) in Spain from 2001 to 2008. Prior to E&Y, he led the Corporate Value Consulting practice at PricewaterhouseCoopers (PwC) in its Barcelona office from 1999 to 2001. Prior to joining PwC Spain, he worked for PwC and Houlihan Valuation Advisors in San Francisco from 1996 to 1999, and at the Barcelona Stock Exchange, where he started his professional career as a research and equities analyst in 1992. Mr. Gutierrez Roy is a Board or Advisory Board member of several portfolio companies of THCapital. He has also advised companies in cross-border transactions in Europe, the United States, Asia and Latin America. Mr. Gutierrez Roy holds a B.Sc. in Business Administration from the University of Barcelona, and an MBA from the University of San Francisco.

Mr. David Golan has been an external director of the Company since February 2009. Mr. Golan provides private investment banking, managerial and consulting services. He currently serves as a director in several companies, both public and private. Previously, until 2002, he served as an Executive Director of a group of companies in the Rad-Bynet group. In the years 1998-2000 he served as President of the Zeevi Investments group. Between 1997-1998, Mr. Golan served as President of Clal Trading Ltd. and between 1992-1997 he served as Vice President in Clal Trading Ltd. Between the years 1988-1992 Mr. Golan served as managing director of Gal Industries Ltd. Mr. Golan holds a bachelor's degree in Economics and Statistics from the Hebrew University, an MBA from New York University and took part in a senior management course in IMD Lausanne.

Ms. Orit Nir Schwartz has been an external director of the Company since December 2011. Ms. Schwartz is the current Marketing Manager of the Imaging and Printing Group of Hewlett-Packard (HP) in Israel. Between 2004 and 2011, Ms. Schwartz worked as the Marketing Manager of Miller Jewellers, and previously, as Managing Manager of Siemens Mobile Phones from 2002 to 2003, and as Product Marketing Manager in the Marketing Division of Cellcom from 2000 to 2002. Ms. Schwartz holds a bachelor's degree in Economics and Management from the Technion - Israel Institute of Technology and an MBA from Tel Aviv University with concentrations in Marketing, Technology & Operational Systems Management.



## 6B. Compensation

The following table presents the total compensation paid to or accrued on behalf of all of our directors and officers as a group for the year ended December 31, 2012:

	Salaries, Directors' fees, Service fees, Commissions and Bonus <sup>1</sup>	Pension, Retirement and Similar benefits
All directors and officers as a group (then 9 persons)	\$ 695,788	\$89,490

<sup>1</sup> Includes consulting and other fees paid to Cukierman & Co., of which Mr. Edouard Cukierman, the Company's Chairman, is (indirectly) a controlling shareholder. Also includes consulting and other fees paid to Telegraph Hill Capital Fund I, LLC, of which Mr. Gutierrez Roy, a Company's director, may be deemed to have shared voting and dispositive power. Such remuneration includes stock based compensation in the amount of \$98,000. Such remuneration does not include amounts expended by the Company for expenses, including business association dues and expenses reimbursed to said officers, and other fringe benefits commonly reimbursed or paid by companies in the location in which the particular executive officer of the Company is located, as the case may be.

In December 2012, an amendment to the Israeli Companies Law, or Amendment 20, became effective, requiring companies to appoint a compensation committee.

Under Amendment 20, we are required to adopt a Compensation Policy by September 11, 2013, which will set forth company policy regarding the terms of office and employment of office holders, including compensation, severance and other benefits, exemption from liability, insurance and indemnification. The Compensation Policy must be based on those considerations, must include those provisions and needs to reference those matters as are detailed in the Companies Law. An "office holder" is defined in the Israeli Companies Law as a general manager, chief executive officer, chief business manager, deputy general manager, vice general manager, any other person assuming the responsibilities of any of the foregoing positions without regard to such person's title, a director and a manager directly subordinate to the chief executive officer.

The Compensation Policy must be approved by the board of directors, after considering the recommendations of the compensation committee. The Compensation Policy must also be approved by a majority of the company's shareholders, provided that (i) such majority includes at least a majority of the shareholders who are not controlling shareholders and who do not have a personal interest in the matter, who are present and voting, or (ii) the non-controlling shareholders and shareholders who do not have a personal interest in the matter who were present and voted against the policy hold two percent or less of the voting power of the company (the "Compensation Majority"). The Compensation Policy must be approved by the board of directors and the shareholders every three years. In the event that the compensation policy is not approved by the shareholders, the compensation committee and the board of directors may still approve the policy, if the compensation committee and the board of directors determined, based on specified reasons and following further discussion of the matter, that the Compensation Policy is in the best interests of the company.

In special circumstances, the board of directors and the compensation committee may override the resolutions of the shareholders regarding compensation of office holders (other than directors) following a re-discussion of the matter and for specified reasons.

Changes to existing terms of office and employment of office holders (other than directors), requires the approval of the compensation committee only, if the committee determines that the revised terms are not substantially different from the existing terms.

During the transition period, until a Compensation Policy is adopted, the terms of office and employment of office holders, including any amendment thereof, are required to be approved as described below with respect to the different categories of office holders and must be based on, include and refer to the same considerations as required with respect to the creation of the Compensation Policy described above.

Pursuant to Amendment 20, any arrangement between a company and an office holder (other than a director or the chief executive officer) as to his or her terms of office and employment must be in line with the Compensation Policy and requires the approval of the compensation committee and the board of directors.

#### Directors

Pursuant to Amendment 20, any arrangement between a company and a director as to his or her terms of office and employment must be in line with the Compensation Policy and requires the approval of the compensation committee, the board of directors and the shareholders by a simple majority.

Under certain circumstances and conditions, the compensation committee and the board of directors may approve an arrangement that deviates from the Compensation Policy, provided that such arrangement is approved by the company's shareholders by the Compensation Majority. Such approval will also be required with respect to determining the terms of office and employment of a director during the transition period until the company adopts a Compensation Policy.

In accordance with the approval of our shareholders in 2011, directors who are not employees (excluding the Company's current Chairman of the Board and excluding external directors) are entitled to receive annual compensation of NIS 26,140, and an additional NIS 1,353 for each board meeting attended. The above amounts are subject to adjustment for changes in the Israeli consumer price index after October 2011. In December 2012, the Company's shareholders approved a change in the form of compensation for directors, such that compensation shall be paid in Ordinary Shares instead of in cash.

Payment in the Company's Ordinary Shares is made according to the following terms:

- Payment once a year, at the end of each calendar year.
- The price per share used for the share consideration calculation will be equal to the weighted average closing price of the Ordinary Shares on the applicable stock market on the 20 trading days ending on December 31st of the applicable year.
- Payment in Ordinary Shares applies for compensation due commencing July 1, 2012 onwards.

Under the Companies Law and regulations promulgated pursuant thereto, the compensation payable to external directors and independent directors is subject to certain further limitations. The compensation of the Company's external directors is regulated by the Israeli Companies Regulations (Rules Regarding Compensation and Expenses to External Directors) - 2000, as amended, or the Regulations, and the Companies Regulations (Alleviation for Public Companies whose Shares are Traded on a Stock Exchange Outside of Israel) - 2000, as amended.

The compensation for our external directors, as approved by our shareholders, consists of an annual fee and a per meeting attendance fee equal to the "fixed" statutory amount applicable to companies of the Company's size, as set forth from time to time, in the applicable Regulations, subject to increase in accordance with the Israeli consumer price index.

The current compensation rates for our external directors consist of an annual fee of approximately NIS 25,000 and a participation fee in meetings of approximately NIS 1,590. These amounts are subject to adjustment for changes in the Israeli consumer price index after December 2007 and to changes in the amounts payable pursuant to Israeli law from time to time.

Board members are compensated for telephone participation in board and committee meetings in an amount of 60% of what would be received for physical attendance and 50% of such fee for a meeting held without convening.

Each of our current directors (including the external directors but excluding the current Chairman of the Board) was also granted options to purchase 1,500 ordinary shares upon commencement of his or her term as director and at an exercise price equal to the average closing prices of the shares on the Nasdaq Capital Market on the 20 trading days preceding the appointment of the director. The Options will vest and become exercisable annually over a period of three years, in three equal parts. The maximum option term is five years from grant.

If applicable, a director shall receive an additional amount of 1,500 options to purchase the Company's Ordinary Shares on the third anniversary of his or her service as a director of the Company.

The Company does not have any contracts with any of its non-employee/consultant directors that would provide for benefits upon termination of service.

#### Chairman of the Board

For a discussion regarding payments made to the Chairman of the Board, see Item 7B: Related Party Transactions.

#### Chief Executive Officer

Pursuant to Amendment 20, any arrangement between a company and its chief executive officer as to his or her terms of office and employment must be in line with the Compensation Policy and requires the approval of the compensation committee, the board of directors and the company's shareholders by the Compensation Majority.

Under certain circumstances and conditions, the compensation committee and the board of directors may approve an arrangement that deviates from the Compensation Policy provided it is approved by the shareholders by the Compensation Majority. Such approval will also be required with respect to determining the terms of office and employment of a chief executive officer during the transition period until the company adopts a Compensation Policy. In addition, under certain circumstances, a company may be exempt from receiving the shareholders' approval with respect to the terms of office and employment of a candidate for chief executive officer if such candidate meets certain independence criteria and the compensation committee has determined for specified reasons that shareholder approval would prevent the engagement, provided that the terms are in line with the Compensation Policy.

6C.

Board Practices

Directors:

Our Board of Directors is currently comprised of six directors, including two external directors. The directors (except for the external directors) are elected by simple majority at the annual shareholders' meeting, to serve until the next annual meeting of our shareholders and until their respective successors are elected and qualified. External directors, by rule of the Israeli Companies Law, are elected for a three-year term. Our Articles of Association provide that the number of directors in the Company (including external directors) shall be determined from time to time by the annual general meeting of shareholders, provided that it shall not be less than four nor more than eleven. Our Articles of Association provide that the directors may appoint additional directors (whether to fill a vacancy or to expand the Board) so long as the number of directors so appointed does not exceed the number of directors authorized by shareholders at the annual general meeting, and such appointees shall serve until the next annual general meeting.

NASDAQ Marketplace Rules require that the board of directors of a NASDAQ-listed company have a majority of independent directors, within the meaning of NASDAQ rules. Our board of directors has determined that Messrs. Adler, Golan, Zavlik and Ms. Nir Schwartz, who constitute a majority of the Board of Directors, are independent directors under the applicable Nasdaq Stock Market requirements.

Our Articles of Association provide that a director may appoint, by written notice to us, any individual to serve as an alternate director, up to a maximum period of one month, if the alternate is not then a member of the Board. Any alternate director shall have all of the rights and obligations of the director appointing him or her and shall be subject to all of the provisions of the Articles of Association and the Israeli Companies Law. Unless the time period or scope of any such appointment is limited by the appointing director, such appointment is effective for all purposes for a period of one month, but in any event will expire upon the expiration of the appointing director's term, removal of the alternate at an annual general meeting, the bankruptcy of the alternate, the conviction of the alternate for an offense in accordance with the Israeli Companies Law, the legal incapacitation of the alternate, the removal of the alternate by court order or the resignation of the alternate. Currently, no alternate directors have been appointed. A director may appoint an alternate to serve in his place as a member of a committee of the Board of Directors, even if the alternate currently serves as a director, as long as he does not already serve as a member of that committee.

Officers serve at the discretion of the Board or until their successors are appointed.

According to the provisions of our Articles of Association and the Israeli Companies Law, the Board of Directors convenes in accordance with the Company's requirements, and at least once every three months. In practice, our Board of Directors convenes more often. Furthermore, our Articles of Association provide that the Board of Directors may also pass resolutions without actually convening, provided that all the directors entitled to participate in the discussion and vote on a matter that is brought for resolution agree not to convene for discussion of the matter. Resolutions passed without convening, shall be passed by an ordinary majority (just as in the case of convened meetings) and shall have the same effect as resolutions passed at a duly convened meeting.

In accordance with the requirements of the Nasdaq Stock Market, nominees for directors are recommended for selection by a majority of the independent directors.

External Directors:

Under the Israeli Companies Law, public companies are required to elect two external directors who must meet specified standards of independence. External directors may not have during the two years preceding their appointment, directly or indirectly through a relative, partner, employer or controlled entity, any affiliation with (i) the public company, (ii) those of its shareholders who are controlling shareholders at the time of appointment, or (iii) any entity controlled by the company or by its controlling shareholders.

The term “affiliation” includes an employment relationship, a business or professional relationship maintained on a regular basis, control and services as an office holder. The term “controlling shareholder” is defined as a shareholder who has the ability to direct the activities of a company, other than if this power derives solely from the shareholder’s position on the board of directors or any other position with the company. The definition also includes shareholders that hold 25% or more of the voting rights if no other shareholder owns more than 50% of the voting rights in the company.

In addition, an individual may not be appointed as an External Director in a company that does not have a controlling shareholder, in the event that he has affiliation, at the time of his appointment, to the chairman, chief executive officer, a 5% shareholder or the chief financial officer. An individual may not be appointed as an External Director if his relative, partner, employer, supervisor, or an entity he controls, has other than negligible business or professional relations with any of the persons with which the External Director himself may not be affiliated.

No person can serve as an external director if the person’s other positions or business creates or may create conflicts of interest with the person’s responsibilities as an external director. Until the lapse of two years from termination of office, a company may not engage an external director as an employee or otherwise. If, at the time an external director is to be appointed, all current members of the board of directors are of the same gender, then at least one external director must be of the other gender.

A person is qualified to serve as an external director only if he or she has “accounting and financial expertise” or “professional qualifications,” as such terms are defined under regulations promulgated under the Israeli Companies Law. At least one external director must have “accounting and financial expertise.” David Golan, a member of our Audit Committee, is an external director who has accounting and financial expertise.

External directors serve for an initial three-year term, The initial three-year term of service can be extended, at the election of a company subject to certain conditions, by two additional three-year terms. External Directors will be elected by a majority vote at a shareholders’ meeting, provided that either the majority of shares voted at the meeting, including at least one-half of the shares held by non-controlling shareholders voted at the meeting, vote in favor; or the total number of shares held by non-controlling shareholders voted against does not exceed two percent of the aggregate voting rights in the company.

External Directors may be re-elected for additional terms by means of 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, or (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, excluding the votes of controlling shareholders and those who have a personal interest in the matter as a result of their relations with the controlling shareholders, 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 relations with the controlling shareholders in favor of the nominee constitute more than 2% of the voting rights in the company.

External directors can be removed from office only by the court or by the same special percentage of shareholders that can elect them, and then only if the external directors cease to meet the statutory qualifications with respect to their appointment or if they violate their fiduciary duty to the company. The court may additionally remove external directors from office if they were convicted of certain offenses by a non-Israeli court or are permanently unable to fulfill their position.

If delegated any authority of the board of directors, any committee of the board of directors must include at least one external director. An external director is entitled to compensation as provided in regulations adopted under the Companies Law and is otherwise prohibited from receiving any other compensation, directly or indirectly, in connection with such service.

The Companies Law requires external directors to submit to the company, prior to the date of the notice of the general meeting convened to elect the external directors, a declaration stating their compliance with the requirements imposed by Companies Law for the office of external director.

Our board of directors currently has two external directors under Israeli law: (i) Mr. David Golan, who has serviced as an external director in the Company since February 2009, and was reelected for an additional three-year period at our annual general meeting of shareholders held on December 20, 2011; and (ii) Ms. Orit Nir Schwartz who was elected to serve as an external director at our annual general meeting of shareholders held on December 20, 2011.

**Fiduciary Duties of Office Holders:**

The Israeli Companies Law codifies the fiduciary duties that “office holders,” including directors and executive officers, owe to a company. An office holder’s fiduciary duties consist of a duty of care and a duty of loyalty. The duty of care requires an office holder to act at a level of care that a reasonable office holder in the same position would employ under the same circumstances. This includes the duty to utilize reasonable means to obtain (i) information regarding the business feasibility of a given action brought for his approval or performed by him by virtue of his position and (ii) all other information of importance pertaining to the foregoing actions. The duty of loyalty requires that an office holder act in good faith and for the benefit of the company, including (i) avoiding any conflict of interest between the office holder’s position in the company and any other position he holds or his personal affairs, (ii) avoiding any competition with the company’s business, (iii) avoiding exploiting any business opportunity of the company in order to receive personal gain for the office holder or others, and (iv) disclosing to the company any information or documents relating to the company’s affairs that the office holder has received by virtue of his position as an office holder.

**Disclosure of Personal Interests of an Office Holder; Approval of Transactions with Office Holders:**

The Israeli Companies Law requires that an office holder promptly, and no later than the first board meeting at which such transaction is considered, disclose any personal interest that he or she may have and all related material information known to him or her and any documents in their possession, in connection with any existing or proposed transaction relating to our company. In addition, if the transaction is an extraordinary transaction, that is, a transaction other than in the ordinary course of business, other than on market terms, or likely to have a material impact on the company’s profitability, assets or liabilities, the office holder must also disclose any personal interest held by the office holder’s spouse, siblings, parents, grandparents, descendants, spouse’s descendants and the spouses of any of the foregoing (“relatives”), or by any corporation in which the office holder or a relative is a 5% or greater shareholder, director or general manager or in which he or she has the right to appoint at least one director or the general manager.

Under the Israeli Companies Law, all arrangements as to compensation of office holders who are not directors require approval by the board of directors, and exculpation, insurance and indemnification of, or an undertaking to, indemnify an office holder who is not a director requires both board of directors and audit committee approval. The compensation of office holders who are directors must be approved by our Audit Committee, Board of Directors and shareholders, in that order.



Some other transactions, actions and arrangements involving an office holder (or a third party in which an office holder has an interest) must be approved by the board of directors or as otherwise provided for in a company's articles of association, however, a transaction that is adverse to the company's interest may not be approved. In some cases, such a transaction must be approved by the audit committee and by the board of directors itself, and under certain circumstances shareholder approval may be required. Generally, in all matters in which a director has a personal interest he or she shall not be permitted to vote on the matter or be present in the meeting in which the matter is considered, except in case of a transaction that is not extraordinary or the purpose of presenting the proposed transaction, if the chairman of the audit committee or board of directors (as applicable) determines it necessary. Should a majority of the audit committee or of the board of directors have a personal interest in the matter, then: (a) all of the directors are permitted to vote on the matter and attend the meeting at which the matter is considered; and (b) the matter requires approval of the shareholders at a general meeting.

#### Committees

Each committee of a company's Board of Directors that has the authority to exercise powers of the Board of Directors is required to include at least one external director and its audit committee must include all external directors.

#### Audit Committee:

Our Audit Committee currently consists of David Golan, Ronen Zavlik and Orit Nir Schwartz. Under the Israeli Companies Law, public companies must establish an audit committee. The audit committee must consist of at least three members, and must include all of the company's external directors. A majority of an audit committee must be comprised of "independent directors" (as such term is defined in the Companies Law). The chairman of the board of directors, any director employed by the company or providing services to the company on a regular basis, any controlling shareholder and any relative of a controlling shareholder may not be a member of the audit committee. An audit committee may not approve an action or a transaction with an officer or director, a transaction in which an officer or director has a personal interest, a transaction with a controlling shareholder and certain other transactions specified in the Companies Law, unless at the time of approval two external directors are serving as members of the audit committee and at least one of the external directors was present at the meeting in which an approval was granted.

Our Audit Committee assists our Board of Directors in overseeing the accounting and financial reporting processes of our company and audits of our financial statements, including the integrity of our financial statements, compliance with legal and regulatory requirements, compensation of our executive officers, our independent registered public accountants' qualifications, independence and compensation (including for non-audit services), the performance of our internal audit function, finding defects in the business management of our company and proposing to our Board of Directors ways to correct such defects, determine whether certain related party actions and transactions are "material" or "extraordinary" in connection with their approval procedures, approve related-party transactions as required by Israeli law, establish whistle blower procedures (including in respect of the protections afforded to whistle blowers) and such other duties as may be directed by our Board of Directors. 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.

The Company has adopted an Audit Committee Charter which sets forth the responsibilities of the committee. A copy of this charter is available upon written request to the Company at its address in Israel.

Under the Sarbanes-Oxley Act of 2002, the Audit Committee is responsible for the appointment, compensation, retention and oversight of the work of the Company's external auditors. However, under Israeli law, the appointment of external auditors requires the approval of the shareholders of the Company. Accordingly, the appointment of the external auditors is approved and recommended to the shareholders by the Audit Committee and ratified by the shareholders. Furthermore, pursuant to the Company's Articles of Association, the Board of Directors is the organ that has the authority to determine the compensation of the external auditors; however, the Board of Directors delegated its authority to the audit committee, so that a second discussion by the Board of Directors shall not be necessary.

The Company has determined that all the members of its Audit Committee meet the applicable Nasdaq Stock Market and SEC independence standards.

#### Compensation Committee:

Our Board of Directors has established a Compensation Committee, which offers recommendations to the Board of Directors regarding equity compensations issues (with the Board also approving compensation of our executive officers). The Compensation Committee also makes recommendations to our Board of Directors in connection with the terms of employment of our chief executive officer and all other executive officers.

Under the Israeli Companies Law, the compensation committee is responsible for: (i) making recommendations to the board of directors with respect to the approval of the Compensation Policy applicable to the company's office holders and any extensions thereto; (ii) providing the board of directors with recommendations with respect to any amendments or updates to the Compensation Policy and periodically reviewing the implementation thereof; (iii) reviewing and approving arrangements with respect to the terms of office and employment of office holders; and (iv) determining whether or not to exempt a transaction with a candidate for chief executive officer from shareholder approval.

Our Compensation Committee consists of Mr. Golan, Ms. Schwartz, and Mr. Zavlik. All of the members of our Compensation Committee are independent directors, within the meaning of NASDAQ rules and the Israeli Companies Law.

Israeli Securities Authority Administrative Enforcement:

Under the Israeli Securities Law- 1968, the Israeli Securities Authority, or ISA, may take certain administrative enforcement actions against a company or a person, including a director, officer or shareholder of a company, if performing certain transgressions designated in the Securities Law.

The ISA is also authorized to impose fines on any person or company breaching certain provisions designated under the Companies Law.

6D. Employees

As of March 31, 2013, we employed 59 employees, all of them in Israel. Of these 59 employees: 9 employees are in general and administrative positions, 22 employees are in marketing and sales, 12 employees are employed as technicians and 16 employees are in operating activities. We believe that our relations with our employees are satisfactory. We have not experienced a collective labor dispute or a strike.

Israeli labor laws are applicable to all of our employees in Israel.

Recent rulings by Israel's National Labor Court and changes to Israel's largest labor union's bylaws substantially facilitate the organization of a labor union in companies in Israel. We and our employees are not parties to any collective bargaining agreements and our employees are not represented by any labor union. However, certain provisions of the collective bargaining agreements between the Histadrut (General Federation of Labor in Israel) and the Coordination Bureau of Economic Organizations (including the Manufacturers' Association of Israel) are applicable to all Israeli employees by order of the Israeli Ministry of Labor and Welfare. These provisions principally concern the length of the work day and the work week, minimum wages for workers, contributions to a pension fund, insurance for work-related accidents, procedures for dismissing employees, determination of severance pay and other conditions of employment. These provisions are modified from time to time.

A new Israeli labor law, passed in 2012, subjects employers to increased liability, including monetary sanctions and criminal liability, in cases of violations of certain labor laws and certain violations by contractors providing maintenance, security and cleaning services.

All of our Israeli employees are covered by pension insurance policies. Israeli employees and employers are required to pay predetermined sums to the Israel National Insurance Institute which amounts also include, since January 1, 1995, payments for national health insurance.

In December 2008 and in May 2009, we effected a progressive reduction in the salaries of the employees of the Company and its subsidiaries of up to 15%, depending on the level of salary. In connection with such reduction, in May 2009, the Company granted its employees a total of 107,751 options to purchase ordinary shares of the Company with exercise price of \$0.00 per ordinary share. The options vested on a quarterly basis starting from January 2009 over a period of four quarters, in four equal parts and are now fully vested. The exercise period of the options is 5 years from January 1, 2009.

In addition, in May 2009, the Company's employees were granted a total of 109,034 options to purchase the Company's ordinary shares, as a prospective incentive. The exercise price of these options is \$5.00 per ordinary share. These options vest on a yearly basis starting from January 2009 over a period of four years, in four equal parts. The exercise period of the options is 5 years from January 1, 2009.

#### 6E. Share Ownership

As of March 31, 2013, shares, options and warrants held by our officers and directors, then consisting of 9 persons, are as follows:

Name	Position	Shares	Options and Warrants
Mr. Edouard Cukierman <sup>1</sup>	Chairman of the Board of Directors	44,984	31,180
Mr. Joel Adler <sup>2</sup>	Director	7,047	1,075
Mr. Avidan Zelicovsky	President	4,339	14,870
Mr. Yuval Viner	Chief Executive Officer	2,839	9,120
Mr. Eyal Cohen	Chief Financial Officer	186	7,539
Mr. Luis Gutierrez Roy <sup>3</sup>	Director	65,780	18,985
Other directors		1,391	1,450

<sup>1</sup> Mr. Edouard Cukierman held 6,203 ordinary shares directly, 13,804 ordinary shares through a wholly owned company, E.D.I European Development and Investments Ltd. and an additional 24,977 ordinary shares through Cukierman & Co. Investment House that is indirectly controlled by Mr. Cukierman. Does not include shares as to which Mr. Cukierman may be deemed to share beneficial ownership. See "Item 7A: Major Shareholders".

<sup>2</sup> Brada Investments Limited is a discretionary trust of which Mr. Joel Adler, a director of the Company, is one of the beneficiaries. Brada Investments Limited holds 7,047 ordinary shares. Mr. Joel Adler holds 1,075 options, which he received as a director.

<sup>3</sup> Securities are held by Telegraph Hill Capital Fund I, LLC. Mr. Gutierrez Roy may be deemed to have shared voting and dispositive power with respect to the holdings by Telegraph Hill Capital Fund I, LLC. Includes 3,600 warrants held by Telegraph Hill Capital Fund pursuant to an advisory agreement

## Share Option Plans

The purpose of the Share Option Plans is to enable us to attract and retain qualified persons as employees, officers, directors, consultants and advisors and to motivate such persons by providing them with an equity participation in the Company. The Share Option Plans will expire 10 years after their adoption, unless terminated earlier by the Board of Directors.

The Share Option Plans are administered by the Board of Directors, which has broad discretion, subject to certain limitations, to determine the persons entitled to receive options.

Under the Share Option Plans, the terms and conditions under which options are granted and the number of shares subject thereto shall be determined by the Board of Directors. The Board of Directors also has discretion to determine the nature of the consideration to be paid upon the exercise of an option under the Share Option Plans. Such consideration generally may consist of cash, or, at the discretion of the Board of Directors, cash and a recourse promissory note.

The ordinary shares acquired upon exercise of an option are subject to certain restrictions on transfer, sale or hypothecation. Options are exercisable and restrictions on disposition of shares lapse pursuant to the terms of the individual agreements under which such options were granted or shares issued.

The Section 102 Share Options Plans are designed to afford qualified optionees certain tax benefits under the Israel Income Tax Ordinance.

## 2003 Plan

In May 2003 the Company's shareholders approved the adoption of the 2003 Israeli Stock Option Plan, pursuant to which 31,250 ordinary shares were reserved for purchase by the employees, directors, consultants and service providers of the Company and its subsidiaries. Subsequently, the shareholders approved increases of the shares reserved for issuance under the 2003 Plan, initially to 50,000, and thereafter to 75,000, to 130,000, to 208,000 and in December 21, 2011 to 275,000. The Board of Directors has resolved that no further grants shall be made under previous plans. The Company has elected to designate the 2003 Plan as providing benefits available under the "capital gains" alternative. Pursuant to the election made by the Company, capital gains derived by optionees arising from the sale of shares derived from the exercise of options granted to them under Section 102, will be subject to a flat capital gains tax rate of 25% (instead of the gains being taxed as salary income at the employee's marginal tax rate). However, as a result of this election, the Company is not allowed to claim as an expense for tax purposes the amounts credited to such employees as a benefit when the related capital gains tax is payable by them. The Company may change its election from time to time, as permitted by the Tax Ordinance. There are various conditions that must be met in order to qualify for these benefits, including registration of the options in the name of a trustee (the "Trustee") for each of the employees who is granted options. Each option, and any ordinary shares acquired upon the exercise of the option, must be held by the Trustee for a period commencing on the date of grant and ending no earlier than 24 months from the date of grant.

In December 2012, the Company's shareholders approved a 10 year extension to the Plan, according to which the board of directors may grant options under the Plan through May 31, 2023.

As of March 31, 2013, we had 79,952 options outstanding under this plan (of which 69,920 are exercisable) with the exercise prices as set forth below:

Exercise Price Per Share \$	Outstanding
\$ 0.0	1,313
\$ 3.40	375
\$ 3.80	11,180
\$ 8.00	9,199
\$ 9.91	375
\$ 10.00	5,000
\$ 12.20	1,500
\$ 20.00	12,455
\$ 29.98	375
\$ 33.60	3,750
\$ 47.70	20,000
\$ 50.40	14,030
\$ 60.00	400
Total	79,952

Item 7: Major Shareholders and Related Party Transactions

7A. Major Shareholders

We are not directly or indirectly owned or controlled by another corporation or by any foreign government.

The following table sets forth, as of March 31, 2013, to the best of the Company's knowledge, information as to each person known to the Company to be the beneficial owner of more than five percent (5%) of the Company's outstanding ordinary shares. Except where indicated, to the best of the Company's knowledge based on information provided by the owners, the beneficial owners of the ordinary shares listed below have sole investment and voting power with respect to those shares. Applicable percentage ownership in the following table is based on 1,154,633 shares outstanding as of March 31, 2013.

The shareholders' holdings reflect their voting rights. The Company's major shareholders do not have different voting rights than other shareholders, with respect to their shares.

Name and Address	Shares Beneficially Owned			Percent	
	Outstanding Shares	Warrant Shares (2)	Total Shares		
Catalyst Funds (1) 3 Daniel Frisch Street, Tel-Aviv 64731, Israel	110,700	40,770	151,470	12.67	%
Bellite Pty Limited (3) 7 Beresford Road, Rose Bay 2029, NSW, Australia	116,286	28,847	145,133	12.26	%
Dimex Systems (1988) Ltd. (4) 3 Tvuot Ha'aretz Street, Tel Aviv 69546, Israel	106,346	49,439	155,785	13.24	%
Telegraph Hill Capital Fund I, LLC (5)	65,780	18,985	84,765	7.22	%

(1) Represents shares held by Catalyst Investments L.P. and by Catalyst Private Equity Partners (Israel) II L.P. Catalyst Investments II, L.P. is the general partner of Catalyst Private Equity Partners (Israel) II L.P.

Mr. Edouard Cukierman may be deemed to have sole voting and dispositive power with respect to shares held by Catalyst Investments L.P. and Catalyst Private Equity Partners (Israel) II L.P. Mr. Cukierman disclaims beneficial ownership in such shares, except to the extent of his proportionate interest in them as an indirect shareholder in Catalyst Investments L.P. and in Catalyst Investments II, L.P.

- (2) Represents shares issuable upon exercise of warrants that may be exercised within 60 days following the date of this report.
- (3) Mr. Les Szekely may be deemed to have sole voting and dispositive power with respect to the shares held by Bellite Pty Limited.
- (4) Ms. Gabriela Jacobs may be deemed to have sole voting and dispositive power with respect to the shares held by Dimex Systems.
- (5) Mr. Luis Gutierrez Roy may be deemed to have sole voting and dispositive power with respect to the shares held by Telegraph Hill Capital Fund I, LLC.

The changes in holdings (excluding warrants) of the major shareholders over the last three years are detailed, to the best of our knowledge, in the table below:

Holdings as of:	December 31, 2010	December 31, 2011	December 31, 2012	March 31, 2013
Catalyst Funds (1)	105,863	212,526	192,107	110,700
Dimex Systems (1988) Ltd.	106,346	106,346	106,346	106,346
SITA	43,934	156,996	113,063	-
Bellite Pty Limited	40,817	116,286	116,286	116,286
Telegraph Hill Capital Fund I, LLC	24,091	64,341	65,780	65,780

- (1) Represents shares held by Catalyst Investments L.P. and by Catalyst Private Equity Partners (Israel) II L.P.



As of March 31, 2013, there were 64 record holders of ordinary shares, of which 10 were registered with addresses in the United States, representing approximately 60% of the outstanding ordinary shares. However, the number of record holders in the United States is not representative of the number of beneficial holders nor is it representative of where such beneficial holders are resident since many of the ordinary shares are held of record by brokers and other nominees.

7B. Related Party Transactions

Grant of Shares and Options to Mr. Cukierman

Active Chairman Agreement

On November 7, 2007 the Company's shareholders approved an Active Chairman Agreement with Mr. Edouard Cukierman. Pursuant to this Agreement, in consideration for Mr. Cukierman's services as the Company's Active Chairman in the years 2007-2010, he was granted 20,000 options in four equal annual tranches (pro-rated for any part of the Calendar year). The options were in lieu of any compensation, fees or options otherwise payable by the Company to Mr. Cukierman as a director.

The options vested on a quarterly basis. The exercise price of the options was \$47.7, which was equal to the weighted average of the closing prices of the Company's ordinary shares on the Nasdaq Global Market during the thirty-day period preceding the shareholders approval. Unexercised options expire after five years from their respective grant date.

In December 2011, the Company's shareholders approved a new Active Chairman Agreement with Mr. Cukierman. Pursuant to this agreement, in consideration for Mr. Cukierman's services as the Company's Active Chairman in the years 2011-2014, he shall be granted options to purchase 22,360 ordinary shares, and be paid a monthly cash payment of \$5,000, plus VAT at the prevailing rate. Payment of the cash fee shall be made each month in respect of the previous month of service. Following approval by the shareholders in December, 2011, the cash fees for 2011 were paid retroactively for the entire year. The exercise price of the options is \$3.8 and they vest and become exercisable in 16 equal quarterly installments. The first three installments vested immediately following the shareholders' approval, and the fourth installment vested on December 31, 2011. Additional installments vest at the end of each subsequent calendar quarter, provided that Mr. Cukierman shall hold his position as Chairman of the Board at the applicable vesting date. Pursuant to the agreement, if Mr. Cukierman's service to the Company is terminated by the Company for no cause then: (a) any unvested options shall be accelerated, so that they become immediately vested in full as of the date of the termination and (b) the accelerated options and any previously vested options shall be exercisable for twenty four (24) months following the termination. Except for in the events of acceleration or termination for cause, the options are exercisable for five years from the grant date.

The options and the cash fee are in lieu of any compensation, fees or options otherwise payable by the Company to Mr. Cukierman as a director.

At the Company's request, the Chairman has agreed that the monthly payment of \$5,000 shall be paid in Ordinary Shares instead of in cash. In December 2012, the shareholders approved an amendment to the Active Chairman Agreement to this effect, as follows:

- Payment will be made once a year, at the end of each calendar year.
- The price per share used for the share consideration calculation will be equal to the weighted average closing price of the Ordinary Shares on the applicable stock market on the 20 trading days ending on December 31st of the applicable year.
  - Payment in Ordinary Shares applies for compensation due commencing July 1, 2012 onwards.

On December 31, 2012, the Company issued to Edouard Cukierman 5,119 ordinary shares pursuant to the revised Active Chairman Agreement.

Services Agreement with Cukierman & Co. Investment House.

In 2003, the Company's audit committee and Board approved the engagement of Cukierman & Co. Investment House Ltd. ("Cukierman & Co."), to provide non-exclusive investment-banking services and business development services to the Company, effective April 15, 2003 (the "Services Agreement"). Cukierman & Co. is a company indirectly controlled by Mr. Edouard Cukierman. Since June 26, 2003, he serves as Chairman of the Company's Board, and he may also be deemed to have sole voting and dispositive power with respect to shares held by Catalyst Investments and by Catalyst Private Equity Partners (Israel) II L.P. For its services, Cukierman & Co. is paid a monthly sum of \$10,000 plus VAT (from February 9, 2009 until December 31, 2010, Cukierman & Co. agreed to temporarily reduce such fee to \$8,500), in addition to a success fee of 4%-6% for a consummated private placements. The Services Agreement, as supplemented, provides for success fees in connection with securing M&A transactions of 3.5% of the proceeds exchanged in such a transaction and also for a success fee of 6% of the revenues actually received by the Company in respect of a sale of the Company's products to a new customer which was introduced by Cukierman & Co.

According to its terms, the Company may terminate the Service Agreement at any time, by giving a one-month prior written notice.

Following the approvals by the Board of Directors and Audit Committee, the Company has entered into an amendment to the Services Agreement, dated January 13, 2013, pursuant to which the private placement portion of Cukierman & Co's services was discontinued, commencing July 1, 2012. As a result, the retainer payment in respect of July 2012 onwards was reduced to \$6,350, reflecting payment for the business development and mergers acquisitions only. In addition, the Company has requested and Cukierman & Co. has agreed, that payment of the retainer shall be made by way of equity (i.e., issuance to Cukierman & Co. of BOS' Ordinary Shares) instead of in cash, as follows:

- Payment is made once a year, at the end of each calendar year.
- The price per Company Ordinary Share used for the calculation is equal to the weighted average closing price of the Ordinary Shares on the applicable stock market on the 20 trading days ending on December 31st of the year.

On December 31, 2012 the company issued 6,501 Ordinary Shares to Cukierman & Co. in accordance with the revised Services Agreement.

For payments the Company paid and accrued pursuant to the Services Agreement in 2012, see Note 18 to the Consolidated Financial Statements for the year ended December 31, 2012.

Agreements with Telegraph Hill Capital Fund I, LLC ("Telegraph Hill Capital")

Mr. Luis Gutierrez Roy, a director of the Company since October 2010, is the managing partner of Telegraph Hill Capital and may be deemed to have shared voting and dispositive power with respect to company shares held by Telegraph Hill Capital.

In September 2009, the Company entered into an advisory agreement with Telegraph Hill Capital, pursuant to which Telegraph Hill Capital was to provide the Company with non-exclusive private financing and business consulting services (the "Advisory Agreement"). In consideration, the Company issued to Telegraph Hill Capital warrants to purchase 3,600 Ordinary Shares at an exercise price of \$11 per share. The warrants were exercisable as of February 28, 2011, and could be exercised until August 31, 2012.

In November 2009, the Company entered into an amendment to the Advisory Agreement with THGroup LLC (management company of Telegraph Hill Capital), pursuant to which THGroup LLC shall be paid a success fee of 5% of the revenues generated to the Company from the sale of the Company products to business partners introduced by THGroup LLC. For payments the Company paid and accrued pursuant to the Advisory Agreement in 2012, see Note 18c to the Consolidated Financial Statements for the year ended December 31, 2012.

On October 5, 2010, the Company entered into a share purchase agreement with Telegraph Hill Capital for the issuance of an aggregate of 24,091 Ordinary Shares at a price per share of \$12.44, or approximately \$300,000 in total. Pursuant to this agreement, Mr. Luis Gutierrez Roy was appointed to the Board of Directors.

In December 2012, the Company's shareholders approved an additional grant to Telegraph Hill Capital of warrants to purchase 3,600 Ordinary Shares. The warrants' exercise price is equal to the weighted average of the closing prices of the Company's Ordinary Shares on the Nasdaq Capital Market, during the twenty-day period preceding the date of the shareholders' meeting in December (i.e., \$2.39). The warrants are exercisable for 3 years from their issuance date.

In addition, the shareholders approved an additional amendment to the Advisory Agreement with Telegraph Hill Capital, pursuant to which Telegraph Hill Capital will be paid a retainer for business development services that it provides to the Company. The retainer is in an amount of \$3,650 per month, and is paid in the Company's Ordinary Shares as follows:

- Payment is made once a year, at the end of each calendar year.
- The price per share used for the share consideration calculation is equal to the weighted average closing price of the Ordinary Shares on the applicable stock market on the 20 trading days ending on December 31st of the applicable year.

Accordingly, on December 31, 2012, the Company issued 1,439 ordinary shares to Telegraph Hill Capital for business development services.

#### Indemnity Undertakings by the Company to its Directors and Officers

On February 18, 2003, the Company's shareholders approved indemnity undertakings to its directors and officers (including future directors and officers as may be appointed from time to time), in excess of any insurance proceeds, not to exceed, in the aggregate over the years, a total amount of \$2,500,000. On May 18, 2006, at the recommendation of the Audit Committee and the Board of Directors, the shareholders approved amendments to the indemnity undertakings, in light of changes to the Israeli Companies Law. On December 20, 2011, following an amendment to the Israeli Securities Law and a corresponding amendment to the Companies Law, which had authorized the Israeli Securities Authority to impose administrative sanctions against companies and their office holders for certain violations of the Israeli Securities Law or the Companies Law, the Company's shareholders approved a modified form of such indemnification agreement to ensure that the Company's directors were afforded protection to the fullest extent permitted by law. In addition, under the new indemnification agreements, the Company exempts and releases each director from any and all liability to the Company related to any breach by each director of his duty of care to the Company, to the maximum extent permitted by law.

#### 7C. Interests of Experts and Counsel

Not applicable.

## Item 8: Financial Information

## 8A. Consolidated Statements and Other Financial Information

## Consolidated Financial Statements

See “Item 18. Financial Statements”.

## Sales Outside of Israel

The total amount of revenues of the Company and its subsidiaries continued operations from sales out of Israel has been as follows:

Year	Export revenues	% of all revenues
2012	\$3,656,000	15%
2011	\$6,433,000	19%
2010	\$5,635,000	19%

## Legal Proceedings

On November 2008, Blockshtil Ltd. filed a claim in the Petach-Tikva Magistrate Court alleging breach of contract by the Company and seeking damages in the amount of NIS 149,000 (approximately \$43,000). During 2012, the Company has served a statement of defense and the case has been heard. The parties will be filing their written summations and thereafter the Court will render its judgment. The Company's financial statements include a provision in this respect.

## Dividend Policy

The Company does not currently have a dividend policy. The declaration and payment of any cash dividends in the future will be determined by the Board of Directors in light of the conditions existing at that time. This will include our earnings and financial condition. We may only pay cash dividends in any fiscal year, out of “profits”, as defined under Israeli law. Any cash dividend in the future out of an approved enterprise will be subject to an additional tax. Currently we have no profits from an approved enterprise; hence no provision has been made for tax on future dividends.

## 8B. Significant Changes

Not applicable.

Item 9: The Offer and Listing

9A. Offer and Listing Details

Commencing April 1996, our ordinary shares were traded, and our warrants, until they expired on April 2, 2000, were traded in the over-the-counter market in the United States, and quoted on what is now called the NASDAQ Capital Market under the symbol “BOSC” and “BOSCW,” respectively. In September 2000, our shares started to be traded on what is now called the NASDAQ Global Market. In January 2002, our shares began trading also on the TASE, under the symbol “BOSC”, pursuant to the dual-listing regulations of the Israeli Securities Authority. On May 12, 2009, we delisted our ordinary shares from trade on the TASE. The delisting of the ordinary shares from the TASE did not affect the continued listing of the ordinary shares on the NASDAQ Global Market under the symbol BOSC. After the delisting of the Company’s ordinary shares from the TASE, we are no longer subject to reporting requirements in Israel. On October 16, 2009, the Company’s ordinary shares were transferred to the NASDAQ Capital Market and are traded on such market under the symbol “BOSC”.

Prices set forth below are high and low reported closing prices for our ordinary shares as reported by NASDAQ for the periods indicated. All share prices have been retroactively adjusted to reflect the 1:4 reverse stock split effected on December 14, 2012.

Period		High (\$)	Low (\$)
<b>Annual Information</b>			
2008	Annual	41.00	4.60
2009	Annual	13.20	4.40
2010	Annual	13.20	3.08
2011	Annual	14.08	2.72
2012	Annual	8.19	1.64
<b>Quarterly Information (2011)</b>			
	First Quarter	10.72	5.44
	Second Quarter	14.08	7.6
	Third Quarter	10.92	4.4
	Fourth Quarter	5.08	2.72
	December	4.00	2.72
<b>Quarterly Information (2012)</b>			
	First Quarter	4.76	2.84
	Second Quarter	4.2	2.56
	Third Quarter	3.6	1.64
	Fourth Quarter	8.19	1.64
	November	3.00	1.76
	December	8.19	2.24
<b>Monthly Information (2013)</b>			
	January	6.08	4.05
	February	4.72	2.95
	March	3.97	2.66
	April (until April 29)	4.73	3.05

9B. Plan of Distribution

Not applicable.

9C. Markets

Our securities are traded on the NASDAQ Capital Market under the symbol "BOSC".

9D. Selling Shareholders

Not applicable.

9E. Dilution

Not applicable.

9F. Expenses of Issue

Not applicable.

Item 10: Additional Information

10A. Share Capital

Not applicable.

10B. Memorandum and Articles of Association

The Company's registration number at the Israeli Registrar of Companies is 52-0042565.

In March 2002 the Company adopted new Articles of Association, in view of the Israeli Companies Law. Since then, certain articles of the Article of Association have been amended.

Set forth below is a summary of certain provisions of our Memorandum and Articles of Association. This summary is not complete and should be read together with our Memorandum and Articles of Association, filed as exhibits hereto.

1. Objects of the Company:

The Company's Memorandum of Association (Article 2(p)) and Articles of Association (Article 2) provide that the Company may engage in any legal business.



2. Provisions related to the directors of the Company:

The Board of Directors may issue shares and other securities, which are convertible or exercisable into shares, up to the limit of the Company's authorized share capital.

(a) Approval of Certain Transactions under the Israeli Companies Law:

We are subject to the provisions of the Israeli Companies Law, which became effective on February 1, 2000, as amended. See Item 6C: Board Practices above.

(b) Borrowing powers exercisable by the Directors are not specifically outlined in the Company's Articles of Association, however, according to Article 15: "Any power of the Company which has not been vested in another organ pursuant to the Israeli Companies Law or the articles may be exercised by the Board of Directors".

(c) The Company's Articles of Association do not contain provisions regarding the retirement of directors under an age limit requirement, nor do they contain a provision requiring a Director to hold any Company shares in order to qualify as a Director.

3. With regard to the rights, preferences and restrictions attaching to the shares, the Company's Articles of Association provide the following:

(a) Dividends, Rights to Share in the Company's Profits and Rights to Share in any Surplus upon Liquidation

All holders of paid-up ordinary shares of the Company have an equal right to participate in the distribution of (i) dividends, whether by cash or by bonus shares; (ii) Company assets; and (iii) the Company's surplus assets upon winding up, all pro rata to the nominal value of the shares held by them (Articles 4.2.2, 4.2.3 and 7.3).

The Board of Directors is the organ authorized to decide upon the distribution of dividends and bonus shares (Article 26). The shareholders who are entitled to a dividend are the shareholders on the date of the resolution for the dividend or on a later date if another date is specified in the resolution on the dividend's distribution. If the Board of Directors does not otherwise determine, any dividend may be paid by way of a cheque or payment order that shall be sent by mail in accordance with the registered address of the shareholder or person entitled thereto, or in the case of registered joint shareholders to the shareholder whose name appears first in the shareholders' register in relation to the joint shareholding. Every such cheque shall be drawn up to the order of the person to whom it is being sent. The receipt of a person who on the date of the dividend's declaration is listed in the shareholders' register as the holder of any share or, in the case of joint shareholders, of one of the joint shareholders shall serve as confirmation of all the payments made in connection with such share. For the purpose of implementing any resolution pursuant to the provisions of this paragraph, the Board of Directors may settle, as it deems fit, any difficulty arising in relation to the distribution of the dividend and/or bonus shares, including determine the value for the purpose of the said distribution of certain assets and resolve that payments in cash shall be made to members in reliance upon the value thus determined, determine regulations in relation to fractions of shares or in relation to non-payment of amounts less than NIS 200.

(b) Voting Rights

All holders of paid-up ordinary shares of the Company have an equal right to participate in and vote at the Company's general meetings, whether ordinary or special, and each of the shares in the Company shall entitle its holder, present at the meeting and participating in the vote, himself, by proxy or through a voting instrument, to one vote (Article 4.2.1). Such voting rights may be affected in the future by the grant of any special voting rights to the holders of a class of shares with preferential rights. Shareholders may vote either in person or through a proxy or voting instrument, unless the Board of Directors prohibited voting through a voting instrument on a certain matter and stated so in the notice of the meeting (Articles 14.1 and 14.6). A resolution at the general meeting shall be passed by an ordinary majority unless another majority is specified in the Israeli Companies Law or the Company's Articles of Association (Article 14.3). For applicable provisions of the Israel Companies Law, see Item 6C: Board Practices.

(c) Election of Directors.

The Company's directors are elected by the shareholders at a shareholders' meeting. The ordinary shares do not have cumulative voting rights in the election of directors. The holders of ordinary shares conferring more than 50% of the voting power present by person or by proxy at the shareholders' meeting, have the power to elect the directors. The directors elected shall hold office until the next annual meeting, or sooner if they cease to hold office pursuant to the provisions of the Company's Articles. In addition, the Board of Directors may appoint a director (to fill a vacancy or otherwise) between shareholder meetings, and such appointment shall be valid until the next annual meeting or until such appointee ceases to hold office pursuant to the provisions of the Company's Articles. In compliance with the Israeli Companies Law, the Company has two external directors. The external directors are also appointed by the shareholders, subject to special majority requirements. Directors of the Company stand for reelection at every annual meeting (Article 16.2) and not at staggered intervals, with the exception of the External directors who are appointed for a term of 3 years under the Israeli Companies Law.

(d) Redemption

The Company may, subject to any applicable law, issue redeemable securities on such terms as determined by the Board of Directors, provided that the general meeting of shareholders approves the Board of Director's recommendation and the terms determined (Article 27).

(e) Capital Calls by the Company

The Board of Directors may only make calls for payment upon shareholders in respect of monies not yet paid for shares held by them (Article 7.2).

(f) Discrimination

No provision in the Company's Articles of Association discriminates against an existing or prospective holder of securities, as a result of such shareholder owning a substantial amount of shares.

4. Modification of Rights of Holders of Stock:

The general meeting of shareholders may resolve to create new shares of an existing class or of a new class with special rights and/or restrictions (Article 9.1).

So long as not otherwise provided in the shares' issue terms and subject to the provisions of any law, the rights attached to a particular class of shares may be altered, after a resolution is passed by the Company and with the approval of a resolution passed at a general meeting of the holders of the shares of such class or the written agreement of all the class holders. The provisions of the Company's Articles of Association regarding general meetings shall apply, mutatis mutandis, to a general meeting of the holders of a particular class of shares (Article 10.1). The rights vested in the holders of shares of a particular class that were issued with special rights shall not be deemed to have been altered by the creation or issue of further shares ranking equally with them, unless otherwise provided in such shares' issue terms (Article 10.2).

The above mentioned conditions are not more onerous than is required by law.

5. Annual General Meetings and Extraordinary General Meetings:

General meetings shall be convened at least once a year at such place and time as determined by the Board of Directors but no later than 15 months from the last general meeting. Such general meetings shall be called "annual meetings". The Company's other meetings shall be called "special meetings" (Article 12.1). The annual meeting's agenda shall include a discussion of the Board of Directors' reports and the financial statements as required at law. The annual meeting shall appoint an auditor, appoint the directors and discuss all the other matters which must be discussed at the Company's annual general meeting, pursuant to Company's Articles or the Companies Law, as well as any other matter determined by the Board of Directors (Article 12.2).

The Board of Directors may convene a special meeting pursuant to its resolution and it must convene a general meeting if it receives a written requisition from any one of the following (hereinafter referred to as “requisition”) (i) two directors or one quarter of the directors holding office; and/or (ii) one or more shareholders holding at least 5% of the issued capital and at least 1% of the voting rights in the Company; and/or (iii) one or more shareholders holding at least 5% of the voting rights in the Company (Article 12.3). A requisition must detail the objects for which the meeting must be convened and shall be signed by the persons requisitioning it and sent to the Company’s registered office. The requisition may be made up of a number of documents in an identical form of wording, each of which shall be signed by one or more of the persons requisitioning the meeting (Article 12.4). Where the Board of Directors is required to convene a special meeting, it shall do so within 21 days of the requisition being submitted to it, for a date that shall be specified in the invitation and subject to the law (Article 12.5).

Notice to the Company’s members regarding the convening of a general meeting shall be sent to all the shareholders listed in the Company’s shareholders’ register at least 21 days prior to the meeting and shall be published in other ways insofar as required by the law. The notice shall include the agenda, proposed resolutions and arrangements with regard to a written vote. The accidental omission to give notice of a meeting to any member, or the non-receipt of notice sent to such member, shall not invalidate the proceedings at such meeting (Article 12.6).

The shareholders entitled to participate in and vote at the general meeting are the shareholders on the date specified by the Board of Directors in the resolution to convene the meeting, and subject to the law (Article 14.1).

No discussions may be commenced at the general meeting unless a quorum is present at the time of the discussion’s commencement. A quorum is the presence of at least two shareholders holding at least 33 % of the voting rights (including presence through a proxy or a voting instrument), within half an hour of the time fixed for the meeting’s commencement (Article 13.1). If no quorum is present at a general meeting within half an hour of the time fixed for the commencement thereof, the meeting shall be adjourned for one week, to the same day, time and place, or to a later time if stated in the invitation to the meeting or in the notice of the meeting (hereinafter referred to as the “adjourned meeting”) (Article 13.2). The quorum for the commencement of the adjourned meeting shall be any number of participants.

The Articles of Association provide that all shareholder resolutions shall be passed by an ordinary (simple) majority of the votes cast, unless another majority is specified in the Israeli Companies Law or in the Articles (Article 14.3).

6. Limitations on the rights to own securities:

There are no limitations on the rights to own the Company’s securities, including the rights of non-residents or foreign shareholders to do so.

7. Change of Control:

Under the Israeli Companies Law, a merger is generally required to be approved by the shareholders and Board of Directors of each of the merging companies. Shareholder approval isn't required if the company that will not survive is controlled by the surviving company. Additionally, the law provides some exceptions to the shareholder approval requirement in the surviving company. If the share capital of the company that will not be the surviving company is divided into different classes of shares, the approval of each class is also required, unless determined otherwise by the court. A majority of votes approving the merger shall suffice, unless the company (like ours) was incorporated in Israel prior to the Israeli Companies Law, in which case a majority of 75% of the voting power is needed in order to approve the merger. Additionally, unless the court determines differently, a merger will not be approved if it is objected to by a majority of the shareholders present at the meeting, after excluding the shares held by the other party to the merger, by any person who holds 25% or more of the other party to the merger and by the relatives of and corporations controlled by these persons. 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 of the merger. Also, a merger can be completed only after all approvals have been submitted to the Israeli Registrar of Companies and provided that 30 days have elapsed since shareholder approval was received and 50 days have elapsed from the time that a proposal for approval of the merger was filed with the Registrar by each merging company.

The Israeli Companies Law also 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 would become a holder of 25% or more of the voting power at general meetings. This rule does not apply if there is already another holder of 25% or more of the voting power at general meetings. 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 would become a holder of more than 45% of the voting power of the company. This rule does not apply if someone else already holds 45% of the voting power of the company. An acquisition from a 25% or 45% holder, which turns the purchaser into a 25% or 45% holder respectively, does not require a tender offer. An exception to the tender offer requirement may also apply when the additional voting power is obtained by means of a private placement approved by the general meeting of shareholders.

Under the Israeli Companies Law, a person may not acquire shares in a public company if, after the acquisition, he will hold more than 90% of the shares or more than 90% of any class of shares of that company, unless a tender offer is made to purchase all of the shares or all of the shares of the particular class. The Israeli Companies Law also provides that as long as a shareholder in a public company holds more than 90% of the company's shares or of a class of shares, that shareholder shall be precluded from purchasing any additional shares. If a tender offer is accepted and less than 5% of the shares of the company are not tendered, and a majority of the offeree shareholders not having a personal interest accepted the offer, all of the shares will transfer to the ownership of the purchaser. The Companies Law provides for appraisal rights if any shareholder files a request in court within six months following the consummation of a full tender offer. However, the acquirer may stipulate in the tender offer that any shareholder tendering his shares will not be entitled to appraisal rights. If more than 5% of the outstanding shares are not tendered in the tender offer, then the acquirer may not acquire shares in the tender offer that will cause his shareholding to exceed 90% of the outstanding shares.

8. Disclosing Share Ownership:

The Company has no bylaw provisions governing the ownership threshold, above which shareholder ownership must be disclosed.

10C. Material Contracts

All material contracts have been described in detail throughout this form, wherever applicable.

10D. Exchange Controls

There are currently no Israeli currency control restrictions on payments of dividends or other distributions with respect to our ordinary shares or the proceeds from the sale of the shares, except for the obligation of Israeli residents to file reports with the Bank of Israel regarding certain transactions. However, legislation remains in effect pursuant to which currency controls can be imposed by administrative action at any time.

10E. Taxation

The following is a summary of the material Israeli tax consequences, Israeli foreign exchange regulations and certain Israeli government programs affecting the Company.

To the extent that the discussion is based on new tax or other legislation that has not been subject to judicial or administrative interpretation, there can be no assurance that the views expressed in the discussion will be accepted by the tax or other authorities in question. The discussion is not intended, and should not be construed, as legal or professional tax advice and is not exhaustive of all possible tax considerations.

**ISRAELI TAX CONSIDERATIONS**

The following is a description of material tax consequences regarding the ownership and disposition of our ordinary shares under Israeli tax laws to which our shareholders may be subject. The information below does not apply to specific persons or cover specific situations. Therefore, you are advised to consult your own tax advisor as to particular tax consequences unique to you related to an investment in our ordinary shares including the effects of applicable Israeli or foreign or other tax laws and possible changes in the tax laws.

To the extent that the discussion is based on legislation yet to be judicially or administratively interpreted, we cannot assure you that the views we express herein will accord with any such interpretation in the future.

#### Tax Consequences Regarding Disposition of Our Ordinary Shares

Israeli law generally imposes a capital gains tax on the sale of any capital assets by residents of Israel, as defined for Israeli tax purposes, and on the sale of assets located in Israel, including shares in Israeli companies, by non-residents of Israel, if those assets are either (i) located in Israel; (ii) are shares or a right to a share in an Israeli resident corporation (iii) represent, directly or indirectly, rights to assets located in Israel, unless a specific exemption is available or unless a tax treaty between Israel and the shareholder's country of residence provides otherwise.

However, as of January 1, 2003, nonresidents of Israel are exempt from capital gains tax in relation to the sale of our shares for so long as (i) the capital gains are not accrued or derived by the nonresident shareholder's permanent enterprise in Israel, (ii) the shares were not acquired from the seller's relative and the provisions of Part Five "B" (Restructuring and Merger) or the provisions of section 70 of the Real Estate Taxation Law did not apply on the shares, (iii) the shares are not tradable in the Israeli stock exchange on the day of the sale.

As of January 1, 2012, the tax rate generally applicable to capital gains derived from the sale of shares, whether listed on a stock market or not, is 25% for Israeli individuals, unless such shareholder claims a deduction for financing expenses in connection with such shares, in which case the gain will generally be taxed at a rate of 30%. Additionally, if such shareholder is considered a "Significant Shareholder" at any time during the 12-month period preceding such sale, i.e. such shareholder holds directly or indirectly, including with others, at least 10% of any means of control in the company, the tax rate shall be 30%. However, the foregoing tax rates will not apply to: (i) dealers in securities; and (ii) shareholders who acquired their shares prior to an initial public offering (that may be subject to a different tax arrangement).

As of January 1, 2013, shareholders that are individuals who have taxable income that exceeds NIS 800,000 in a tax year (linked to the CPI each year), will be subject to an additional tax, referred to as High Income Tax, at the rate of 2% on their taxable income for such tax year which is in excess of NIS 800,000. For this purpose taxable income will include taxable capital gains from the sale of our shares and taxable income from dividend distributions.

Israeli Companies are subject to the Corporate Tax rate of 25% on capital gains derived from the sale of listed shares.

#### U.S.-Israel Tax Treaty

Pursuant to the treaty between the Government of the United States of America and the Government of Israel with Respect to Taxes on Income, as amended (the "U.S. - Israel Tax Treaty"), the sale, exchange or disposition of ordinary shares by a person who (i) holds the ordinary shares as a capital asset, (ii) qualifies as a resident of the United States within the meaning of the U.S.-Israel Tax Treaty and (iii) is entitled to claim the benefits afforded to such resident by the U.S.-Israel Tax Treaty generally will not be subject to Israeli capital gains tax unless either such resident holds, directly or indirectly, shares representing 10% or more of the voting power of a company during any part of the 12-month period preceding such sale, exchange or disposition, subject to certain conditions, or the capital gains from such sale, exchange or disposition can be allocated to a permanent establishment in Israel. In the event that the exemption shall not be available, the sale, exchange or disposition of ordinary shares would be subject to such Israeli capital gains tax to the extent applicable; however, under the U.S.-Israel Tax Treaty, such residents may be permitted to claim a credit for such taxes against U.S. federal income tax imposed with respect to such 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 state or local taxes.





#### Taxes Applicable to Dividends distributed

Non-residents of Israel are generally subject to Israeli income tax on the receipt of dividends paid on our ordinary shares at the rate of 25%, which will be withheld at source, unless a different rate is provided in a treaty between Israel and the shareholder's country of residence. However, if the individual shareholder is a "Controlling Shareholder" such dividend will be taxed at the rate of 30% unless a different rate is provided in a treaty between Israel and the shareholders country of residence.

Under the U.S.-Israel Tax Treaty, the maximum rate of tax withheld in Israel on dividends paid to a holder of our ordinary shares who is a U.S. resident (within the meaning of the U.S.-Israel Tax Treaty) is 25%. Furthermore, the maximum rate of withholding tax on dividends, that are paid to a U.S. corporation holding 10% or more of our outstanding voting capital during the part of the tax year that precedes the date of the payment of the dividend and during the whole of its prior tax year, is 12.5%. This reduced rate will not apply if more than 25% of our gross income consists of interest or dividends, other than dividends or interest received from a subsidiary corporation 50% or more of the outstanding shares of the voting shares of which are owned by the company. In order to obtain such a reduced tax rate, it is necessary to submit an application to the tax assessing officer.

Israeli resident individuals are generally subject to Israeli income tax on the receipt of dividends paid on our ordinary shares, other than bonus shares (share dividends) or stock dividends, at the rate of 25%. However, if the individual shareholder is a "Controlling Shareholder" such dividend will be taxed at the rate of 30%. Dividends paid on our ordinary shares to Israeli companies are exempt from such tax, except for dividends distributed from income derived outside of Israel, which are subject to the 25% tax rate.

#### General Corporate Tax Structure in Israel

Israeli companies are generally subject to corporate tax at the rate of 24% for the 2011 tax year, 25% for the 2012 and 2013 tax years.

#### Special Provisions Relating to Taxation under Inflationary Conditions

The Income Tax Law (Inflationary Adjustments), 1985, generally referred to as the Inflationary Adjustments Law, represents an attempt to overcome the problems presented to a traditional tax system by an economy undergoing rapid inflation.

According to the Inflationary Adjustments Law, until 2007, the results for tax purposes were adjusted for the changes in the Israeli CPI. In February 2008, the “Knesset,” the Israeli parliament, passed an amendment to the Inflationary Adjustments Law, which limits the scope of the law. Starting 2008, the results for tax purposes are measured in nominal values, excluding certain adjustments for changes in the Israeli CPI carried out in the period up to December 31, 2007. The amendment to the Inflationary Adjustments Law includes, inter alia, the elimination of the inflationary additions and deductions and the additional deduction for depreciation starting 2008.

#### Foreign Exchange Regulations

Under the Foreign Exchange Regulations the Israeli company calculates its tax liability in U.S. Dollars according to certain conditions. The tax liability, as calculated in U.S. Dollars is translated into NIS according to the exchange rate as of December 31st of each year.

#### UNITED STATES FEDERAL INCOME TAX CONSIDERATIONS

Subject to the limitations described herein, the following is a discussion of the material U.S. federal income tax consequences of the purchase, ownership and disposition of our ordinary shares to a U.S. holder. A U.S. holder is a beneficial owner of our ordinary shares who is:

- an individual who is a citizen or resident of the United States for U.S. federal income tax purposes;
- a corporation (or other entity taxable as a corporation for U.S. federal income tax purposes) created or organized under the laws of the United States or any political subdivision thereof or the District of Columbia;
- an estate, the income of which is includible in gross income for U.S. federal income tax purposes regardless of its source; or
- a trust: (i) if a U.S. court is able to exercise primary supervision over its administration and one or more U.S. persons have the authority to control all of its substantial decisions; or (ii) that has in effect a valid election under applicable U.S. Treasury Regulations to be treated as a U.S. person.

A non-U.S. holder is a beneficial owner of our ordinary shares that is not a U.S. holder. Unless otherwise specifically indicated, this discussion does not consider the U.S. federal income tax consequences to a person that is a non-U.S. holder of our ordinary shares and considers only U.S. holders that will own the ordinary shares as capital assets (generally for investment).

If a partnership (or any other entity treated as a partnership for U.S. federal income tax purposes) holds our ordinary shares, the tax treatment of the partnership and a partner in such partnership will generally depend on the status of the partner and the activities of the partnership. Such a partner or partnership should consult its tax advisor as to its tax consequences.

This discussion is based on current provisions of the Internal Revenue Code of 1986, as amended (the “Code”), current and proposed Treasury Regulations promulgated under the Code and administrative and judicial interpretations of the Code, all as currently in effect and all of which are subject to change, possibly with retroactive effect. This discussion does not address all aspects of U.S. federal income taxation that may be relevant to any particular U.S. holder based on the U.S. holder’s particular circumstances. In particular, this discussion does not address the U.S. federal income tax consequences to U.S. holders who are broker-dealers or who own, directly, indirectly or constructively, 10% or more (by voting power) of our company, real estate investment trusts, regulated investment companies, grantor trusts, U.S. holders holding the ordinary shares as part of a hedging, straddle or conversion transaction, U.S. holders whose functional currency is not the U.S. dollar, insurance companies, tax-exempt organizations, financial institutions, persons that receive ordinary shares as compensation for the performance of services, certain former citizens or long-term residents of the United States and persons subject to the alternative minimum tax, who may be subject to special rules not discussed below. Additionally, this discussion does not address the possible application of U.S. federal estate or gift taxes or any aspect of state, local or non-U.S. tax laws.

Each holder of our ordinary shares is advised to consult his or her tax advisor with respect to the specific U.S. federal, state, local and foreign income tax consequences to him or her of purchasing, holding or disposing of our ordinary shares.

#### U.S. Holders of Ordinary Shares

##### Taxation of distributions on ordinary shares

Subject to the discussion below under “Tax consequences if we are a passive foreign investment company,” a distribution paid by us with respect to our ordinary shares, including the amount of any non- U.S. taxes withheld, to a U.S. holder will be treated as dividend income to the extent that the distribution does not exceed our current and accumulated earnings and profits, as determined for U.S. federal income tax purposes. Dividends that are received with respect to ordinary shares by U.S. holders that are individuals, estates or trusts generally will be taxed at the rate applicable to long-term capital gains (currently a maximum rate of 20% for the taxable years beginning after December 31, 2012), provided that such dividends meet the requirements of “qualified dividend income.” Dividends that fail to meet such requirements, and dividends received by corporate U.S. holders, are taxed at ordinary income rates. No dividend received by a U.S. holder will be a qualified dividend (1) if the U.S. holder held the ordinary share with respect to which the dividend was paid for less than 61 days during the 121-day period beginning on the date that is 60 days before the ex-dividend date with respect to such dividend, excluding for this purpose, under the rules of Code section 246(c), any period during which the U.S. holder has an option to sell, is under a contractual obligation to sell, has made and not closed a short sale of, is the grantor of a deep-in-the-money or otherwise nonqualified option to buy, or has otherwise diminished its risk of loss by holding other positions with respect to, such ordinary share (or substantially identical securities); or (2) to the extent that the U.S. holder is under an obligation (pursuant to a short sale or otherwise) to make related payments with respect to positions in property substantially similar or related to the ordinary share with respect to which the dividend is paid. If we were to be a “passive foreign investment company” (as such term is defined in the Code) for any taxable year, dividends paid on our ordinary shares in such year or in the following taxable year would not be qualified dividends. In addition, a non-corporate U.S. holder will be able to take a qualified dividend into account in determining its deductible investment interest (which is generally limited to its net investment income) only if it elects to do so; in such case the dividend will be taxed at ordinary income rates.

The amount of any distribution which exceeds the amount treated as a dividend will be treated first as a non-taxable return of capital, reducing the U.S. holder's tax basis in its ordinary shares to the extent thereof, and then as capital gain from the deemed disposition of the ordinary shares. Corporate holders will not be allowed a deduction for dividends received in respect of the ordinary shares.

Dividends paid by us in NIS will be included in the gross income of U.S. holders at the U.S. dollar amount of the dividend (including any non-U.S. taxes withheld therefrom), based upon the spot rate of exchange in effect on the date the distribution is included in income. U.S. holders will have a tax basis in the NIS for U.S. federal income tax purposes equal to that dollar value. Any subsequent gain or loss in respect of the NIS arising from exchange rate fluctuations will generally be taxable as U.S. source ordinary income or loss.

Subject to the limitations set forth in the Code and the Treasury Regulations thereunder, U.S. holders may elect to claim as a foreign tax credit against their U.S. federal income tax liability the non-U.S. income tax withheld from dividends received in respect of the ordinary shares. The limitations on claiming a foreign tax credit include, among others, computation rules under which foreign tax credits allowable with respect to specific classes of income cannot exceed the U.S. federal income taxes otherwise payable with respect to each such class of income. In this regard, dividends paid by us generally will be foreign source "passive income" for U.S. foreign tax credit purposes. U.S. holders that do not elect to claim a foreign tax credit may instead claim a deduction for the non-U.S. income tax withheld if they itemize deductions. The rules relating to foreign tax credits are complex, and you should consult your tax advisor to determine whether and to what extent you would be entitled to this credit. A U.S. holder will be denied a foreign tax credit for non-U.S. income taxes withheld from a dividend received on the ordinary shares (i) if the U.S. holder has not held the ordinary shares for at least 16 days of the 31-day period beginning on the date which is 15 days before the ex-dividend date with respect to such dividend or (ii) to the extent the U.S. holder is under an obligation to make related payments with respect to positions in substantially similar or related property. Any days during which a U.S. holder has substantially diminished its risk of loss on the ordinary shares are not counted toward meeting the required 16-day holding period. Distributions of current or accumulated earnings and profits generally will be foreign source passive income for U.S. foreign tax credit purposes.

#### Taxation of the disposition of ordinary shares

Subject to the discussion below under “Tax consequences if we are a passive foreign investment company” upon the sale, exchange or other disposition of our ordinary shares, a U.S. holder will recognize capital gain or loss in an amount equal to the difference between the amount realized on the disposition and the U.S. holder’s tax basis in the ordinary shares. The gain or loss recognized on the disposition of the ordinary shares will be long-term capital gain or loss if the U.S. holder held the ordinary shares for more than one year at the time of the disposition (long-term capital gains are currently taxable at a maximum rate of 20% for taxable years beginning after December 31, 2012). Capital gain from the sale, exchange or other disposition of ordinary shares held for one year or less is short-term capital gain. Gain or loss recognized by a U.S. holder on a sale, exchange or other disposition of ordinary shares generally will be treated as U.S. source income or loss for U.S. foreign tax credit purposes.

A U.S. holder that uses the cash method of accounting calculates the U.S. dollar value of the proceeds received on the sale as of the date that the sale settles. However, a U.S. holder that uses the accrual method of accounting is required to calculate the value of the proceeds of the sale as of the trade date and may therefore realize foreign currency gain or loss. A U.S. holder may avoid realizing foreign currency gain or loss by electing to use the settlement date to determine the proceeds of sale for purposes of calculating the foreign currency gain or loss. In addition, a U.S. holder that receives foreign currency upon disposition of ordinary shares and converts the foreign currency into U.S. dollars after the settlement date or trade date (whichever date the U.S. holder is required to use to calculate the value of the proceeds of sale) will have foreign exchange gain or loss based on any appreciation or depreciation in the value of the foreign currency against the U.S. dollar, which will generally be U.S. source ordinary income or loss.

#### Medicare Tax

With respect to taxable years beginning after December 31, 2012, certain non-corporate U.S. holders will be subject to an additional 3.8% Medicare tax on all or a portion of their “net investment income”, which may include dividends on, or capital gains recognized from the disposition of, our ordinary shares. U.S. holders are urged to consult their own tax advisors regarding the implications of the additional Medicare tax on their investment in our ordinary shares.

#### Tax consequences if we are a passive foreign investment company

We will be a passive foreign investment company, or PFIC, for a taxable year if either (1) 75% or more of our gross income in a taxable year is passive income or (2) 50% or more of the value, determined on the basis of a quarterly average, of our assets in the taxable year produce, or are held for the production of, passive income. If we own (directly or indirectly) at least 25% by value of the stock of another corporation, we will be treated for purposes of the foregoing tests as owning our proportionate share of the other corporation’s assets and as directly earning our proportionate share of the other corporation’s income. Passive income for this purpose generally includes dividends, interest, royalties, rents and gains from commodities and securities transactions.

We believe that we were not a PFIC for our 2012 taxable year. Our status in the current and future taxable years will depend on our assets and income in those years. We have no reason to believe that our assets or income will change in a manner that would cause us to be classified as a PFIC. However, since the determination of whether we are a PFIC is based upon such factual matters as the valuation of our assets (which may depend upon our market capitalization, which is subject to fluctuation) and, in certain cases, the assets of companies held by us, there can be no assurance that we will not become a PFIC. If we were a PFIC, and you are a U.S. holder, you generally would be subject to imputed interest charges and other disadvantageous tax treatment with respect to any gain from the sale or exchange of, and certain distributions with respect to, your ordinary shares (including the denial of the taxation of such distributions and gains at the lower rates applicable to long-term capital gains as discussed above under “Taxation of distributions on ordinary shares” and “Taxation of the disposition of ordinary shares”).

If we were a PFIC, you could make certain elections that may alleviate certain tax consequences referred to above, and one of these elections may be made retroactively if certain conditions are satisfied. It is expected that the conditions necessary for making certain of such elections will apply in the case of our ordinary shares. Neither the Company nor its advisors have the duty to or will undertake to inform U.S. Shareholders of changes in circumstances that would cause the Company to become a PFIC. The Company does not currently intend to take the action necessary for a U.S. Shareholder to make a “qualified electing fund” election in the event the Company is determined to be a PFIC.

U.S. holders are urged to consult their tax advisors regarding the application of the PFIC rules, including eligibility for and the manner and advisability of making certain elections with respect to our PFIC status.

#### Information reporting and backup withholding

A U.S. holder generally is subject to information reporting and may be subject to backup withholding at a rate of 28% with respect to dividend payments made with respect to, and proceeds from the disposition of, the ordinary shares. Backup withholding will not apply with respect to payments made to exempt recipients, including corporations, or if a U.S. holder provides a correct taxpayer identification number, certifies that such holder is not subject to backup withholding or otherwise establishes an exemption. Backup withholding is not an additional tax. It may be claimed as a credit against the U.S. federal income tax liability of a U.S. holder or the U.S. holder may be eligible for a refund of any excess amounts withheld under the backup withholding rules provided, in either case, that the required information is furnished to the Internal Revenue Service.

Non-U.S. Holders of Ordinary Shares

Except as provided below, a non-U.S. holder of ordinary shares will not be subject to U.S. federal income or withholding tax on the receipt of dividends on, and the proceeds from the disposition of, an ordinary share, unless that item is effectively connected with the conduct by the non-U.S. holder of a trade or business in the United States and, in the case of a resident of a country which has an income tax treaty with the United States, that item is attributable to a permanent establishment in the United States or, in the case of an individual, a fixed place of business in the United States. In addition, gain recognized by an individual non-U.S. holder on the disposition of the ordinary shares will be subject to tax in the United States if such non-U.S. holder is present in the United States for 183 days or more in the taxable year of the sale and other conditions are met.

Non-U.S. holders are generally not subject to information reporting or backup withholding with respect to the payment of dividends on, or proceeds from the disposition of, ordinary shares, provided that the non-U.S. holder provides its taxpayer identification number, certifies to its foreign status or otherwise establishes an exemption.

10F. Dividends and Paying Agents

Not applicable.

10G. Statement by Experts

Not applicable.

10H. Documents on Display

The documents concerning the Company that are referred to in the form may be inspected at the Company's office in Israel. We file annual reports on Form 20-F electronically with the SEC and post a copy on our website, [www.boscom.com](http://www.boscom.com).

10I. Subsidiary Information

For information relating to the Company's subsidiaries, see "Item 4C. Organizational Structure" as well as the Company's Consolidated Financial Statements (Items 8 and 18 of this form).

Item 11: Quantitative and Qualitative Disclosure about Market Risk

Market risk represents the risk of changes in the value of our financial instruments caused by fluctuations in interest rates, foreign exchange rates and equity prices. We do not engage in trading market-risk instruments or purchase hedging or "other than trading" instruments that are likely to expose us to market risk, whether interest rate, commodity price or equity price risk. We have purchased forward contracts but do not use derivative financial instruments for speculative trading purposes.

### Foreign Currency Exchange Rate Risk:

We are exposed to currency transaction risk because some of our expenses are incurred in a different currency from the currency in which our revenues are received. Our most significant currency exposures are to the NIS. In periods when the U.S. dollar devaluates against this currency, our reported results of operations may be adversely affected. The Company enters into foreign currency contracts, with financial institutions to reduce the risk of exchange rate fluctuations. Such contracts are not designated as hedging instruments. From time to time, the Company recognizes derivative instruments as either assets or liabilities on the balance sheet at fair value. As of December 31, 2012, the notional principal of foreign exchange contracts to purchase U.S. dollars with foreign currencies and to sell Euros for foreign currencies was \$770,000, and €930,000. Although from time to time we enter into foreign currency contracts to reduce currency transaction risk, these transactions will not eliminate translation risk or all currency risk.

### Credit Risk Management

The Company sells its products and purchases products from vendors on credit terms.

The trade receivables of the Company are derived from sales to customers located primarily in Israel and in the Far East. The Company generally does not require collateral, however most of the Company's customers outside of Israel are insured against customer nonpayment, through the Israeli Credit Insurance Company Ltd., and in certain circumstances, the Company may require letters of credit, advanced payments, or other collateral.

Provisions are made for doubtful debts on a specific basis and, in management's opinion, appropriately reflect the loss inherent in collection of the debts. Management bases this provision on its assessment of the risk of the debt.

The table below presents the account receivables balance by geographical market as of December 31, 2012 and December 31, 2011:

	December 31	
	2012	2011
Americas	\$26,000	\$136,000
Europe	334,000	152,000
Far East	113,000	724,000
Israel and others	7,534,000	7,495,000
	\$8,007,000	\$8,507,000



#### Interest Rate Risk

The Company's exposure to market risk for changes in interest rates, is due to loans that carry variable interest.

A material change in interest pay on our loans may have an effect on the Company's financial results and cash flow. In the event that interest rates associated with the Company's variable rate borrowings were to increase 100 basis points, the after tax impact on future cash flows would be a decrease of 75,000.

#### Bank Risk

The Company manages its loans mainly in Bank Leumi and Bank Hapoalim, which provides credit to the Company and its Israeli subsidiaries. In case of the termination or expiration of our credit lines, a deterioration in our relations with our bank or adverse changes in the financial position of the bank, our liquidity could be materially adversely affected.

#### Item 12: Description of Securities Other than Equity Securities

Not applicable.

## PART II

#### Item 13: Defaults, Dividend Arrearages and Delinquencies

Not applicable.

#### Item 14: Material Modifications to the Rights of Security Holders and Use of Proceeds

Not applicable.

#### Item 15: Controls and Procedures

##### (a) Disclosure controls and procedures.

The Company's principal executive officer and its principal financial officer evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report at the reasonable level of assurance (see paragraph (d) below). Based on that evaluation, such principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report. This Annual Report does not include an attestation report of our registered public accounting firm regarding the effectiveness of the Company's internal control over financial reporting. Management's report was not subject to attestation by our registered public accounting firm pursuant to rules of the Securities and Exchange Commission that permit us to provide only management's report in this Annual Report.

(b) Management's Annual Report on Internal Control Over Financial Reporting.

Our management, under the supervision of our Chief Executive Officer and Chief Financial Officer, is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) and Rule 15d-15(f) of the Exchange Act. Our internal control system was designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation and fair presentation of our consolidated financial statements for external purposes in accordance with generally accepted accounting principles. Our Chief Executive Officer and Chief Financial Officer assessed the effectiveness of our internal control over financial reporting as of December 31, 2012. In making this assessment, they used the criteria established in Internal Control–Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, our Chief Executive Officer and Chief Financial Officer have concluded that, as of December 31, 2012, our internal control over financial reporting is effective based on those criteria. Notwithstanding the foregoing, all internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective may not prevent or detect misstatements and can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, 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.

This Annual Report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to rules of the SEC that permit the Company to provide only management's report in this Annual Report.

(c) Change in Internal Control over Financial Reporting.

There were no changes in the Company's internal controls over financial reporting that occurred during the fiscal year ended December 31, 2012, that have materially affected or are reasonably likely to materially affect these controls.

(d) Other.

The Company believes that a control system, no matter how well designed and operated, can not provide absolute assurance that the objectives of the control system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, with the Company have been determined. Therefore, a control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Our disclosure controls and procedures are designed to provide such reasonable assurances of achieving our desired control objectives, and our Chief Executive Officer and Chief Financial Officer have concluded, as of December 31, 2012, that our disclosure controls and procedures were effective in achieving that level of reasonable assurance.

Item 16: [Reserved]

Item 16A: Audit Committee Financial Expert

The Company's Board of Directors has determined that Mr. David Golan and Mr. Ronen Zavlik, members of the audit committee, are "audit committee financial experts", as defined by the applicable SEC regulations.

All the members of the Audit Committee are "independent" under the applicable SEC and Nasdaq regulations. The experience of each member is listed under Item 6A.

Item 16B: Code of Ethics

The Company has adopted a Code of Ethics applicable to its executive officers, directors and all other employees. A copy of the code is posted on our website and may also be obtained, without charge, upon a written request addressed to the Company's investor relations department.

Item 16C: Principal Accountant Fees and Services

The Company's principal accountants for the years 2010 and 2011 were Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global.

The table below summarizes the audit and other fees paid and accrued by the Company and its consolidated subsidiaries to Kost Forer Gabbay & Kasierer during each of 2011 and 2012:

	Year Ended December 31, 2012		Year Ended December 31, 2011		
	Amount	Percentage	Amount	Percentage	
Audit Fees	\$77,000	85 %	\$73,000	88 %	
Tax Fees (1)	\$14,000	15 %	\$10,000	12 %	
Total	\$91,000	100 %	\$83,000	100 %	

(1) "Tax Fees" are fees for professional services rendered by the Company's auditors with respect to annual tax reports.

Audit Committee's pre-approval policies and procedures:

The Audit Committee is responsible for the oversight of the independent auditors' work, including the approval of services provided by the independent auditors. These services may include audit, audit-related, tax or other services, as described above. On an annual basis the audit committee pre-approves audit and non-audit services to be provided to the Company by its auditors, listing the particular services or categories of services, and sets forth a specific budget for such services. Additional services not covered by the annual pre-approval may be approved by the Audit Committee on a case-by-case basis as the need for such services arises. Furthermore, the Audit Committee has authorized the Committee Chairman to pre-approve engagements of the Company's auditors so long as the fee for each such engagement does not exceed \$5,000 and so long as the engagement is notified to the Committee at its next subsequent meeting. Any services pre-approved by the Audit Committee (or by the Chairman) must be permitted by applicable law. Once services have been pre-approved, the audit committee receives a report on a periodic basis regarding the extent of the services actually provided and the fees paid.



Item 16D: Exemptions from the Listing Standards for Audit Committees

Not applicable.

Item 16E: Purchases of Equity Securities by the Issuer and Affiliated Purchasers

The Company (or anyone acting on its behalf) did not purchase any of the Company's securities in 2011.

Item 16F: Change in Registrant's Certifying Accountant

Not applicable.

Item 16G: Corporate Governance

Not applicable.

Item 16H: Mine Safety Disclosures.

Not applicable.

### PART III

Item 17: Financial Statements

Not applicable.

Item 18: Financial Statements

The following financial statements are filed as part of this Annual Report:

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The audited financial statements filed as part of this Form 20-F are identical to the audited financial statements that were furnished under Form 6-K on April 4, 2013, except for a correction of several non-material typographical errors.

Item 19: Exhibits

The following exhibits are filed as part of this Annual Report:

- 1.1\* Memorandum of Association, as amended.
- 1.2\* Articles of Association, as amended.
- 4.1 Form of Indemnification Agreement between the Company and its officers and directors, as amended (incorporated by reference to Annex A of the Company's Proxy Statement on Form 6-K, filed on November 9, 2011).
- 4.2 Services Agreement, dated as of April 15, 2003, between Cukierman & Co. Investment House Ltd., Dimex Solutions Ltd. and the Company (incorporated by reference to the Company's Annual Report on Form 20-F filed on June 17, 2004).
- 4.3 M&A Addendum to the Services Agreement, as of August 22, 2004, by and among Cukierman & Co. Investment House Ltd., Dimex Solutions Ltd. and the Company (incorporated by reference to the Company's Annual Report on Form 20-F filed on June 27, 2005).
- 4.4 Business Development Addendum to the Services Agreement, as of May 24, 2010, by and among Cukierman & Co. Investment House Ltd., BOS-Dimex Ltd., and the Company. (incorporated by reference to the Company's Annual Report on Form 20-F filed on June 30, 2010).
- 4.5\* Amendment to the Services Agreement, dated as of January 13, 2013, by and among Cukierman & Co. Investment House Ltd., BOS-Dimex Ltd. and the Company.
- 4.6 The Company's Israeli 2003 Share Option Plan (incorporated by reference to the Company's Registration Statement on Form S-8 No. 333-11650).
- 4.7 Asset Purchase Agreement as of January 29, 2008 by and between Dimex Systems (1988) Ltd., Dimex Hagalil Ltd., and the Company (incorporated by reference to the Company's Annual Report on Form 20-F filed on June 30, 2008).
- 4.8 Amendment No. 1 to Asset Purchase Agreement by and among the Company, Dimex Systems (1988) Ltd. and Dimex Hagalil Ltd., dated March 23, 2009 (incorporated by reference to the Company's Amendment No. 2 to Registration Statement on Form F-3 No. 333-152020).
- 4.9 Amendment No. 2 to Asset Purchase Agreement by and among the Company, Dimex Systems (1988) Ltd. and Dimex Hagalil Ltd., dated February 3, 2010 and Warrant dated as of February 3, 2010 issued by the Company to Dimex Systems (1988) Ltd. (incorporated by reference to the Company's Annual Report on Form 20-F filed on June 30, 2010).

- 4.10\* Amendment No. 3 to the Asset Purchase Agreement as of December 31, 2012 by and among the Company, Dimex Systems (1988) Ltd. and Dimex Hagalil Ltd.
- 4.11 Loan Agreement by and between the Company and Dimex Systems (1988) Ltd., dated February 3, 2010; Registration Rights Agreement dated as of the February 3, 2010 by and between the Company and Dimex Systems (1988) Ltd.; Warrant dated as of February 3, 2010 issued by the Company to Dimex Systems (1988) Ltd. (incorporated by reference to the Company's Annual Report on Form 20-F filed on June 30, 2010).
- 4.12 Agreement by and between the Company and Dimex Systems dated November 9, 2011; Amendments to Warrants issued by the Company to Dimex Systems. (incorporated by reference to the Company's Annual Report on Form 20-F filed on April 30, 2012).
- 4.13 Form of 2009 Loan Agreement and Registration Rights Agreement by and among certain lenders and the Company. Form of Warrant issued by the Company to certain lenders. (incorporated by reference to the Company's Annual Report on Form 20-F filed on June 30, 2010).
- 4.14 Form of Agreement by and among certain lenders and the Company (Conversion Amendments); Form of Amendment to Warrant issued by the Company to certain lenders. (incorporated by reference to the Company's Annual Report on Form 20-F filed on April 30, 2012).
- 4.15 Bank Leumi Le-Israel Ltd. Agreements: Summary of Economic Terms; Form of Request to Allocate a Credit in Israeli Currency (unlinked); Form of Request to Allocate a Credit Framework in Debitory Account (unlinked); Form of Subordination Letters of BOS-Dimex Ltd. and of BOS-Odem Ltd.; and B.O.S Better Online Solutions Ltd. Subordination Letter. (incorporated by reference to the Company's Annual Report on Form 20-F filed on April 30, 2012).
- 4.16 Bank Hapoalim Ltd. Agreements: Summary of Economic Terms; Irrevocable Undertakings by BOS-Dimex Ltd., BOS-Odem Ltd. and the Company. (incorporated by reference to the Company's Annual Report on Form 20-F filed on April 30, 2012).
- 4.17 Share Purchase Agreement dated as of October 4, 2010 between the Company and Telegraph Hill Capital Fund I, LLC (incorporated by reference to the Company's Annual Report on Form 20-F filed on June 30, 2011).
- 4.18\* Advisory Agreement dated September 1, 2009, by and between the Company and Telegraph Hill Group LLC.
- 4.19\* Amendment Number 1 to Advisory Agreement dated November 16, 2009, by and between the Company and Telegraph Hill Group LLC.
- 4.20\* Amendment Number 2 to Advisory Agreement dated February 8, 2013, by and between the Company and Telegraph Hill Group LLC; Warrant issued by the Company to Telegraph Hill Capital Fund I, LLC.

- 8.1 List of subsidiaries (incorporated by reference to Item 4C of this Annual Report on Form 20-F).
- 11\* Statement of Computation of Earnings Per Share.
- 12.1\* Certification by Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934.
- 12.2\* Certification by Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934.
- 13.1\* Certification by Chief Executive Officer and Chief Financial Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934.
- 23.1\* Consent of Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global.
- 101\* The following financial information from the Company's Annual Report on Form 20-F for the year ended December 31, 2012, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Statements of Operations for the years ended December 31, 2012, 2011 and 2010; (ii) Consolidated Balance Sheets at December 31, 2012 and 2011; (iii) Consolidated Statements of Changes in Shareholders' Equity for the years ended December 31, 2012, 2011 and 2010; (iv) Consolidated Statements of Cash Flows for the years ended December 31, 2012, 2011 and 2010; and (v) Notes to Consolidated Financial Statements, tagged as blocks of text. Users of this data are advised, in accordance with Rule 406T of Regulation S-T promulgated by the SEC, that this Interactive Data File is deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of Section 18 of the Exchange Act, and otherwise is not subject to liability under these sections.

\* Filed herewith.



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.

B.O.S. Better Online Solutions Ltd.

/s/ Yuval Viner	/s/ Eyal Cohen
Yuval Viner	Eyal Cohen
Chief Executive Officer	Chief Financial Officer

Date: April 30, 2013

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B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND SUBSIDIARIES  
CONSOLIDATED FINANCIAL STATEMENTS  
AS OF DECEMBER 31, 2012  
IN U.S. DOLLARS  
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Kost Forer Gabbay & Kasierer  
3 Aminadav St.  
Tel-Aviv 67067, Israel

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www.ey.com

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of

B.O.S. BETTER ONLINE SOLUTIONS LTD.

We have audited the accompanying consolidated balance sheets of B.O.S Better Online Solutions Ltd. ("the Company") and subsidiaries as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive loss, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2012. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and subsidiaries at December 31, 2012 and 2011, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2012, in conformity with U.S. generally accepted accounting principles.

Tel-Aviv, Israel  
April 4, 2013

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

B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	December 31,	
	2012	2011
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 354	\$ 411
Trade receivables (net of allowance for doubtful accounts of \$ 127 and \$ 115 at December 31, 2012 and 2011, respectively)	8,007	8,507
Other accounts receivable and prepaid expenses	616	744
Inventories	3,160	4,020
<b>Total current assets</b>	<b>12,137</b>	<b>13,682</b>
<b>LONG-TERM ASSETS:</b>		
Severance pay fund	21	41
Bank deposits	438	427
Investment in other company	-	68
Other assets	11	23
<b>Total long-term assets</b>	<b>470</b>	<b>559</b>
<b>PROPERTY, PLANT AND EQUIPMENT, NET</b>	<b>963</b>	<b>1,166</b>
<b>OTHER INTANGIBLE ASSETS, NET</b>	<b>357</b>	<b>540</b>
<b>GOODWILL</b>	<b>4,122</b>	<b>4,122</b>
	<b>\$ 18,049</b>	<b>\$ 20,069</b>

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

B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

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

	December 31,	
	2012	2011
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Short-term bank loans and current maturities	\$6,383	\$7,496
Trade payables	4,915	4,165
Employees and payroll accruals	408	553
Deferred revenues	467	550
Current maturities of liability to Dimex Systems	136	300
Accrued expenses and other liabilities	567	967
<b>Total current liabilities</b>	<b>12,876</b>	<b>14,031</b>
<b>LONG-TERM LIABILITIES:</b>		
Long-term bank loans, net of current maturities	1,188	1,530
Accrued severance pay	119	163
Liability to Dimex Systems, net of current maturities	710	747
<b>Total long-term liabilities</b>	<b>2,017</b>	<b>2,440</b>
<b>COMMITMENTS AND CONTINGENT LIABILITIES</b>		
<b>SHAREHOLDERS' EQUITY:</b>		
Share capital:		
Ordinary shares of NIS 80.00 nominal value: Authorized; 2,500,000 shares at December 31, 2012 and 2011; Issued and outstanding: 1,132,685 and 1,116,981 shares at December 31, 2012 and 2011, respectively	23,374	23,065
Additional paid-in capital	50,891	51,093
Accumulated other comprehensive loss	(243 )	(243 )
Accumulated deficit	(70,866 )	(70,317 )
<b>Total shareholders' equity</b>	<b>3,156</b>	<b>3,598</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$18,049</b>	<b>\$20,069</b>

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



B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

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

	Year ended December 31,		
	2012	2011	2010
Revenues	\$ 24,503	\$ 33,434	\$ 30,187
Cost of revenues	19,050	26,481	22,668
Inventory write offs	385	443	36
Gross profit	5,068	6,510	7,483
Operating costs and expenses:			
Research and development	125	403	372
Sales and marketing	3,058	4,273	4,068
General and administrative	1,693	2,252	1,786
Impairment of other intangible assets	-	555	-
Total operating costs and expenses	4,876	7,483	6,226
Operating Profit (loss)	192	(973 )	1,257
Financial expenses, net	(781 )	(2,241 )	(961 )
Other expenses, net	(147 )	(172 )	(120 )
Income (loss) before taxes on income	(736 )	(3,386 )	176
Tax benefit (taxes on income)	187	172	(5 )
Income (loss) from continuing operations	(549 )	(3,214 )	171
Loss from discontinued operations	-	-	(806 )
Net loss	\$ (549 )	\$ (3,214 )	\$ (635 )
Basic and diluted net earnings (loss) per share from continuing operations	\$ (0.49 )	\$ (4.56 )	\$ 0.28
Basic and diluted net loss per share from discontinued operations	\$ -	\$ -	\$ (1.24 )
Basic and diluted net loss per share	\$ (0.49 )	\$ (4.56 )	\$ (0.96 )

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





B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

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

	Year ended December 31,		
	2012	2011	2010
Net loss	\$(549 )	\$(3,214 )	\$(635 )
Other comprehensive income (loss):			
Change in foreign currency translation adjustment	-	(295 )	262
Realized gain related to available for sale securities	-	-	(54 )
	-	(295 )	208
Comprehensive loss	\$(549 )	\$(3,509 )	\$(427 )

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B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. dollars in thousands, except share data

	Ordinary shares	Share capital and additional paid-in capital	Accumulated other comprehensive income (loss)	Accumulated deficit	Total shareholders' equity
Balance at January 1, 2010	654,540	\$ 70,267	\$ (156 )	\$ (66,468 )	\$ 3,643
Issuance of Ordinary shares for options exercised	9,499	-	-	-	-
Issuance of shares related to the private placement (net of \$ 35 issuance expenses)	24,090	265	-	-	265
Issuance of warrants related to convertible note	-	15	-	-	15
Share-based compensation expense	-	217	-	-	217
Other comprehensive loss	-	-	208	-	208
Net loss	-	-	-	(635 )	(635 )
Total comprehensive loss	-	-	-	(635 )	(635 )
Balance at December 31, 2010	688,129	70,764	52	(67,103 )	3,713
Issuance of Ordinary shares for options exercised	8,361	-	-	-	-
Issuance of Ordinary shares related to an inducement of a convertible note	420,491	3,139	-	-	3,139
Extension of warrants related to convertible note	-	86	-	-	86
Share-based compensation expense	-	169	-	-	169
Other comprehensive loss	-	-	(295 )	-	(295 )
Net loss	-	-	-	(3,214 )	(3,214 )
Total comprehensive loss	-	-	-	-	-
Balance at December 31, 2011	1,116,981	74,158	(243 )	(70,317 )	3,598
Issuance of Ordinary shares for options exercised	1,254	-	-	-	-
Issuance of Ordinary shares to directors	14,450	84	-	-	84
Share-based compensation expense	-	23	-	-	23
Other comprehensive loss	-	-	-	-	-
Net loss	-	-	-	(549 )	(549 )

Balance at December 31, 2012	1,132,685	\$	74,265	\$	(243	)	\$	(70,866	)	\$	3,156
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The accompanying notes are an integral part of the consolidated financial statements.

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B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2012	2011	2010
<b>Cash flows from operating activities:</b>			
Net loss	\$(549 )	\$(3,214 )	\$(635 )
Loss from discontinued operations	-	-	806
<b>Net profit (loss) from continuing operations</b>	<b>(549 )</b>	<b>(3,214 )</b>	<b>171</b>
<b>Adjustments to reconcile net loss to net cash provided by (used in) operating activities:</b>			
Depreciation and amortization	363	656	611
Inventory write off	385	443	36
Impairment of other intangible assets	-	555	-
Capital gain / loss from sale and disposal of property, plant and equipment	79	-	-
Capital loss from sale of investment in other company	-	-	7
Currency fluctuation of long term deposits	(11 )	-	-
Impairment of available for sale securities	-	156	-
Impairment of investment in other company	68	39	111
Severance pay, net	(24 )	5	-
Share-based compensation expenses related to employees, directors and service providers	107	169	217
Amortization of discount on convertible note	22	202	225
Accrued interest on long-term convertible note and liability to Dimex Systems Ltd	32	230	196
Conversion expenses of convertible note	-	760	-
Revaluation of fair value related to extension of warrants as part of an Inducement of a convertible note	-	86	-
Decrease (increase) in trade receivables, net	500	(1,045 )	(417 )
Change in income tax accruals	(187 )	(199 )	52
Decrease (increase) in other accounts receivable and other assets	140	363	(114 )
Decrease (increase) in inventories	475	506	138
Increase (decrease) in trade payables	750	(46 )	332
Decrease in employees and payroll accruals, deferred revenues, accrued expenses and other liabilities	(441 )	(31 )	(105 )
<b>Net cash provided by (used in) operating activities from continuing operations</b>	<b>1,709</b>	<b>(365 )</b>	<b>1,460</b>
<b>Net cash used in operating activities from discontinued operations</b>	<b>-</b>	<b>-</b>	<b>(176 )</b>

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Net cash provided by (used in) operating activities	1,709	(365 )	1,284
Cash flows from investing activities:			
Purchase of property, plant and equipment	(82 )	(357 )	(108 )
Proceeds from sale of property, plant and equipment	26	-	-
Change in long term bank deposits	-	(427 )	-
Proceeds from sale of investment in other company	-	-	150
Repayment of deferred consideration for the acquisition of Dimex Systems Ltd activity	(255 )	(256 )	(147 )
Net cash used in investing activities from continuing operations	(311 )	(1,040 )	(105 )
Net cash used in investing activities from discontinued operations	-	-	-
Net cash used in investing activities	(311 )	(1,040 )	(105 )
Cash flows from financing activities:			
Proceeds from issuance of shares, net	-	-	265
Repayment of (proceeds from) short and long-term bank loans	(1,455 )	1,113	(841 )
Proceeds from (repayment of) long-term convertible note and warrants, net of issuance expenses	-	-	(28 )
Net cash provided by (used in) financing activities from continuing operations	(1,455 )	1,113	(604 )
Net cash provided by (used in) financing activities from discontinued operations	-	-	(308 )
Net cash used in (provided by) financing activities	(1,455 )	1,113	(912 )
Increase (decrease) in cash and cash equivalents	(57 )	(292 )	267
Increase (decrease) in cash and cash equivalents from discontinued operations	-	-	(128 )
Cash and cash equivalents at the beginning of the year	411	703	564
Cash and cash equivalents at the end of the year	\$354	\$411	\$703

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

B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

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U.S. dollars in thousands

	Year ended December 31,		
	2012	2011	2010
<b>Supplemental disclosure of cash flow activities:</b>			
<b>(i) Net cash paid during the year for:</b>			
Interest	\$ 502	\$ 572	\$ 463
<b>(ii) Non-cash activities:</b>			
Conversion of payable into long-term convertible debentures	\$ -	\$ -	\$ 161
Sale of investment in other company	\$ -	\$ -	\$ 150
Conversion of convertible note into share capital	\$ -	\$ 2,523	\$ -

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

B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:- GENERAL

- a. B.O.S. Better Online Solutions Ltd. ("BOS" or "the Company") is an Israeli corporation.

The Company's shares are listed on NASDAQ under the ticker BOSC.

b. In the years ended December 31, 2012, 2011, and 2010 the Company incurred losses of \$ 549, \$3,214, and profit of 635 respectively. In the years ended December 31, 2012, 2011, and 2010 the Company generated positive cash flow from operating activities from continuing operations amounting to \$ 1,709 in 2012, negative cash flow of \$365 in 2011, and positive cash flow of \$1,460 in 2010. Due to the above, the Company's cash and cash equivalent decreased from \$ 411 as of December 31, 2011 to \$ 354 as of December 31, 2012. The Company had negative working capital of \$739 as of December 31, 2012 and \$349 as of December 31, 2011. As of December 31, 2012, the Company was not in compliance with certain financial covenants. The Company received a waiver from the lender with respect to the covenants as of December 31, 2012, valid through May 1, 2014.

c. All share and per share data in this report is reported after giving effect to the 1 for 4 reverse split that occurred on December 14, 2012 (see Note 14).

d. The Company has two operating segments: the RFID and Mobile Solutions segment and the Supply Chain Solutions segment (see Note 17).

The Company's wholly-owned subsidiaries include:

- (1) BOS-Dimex Ltd. (previously "Dimex Solutions Ltd"), an Israeli company that provides comprehensive turn-key solutions for Automatic Identification and Data Collection. BOS-Dimex comprises the RFID and Mobile Solutions segment.
- (2) BOS-Odem Ltd. ("BOS-Odem"), an Israeli company, is a distributor of electronic components and advanced technologies worldwide. BOS-Odem is a part of the Supply Chain Solutions segments; and
- (3) Ruby-Tech Inc., a New York corporation, a wholly-owned subsidiary of BOS-Odem and a part of the Supply Chain Solutions segments;

B.O.S. BETTER ONLINE SOLUTIONS LTD.  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:-

GENERAL (Cont.)

e. Discontinued operations:

On November 23, 2010 the Company announced that its two U.S. subsidiaries that were part of its Supply Chain Solutions division, Lynk and its subsidiary Summit, have filed a Chapter 7 petition with the US Bankruptcy Court.

Summarized selected financial information of the discontinued operations is as follows:

	2010
Revenues	\$ 8,338
Cost of revenues	6,990
Gross profit	1,348
Impairment of goodwill	-
Total operating costs and expenses	1,487
Operating loss	(139 )
Financial expenses, net	(213 )
Other expenses, net (*)	(496 )
Loss before taxes on income	(848 )
Tax benefit (taxes on income)	42
Net loss	\$ (806 )

(\*)In 2010, other expenses include \$ 554 related to the write off of net assets and liabilities related to discontinued operations.



B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements are prepared according to United States generally accepted accounting principles ("U.S. GAAP").

a. Use of estimates:

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. The most significant assumptions are employed in estimates used in determining values of goodwill and identifiable intangible assets, provision for inventory, revenue recognition, tax assets and tax positions, legal contingencies, stock-based compensation costs, and assumptions utilized in troubled debt restructuring. Actual results could differ from those estimates.

b. Financial statements in U.S. dollars:

A substantial portion of the Company's revenues is generated in U.S. dollar ("dollars"). In addition, most of the Company's costs are incurred in dollars. The Company's management believes that the dollar is the primary currency of the economic environment in which the Company operates. Thus, the functional and reporting currency of the Company is the dollar. Accordingly, monetary accounts maintained in currencies other than the dollar are premeasured into dollars in accordance with ASC 830, Foreign Currency Matters. All transactions gains and losses from the measurement of monetary balance sheet items are reflected in the statement of operations as financial income or expenses as appropriate.

As of December 31, 2011, the financial statements of a certain subsidiary, whose functional currency is other than the dollar, have been translated into U.S. dollars. All balance sheet accounts have been translated using the exchange rates in effect at the balance sheet date. Statement of operations amounts have been translated using the average exchange rate for the period. The resulting translation adjustments are reported as a component of shareholders' equity in accumulated other comprehensive loss.

As of January 1, 2012, as a result of business changes in a certain subsidiary, the Company changed the functional currency of the subsidiary from NIS to US Dollars.

c. Principles of consolidation:

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



B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

## d. Cash equivalents:

Cash equivalents are short-term highly liquid investments that are readily convertible to cash purchased with original maturities of less than three months.

## e. Inventories:

Inventories are valued at the lower of cost or market value. Cost is determined using the moving average cost method.

Inventory write-offs and write-downs are made to cover risks arising from slow-moving items or technological obsolescence.

## f. Property, plant and equipment:

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

	%	
Computers and software	20 - 33	(Mainly 33%)
Office furniture and equipment	6 - 15	(Mainly 10%)
Leasehold improvements	over the shorter of the period of the lease or the life of the assets	
Motor vehicles	15	
Real estate	4	

## g. Impairment of long-lived assets:

The Company's long-lived assets are reviewed for impairment in accordance with ASC 360-10, Accounting for the Impairment or Disposal of Long-Lived Asset, whenever events or changes in circumstances indicate that the carrying amount of an asset (or asset group) may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset (or asset group) to the future undiscounted cash flows expected to be generated by the assets (or asset group). If such assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the assets exceeds their fair value. During 2012 no impairment losses have been identified. The fair value of the brand name and customer list related intangibles was determined by the income approach method. Assumptions in the fair value assessment included: the impact of changes in economic conditions, revenue and cash flow forecasts for the remaining lives of the intangibles and the Company's weighted average cost of capital ("WACC").

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B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

During the year 2011 the Company recognized an impairment loss \$555 related to a brand name and customer list of which \$470 was attributed to the Supply Chain solutions segment and \$85 were attributed to the RFID and Mobile solutions segment.

During 2012 and 2010 no impairment losses have been identified.

h. Goodwill:

Goodwill represents excess of the costs over the net assets of businesses acquired. Under ASC 350, Intangibles - Goodwill and Other ("ASC 350"), goodwill is not amortized but instead is tested for impairment at least annually or between annual tests in certain circumstances, and written-down when impaired.

Goodwill as of December 31, 2012 and December 31, 2011 amounted to \$4,122. The translation impact on goodwill during the year ended December 31, 2011 was (\$316), and \$0 during the year ended December 31, 2012 due to the reporting segment's change in functional currency from the NIS to the US Dollar.

Testing Methodology:

The Company performs its annual impairment analysis of goodwill as of December 31 of each year, or more often if there are indicators of impairment present. The provisions of ASC 350 requires that a two-step impairment test be performed on goodwill at the level of the reporting units. In the first step, or Step 1, the Company compares the fair value of each reporting unit to its carrying value. If the fair value exceeds the carrying value of the net assets, goodwill is considered not impaired, and the Company is not required to perform further testing. If the carrying value of the net assets exceeds the fair value, then the Company must perform the second step, or Step 2, of the impairment test in order to determine the implied fair value of goodwill. To determine the fair value used in Step 1, the Company uses discounted cash flows. If and when the Company is required to perform a Step 2 analysis, determining the fair value of its net assets and its off-balance sheet intangibles would require it to make judgments that involve the use of significant estimates and assumptions.

The reporting unit of the Company for purposes of the impairment test is the Company's RFID and Mobile solutions segment. Discrete financial information is available for this component of the business. Segment management regularly reviews the operating results of this component.

The Company determined the fair value of the reporting unit using the Income Approach, which utilizes a discounted cash flow model, as it believes that this approach best approximates the reporting unit's fair value at this time. Judgments and assumptions related to revenue, operating income, future short-term and long-term growth rates, weighted average cost of capital, interest, capital expenditures, cash flows, and market conditions are inherent in developing the discounted cash flow model. The material assumptions used for the Income Approach for 2012 were five years of projected net cash flows, WACC of 16.06% and a long-term growth rate of 3%. The Company considered historical rates and current market conditions when determining the discount and growth rates to use in its

analyses. If these estimates or their related assumptions change in the future, the Company may be required to record impairment charges for its goodwill. The aggregate fair value of the Company depends on various factors, some of which are qualitative and involve management judgment, including stable backlog coverage and experience in meeting operating cash flow targets.

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B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Testing Results:

During 2012, 2011 and 2010 no impairment losses have been identified.

i. Research and development costs:

ASC 985, Software, requires capitalization of certain software development costs subsequent to the establishment of technological feasibility. Based on the Company's product development process, technological feasibility is established upon completion of a working model. Research and development costs incurred in the process of developing product improvements or new products, are generally charged to expenses as incurred. Costs incurred by the Company between completion of the working model and the point at which the product is ready for general releases are insignificant.

j. Severance pay:

The Company's liability for severance pay for Israeli employees is calculated pursuant to the Israeli Severance Pay Law based on the most recent salary of the employees multiplied by the number of years of employment as of the balance sheet date. Employees are entitled to one month's salary for each year of employment or a portion thereof above one year. The Company's liability for its Israeli employees is mostly covered by insurance policies designed solely for distributing severance pay. The value of these policies is not under the Company's control, thus just the liability net of funds under insurance policy is presented in the balance sheet.

The Company has two general deposit funds for severance. The value of the deposited funds includes profits, and is recorded as an asset in the Company's balance sheet.

The Company's payroll includes employees whom its severance pay liability is calculated pursuant to Article 14 of the Israel's Severance Pay Law. The Company currently deposits the corresponding amounts required in accordance with Article 14 to the relevant pension funds. These amounts will be released to the applicable employees upon termination of employment and this substitutes the obligation described above, to pay severance based on the most recent salary of the employee multiplied by the number of years of employment. The aforementioned deposited amounts are not reflected on the financial statements due to the fact that they are not under the Company's control.

Severance expenses for 2012, 2011 and 2010 amounted to \$ 117, \$ 242 and \$ 137, respectively.

B.O.S. BETTER ONLINE SOLUTIONS LTD.  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

k. Revenue recognition:

The Company derives its revenues mainly from the sale of products and support services.

Revenues from product sales, related to both the Supply Chain Solutions and RFID and Mobile Solutions segments, are recognized in accordance with SAB 104, Revenue Recognition ("ASC 605") when delivery has occurred, persuasive evidence of an arrangement exists, the vendor's fee is fixed or determinable, no further obligation exists, and collectability is reasonably assured.

l. Income taxes:

The Company and its subsidiaries account for income taxes in accordance with ASC 740, Income Taxes ("ASC 740"). ASC 740 prescribes the use of the liability method whereby deferred tax assets and liability account balances are determined based on the differences between the financial reporting and the tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company and its subsidiaries provide a valuation allowance, if necessary, to reduce deferred tax assets to the amounts that are more likely-than-not to be realized.

The Company implements a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with ASC 740. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is- more- likely- than- not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. During the years ended December 31, 2012 and 2011, the Company recorded tax income of \$ 195 and \$261, respectively in regard to a decrease of uncertain tax position for closed tax years.

m. Concentrations of credit risk:

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, trade receivables and other accounts receivable.

The trade receivables of the Company are derived from sales to customers located primarily in Israel, America, the Far East and Europe. The Company generally does not require collateral; however most of the Company's customers outside of Israel are insured against customer nonpayment, through the Israeli Credit Insurance Company Ltd. In certain circumstances, the Company may require letters of credit, other collateral, additional guarantees or advanced payments. An allowance for doubtful accounts is determined with respect to specific debts that are doubtful of collection.





B.O.S. BETTER ONLINE SOLUTIONS LTD.  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

n. Derivative financial instruments:

The Company's derivatives consist primarily of forward contracts the Company uses to hedge the Company's exposure to currencies other than the U.S. dollar. The Company recognized derivative instruments as either assets or liabilities and measures those instruments at fair value. The derivative instruments that the Company holds do not meet the definition of hedging instruments under ASC 815, Derivatives and Hedging (originally issued as SFAS 133 and SFAS161). Therefore, the Company recognizes changes in the fair values of the derivatives in its statement of income in financial income, net, at the same period as the re-measurement of gain and loss of the related foreign currency denominated assets and liabilities.

As of December 31, 2012, the notional principal of foreign exchange contracts to purchase U.S. dollars with foreign currencies and to sell Euros for foreign currencies was \$ 770 and € 930, respectively. The Company recorded the fair value of derivative liability in the amount of \$ 5 in accrued expenses and other liabilities.

o. Basic and diluted net earnings (loss) per share:

Basic net earnings (loss) per share are calculated based on the weighted average number of ordinary shares outstanding during each year. Diluted net earnings (loss) per share are calculated based on the weighted average number of ordinary shares outstanding during each year, plus the potential dilution to ordinary shares considered outstanding during the year, in accordance with ASC 260, Earning per Share.

The total number of ordinary shares related to outstanding options and warrants that was excluded from the calculations of diluted net earnings (loss) per share, since they would have an anti-dilutive effect, was 255,228, 381,153 and 360,585 for the years ended December 31, 2012 , 2011 and 2010, respectively.

p. Accounting for share-based compensation:

The Company accounts for equity-based compensation in accordance with ASC 718, Stock Compensation ("ASC 718") which requires the recognition of compensation expenses based on estimated fair values for all equity-based awards made to employees and nonemployees and directors.

ASC 718 requires companies to estimate the fair value of equity-based payment awards on the date of grant using an option pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as an expense over the requisite service periods in the Company's consolidated statements of operations.

The Company recognizes compensation expenses for the value of its awards granted based on the straight line method over the requisite service period of each of the awards, net of estimated forfeitures. ASC 718 requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Estimated forfeitures are based on actual historical pre-vesting forfeitures. The Company considers many factors when estimating forfeitures, including employee class and historical experience.

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B.O.S. BETTER ONLINE SOLUTIONS LTD.  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company estimates the fair value of stock options granted using the Black-Scholes option pricing model. The option-pricing model requires a number of assumptions, of which the most significant are expected stock price volatility and the expected option term. Expected volatility was calculated based upon actual historical stock price movements over the most recent periods ending on the date of grant, equal to the expected option terms. The expected option term represents the period that the Company's stock options are expected to be outstanding and was determined based on the Simplified method permitted by SAB 107 and extended by SAB 110 as the average of the vesting period and the contractual term. The Company currently uses the simplified method as adequate historical experience is not available to provide a reasonable estimate. The Company adopted SAB 110 effective January 1, 2008 and will continue to apply the simplified method until enough historical experience is available to provide a reasonable estimate of the expected term for stock option grants. The risk-free interest rate is based on the yield from U.S. Treasury zero-coupon bonds with an equivalent term. The Company has historically not paid dividends and has no foreseeable plans to pay dividends.

The fair value for options granted in 2012 and 2011 was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	Year ended December 31,	
	2012	2011
Risk-free interest	1.34	1.17
Dividend yields	0	0
Volatility	83	96
Expected option term	3 years	3.83 years
Forfeiture rate	0	24

During 2012, 2011 and 2010, the Company recognized stock-based compensation expense related to employee and director stock options as follows:

	Year ended December 31,		
	2012	2011	2010
Selling and marketing	\$ -	\$ 8	\$ 39
General and administrative	107	161	178
Total stock-based compensation expense	\$ 107	\$ 169	\$ 217



B.O.S. BETTER ONLINE SOLUTIONS LTD.  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company applies ASC 718 and ASC 505-50 for equity instruments that are issued to other than employees for acquiring, or in conjunction with, selling, goods or services.

q. Fair value of financial instruments:

The following methods and assumptions were used by the Company in estimating fair value disclosures for financial instruments:

The carrying amounts of cash and cash equivalents, trade receivables, other accounts receivable, short term loans and trade payables approximate their fair value due to the short-term maturities of such instruments. The carrying amounts of long-term loans approximate their fair value.

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2012 are comprised of foreign currency forward contracts.

Assets measured at fair value on a non-recurring basis as of December 31, 2012 are Investment in shares of a cost method investee and intangible assets and goodwill that were written down to zero as a result of an impairment loss.

ASC 820 establishes a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1 - Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 - Include other inputs that are directly or indirectly observable in the marketplace.

Level 3 - Unobservable inputs which are supported by little or no market activity.

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

r. Reclassification:

Certain 2011 figures have been reclassified to conform to the 2012 presentation. The reclassification had no effect on previously reported net income or shareholders' equity.

B.O.S. BETTER ONLINE SOLUTIONS LTD.  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 3:- OTHER ACCOUNTS RECEIVABLE AND PREPAID EXPENSES

	December 31,	
	2012	2011
Government authorities	\$ 78	\$ 92
Advances to suppliers	258	411
Prepaid expenses	163	172
Deferred expenses attributed to software projects	22	52
Other	95	17
	\$ 616	\$ 744

NOTE 4:- FAIR VALUE MEASUREMENTS

In accordance with ASC 820, derivative contracts are classified within Level 2 as the valuation inputs are based on quoted prices and market observable data of similar instruments.

The Company's financial liabilities and assets measured at fair value on a recurring basis, consisted of derivatives which were classified within Level 2 and amounted to a \$ (5) and a \$ (67) liability as of December 31, 2012 and 2011, respectively.

NOTE 5:- INVENTORIES

	December 31,	
	2012	2011
Raw materials	\$ 163	\$ 189
Finished goods	2,997	3,831
	\$ 3,160	\$ 4,020

NOTE 6:- INVESTMENT IN OTHER COMPANIES

The Company's investments in companies comprise of an investment in Surf Communication Systems Ltd.:

	December 31,	
	2012	2011
Cost net of cumulative impairment losses	\$ -	\$ 68

During 2012, a full impairment loss of \$68 was recognized against the investment in Surf Communication Systems Ltd.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 7:- PROPERTY, PLANT AND EQUIPMENT

	December 31,	
	2012	2011
<b>Cost:</b>		
Computers and software	\$ 728	\$ 921
Office furniture and equipment	706	1,031
Leasehold improvements and real estate	648	1,446
Motor Vehicles	347	341
	2,429	3,739
<b>Accumulated depreciation:</b>		
Computers and software	674	805
Office furniture and equipment	343	615
Leasehold improvements and real estate	299	988
Motor vehicles	150	165
	1,466	2,573
<b>Depreciated cost</b>	<b>\$ 963</b>	<b>\$ 1,166</b>

Depreciation expenses amounted to \$ 180, \$ 280 and \$ 241 for the years ended December 31, 2012, 2011 and 2010, respectively.

B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 8:- OTHER INTANGIBLE ASSETS, NET

	December 31, 2012	Weighted average amortization period	December 31, 2011	Weighted average amortization period
<b>Cost:</b>				
Backlog	\$ 27	-	\$ 27	-
Technology	226	-	226	-
Brand name	670	4.1	670	4.1
Customer list	2,450	2.5	2,450	2.5
	3,373		3,373	
<b>Accumulated amortization:</b>				
Backlog	27		27	
Technology	226		226	
Brand name	475		411	
Customer list	2,288		2,169	
	3,016		2,833	
Amortized cost	\$ 357		\$ 540	

Intangible assets are amortized based on the straight line method for their remaining useful life.

Amortization expenses amounted to \$ 183, \$ 931 and \$ 369 for the years ended December 31, 2012, 2011 and 2010, respectively.

Estimated amortization expenses for the years ended:

December 31,	
2013	180
2014	177
	\$ 357



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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 9:- SHORT-TERM BANK LOANS AND CURRENT MATURITIES

Loan currency	Weighted interest rate as of December 31, 2012 %	December 31,	
		2012	2011
NIS	6.70	\$ 929	\$ 3,904
\$	4.8	4,937	2,932
Euro	4.67	93	-
		5,959	6,836
Current maturities	4.97	424	660
		\$ 6,383	\$ 7,496

The repayment of the Company's bank debt (to Bank Leumi) is secured by a first priority floating charge on all of the Company's assets, and by a first priority fixed charge on all of the Company's issued and unpaid share capital, its goodwill and its shares of its Israeli subsidiaries.

The loan terms restrict substantial asset sales, cash dividends, and certain inter-company and shareholders payments. In addition, the Company and its Israeli subsidiaries entered into a series of inter-company guarantees in favor of the bank.

There were no Bank Leumi covenants related to short term loans applicable for the fiscal years 2012 and 2011.

## NOTE 10:- ACCRUED EXPENSES AND OTHER LIABILITIES

	December 31,	
	2012	2011
Government authorities	\$ 300	\$ 275
Professional services	120	196
Derivative liability	5	67
Tax accruals	86	273
Other	56	156
	\$ 567	\$ 967



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## NOTE 11:- LONG-TERM BANK LOANS, NET OF CURRENT MATURITIES

- a. Classified by linkage terms and interest rates, the total amount of the loans is as follows:

Loan currency	Weighted interest rate as of December 31, 2012 %	December 31,	
		2012	2011
NIS	4.97 (Prime minus 0.5 up to Prime plus 1.5)	\$ 1,612	\$ 2,190
		1,612	2,190
Less - current maturities	4.97	424	660
		\$ 1,188	\$ 1,530

Bank Leumi debt amounted to \$ 0 and \$ 367 in December 31, 2012 and December 31, 2011, respectively.

Bank HaPoalim debt amounted to \$ 1,521 and \$ 1,714 as of December 31, 2012 and 2011, respectively.

The repayment of the Company's bank debt to Bank HaPoalim is not secured, except by long term bank deposits in the amount of \$ 438. The Bank HaPoalim loan agreements contain various financial covenants which require that the Company's Israeli subsidiaries maintain certain financial ratios and level of profitability.

As of December 31, 2012, the Company was not in compliance with certain financial covenants. The Company received a waiver from the bank with respect to the covenants as of December 31, 2012, valid through the earlier of May 1, 2014 or the Company's filing of its 2013 financial statements.

- b. The Company loans mature in the following years subsequent to the balance sheet dates:

2013 (Current maturities)	\$424
2014	464
2015	399
2016	325
	\$1,612



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## NOTE 12:- LIABILITY TO DIMEX SYSTEMS

In March 2008, BOS-Dimex purchased the assets and activities of Dimex Systems Ltd. As part of this acquisition, the Company and BOS Dimex owe to Dimex Systems Ltd. an amount on account of the purchase price as summarized below:

Loan currency	Nominal interest rate as of December 31, 2012 %	December 31, 2012	December 31, 2011
NIS (1)	4.0	\$ 527	\$ 473
NIS (2)	4.0	319	\$ 574
		846	1,047
Less - current maturities	4.0	136	300
		\$ 710	\$ 747

(1) Will be paid in 24 equal monthly payments commencing January, 2014 (see note 14a).

(2) The loan originally carried a nominal interest rate of 8% and with principle and interest payments to be made through December 2013. On December 31, 2012, the loan agreement was modified to reduce the nominal interest rate to 4% and principle and interest payments were spread out through June 2015. The Company accounted for the loan modification in accordance with ASC 470-60 Troubled Debt Restructurings by Debtors, and as a result of which, there was no material effect to the December 31, 2012 balance sheet and the results of operations through December 31, 2012.

## NOTE 13:- COMMITMENTS AND CONTINGENT LIABILITIES

a. Commitments:

1. Royalty commitments:

a) Under the Company's research and development agreements with the Office of the Chief Scientist ("OCS") and pursuant to applicable laws, the Company is required to pay royalties at the rate of 3.5% of sales of products developed with funds provided by the OCS, up to an amount equal to 100% of the Research and development grants (dollar-linked) received from the OCS. The obligation to pay these royalties is contingent upon actual sales of the products. Royalties payable with respect to grants received under programs approved by the OCS after January 1, 1999, are subject to interest on the U.S. dollar-linked value of the total grants received at the annual rate



of LIBOR applicable to U.S. dollar deposits at the time the grants are received. No grants were received during the years 2010 through 2012.

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NOTE 13:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

As of December 31, 2012, the Company has an outstanding contingent obligation to pay royalties to the OCS, including interest, in the amount of approximately \$ 3,316, in respect of these grants. Royalty expenses in the amount of \$ 0 and \$3 were recorded on such royalties during 2012 and 2011, respectively. Commencing year 2012, there are no sales of products that were developed using funds provided by the OCS. Additionally, the developed software for which the grant was received is no longer being sold.

b) The Israeli Government, through the Overseas Marketing Fund, awarded the Company grants for participation in expenses for overseas marketing. The Company is committed to pay royalties to the Fund for Encouragement of Marketing Activities (the "Marketing Fund") at the rate of 3% of the increase in export sales, up to the amount of the grants received by the Company linked to the dollar and bearing interest. No grants were received during the years 2010 through 2012.

As of December 31, 2012, the Company has an outstanding contingent obligation to pay royalties to the Marketing Fund including interest, in the amount of \$ 107. No Marketing Fund royalty expenses were recorded during 2012, 2011 and 2010. Additionally, the developed software for which the grant was received is no longer being sold.

2. The facilities of the Company are rented under operating lease agreements that expire on various dates ending in 2016. Minimum future rental payments for 2013, 2014 and 2015 are \$ 105, \$ 80 and \$ 51, respectively.

The Company's motor vehicles are leased under various cancelable operating lease agreements. The lease agreements for the motor vehicles expire on various dates ending in 2015. The maximum breach of contract fees may amount to \$ 37.

Lease expenses for the facilities occupied by the Company and the Company's motor vehicles in 2012, 2011 and 2010 amounted to \$ 420, \$ 551 and \$ 563, respectively.

3. Litigation:

On November 2008, Blockshtil Ltd. filed a claim in the Petach-Tikva Magistrate Court alleging breach of contract by the Company and seeking damages in the amount of NIS 149 thousand (approximately \$43). During 2012, The Company has served a statement of defense and the case has been heard. The parties will be filing their written summations and thereafter the Court will render its judgment. The Company's financial statements include a provision in this respect.

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NOTE 14:- SHAREHOLDERS' EQUITY

a. Share reverse split

On December 14, 2012 the Company announced a reverse split of its Ordinary shares.

Pursuant to the reverse split, each 4 Ordinary Shares, NIS 20.00 nominal value per share, will be converted into one Ordinary Share, NIS 80.00 nominal value per share. No fractional shares will be issued as a result of the reverse-split. Instead, all fractional shares will be rounded up to the next higher whole number of shares. All share and per share data in these financial statements and related notes are reported after the giving effect to the 1 for 4 reverse split.

As of December 13, 2012, there were 4,472,298 Ordinary Shares outstanding and after the reverse split there were 1,118,081 Ordinary Shares outstanding.

b. Private placements:

On October 5, 2010 the Company entered into a definitive private placement agreement with Telegraph Hill Capital Fund I, LLC ("THCAP") for the issuance of an aggregate of 24,091 Ordinary Shares at a price per share of \$ 12.44, or approximately \$ 300 in total. In addition, the Company announced that Mr. Luis Gutierrez Roy, managing partner in THCAP was appointed to its Board of Directors.

On December 21, 2011 the company announced that it has entered into agreements with its convertible debt lenders, for the amendment of their loan agreements and the subsequent conversion of their debt into the Company's ordinary shares.

The amendments to the loan agreements provide that the amount of \$ 2,523 of these loans was converted into the company's ordinary shares at a reduced conversion price of \$ 6 per share, instead of the conversion rate of \$ 13 per share set in the original loan agreements. As a result of the conversion, the company issued 420,491 ordinary shares.

In connection with the conversion, the term of warrants to purchase 160,996 shares that had been issued to the lenders, was extended by 2 years, until July 2014 and February 2015 (see Note 12). Following the extension of the warrants as mentioned above, in accordance with ASC 815, the Company recorded \$86 financial expenses in its statement of operations in 2011, reflecting the incremental compensation caused directly from the extension.

On December 21, 2011 the remaining convertible loan of \$ 501 (the "Deferred Loan" or the "2011 restructuring") remains outstanding, and will bear a reduced interest rate of 4% (as was accounted for in the Conversion Agreements). The Deferred Loan will no longer be convertible. The Deferred Loan will be repaid in 24 equal monthly installments commencing January 10, 2014 (instead of in two payments - in July 2012 and February 2013, according to the original convertible note agreement). The balance of the deferred loan as of December 31, 2012 is \$527(see note 12).



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## NOTE 14:- SHAREHOLDERS' EQUITY (Cont.)

## c. Warrants to shareholders

The Company's outstanding warrants to shareholders as of December 31, 2012 are as follows

Outstanding and exercisable warrants as of December 31, 2012	Weighted average exercise price of outstanding warrants	Weighted average remaining contractual life (years)
154,781	\$ 11	1.6
6,215	\$ 11	2.1

## d. Stock option plans:

In May 2003, the Company's shareholders approved the adoption of the 2003 Israeli Stock Option Plan ("the Plan"), pursuant to which 31,250 ordinary shares were reserved for purchase by the employees, directors, consultants and service providers of the Company and its subsidiaries. Subsequently, the shareholders approved increases of the shares reserved for issuance under the Plan, initially to 50,000, and thereafter to 75,000, to 130,000, to 208,000 and in December 21, 2011 to 275,000. Any option which is canceled or forfeited before expiration will become available for future grants.

In December 2012, the Company's shareholders approved a 10-year extension to the Plan, until May 31, 2023,

As of December 31, 2012 an aggregate of 144,982 options are available for future grants under the Plan. Each option granted under the Plan expires between 3-10 years from the date of the grant. The options vest gradually over a period of up to four years.

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## NOTE 14:- SHAREHOLDERS' EQUITY (Cont.)

A summary of the Company's employee and director stock option activity and related information for the year ended December 31, 2012, is as follows:

	Number of options	Weighted-average exercise price	Weighted-average remaining contractual term (in years)	Aggregate intrinsic value
Outstanding at January 1, 2012	124,707	\$ 25	2.91	\$ 60
Changes during the year:				
Granted	-			
Exercised	(1,093 )			
Forfeited or cancelled	(30,102 )	\$ 55.85		
Outstanding at December 31, 2012	93,512	\$ 23.45	2.74	78
Vested and expected to vest	81,284	\$ 26.20	2.59	70
Exercisable at December 31, 2012	81,284	\$ 26.20	2.59	70

No options were granted during 2012 and 2010, the weighted-average grant-date fair value of options granted during the year ended December 31 2011 was \$ 6.76. The aggregate intrinsic value in the table above represents the total intrinsic value (the difference between the fair market value of the Company's ordinary shares on December 31, 2012 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on December 31, 2012.

Total intrinsic value of options exercised for the years ended December 31, 2012, 2011 and 2010 was \$ 5, \$ 33 and \$ 62, respectively. As of December 31, 2012, there was \$ 21 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the Company's Plan. That cost is expected to be recognized through 2014.

No cash was received from exercise of options in the years ended December 31, 2012, 2011 and 2010.

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## NOTE 14:- SHAREHOLDERS' EQUITY (Cont.)

The options granted to employees and director outstanding as of December 31, 2012 separated into ranges of exercise prices, are as follows:

exercise price	Options outstanding as of December 31, 2012	Weighted average remaining contractual life (years)	Options exercisable as of December 31, 2012	Weighted average Remaining contractual life of options exercisable (years)
\$ 0	11,751	0.85	11,751	0.85
\$ 3.80	22,360	3.97	11,180	3.97
\$ 8.00	9,199	3.25	9,199	3.25
\$ 9.91	375	1.14	375	1.14
\$ 11.00	617	1.56	617	1.56
\$ 12.20	1,500	0.88	1,500	0.88
\$ 20.00	9,155	1.00	8,107	1.00
\$ 29.98	375	0.49	375	0.49
\$ 33.60	3,750	5.24	3,750	5.24
\$ 47.70	20,000	1.75	20,000	1.75
\$ 50.40	14,030	4.3	14,030	4.3
\$ 60.00	400	1.63	400	1.63
	93,512	2.74	81,284	3.2

## e. Warrants issued to service providers and debt providers:

The Company accounts for warrants issued to service providers and debt providers in accordance with the provisions of ASC 505-50, "Equity-Based Payments to Non-Employees". The fair value for these warrants was estimated at the date of grant using the Black-Scholes option pricing model. During the years 2012 and 2010 the Company granted warrants to several service and debt providers (see Note 12). No warrants were granted in 2011 to service and debt providers.

In March 2012, the company's Audit Committee and Board of Directors approved a grant of warrants to purchase 3,600 Ordinary shares to THCAP. The grant was approved by the company's shareholders on December 13, 2012. The warrants exercise price is \$2.39 and will be exercisable for 3 years starting December 13, 2012.





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NOTE 14:- SHAREHOLDERS' EQUITY (Cont.)

The Company's outstanding warrants to service and debt holders as of December 31, 2012 are as follows:

exercise price	Warrants outstanding as of December 31, 2012	Weighted average remaining contractual life (years)	Warrants exercisable as of December 31, 2012	Weighted average remaining contractual life of warrants exercisable (years)
\$ 0.00	330	1.00	330	1.00
\$ 2.39	3,600	2.95	3,600	2.95
\$ 10.00	5,000	3.58	5,000	3.58
\$ 11.00	6,216	0.09	6,216	0.09
\$ 14.88	17,274	1.093	17,274	1.093
\$ 20.00	3,300	1.00	3,300	1.00
\$ 80.80	1,218	0.62	1,218	0.62
\$ 106.00	2,436	0.62	2,436	0.62
	39,374	1.37	39,374	1.37

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NOTE 15:-

## TAXES ON INCOME

## a. Change in corporate tax rate:

The Israeli corporate tax rate was 25% in 2010 and 24% in 2011 and 25% in 2012.

On December 5, 2011, the Israeli Parliament (the Knesset) passed the Law for Tax Burden Reform (Legislative Amendments), 2011 ("the Law") which, among other things, cancels, effective from 2012, the scheduled progressive reduction in the corporate tax Rate. The Law also increases the corporate tax rate to 25% in 2012.

## b. Loss carry forward:

The Company and its Israeli subsidiaries have accumulated losses for Israeli income tax purposes as of December 31, 2012, in the amount of approximately \$ 32,463. These losses may be carried forward and offset against taxable income in the future for an indefinite period. In addition, the Company and its Israeli subsidiaries have accumulated capital losses in the amount of approximately \$21,914 which may be carried forward under certain limitations.

## c. Deferred income taxes:

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

	December 31,	
	2012	2011
Assets in respect of:		
Allowances and provisions	\$ 142	\$ 195
Net operating loss carry forward (1)	8,116	7,778
	8,258	7,973
Valuation allowance (2)	(8,168 )	(7,838 )
	90	135
Liabilities in respect of intangible assets	(90 )	(135 )
Net deferred tax assets (liability)	\$ -	\$ -



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## NOTE 15:- TAXES ON INCOME (Cont.)

(1) See Note 15b.

(2) In 2012, the Company has provided valuation allowances on deferred tax assets that results from tax loss carry forward and other reserves and allowances due to its history of operating losses and current uncertainty about the ability to realize these deferred tax assets in the future.

d. Tax benefit (taxes on income) is comprised as follows:

	Year ended December 31,		
	2012	2011	2010
Current	\$ 187	\$ 172	\$ (2 )
Prior years	-	-	(3 )
	\$ 187	\$ 172	\$ (5 )
Domestic	195	172	\$ (73 )
Foreign	(8 )	-	68
	\$ 187	\$ 172	\$ (5 )

e. Profit (Loss) before taxes is comprised as follows:

	Year ended December 31,		
	2012	2011	2010
Domestic	\$ (572 )	\$ (3,429 )	\$ 228
Foreign	23	43	(52 )
	\$ (549 )	\$ (3,386 )	\$ 176

f. Reconciliation of the theoretical tax expense to the actual tax expense:

The main reconciling items between the statutory tax rate of the Company and the effective tax rate are the non-recognition of tax benefits from accumulated net operating losses carry forward among the Company and various subsidiaries due to uncertainty of the realization of such tax benefits.

g. Tax assessments:

BOS Odem and BOS Dimex have final assessments through 2008. Bos has final assessments through 2007. Dimex Hagalil was incorporated in 2008, and therefore, does not have any final assessments.

Ruby-Tech Inc., a U.S. subsidiary, has final assessments through 2008.

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## NOTE 15:- TAXES ON INCOME (Cont.)

h. In accordance with the Company's accounting policy, interest expense and potential penalties related to income taxes are included in the tax expense line of the Company's consolidated statements of operations.

The Company and its subsidiaries file income tax returns in Israel and in the United States. BOS, BOS Dimex and BOS Odem may be subject to auditing by the Israel tax authorities for fiscal years 2009 and thereafter. Dimex Hagalil may be subject to auditing by the Israel tax authorities for fiscal years 2008 and thereafter. Ruby-Tech Inc., a U.S.

subsidiary, may be subject to auditing by the U.S. Internal Revenue Service for fiscal years 2008 and thereafter.

The Company believes that it has adequately provided for any reasonably foreseeable outcome related to tax audits and settlement. The final tax outcome of the Company's tax audits could be different from that which is reflected in the Company's income tax provisions and accruals. Such differences could have a material effect on the Company's income tax provision and net loss in the period in which such determination is made.

## i. Uncertain tax positions

	December 31,	
	2012	2011
Uncertain tax positions, beginning of year	\$ 172	\$ 379
Decreases in tax positions for prior years	(172 )	(207 )
Increases in tax positions for current year	31	-
Uncertain tax positions, end of year	\$ 31	\$ 172

The Company recognizes interest accrued that is related to unrecognized tax benefits and penalties in taxes on income. During the years ended December 31, 2012 and 2011, the Company recognized approximately \$ (54) and \$ (54), respectively, in interest and penalties. The Company had approximately \$ 0 and \$ 54 accruals for the payment of interest and penalties at December 31, 2012 and 2011, respectively.

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## NOTE 16:- SUPPLEMENTARY INFORMATION TO STATEMENTS OF OPERATIONS

a.	Financial expenses, net:		
	Year ended December 31,		
	2012	2011	2010
<b>Financial income:</b>			
Interest on bank deposits	\$ 5	\$ 3	\$ 32
Change in fair value of forward contracts	-	-	141
	5	3	173
<b>Financial expenses:</b>			
In respect of bank loans, bank fees, convertible note and liability to Dimex Systems	(681 )	(1,251 )	(1,039 )
Inducement and related cost (Note 12)	-	(760 )	-
Revaluation of fair value related to extension of warrants as part of an Inducement of a convertible note	-	(86 )	-
Change in fair value of forward contracts	(34 )	(44 )	
Other (mainly foreign currency transaction losses)	(71 )	(103 )	(95 )
	(786 )	(2,244 )	(1,134 )
	\$ (781 )	\$ (2,241 )	\$ (961 )
b.	Net earnings (loss) per share:		
<b>1. Numerator:</b>			
Numerator for basic and diluted net Earnings (loss) per share:			
Income (loss) from continuing operations	\$ (549 )	\$ (3,214 )	\$ 171
Loss from discontinued operations	-	-	(806 )
Net loss available to ordinary shareholders	\$ (549 )	\$ (3,214 )	\$ (635 )
<b>2. Denominator (in thousands):</b>			
Basic weighted average ordinary shares outstanding (in thousands)			
	1,118	705	656
Diluted weighted average ordinary shares outstanding (in thousands)			
	1,118	705	690
	\$ (0.49 )	\$ (4.56 )	\$ 0.28

Basic and diluted net earnings (loss) per share from  
 continuing operations

Basic and diluted net earnings (loss) per share from discontinued operations	\$ -	\$ -	\$ (1.24 )
Basic and diluted net loss per share	\$ (0.49 )	\$ (4.56 )	\$ (0.96 )

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NOTE 17:- SEGMENTS AND GEOGRAPHICAL INFORMATION

The Company manages its business in two reportable segments, consisting of the RFID and Mobile Solutions segment and the Supply Chain Solutions segment.

The Company's management makes financial decisions and allocates resources, based on the information it receives from its internal management system. The Company allocates resources and assesses performance for each operating segment using information about revenues and gross profit. The Company applies ASC 280, Segment Reporting.

a. Revenues, gross profit and assets for the operating segments for the years 2012, 2011 and 2010 were as follows:

	RFID and Mobile Solutions	Supply Chain Solutions	Not Allocated/ Intercompany	Consolidated
<b>2012</b>				
Revenues	\$ 8,894	\$ 15,915	\$ (306 )	\$ 24,503
Gross profit	\$ 2,345	\$ 2,723	\$ -	\$ 5,068
Assets related to segment	\$ 8,558	\$ 9,491	\$ -	\$ 18,049
<b>2011</b>				
Revenues	\$ 13,128	\$ 21,332	\$ (1,026 )	\$ 33,434
Gross profit	\$ 3,105	\$ 3,405	\$ -	\$ 6,510
Assets related to segment	\$ 10,132	\$ 9,869	\$ 68	\$ 20,069
<b>2010</b>				
Revenues	\$ 12,463	\$ 17,724	\$ -	\$ 30,187
Gross profit	\$ 3,632	\$ 3,851	\$ -	\$ 7,483
Assets related to segment	\$ 12,418	\$ 9,605	\$ 107	\$ 22,130

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## NOTE 17:- SEGMENTS AND GEOGRAPHICAL INFORMATION (Cont.)

b. The following presents total revenues and long-lived assets for the years 2012, 2011 and 2010 based on the location of customers:

	2012		Year ended December 31, 2011		2010	
	Total revenues	Long-lived assets *)	Total revenues	Long-lived assets *)	Total revenues	Long-lived assets *)
America	\$ 493	\$ -	\$ 1,514	\$ -	\$ 2,596	\$ -
Far East	1,985	-	3,943	-	2,228	-
Europe	1,178	-	976	-	811	-
Israel and others	20,847	963	27,001	1,166	24,552	1,135
	\$ 24,503	\$ 963	\$ 33,434	\$ 1,166	\$ 30,187	\$ 1,135

\*)Long-lived assets are comprised of property, plant and equipment (intangible assets and goodwill are not included).

c. Major customer data as a percentage of total revenues:

	Year ended December 31,		2011		2010	
	2012		2011		2010	
Customer A (Supply Chain Segment)	15	%	10	%	7	%

## NOTE 18:-

## RELATED PARTIES

a. Service Agreement of Cukierman & Co.:

The Company's Audit Committee and Board of Directors approved an engagement with Cukierman & Co. Investment House Ltd. ("Cukierman & Co"), to provide non-exclusive investment-banking services and business development services to the Company ("the Service Agreement"), effective April 15, 2003. Cukierman & Co. is a company indirectly controlled by Mr. Edouard Cukierman. Since June 26, 2003, Mr. Cukierman serves as Chairman of the Company's Board, and he is also a co-manager of the Catalyst Fund, the Company's largest shareholder. For its services, Cukierman & Co. is paid a monthly sum of \$ 10 plus VAT, in addition to a success fee of 4%-6% for a consummated private placement. The Service Agreement provides for success fees in connection with securing M&A transactions of 3.5% of the proceeds exchanged in such a transaction and also for a success fee of 6% of the revenues actually received by the Company in respect of a sale of the Company's products to a new customer which was introduced by Cukierman & Co. According to its terms, the Company may terminate the Service Agreement at any time, by giving a one-month prior written notice.

Pursuant to an amendment to the Service Agreement, as of July 1, 2012, the monthly payment was reduced to \$6.4 plus VAT.

In addition, the payment will be made once a year at the end of each calendar year by way of issuance of the Company's shares and not in cash, using a price per share as stipulated in the revised Service Agreement.

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## NOTE 18:- RELATED PARTIES (Cont.)

On December 31, 2012 the company issued 6,501 ordinary shares to Cukierman & Co as per the revised Service Agreement.

Expenses the Company recorded according to the Service Agreement with Cukierman & Co. are:

	Year ended December 31,		
	2012	2011	2010
Retainer fee	\$ 98	\$ 120	\$ 95
Success fee in respect of issuance of private placements, According to Service Agreement	-	-	18
<b>Total</b>	<b>\$ 98</b>	<b>\$ 120</b>	<b>\$ 113</b>

## b. Active Chairman Agreement with Edouard Cukierman:

On November 7, 2007, the shareholders approved an Active Chairman Agreement with Mr. Edouard Cukierman, the Chairman of the Board, pursuant to which, Mr. Edouard Cukierman was granted options (the "Options") to purchase up to 5,000 ordinary shares of the Company per each calendar year of service as the Company's Chairman of the Board of Directors (the "Service") in the years 2007-2010. The Options were in lieu of any compensation, fees or options otherwise payable by the Company to Mr. Cukierman as a director.

The exercise price of the Options was \$ 47.7, which was equal to the weighted average of the closing prices of the Company's ordinary shares on the Nasdaq Global Market during the thirty-day period preceding the shareholders' approval. Unexercised Options expire after five years from their grant date.

In March 2011, the Company's Audit Committee and Board of Directors approved a new Active Chairman Agreement with Mr. Cukierman for services in the years 2011-2014. The agreement was approved by the Company's shareholders on December 20, 2011. Pursuant to this agreement in consideration for Mr. Cukierman's services as the Company's Active Chairman in the years 2011-2014, he shall be granted options to purchase 22,360 ordinary shares, and be paid a monthly cash payment of \$ 5,000 plus VAT at the prevailing rate. Payment of the cash fee shall be made each month in respect of the previous month of service. Following approval by the shareholders, the cash fees for 2011 were paid retroactively for the entire year.

The exercise price of the options is \$ 3.8 and they vest and become exercisable in 16 equal quarterly installments. The first three installments vested immediately following the shareholders' approval, and the fourth installment vested on December 31, 2011. Additional installments vest at the end of each subsequent calendar Quarter, provided that Mr. Cukierman shall hold his position as Chairman of the Board at the applicable vesting date.



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

## NOTE 18:- RELATED PARTIES (Cont.)

Pursuant to the agreement, if Mr. Cukierman's service to the Company is terminated by the Company, for reasons other than cause, then: (a) any unvested options shall be accelerated, so that they become immediately vested in full as of the date of the termination and (b) the accelerated options and any previously vested options shall be exercisable for twenty four (24) months following the termination.

The options and the cash fee are in lieu of any compensation, fees or options otherwise payable by the Company to Mr. Cukierman as a director.

On December 13, 2012 an amendment to the agreement was approved stating that commencing July 1, 2012 the payment for the Chairman services will be paid in ordinary shares of the company instead of in cash.

On December 31, 2012 the company issued to Edouard Cukierman 5,119 ordinary shares pursuant to the revised Agreement.

Expenses incurred in accordance with the Active Chairman Agreement with Edouard Cukierman are as follows:

	Year ended December 31,		
	2012	2011	2010
Chairman fees	\$ 60	\$ 60	\$ -
Share based compensation expenses	10	43	75
Total	\$ 70	\$ 103	\$ 75

## c. Agreements with THCAP:

In September 2009, the Company entered into a service agreement with THCAP, pursuant to which THCAP shall provide the Company with non-exclusive private financing and business consulting services. In consideration, the Company issued to THCAP warrants to purchase 3,600 ordinary shares at an exercise price of \$ 11 per share. The warrants were exercisable as of February 28, 2011 and could be exercised until August 31, 2012.

In November 2009, the Company entered into an amendment to the service agreement with THCAP, pursuant to which THCAP shall be paid a success fee of 5% of the revenues generated to the Company from the sale of the Company products to business partners introduced by THCAP.

On October 5, 2010 the Company entered into a definitive private placement agreement with THCAP pursuant to which the Company issued to THCAP ordinary shares (see Note 14a), and Mr. Luis Gutierrez Roy, the managing partner in THCAP was appointed to its Board of Directors.



B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 18:- RELATED PARTIES (Cont.)

On December 13, 2012, The Company's shareholders approved an additional grant to THCAP of warrants to purchase 3,600 ordinary shares. The warrants' exercise price is \$2.39. The warrants will be exercisable for 3 years from the grant date.

On December 13, 2012 the company's shareholders approved an additional amendment to the agreement with THCAP. Pursuant to this amendment, THCAP will be paid a monthly retainer for business development services in the amount of \$3.7 per month to be paid in the Company's ordinary shares.

On December 31, 2012, the Company issued 1,439 ordinary shares to THCAP pursuant to the amendment.

Expenses incurred according to the agreements with THCAP are as follows:

	Year ended December 31,		
	2012	2011	2010
Retainer fees	\$2	\$ -	\$ -
Share based compensation expenses	6	1	10
Total	\$8	\$ 1	\$ 10

## NOTE 19:- SUBSEQUENT EVENTS

On January 2, 2013 the company received a notice from the NASDAQ Office of General Counsel, Hearings, advising that the Company has regained compliance with the applicable minimum bid price rule and is in compliance with all other applicable requirements for listing on The NASDAQ Capital Market. Accordingly, the Hearings Panel has determined to continue the listing of the Company's securities on The NASDAQ Stock Market.



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CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statements on Form F-3 (Nos. 333-130048 and No. 333-152020) and related prospectus and in the Registration Statements on Form S-8 (Nos. 333-160414, 333-148318, 333-136957, 333-110696, 333-100971, 333-11650 and 333-179253) of B.O.S Better Online Solutions Ltd. (“BOS”) of our report dated April 4, 2013, with respect to the consolidated financial statements of BOS for the year ended December 31, 2012, which appears in BOS’s current report on Form 6-K.

Tel Aviv Israel  
April 4, 2013

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

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