MAGAL SECURITY SYSTEMS LTD
Form 20-F
March 27, 2014

SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

FORM 20-F

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

OR

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

For the fiscal year ended December 31, 2013

OR

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

For the transition period from __________ to __________

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

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

Commission file number: 0-21388

MAGAL SECURITY SYSTEMS LTD.
(Exact Name of Registrant as specified in its charter
and translation of Registrant's name into English)

Israel
(Jurisdiction of incorporation or organization)

P.O. Box 70, Industrial Zone, Yehud 56100, Israel
(Address of principal executive offices)

Ilan Ovadia, Chief Financial Officer
Magal Security Systems Ltd.
P.O. Box 70, Industrial Zone
Yehud 56100, Israel
+972-3-5391444 (phone), +972-3-5366245 (fax)
(Name, Telephone, E-mail and/or Facsimile number of Company Contact Person)

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

Title of each class	Name of each exchange on which registered
Ordinary Shares, NIS 1.0 Par Value	NASDAQ Global Market

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

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

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

Ordinary Shares, par value NIS 1.0 per share ……..…16,147,522
(as of December 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 o No x

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 o No x

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 x No o

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 x No o

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 o	Accelerated filer o	Non-accelerated filer x

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

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

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 o Item 18 o

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 o No x

This Annual Report on Form 20-F is incorporated by reference into the Registrant's Registration Statements on Form S-8, File Nos. 333-127340, 333-164696, 333-174127 and 333-190469.

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INTRODUCTION

Magal Security Systems Ltd. is a leading international solutions provider of safety, security, site management and intelligence gathering and compilation solutions and products. Based on more than 35 years of experience and interaction with customers, we have developed a unique set of solutions and products, optimized for perimeter, outdoor and general security applications. Our turnkey solutions are typically integrated and managed by sophisticated modular command and control software, supported by expert systems for real-time decision support. Our broad portfolio of critical infrastructure protection and site protection technologies includes a variety of smart barriers and fences, fence mounted detectors, virtual gates, buried and concealed detection systems and a sophisticated protection package for sub-surface intrusion. As a world class innovator in the development of closed circuit television, intelligence video analysis and motion detection technology for outdoor operation, we have successfully installed customized solutions and products in more than 75 countries worldwide. Our ordinary shares are traded on the NASDAQ Global Market under the symbol “MAGS”. Our website is www.magal-s3.com. The information on our website is not incorporated by reference into this annual report. As used in this annual report, the terms “we,” “us,” “our,” and “Magal S3” mean Magal Security Systems Ltd. and its subsidiaries, unless otherwise indicated.

ULTRAWAVE, E-FIELD, FLARE, FLEXPI, FLEXPS, GUIDAR, INTELLI-FIELD, LOGO DESIGN (old Senstar), MISCELLANEOUS DESIGN (Stellar logo), OMNITRAX, PANTHER, PERIMITRAX, PINPOINTER, REPELS, S DESIGN, SENNET, SENSTAR, SENSTAR & DESIGN, SENSTAR-STELLAR, SENSTAR-STELLAR & DESIGN, SENTIENT, XFIELD, MAGAL, DTR, FORTIS, DREAMBOX, PIPEGUARD AND MAESTRO DB are registered trademarks and INTELLI-FLEX, INTELLIFIBER, STARLED, STARNET, ARMOURFLEX, FLASH, FLEXZONE, ROBOGUARD, FENSOR, CYBERSEAL, the Magal logo and all other marks used to identify particular products and services associated with our businesses are unregistered trademarks. Any other trademarks and trade names appearing in this annual report are owned by their respective holders.

Our consolidated financial statements appearing in this annual report are prepared in U.S. dollars and in accordance with generally accepted accounting principles in the United States, or U.S. GAAP. All references in this annual report to “dollars” or “$” are to U.S. dollars and all references in this annual report to “NIS” are to New Israeli Shekels. The representative exchange rate between the NIS and the dollar as published by the Bank of Israel and effective on December 31, 2013 was NIS 3.471 per $1.00.

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

This Annual Report on Form 20-F contains various “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and within the Private Securities Litigation Reform Act of 1995, as amended. Such forward-looking statements reflect our current view with respect to future events and financial results. Forward-looking statements usually include the verbs, “anticipates,” “believes,” “estimates,” “expects,” “intends,” “plans,” “projects,” “understands" and other verbs suggesting uncertainty. We remind readers that forward-looking statements are merely predictions and therefore inherently subject to uncertainties and other factors and involve known and unknown risks that could cause the actual results, performance, levels of activity, or our achievements, or industry results, to be materially different from any future results, performance, levels of activity, or our achievements expressed or implied by such forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. We undertake no obligation to publicly release any revisions to these forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. We have attempted to identify additional significant uncertainties and other factors affecting forward-looking statements in the Risk Factors section which appears in Item 3.D "Key Information -Risk Factors."

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. Selected Consolidated Financial Data.

The following selected consolidated financial data for and as of the five years ended December 31, 2013 are derived from our audited consolidated financial statements which have been prepared in accordance with U.S. GAAP. We have derived the following selected consolidated financial data as of December 31, 2012 and 2013 and for each of the years ended December 31, 2011, 2012 and 2013 from our consolidated financial statements set forth elsewhere in this annual report that have been prepared in accordance with U.S. GAAP. We have derived the following selected consolidated financial data as of December 31, 2009, 2010 and 2011 and for each of the years ended December 31, 2009 and 2010 from our audited consolidated financial statements not included in this annual report. The selected consolidated financial data set forth below should be read in conjunction with and are qualified entirely by reference to Item 5. "Operating and Financial Review and Prospects" and our audited consolidated financial statements and notes thereto included elsewhere in this annual report.

	2009(1)	2010	2011	2012	2013
Revenues	$54,518	$49,699	$88,591	$77,697	$51,517
Cost of revenues	33,404	31,400	49,089	44,163	31,059
Gross profit	21,114	18,299	39,502	33,534	20,458
Operating expenses:					
Research and development, net	5,059	4,105	3,898	4,041	4,409
Selling and marketing	10,820	11,261	19,415	16,528	12,781
General and administrative	8,100	7,593	8,682	7,408	7,787
Other income	-	-	(2,304)	-	-
Total operating expenses	23,979	22,959	29,691	27,977	24,977
Operating income (loss)	(2,865)	(4,660)	9,811	5,557	(4,519)
Financial expenses (income), net	1,568	967	(756)	472	(59)
Income (loss) before income taxes	(4,433)	(5,627)	10,567	5,085	(4,460)
Income taxes	864	602	723	991	69
Income (loss) from continuing operations	(5,297)	(6,229)	9,844	4,094	(4,529)

Income (loss) from discontinued operations, net	4,216	-	-	-	-
Net income (loss)	$(1,081)	$(6,229)	$9,844	$4,094	$(4,529)
Less: net income (loss) attributable to non-controlling interest	54	(24)	-	-	(66)
Net income (loss) attributable to Magal's shareholders	$(1,135)	$(6,205)	$9,844	$4,094	$(4,463)
Basic and diluted net earnings (loss) per share from continuing operations	$(0.52)	$(0.60)	$0.78	$0.26	$(0.28)
Basic and diluted net earnings (loss) per share from discontinued operations	0.41	-	-	-	-
Basic and diluted net earnings (loss) per share	$(0.11)	$(0.60)	$0.78	$0.26	$(0.28)
Weighted average number of ordinary shares used in computing basic net earnings per share	10,396,548	10,396,548	12,645,283	16,003,482	16,138,944
Weighted average number of ordinary shares used in computing diluted net earnings per share	10,398,624	10,396,548	12,645,283	16,030,816	16,138,944

(1) In September 2009, our Board of Directors resolved to discontinue the operations of the European integration subsidiary that we acquired in September 2007. The subsidiary was sold in December 2009. Accordingly, operating results and cash flows for the year ended December 31 2009, as well as the capital gain resulting from the sale, were reclassified to disclose the results of that subsidiary as discontinued operations.

	2009	2010	2011	2012	2013
Consolidated statements of Comprehensive Income:					
Net income (loss)	$(1,135)	$(6,205)	$9,844	$4,094	$(4,529)
Realized foreign currency translation adjustments from subsidiary	(789)	-	-	(421)	-
Foreign currency translation adjustments	2,166	1,226	(589)	684	2,365
Total comprehensive income (loss)	$242	$(4,979)	$9,225	$4,357	$(2,164)
Less - comprehensive income (loss) attributable to non-controlling interests	54	(24)	-	-	(66)
Comprehensive income (loss) attributable to Magal shareholders'	$296	$(5,003)	$9,225	$4,357	$(2,098)

	2009	2010	2011	2012	2013
Consolidated Balance Sheets Data:					
Cash and cash equivalents	$11,869	$16,596	$30,005	$36,784	$32,235
Short and long-term bank deposits and restricted deposits	2,019	4,888	10,123	9,607	12,255
Working capital	20,646	26,612	40,493	49,202	46,958
Total assets	60,650	65,710	85,987	91,036	87,787
Short-term bank credit (including current maturities of long-term loans)	10,058	9,830	5,390	5,391	6,270
Long-term bank loans	548	50	38	6	1,912
Loan from related party	-	9,907	-	-	-
Total shareholders' equity	32,309	28,016	51,011	58,326	57,540
Ordinary shares issued and outstanding	10,396,548	10,396,548	15,819,822	16,098,022	16,147,522

B. Capitalization and Indebtedness.

Not applicable.

C. Reasons for the Offer and Use of Proceeds.

Not applicable.

D. Risk Factors.

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

Risks Related to Our Business

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

After two years of profitable operations, we incurred an operating loss in 2013 and may not be able to achieve and sustain profitable operations in the future. If we do not generate sufficient cash from operations, we will be required to obtain additional financing or reduce our level of expenditure or cash balance. Such financing may not be available in the future, or, if available, may not be on terms favorable to us. If adequate funds are not available to us, our business, and results of operations and financial condition will be materially and adversely affected.

We depend on large orders from a relatively small number of customers for a substantial portion of our revenues. The loss of one or more of our key customers could result in a loss of a significant amount of our revenues.

A relatively small number of customers account for a large percentage of our revenues. Revenues from the provision of the perimeter security solution to the port of Mombasa, Kenya accounted for 19.3% and 14.2% of our revenues in 2012 and 2013, respectively and revenues from the provision of the perimeter security and command and control solutions for the 2012 Africa Cup of Nations in the Gabonese Republic, or the Gabonese Republic Project, accounted for 34.8% and 6.7% of our revenues in 2011 and 2012, respectively. Historically, the Israeli Ministry of Defense, or the MOD, and the Israeli Defense Forces, or the IDF, have accounted for a significant amount of our revenues. For the years ended December 31, 2011, 2012 and 2013, they accounted for 7.8%, 9% and 15% of our revenues, respectively.

The MOD, the IDF or any of our other major continuing customers may not maintain their volume of business with us or, if such volume is reduced, other customers generating similar revenues may not replace the lost business. For example, in 2012, we completed the Gabonese Republic Project, and we do not expect to receive any future revenues from this project. Our inability to replace business from large contracts will adversely affect our financial results. Any unanticipated delays in a large project, changes in customer requirements or priorities during the project implementation period, or a customer's decision to cancel a project, may adversely impact our operating results and financial performance.

Because our sales tend to be concentrated among a small number of customers during any period, our operating results may be subject to substantial fluctuations. Accordingly, our revenues and operating results for any particular quarter may not be indicative of our performance in future quarters, making it difficult for investors to evaluate our future prospects based solely on the results of any one quarter.

Given the nature of our customers and products, we receive relatively large orders for products from a relatively small number of customers. Consequently, a single order from one customer may represent a substantial portion of our sales in any one period and significant orders by any customer during one period may not be followed by further orders from the same customer in subsequent periods. Our sales and operating results are subject to very substantial periodic variations. Since quarterly performance is likely to vary significantly, our results of operations for any quarter or calendar year are not necessarily indicative of the results that we might achieve for any subsequent period. Accordingly, quarter-to-quarter and year-to-year comparisons of our operating results may not be meaningful. In addition, we have a limited order backlog that is generally composed of orders that are mostly fulfilled within a period of three to twelve months after receipt, which makes revenues in any quarter substantially dependent upon orders received in prior quarters.

We may not be able to complete the implementation of our 2013 growth strategy plan and may not be able to successfully expand our business activity and increase our sales.

In last quarter of 2013 we adopted a growth strategy beyond the core of our PIDS activity. Pursuant to this growth strategy, we will seek to acquire a security products or cyber company that will expand our portfolio in the security business (HLS) both in the physical and logical field. In addition, we determined to focus our business on our sensor activity, expand our sales channels and close certain technology gaps in response to new demands in the market place. We intend to implement the plan though organic growth or the acquisition of, or investment in, businesses, products and technologies that complement our security business within the PIDS or Cyber fields.

We may not be able to implement our growth strategy plan and may not be able to successfully expand our business activity and increase our sales. If we are successful in the implementation of our strategic plan, we may be required to hire additional employees in order to meet customer demands, and if we are unable to attract or retain qualified employees, our business could be adversely affected.

We may not be able to consummate any acquisitions or investments in the future or realize the benefits of such acquisitions and investments, if consummated.

Our failure to successfully integrate the operations of an acquired business or to retain key employees of acquired businesses and integrate and manage our growth may have a material adverse effect on our business, financial condition, results of operation or prospects. We may not be able to realize the anticipated benefits of any acquisition. Moreover, future acquisitions by us could result in potentially dilutive issuances of our equity securities, the incurrence of debt and contingent liabilities and amortization expenses related to identifiable intangible assets, any of which could materially adversely affect our operating results and financial position. Acquisitions also involve other risks, including risks inherent in entering markets in which we have no or limited prior experience.

Our revenues depend on government procurement procedures and practices. A substantial decrease in our customers' budgets would adversely affect our results of operations.

Our products are primarily sold to governmental agencies, governmental authorities and government-owned companies, many of which have complex and time consuming procurement procedures. A substantial period of time often elapses from the time we begin marketing a product until we actually sell that product to a particular customer. In addition, our sales to governmental agencies, authorities and companies are directly affected by these customers' budgetary constraints and the priority given in their budgets to the procurement of our products. A decrease in governmental funding for our customers' budgets would adversely affect our results of operations. This risk is heightened during periods of global economic slowdown.

Accordingly, governmental purchases of our systems, products and services may decline in the future as the governmental purchasing agencies may terminate, reduce or modify contracts or subcontracts if:

- their requirements or budgetary constraints change;
- they cancel multi-year contracts and related orders if funds become unavailable;
- they shift spending priorities into other areas or for other products; or
- they adjust contract costs and fees on the basis of audits.

Any such event may have a material adverse effect on us.

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

The global market for safety, security, site management solutions and products is highly fragmented and intensely competitive. It is characterized by rapidly changing technology, frequent new product introductions and rapidly changing customer requirements. We compete principally in the market for perimeter intrusion detection systems, or PIDS, and turnkey projects and solutions. Some of our competitors and potential competitors have greater research, development, financial and personnel resources, including governmental support. We cannot assure you that we will be able to maintain the quality of our products relative to those of our competitors or continue to develop and market new products effectively. Continued competitive pressures could cause us to lose significant market share.

Increased competition and bid protests in a budget-constrained environment may make it more difficult to maintain our financial performance.

A substantial portion of our business is awarded through competitive bidding. Governments increasingly have relied upon competitive contract award types and multi-award contracts, which has the potential to create pricing pressure and increase our cost by requiring that we submit multiple bids and proposals. The competitive bidding process entails substantial costs and managerial time to prepare bids and proposals for contracts that may not be awarded to us or may be split among competitors. Following award, we may encounter significant expenses, delays, contract modifications, or even loss of the contract if our competitors protest or challenge contracts that are awarded to us. Multi-award contracts require that we make sustained efforts to obtain task orders under the contract.

As an example, in October 2012, we participated in a MOD experimental program with respect to the Israeli border security fence. During 2013, our technology was tested and we were eventually chosen to install 15 km of border sensors. Two other Israeli contractors were also awarded contracts. However, follow-up orders may be split between the three competing parties pending the customer’s determination of the performance of the different technologies. As a result, the amount of revenues to be generated from this project is uncertain.

Unfavorable global economic conditions may adversely affect our customers, which directly impact our business and results of operations.

Our business and financial condition is affected by global economic conditions. For example, starting in late 2008 and lasting through much of 2009, a steep downturn in the global economy sparked by uncertainty in credit markets and deteriorating consumer confidence, reduced technology spending by many organizations. More recently, credit and sovereign debt issues destabilized certain European economies as well and thereby increased global macroeconomic uncertainties. Uncertainty about current global economic conditions continues to pose a risk as customers may postpone or reduce spending in response to restraints on credit. Should the economic slowdown increase and/or companies in our target markets reduce capital expenditures, it may cause our customers to reduce or postpone their capital spending significantly, potentially resulting in reductions in sales of our products, longer sales cycles, collectability delays, non-payment for product, slower adoption of new technologies and increased price competition, each of which could have a material adverse effect on our business, operating results and financial condition.

We may also be required in the future to record impairment charges relating to the carrying value of our intangible assets and goodwill, increase our reserves for doubtful accounts and further write-down our tax assets. In addition, the fair value of some of our assets may decrease as a result of an uncertain economy and as a result, we may be required to record impairment charges in the future. If global economic and market conditions or economic conditions in key markets remain uncertain or weaken further, our financial condition and operating results may be materially adversely affected.

We may be adversely affected by our long sales cycles.

We have in the past and expect in the future to experience long time periods between initial sales contacts and the execution of formal contracts for our products and completion of product installations. The cycle from first contact to revenue generation in our business involves, among other things, selling the concept of our technology and products, developing and implementing a pilot program to demonstrate the capabilities and accuracy of our products, negotiating prices and other contract terms, and, finally, installing and implementing our products on a full-scale basis. This cycle entails a substantial period of time, sometimes as much as one or more years, and the lack of revenues during this cycle and the expenses involved in bringing new sales to the point of revenue generation may put a substantial strain on our resources. Our business involves significant risks and uncertainties that may not be covered by indemnity or insurance.

Our business involves significant risks and uncertainties that may not be covered by indemnity or insurance.

A significant portion of our business relates to designing, developing, and manufacturing advanced security, site management and intelligence gathering systems and products. New technologies may be untested or unproven. Failure of some of these products and services could result in extensive loss of life or property damage. Accordingly, we also may incur liabilities that are unique to our products and services. In some, but not all circumstances, we may be entitled to certain legal protections or indemnifications from our customers, either through regulatory protections, contractual provisions or otherwise. The amount of insurance coverage that we maintain may not be adequate to cover all claims or liabilities, and it is not possible to obtain insurance to protect against all operational risks and liabilities.

Substantial claims resulting from an accident, failure of our products or services, or other incident, or liability arising from our products and services in excess of any indemnity and our insurance coverage (or for which indemnity or insurance is not available or not obtained) could adversely impact our financial condition, cash flows, or operating results. Any accident, even if fully indemnified or insured, could negatively affect our reputation among our customers and the public, and make it more difficult for us to compete effectively. It also could affect the cost and availability of adequate insurance in the future.

The market for our products is characterized by changing technology, requirements, standards and products, and we may be adversely affected if we do not respond promptly and effectively to these changes.

The market for our products is characterized by evolving technologies, changing industry standards, changing regulatory environments, frequent new product introductions and rapid changes in customer requirements. The introduction of products embodying new technologies and the emergence of new industry standards and practices can render existing products obsolete and unmarketable. Our future success will depend on our ability to enhance our existing products and to develop and introduce, on a timely and cost-effective basis, new products and product features that keep pace with technological developments and emerging industry standards and address the increasingly sophisticated needs of our customers.

In the future:

- we may not be successful in developing and marketing new products or product features that respond to technological change or evolving industry standards;

- we may experience difficulties that could delay or prevent the successful development, introduction and marketing of these new products and features; or

- our new products and product features may not adequately meet the requirements of the marketplace and achieve market acceptance.

If we are unable to respond promptly and effectively to changing technologies and market requirements, we will be unable to compete effectively in the future.

Our failure to retain and attract personnel could harm our business, operations and product development efforts.

Our products require sophisticated research and development, marketing and sales and technical customer support. Our success depends on our ability to attract, train and retain qualified research and development, marketing and sales and technical customer support personnel. Competition for personnel in all of these areas is intense and we may not be able to hire sufficient personnel to achieve our goals or support the anticipated growth in our business. If we fail to attract and retain qualified personnel, our business, operations and product development efforts would suffer.

Our financial results may be significantly affected by currency fluctuations.

Most of our sales are made in North America, Europe, Africa and Israel. Our revenues are primarily denominated in dollars, Euros and NIS, while a portion of our expenses, primarily labor expenses, is incurred in NIS and Canadian Dollars. Additionally, certain assets, especially trade receivables, as well as part of our liabilities are denominated in NIS. As a result, fluctuations in rates of exchange between the dollar and non-dollar currencies may affect our operating results and financial condition. The dollar cost of our operations in Israel may be adversely affected by the appreciation of the NIS against the dollar. In addition, the value of our non-dollar revenues could be adversely affected by the depreciation of the dollar against such currencies. During the years ended December 31, 2012 foreign currency fluctuations had an adverse impact on our results of operations and we recorded foreign exchange losses, net of $530,000. In 2011 and 2013, foreign currency fluctuations had a positive impact on our results of operations and we recorded foreign exchange income, net of $1,394,000 and $89,000, respectively. Our results of operations may continue to be materially affected by currency fluctuations in the future.

If we do not receive Israeli MOD approvals necessary for us to export the products we produce in Israel, our revenues may significantly decrease.

Israel's defense export policy regulates the sale of a number of our systems and products. Current Israeli policy encourages export to approved customers of defense systems and products, such as ours, as long as the export is consistent with Israeli government policy. A license is required to initiate marketing activities. We are also required to obtain a specific export license for any products, services and knowledge exported from Israel. We may not be able to receive all the required licenses for which we may apply in the future. If we do not receive the required licenses for which we apply, our revenues may decrease.

We are subject to laws regulating export of "dual use" items (items that are typically sold in the commercial market, but that also may be used in the defense market) and defense export control legislation. Additionally, our participation in governmental procurement processes in Israel and other countries is subject to specific regulations governing the conduct of the process of procuring defense contracts. Furthermore, solicitations for procurements by governmental purchasing agencies in Israel and other countries are governed by laws, regulations and procedures relating to procurement integrity, including avoiding conflicts of interest and corruption in the procurement process. We may not be able to respond quickly and effectively to changing laws and regulations and any failure to comply with such laws and regulations may subject us to significant liability and penalties.

Our international operations require us to comply with anti-corruption laws and regulations of various governments and different international jurisdictions, and our failure to comply with these laws and regulations could adversely affect our reputation, business, financial condition and results of operations.

Doing business on a worldwide basis requires us and our subsidiaries to comply with the laws and regulations of various governments and different international jurisdictions, and our failure to successfully comply with these rules and regulations may expose us to liabilities. These laws and regulations apply to companies, individual directors, officers, employees and agents, and may restrict our operations, trade practices, investment decisions and partnering activities. In particular, as a company registered with the Securities and Exchange Commission, or the SEC, we are subject to the regulations imposed by the Foreign Corrupt Practices Act, or FCPA. The FCPA prohibits us from providing anything of value to foreign officials for the purposes of influencing official decisions or obtaining or retaining business or otherwise obtaining favorable treatment, and requires companies to maintain adequate record-keeping and internal accounting practices to accurately reflect the transactions of the company. As part of our business, we deal with state-owned business enterprises, the employees and representatives of which may be considered foreign officials for purposes of the FCPA. If our efforts to screen third-party agents and detect cases of potential misconduct fail, we could be held responsible for the noncompliance of these third parties under applicable laws and regulations, which may have a material adverse effect on our reputation and our business, financial condition and results of operations. In addition, some of the international locations in which we operate lack a developed legal system and have elevated levels of corruption. As a result of the above activities, we are exposed to the risk of violating anti-corruption laws. We have established policies and procedures designed to assist us and our personnel to comply with applicable U.S. and international laws and regulations. However, there can be no assurance that our policies and procedures will effectively prevent us from violating these regulations in every transaction in which we may engage, and such a violation could adversely affect our reputation, business, financial condition and results of operations.

Reduction in Israeli government spending or changes in priorities for homeland security products may adversely affect our financial condition, operating results and prospects.

Historically, a significant portion of our revenues were from sales to the MOD and IDF and our financial condition, operating results and prospects would be adversely affected by Israeli government budget cutbacks or spending reductions. The award of additional contracts from the Israeli government could be adversely affected by spending reductions or budget cutbacks at government agencies that currently use or are likely to use our products. Our programs may be affected in the future if there is a reduction in Israeli government defense spending for our programs or a change in priorities to products other than ours. Accordingly, changes in government contracting policies, budgetary constraints and delays or changes in the appropriations process could have an adverse effect on our business, financial condition and results of operations.

We face risks associated with doing business in international markets.

A large portion of our sales is to markets outside of Israel. For the years ended December 31, 2011, 2012 and 2013 approximately 88.6%, 86.9% and 77.6%, respectively, of our revenues were derived from sales to markets outside of Israel. A key component of our strategy is to continue to expand in such international markets. Our international sales efforts are affected by costs associated with the shipping of our products and risks inherent in doing business in international markets, including:

- different and changing regulatory requirements in the jurisdictions in which we currently operate or may operate in the future;
- fluctuations in foreign currency exchange rates;
- export restrictions, tariffs and other trade barriers;
- difficulties in staffing, managing and supporting foreign operations;
- longer payment cycles;
- difficulties in collecting accounts receivable;
- political and economic changes, hostilities and other disruptions in regions where we currently sell or products or may sell our products in the future; and
- seasonal reductions in business activities.

Negative developments in any of these areas in one or more countries could result in a reduction in demand for our products, the cancellation or delay of orders already placed, difficulty in collecting receivables, and a higher cost of doing business, any of which could adversely affect our business, results of operations or financial condition.

We have significant operations in countries that may be adversely affected by political or economic instability, regime replacement, major hostilities or acts of terrorism.

We are a global security company with worldwide operations. Although approximately 63% of our sales are generated in Israel, North America and Western Europe, we expect to derive an increasing portion of our sales and future growth from other regions or regime replacements which freeze the activity, budget allocation and execution decisions in these markets until the new regime is setting up, such as Africa or regime replacements which freeze the activity, budget allocation and execution decisions in these markets until the new regime is setting up, India, Latin America and Central and Eastern Europe, which may be susceptible to political or economic instability.

Significant portions of our operations are conducted outside the markets in which our products and solutions are manufactured or generally sold, and accordingly, we often export a substantial number of products into such markets. We may, therefore, be denied access to potential customers or suppliers or denied the ability to ship products from any of our subsidiaries into the countries in which we currently operate or wish to operate, as a result of economic, legislative, political and military conditions, including hostilities and acts of terrorism, in such countries.

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

Cyber attacks or other breaches of network or information technology (IT) security, natural disasters, terrorist acts or acts of war may cause equipment failures or disrupt our systems and operations. We may be subject to attempts to breach the security of our networks and IT infrastructure through cyber attack, malware, computer viruses and other means of unauthorized access. While we maintain insurance coverage for some of these events, the potential liabilities associated with these events could exceed the insurance coverage we maintain. A failure to protect the privacy of customer and employee confidential data against breaches of network or IT security could result in damage to our reputation. To date, we have not been subject to cyber attacks or other cyber incidents which, individually or in the aggregate, resulted in a material impact to our operations or financial condition.

We may not be able to protect our proprietary technology and unauthorized use of our proprietary technology by third parties may impair our ability to compete effectively.

Our success and ability to compete depend in large part upon protecting our proprietary technology. We have 14 patents and have 5 patent applications pending. We also rely on a combination of trade secret and copyright law and confidentiality, non-disclosure and assignment-of-inventions agreements to protect our proprietary technology. It is our policy to protect our proprietary rights in our products and operations through contractual obligations, including confidentiality and non-disclosure agreements with certain employees, distributors and agents, suppliers and subcontractors. These measures may not be adequate to protect our technology from third-party infringement, and our competitors may independently develop technologies that are substantially equivalent or superior to ours. Additionally, our products may be sold in foreign countries that provide less protection to intellectual property than that provided under U.S. or Israeli laws.

Claims that our products infringe upon the intellectual property of third parties may require us to incur significant costs, enter into licensing agreements or license substitute technology.

Third parties may in the future assert infringement claims against us or claims asserting that we have violated a patent or infringed upon a copyright, trademark or other proprietary right belonging to them. Any infringement claim, even one without merit, could result in the expenditure of significant financial and managerial resources to defend against the claim. In addition, we purchase components for our turnkey products from independent suppliers. Certain of these components contain proprietary intellectual property of these independent suppliers. Third parties may in the future assert claims against our suppliers that such suppliers have violated a patent or infringed upon a copyright, trademark or other proprietary right belonging to them. If such infringement by our suppliers or us were found to exist, a party could seek an injunction preventing the use of their intellectual property. Moreover, a successful claim of product infringement against us or a settlement could require us to pay substantial amounts or obtain a license to continue to use such technology or intellectual property. Infringement claims asserted against us could have a material adverse effect on our business, operating results and financial condition.

Undetected defects in our products may increase our costs and impair the market acceptance of our products.

The development, enhancement and implementation of our complex systems entail substantial risks of product defects or failures. Despite testing by us and our customers, errors may be found in existing or new products, resulting in delays, loss of revenues, warranty expense, loss of market share, failure to achieve market acceptance, adverse publicity, product returns, loss of competitive position or claims against us by customers. Any such problems could be costly to remedy and could cause interruptions, delays, or cessation of our product sales, which could cause us to lose existing or prospective customers and could negatively affect our results of operations. Moreover, the complexities involved in implementing our systems entail additional risks of performance failures. We may encounter substantial difficulties due to such complexities which could have a material adverse effect upon our business, financial condition and results of operations.

If subcontractors and suppliers terminate our arrangements with them, or amend them in a manner detrimental to us, we may experience delays in production and implementation of our products and our business may be adversely affected.

We acquire most of the components utilized in our products, including our turnkey solutions, from a limited number of suppliers. We may not be able to obtain such items from these suppliers in the future or we may not be able to obtain them on satisfactory terms. Temporary disruptions of our manufacturing operations would result if we were required to obtain materials from alternative sources, which may have an adverse effect on our financial results. In addition, the installation of our fence mounted vibration detection systems in Israel is outsourced primarily to two subcontractors. If either or both of such subcontractors were to be unable or unwilling to continue to perform such services, we would have to identify and qualify one or more substitute subcontractors to perform such services. This could cause delays in the implementation of our fence mounted vibration detection systems in Israel, the costs associated with installing such systems may increase and our business may be adversely affected.

We currently benefit from government programs and tax benefits that may be discontinued or reduced in the future, which would increase our future tax expenses.

We currently benefit from grants and tax benefits under Israeli government programs, which require us to meet specified conditions, including, but not limited to, making specified investments from our equity in fixed assets and paying royalties with respect to grants received. In addition, some of these programs restrict our ability to manufacture particular products or transfer particular technology outside of Israel. We also benefit from tax credits pursuant to the Scientific Research and Experimental Development Tax incentive Program in Canada.

If we fail to comply with the conditions imposed by the Israeli law or the Canadian tax program in the future, the benefits we receive could be cancelled and we could be required to refund any payments previously received under these programs, including any accrued interest, or pay increased taxes or royalties. Such a result would adversely affect our results of operations and financial condition.

The Israeli government has reduced the benefits available under these programs in recent years and these programs and benefits may be discontinued or curtailed in the future. If the Israeli or Canadian governments resolve to end these programs and benefits, our business, financial condition, results of operations and net income could be materially adversely affected.

We may fail to maintain effective internal control over financial reporting, which could result in material misstatements in our financial statements.

The Sarbanes-Oxley Act of 2002 imposes certain duties on us and our executives and directors. Our efforts to comply with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 governing internal controls and procedures for financial reporting have resulted in increased general and administrative expense and a diversion of management time and attention, and we expect these efforts to require the continued commitment of significant resources. Section 404 of the Sarbanes-Oxley Act requires management's annual review and evaluation of our internal control over financial reporting in connection with the filing of the annual report on Form 20-F for each fiscal year. We may identify material weaknesses or significant deficiencies in our internal control over financial reporting. Failure to maintain effective internal control over financial reporting could result in material misstatements in our financial statements. Any such failure could also adversely affect the results of our management's evaluations and annual auditor reports regarding the effectiveness of our internal control over financial reporting. Failure to maintain effective internal control over financial reporting could result in investigation or sanctions by regulatory authorities and could have a material adverse effect on our operating results, investor confidence in our reported financial information and the market price of our ordinary shares.

Regulations that impose disclosure requirements regarding the use of “conflict” minerals mined from the Democratic Republic of Congo and adjoining countries in our products will result in additional cost and expense and could result in other significant adverse effects.

Rules adopted by the SEC implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act impose diligence and disclosure requirements regarding the use of “conflict” minerals mined from the Democratic Republic of Congo and adjoining countries in our products. Compliance with these rules may result in additional cost and expense, including for due diligence to determine and verify the sources of any conflict minerals used in our products, in addition to the cost of remediation and other changes to products, processes, or sources of supply as a consequence of such verification activities. These rules may also affect the sourcing and availability of minerals used in the manufacture of our products to the extent that there may be only a limited number of suppliers offering “conflict free” metals that can be used in our products. There can be no assurance that we will be able to obtain such metals in sufficient quantities or at competitive prices. Also, since our supply chain is complex, we may face reputational challenges with our customers, stockholders and other stakeholders if we are unable to sufficiently verify the origins of the metals used in our products. We may also encounter customers who require that all of the components of our products be certified as conflict free. If we are not able to meet customer requirements, such customers may choose to disqualify us as a supplier, which could impact our sales and the value of portions of our inventory.

Risks Relating to Our Ordinary Shares

Volatility of the market price of our ordinary shares could adversely affect our shareholders and us.

The market price of our ordinary shares has been, and is likely to be, highly volatile and could be subject to wide fluctuations in response to numerous factors, including the following:

- actual or anticipated variations in our quarterly operating results or those of our competitors;
- announcements by us or our competitors of technological innovations or new and enhanced products;
- developments or disputes concerning proprietary rights;
- introduction and adoption of new industry standards;
- changes in financial estimates by securities analysts;
- market conditions or trends in our industry;
- changes in the market valuations of our competitors;
- announcements by us or our competitors of significant acquisitions;
- entry into strategic partnerships or joint ventures by us or our competitors;
- additions or departures of key personnel;
- political and economic conditions, such as a recession or interest rate or currency rate fluctuations or political events; and
- other events or factors in any of the countries in which we do business, including those resulting from war, incidents of terrorism, natural disasters or responses to such events.

In addition, the stock market in general, and the market for Israeli companies and home security companies in particular, has been highly volatile. Many of these factors are beyond our control and may materially adversely affect the market price of our ordinary shares, regardless of our performance. In the past, following periods of market volatility, shareholders have often instituted securities class action litigation relating to the stock trading and price volatility of the company in question. If we were involved in any securities litigation, it could result in substantial cost to us to defend and divert resources and the attention of management from our business.

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

We currently intend to retain our existing and future earnings to finance operations and expand our business and, therefore, do not expect to pay any dividends in the foreseeable future. According to the Israeli Companies Law, a company may distribute dividends out of its profits (as defined by the Israeli Companies Law), provided that there is no reasonable concern that such dividend distribution will prevent the company from paying all its current and foreseeable obligations, as they become due, or otherwise upon the permission of the court. The declaration of dividends is subject to the discretion of our board of directors and would depend on various factors, including our operating results, financial condition, future prospects and any other factors deemed relevant by our board of directors. You should not rely on an investment in our company if you require dividend income from your investment.

As a foreign private issuer whose shares are listed on the NASDAQ Global Market, we may follow certain home country corporate governance practices instead of certain NASDAQ requirements. We follow Israeli law and practice instead of NASDAQ rules regarding the director nomination process, compensation of executive officers and the requirement that our independent directors have regularly scheduled meetings at which only independent directors are present.

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

Risks Relating to Our Location in Israel

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

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

Since its establishment in 1948, Israel has been involved in a number of armed conflicts with its Arab neighbors and a state of hostility, varying from time to time in intensity and degree, has continued into 2013. 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, Hezbollah in Lebanon and Syria and El-Qaida in Egypt. 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, we could be adversely affected by the interruption or reduction of trade between Israel and its trading partners. Some countries, companies and organizations continue to participate in a boycott of Israeli companies and others doing business with Israel or with Israeli companies. As a result, we are precluded from marketing our products to these countries, companies and organizations. Foreign government defense export policies towards Israel could also make it more difficult for us to obtain the export authorizations necessary for our activities. Also, over the past several years there have been calls in Europe and elsewhere to reduce trade with Israel. Restrictive laws, policies or practices directed towards Israel or Israeli businesses may have an adverse impact on our operations, our financial results or the expansion of our business.

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

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

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

We are incorporated under Israeli law. The rights and responsibilities of holders of our ordinary shares are governed by our memorandum of association and articles of association and by Israeli law. These rights and responsibilities differ in some respects from the rights and responsibilities of shareholders in typical U.S. corporations. In particular, a shareholder of an Israeli company has a duty to act in good faith in exercising his or her rights and fulfilling his or her obligations toward the company and other shareholders and to refrain from abusing his power in the company, including, among other things, in voting at the general meeting of shareholders on certain matters. Israeli law provides that these duties are applicable in shareholder votes on, among other things, amendments to a company's articles of association, increases in a company’s authorized share capital, mergers and interested party transactions requiring shareholder approval. In addition, a controlling shareholder of an Israeli company or a shareholder who knows that it possesses the power to determine the outcome of a shareholder vote or who has the power to appoint or prevent the appointment of a director or executive officer in the company has a duty of fairness toward the company. However, Israeli law does not define the substance of this duty of fairness. Because Israeli corporate law has undergone extensive revision in recent years, there is little case law available to assist in understanding the implications of these provisions that govern shareholder behavior.

Our shareholders generally may have difficulties enforcing a U.S. judgment against us, our executive officers and directors and some of the experts named in this annual report, or asserting U.S. securities law claims in Israel.

We are incorporated in Israel and all of our executive officers and directors named in this annual report reside outside the United States. Service of process upon them may be difficult to effect within the United States. Furthermore, since substantially all of our assets and all of our directors and officers are located outside the United States, any judgment obtained in the United States against us or these individuals may not be collectible within the United States and may not be enforced by an Israeli court. It also may be difficult for you to assert U.S. securities law claims in original actions instituted in Israel.

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

ITEM 4. Information on the Company

A. History and Development of the Company.

We were incorporated under the laws of the State of Israel on March 27, 1984 under the name Magal Security Systems Ltd. We are a public limited liability company under the Israeli Companies Law, 5739-1999, and operate under this law and associated legislation. Our principal executive offices and primary manufacturing and research and development facilities are located near Tel Aviv, Israel, in the Yehud Industrial Zone. Our mailing address is P.O. Box 70, Industrial Zone, Yehud 56100, Israel and our telephone number is +972-3-539-1444. Our agent for service of process in the United States is Senstar Inc., 13800 Coppermine Road, Second Floor, Herndon, Virginia 20171. Our website address is www.magal-S3.com. The information on our website is not incorporated by reference into this annual report.

We are a leading international provider of products and solutions for physical and cyber security, safety and site management. Over the past 42 years, we have delivered products and tailor-made solutions and turnkey projects to hundreds of satisfied customers in over 80 countries in some of the world's most demanding locations.

We offer comprehensive integrated solutions for critical sites, managed by Fortis4G – our 4th generation cutting edge Physical Security Information Management system (PSIM). The solutions leverage our broad portfolio of homegrown Perimeter Intrusion Detection Systems (PIDS), advanced outdoors Close Circuit Television (CCTV)/ Intelligent Video Analysis (IVA), technology and cyber security solutions.

We will implement our 2013 growth strategy plan to acquire a security products or Cyber company that will broaden our portfolio in the security business (HLS) both in the physical and logical field.

We intend to increase our revenues in the perimeter products segment and Cyber segment by (i) locating new channels to promote and market our products; (ii) maintaining technology leadership; (iii) investing in research and development; (iv) entering into additional OEM agreements; (v) acquiring new technologies independently or through mergers and acquisitions; and (vi) acquiring a new products or cyber company.

In June 2012, our Canadian subsidiary signed an OEM agreement to supply an advanced long range fiber based detection system, which complements our product offerings for sites with long perimeters. We established a new joint venture in India in 2012 and intend to continue to focus on and enhance our presence in emerging markets such as Russia, India and China, in order to increase our exposure to small and medium size business opportunities for both our perimeter products and solutions and turnkey projects segments. In January 2013, we purchased WebSilicon Ltd., an Israeli cyber security company, which later changed its name to CyberSeal Ltd. CyberSeal products and services complement our physical security products and services Our capital expenditures for the years ended December 31, 2011, 2012 and 2013 were approximately $1.2 million, $1.7 million and $1.2 million, respectively. These expenditures were principally for the purchase of vacant land in Cuernavaca, Mexico, on which we are building facilities for our Mexican subsidiary and the purchase of vehicles, computers software, demo and promotional equipment. In addition, part of the acquisition of CyberSeal was paid in cash of approximately $2.6 million.

B. Business Overview.

Overview and Strategy

We develop, manufacture, market and sell comprehensive computerized physical and cyber security, products and systems to high profile customers. Our systems are used in more than 80 countries to protect sensitive facilities, including national borders, military bases, power plants, airports, seaports, prisons, industrial sites, oil and gas facilities, Olympic villages and stadiums and municipalities from intrusion, crime, sabotage or vandalism to infrastructure, assets and personnel.

Based on more than 40 years of experience and interaction with customers, we have developed a comprehensive set of solutions and products, optimized for perimeter, outdoor and general security applications. Our portfolio of mission critical infrastructure and site protection technologies includes a variety of smart fences and barriers, fence mounted sensors, virtual (volumetric) fences and gates, buried and concealed detection systems and a sophisticated protection package for sub-surface intrusion. As a world class innovator in outdoor video motion detection, or VMD, and IVA applications, we deliver comprehensive IP technology and traditional CCTV solutions.

With the addition of CyberSeal's products and expertise, we are now able to expand our solutions to include cyber security. Our initial focus is to provide cyber security for physical security networks; these networks are extremely exposed due to several reasons:

- Lack of awareness –Security solutions have migrated, along the last ten years, to become fully networked. Yet unlike the IT world, where network security is an integral element, customers, integrators and product suppliers have no awareness of the new cyber threats to these networks.

- The proliferation of internet, WiFi and mobile devices into the security market expose these networks to new, easy to access threats.

- Lack of knowhow – Security integrators have very limited knowhow regarding network security and thus fail to implement even basic measurements against cyber threats.

However these security networks have some inherent characteristics that differentiate them from regular IT networks:

- Security networks are relatively static (compared to IT networks). As an example Camera A is always transmitting video through a specific path; Point B is always seeing the same protocol from device C.

- The frequency of changes in the networks is very low (unlike IT networks).

We therefore believe that these networks should be protected by dedicated solutions, rather than trying to implement some very expensive standard cyber security solutions (IT). We currently offer 3 families of products:

- Network security – Hardware and software products which are built into the security network, and monitor abnormal behavior.

- Cellular security – Transceivers with a variety of features enabling secure cellular and RF environments around and within critical sites.

- Cyber management tolls which collect cyber events and support quick reaction and risk mitigation.

Our integrated solutions are based on a broad in-house product portfolio, complemented by OEM and third party products. A typical turnkey solution is integrated and managed by our Fortis - a sophisticated, geographical information system, or GIS, based command and control system. Fortis can also manage the cyber solutions we provide.

A typical turnkey project consists of the following phases:

- Studying and understanding customers' requirements and conducting an environmental and site analysis;

- Conducting a terrain survey;

- Detailed planning that is focused and tailored around the users – first responders and operators in the command and control center(s);

- Implementation - manufacturing, purchasing, integrating, testing and installing the project;

- Commissioning and training; and

- Post-sales support, including upgrades, especially for the cyber portion of our solutions.

Our revenues are principally derived from:

- Sales of security products;
- Installation of comprehensive security solutions and / or turnkey projects derived from process bids leading to fixed-price contracts; and
- Services and maintenance based on post-sale maintenance contracts.

Our primary objective is to become a leading international solution provider of safety, security and site management solutions and products. To achieve this objective, we are implementing a business strategy incorporating the following key elements:

- Leverage existing customer relationships. We believe that we have the capability to offer certain of our customers a comprehensive security package. As part of our product development process, we seek to maintain close relationships with our customers to identify market needs and to define appropriate product specifications. We intend to expand the depth and breadth of our existing customer relationships while initiating similar new relationships. Our new cyber offering is an excellent opportunity to revisit our existing customers.

- Refine and broaden our product portfolio. We have identified the security needs of our customers and intend to enhance our current products' capabilities, develop new products, acquire complementary technologies and products and enter into OEM agreements with third parties in order to meet those needs.

- Refine and broaden our integration and turnkey delivery capabilities. As a solution provider we depend on our capability to tailor specific solutions for each customer. Our integration building blocks and our execution skills are key factors in achieving our growth and profitability.

- Enter new markets and strengthen presence in existing markets. We intend to continue to penetrate new geographic markets by various means, including the establishment of alliances with local distributors and international integrators of security systems. We also intend to increase our marketing efforts in our existing markets and to acquire or invest in complementary businesses and joint ventures.

Emerging Opportunities

- The rapid introduction of digital communication and information technology into the security market provides us with the opportunity to consolidate safety and site management with security applications. Cities and municipalities, air and sea ports, chemical factories, Olympic villages and stadiums and critical infrastructure sites are currently utilizing the benefits of this approach to security management. This integration allows users to share dispersed sensors (such as cameras and emergency buttons), IT systems, traffic management tools, Cyber solutions and other resources and feed them into a single command and control platform. Users from different departments within organizations can now share the same information, allowing for improved communication and coordination, whether it is a routine operation or crisis situation. We believe that we are well positioned and are in the forefront of this emerging market opportunity. We can also address the new cyber threats that massive digitization and networking impose on the sites we traditionally protect with physical security. We believe that these new threats create additional opportunities for us to expand our offerings with products, solutions and services.

- The urgent need to treat cyber and physical security together in a holistic manner is gaining momentum. We believe that following the acquisition of CyberSeal, we are well positioned to capitalize on this trend.

Products and Services

General

Our products are categorized into five families of systems:

- Perimeter security systems, consisting of a mix of PIDS technologies with physical barrier solutions;
- Perimeter security Robot;
- CCTV systems;
- Cyber security systems;
- Command and control systems; and
- Miscellaneous systems tailored for specific vertical market needs.

The following table shows the breakdown of our consolidated revenues for the calendar years 2011, 2012 and 2013 by operating segment:

	Years ended December 31, 2011	2012	2013
	(In thousands)		
Perimeter products	$30,012	$33,941	$30,551
Turnkey projects	59,707	45,038	20,137
Cyber	-	-	1,638
Eliminations	(1,128)	(1,282)	(809)
Total	$88,591	$77,697	$51,517

Perimeter Security Systems

Perimeter security systems enable customers to monitor, limit and control access by unauthorized personnel to specific regions or areas. High-end perimeter systems are sophisticated in nature and are used for correctional facilities, borders, nuclear and conventional power plants, air and sea ports, military installations and other high security installations. In early 2010, two independent research organizations, Frost & Sullivan and IMS Research, recognized our company as the number one provider of PIDS technology.

Our line of perimeter security systems utilizes sophisticated sensor devices to detect and locate intruders and identify the nature of intrusions. Our perimeter security systems have been installed along thousands of kilometers of borders and facility boundaries throughout the world, including more than 600 correctional institutions and prisons in the United States and in several other countries. In addition, we have installed several hundred kilometers of high security smart perimeter systems along Israel's borders.

Our line of outdoor perimeter security systems consists of the following:

- Taut wire – hybrid perimeter intrusion detection systems with physical barrier;

- Fence mounted vibration detection systems – mechanical, copper “microphonic” wire sensors, fiber optic sensors or electronic ranging sensors;

- Smart barriers – a variety of robust detection grids, gates and innocent looking fences, designed to protect water passages, VIP residences and other outdoor applications;

- Buried cable sensors - traditional volumetric buried cable sensors, seismic sensors to protect pipelines and critical assets against digging and fiber sensors to protect buried pipelines (an OEM product);

- Electrical field disturbance sensors (volumetric); and
- Microwave sensors.

Taut Wire Perimeter Intrusion Detection Systems

Our taut wire perimeter systems consist of wire strung at high tension between anchor posts. Sensor posts are located at the middle between anchor posts. These sensor posts contain one or more devices that detect changes in the tension being exerted on and by the taut wires. Any force applied against these wires or released from them (such as by cutting) that is not within the parameters designed into the sensors themselves or programmed into the central control units, automatically triggers an alarm. Taut wire technology provides three critical elements of protection against unauthorized intruders: deterrence, detection and delaying (until first responders may react and intercept the intruder).

Our sealed sensors are not affected by radio frequency interference, climatic or atmospheric conditions, or electrical transients from power lines or passing vehicles. The sensors self-adjust to, or remain unaffected by, extreme temperature variation, minor soil movements and other similar environmental changes that might trigger false alarms in less sophisticated systems. Our taut wire perimeter systems are designed to distinguish automatically between fence tension changes typically caused by small animals or violent weather and forces more typically exerted by a human intruder.

Our taut wire perimeter systems offer customers a wide range of installation options. Sensor posts can be as far as 200 feet apart, with relatively inexpensive ordinary fence anchor posts between them. These systems may stand alone, be mounted on a variety of fence posts or added to an existing wall or other structure, or mounted on short posts, with or without outriggers.

Taut wire perimeter systems have been approved by various Israeli and U.S. security and military authorities. We have installed several hundred kilometers of these perimeter systems along Israel's borders to assist in preventing unauthorized entry and infiltration. Our taut wire perimeter systems are typically sold to the end-user for between $50 to $200 per meter (depending, among other things, on the model, height, density, and corrosion protection level of the system).

Fence Mounted Vibration Detection Systems

We offer various types of vibration detection systems. While less sensitive than taut wire installations, the adaptability of these systems to a wide range of pre-existing barrier structures makes these products viable alternatives for cost-conscious customers. Our vibration detection devices are most effective when installed on common metal fabric perimeter systems, such as chain link or welded mesh. In our BARRICADE system, electro-mechanical sensors are attached to fence panels approximately three meters apart on any of several common types of fence structures. Once attached to the fence, each sensor detects vibrations in the underlying structures. The sensor system's built-in electro-mechanical filtering combines with system input from a weather sensor to minimize the rate of false alarms from wind, hail or other sources of nuisance vibrations. Our BARRICADE II system leverages the same configuration of the first generation and adds a ranging feature, which provides the capability to locate the exact vibrated sensor (rather than causing an alarm of a full physical segment of approximately 100 meters). The last development is the Fensor – an electronic, fence mounted, vibration detection system that is capable of locating the exact location of an intrusion within 3 meters. Each sensor can be tuned separately according to the local environment.

Intelli-FLEX, FLEX PS, Intelli-FIBER and fence protection systems, or FPS, microprocessor-based triboelectric and electric cable fence sensors are vibration sensitive transducers. These systems detect any attempt to cut, climb or penetrate the fence and have microphonic properties. The microphonic feature permits audio to be used for low-cost alarm assessment, providing users with an additional tool for determining the nature of an attempted intrusion. Our vibration detection system is typically sold to the end-user for between $15 to $60 per meter.

We recently began to sell the Pinpointer, a fence-mounted vibration sensor that is capable of defining the exact location of an intrusion to within 2 to 3 meters (6.5 to 10 ft.). While maintaining the legacy features of the original sensor, Pinpointer has the ability to identify the exact disturbed sensor along a long chain of sensors, which are typically 2 to 3 meters (6.5 to 10 ft.) apart.

During 2012, we added the FiberLR as an OEM product that is optimized to protect sites with long perimeters (more than 7km or 4.35 miles).

In 2013, we developed two advanced technologies which are expected to be incorporated in new products that are scheduled to be introduced in the second part of 2014. While our goal is that these new technologies will position us as technology leaders, we believe that these new products will not account for significant revenues in 2014 because of the nature of the market, which is often slow in adopting new technologies.

Buried Sensors

Omnitrax is a fifth generation, covert outdoor perimeter security intrusion detection sensor that generates an invisible radar detection field around buried sensor cables. An alarm is emitted and the exact location identified within one meter if an intruder disturbs the field. Targets are detected by their conductivity, size and movement and the digital processor is able to filter out common alarms caused by environmental conditions and small animals. The Omnitrax system is sold for between $40 to $80 per meter.

PipeGuard and TunnelGuard are products developed around commercial off-the-shelf seismic) sensors in order to detect digging around critical assets. TunnelGuard is installed mainly in Latin America to protect bank vaults and prisons. TunnelGuard is also being used to protect archeological sites in China.

A PipeGuard solution will include an array of standalone sensors, all communicating within a meshed network that senses any attempt to dig close to the protected assets. It can be integrated into a full turnkey solution, including perimeter intrusion protection, ground or air patrols and alarm monitoring and control. PipeGuard combines geophones with advanced technology recognition algorithm capabilities based on the analysis of seismic signals to effectively filter out false alarms. This intelligent signal processing provides a high probability of detection and low false and nuisance alarm rates.

We believe that the target markets for PipeGuard are in the western and developed countries where environmental issues are, or will become, regulated. PipeGuard is an ideal solution for alerting utility operators early enough before digging causes catastrophic damage to existing oil and gas pipes.

FiberLR, our new OEM product is also offered to protect pipelines against sabotage, leakage and siphoning.

Electrical Field Disturbance Sensors

Terrain following volumetric sensors can detect intrusions before the intruder touches the sensor. They can be installed on buildings, free-standing posts, existing fences, walls or rooftops, and will sense changes in the electrostatic field when events, such as intruders penetrating through the wires, take place. The system’s tall, narrow, well contained detection zone allows the sensor to be installed in almost any application and minimizes nuisance alarms caused by nearby moving objects. Our flagship product is X-Field; it consists of a set of four and/or eight parallel field sensing wires and is sold for between $100 and $190 per meter. We also offer a deployable volumetric sensor, used to protect military forces deployed on short notice that need fast reaction with minimal effort.

Microwave Products

We also offer a range of bi-static microwave products that are designed for stable, reliable operation in extreme outdoor environments. Coverage distances range from 180 meters to 450 meters. In 2011, we launched a new version of our microwave product, which has a K band improved sensor, is fully digital and has extended processing and communication features.

Perimeter security Robot;

In 2013, we added new product for perimeter security, called RoboGuard. RoboGuard is a revolutionary innovation in perimeter security: a robot that runs on an elevated rail along the perimeter of protected sites or border lines, carrying an assortment of sensors. The robot can respond promptly and rush to the exact zone or location where intrusions is suspected; or automatically patrol and inspect the fence integrity, looking for holes or suspicious nearby objects, by using sophisticated IVA (Intelligent Video Analytics) algorithms.

A typical RoboGuard configuration would include:

- Two fixed cameras with IR illuminators for stereoscopic fence investigation
- One PTZ camera
- Two-way intercom in order to communicate with intercepted would-be intruders

CCTV Systems

We have a proven track record in delivering CCTV and IVA solutions that are designed for use in outdoor applications. In the past Magal offered a dedicated Video Management System (VMS). These capabilities are now fully embedded as part of Magal's PSIM system – the Fortis4GMTC-1500I.

MTC-1500I is a high-end yet affordable, dual technology (thermal and charge-coupled device) outdoor surveillance system. A high-quality image rendered by the thermal sensor provides long distance detection and recognition of humans in day, night and under poor visibility conditions. The two cameras are mounted on a single pedestal and controlled through an agile and accurate pan-tilt-zoom-focus engine.

The MTC-1500I is suitable for the protection of any critical object or site. Markets for the system include airports, seaports, critical border crossings, utilities (such as oil, gas, refineries and water dams).

MSS-1500I

MSS-1500I is a dual camera (day and night) system designed for outdoor rapid deployment operations. The system is tailored for law enforcement, security and special operations forces. It enables camera installation close to the required observation area and communicates data to a remote center. The deployable element has a low footprint for concealed operation and can be put into operation within less than five minutes.

Command and Control Systems

The development of communication and IT technology has significantly affected the security market. Multiple security systems and technologies, sometimes supplied by different vendors, can now be integrated into a unified command and control system. We offer three types of command and control systems:

- Fortis4G – a fourth generation high-end comprehensive command and control system;
- StarNet 1000 - a basic security management system, or SMS; and
- Network Manager – a middleware (software) package.

Fortis 4G

FORTIS4G, is our latest Physical Security Information Management system (PSIM). It is a comprehensive, wide area and real time command and control solution, designed for entities requiring management of security, safety and dispatching. It is designed to manage daily routines and site activities, security, regular and irregular events as well as crisis situations.

FORTIS4G architecture integrates with legacy systems and sensors from the physical and logical (cyber) levels through a configuration and business logic layer and up to the situational awareness and management levels. It is based on a strong GIS engine, which creates a common layer for inputs, outputs and presentation. The GIS engine enables the display of synchronized information in time and space across all screens such as location of mobile forces, located alarms from stationary sensors, video of related cameras, pop-ups of associated radar screens and managed voice communication related to the managed area. Real-time information enables security personnel to respond immediately, while maintaining a full two-way communication and situational awareness between the command and control center(s) and the first responders. The target markets for Fortis4G are municipalities, city protection applications and, as part of other integrated solutions supplied by us, for use in airport, border and homeland security applications. Fortis4G incorporate the advanced video management capacities with full IVA features:

- Our investments in IVA tools help eliminate dependency on constant human monitoring. Automatic tools and algorithms extract abnormalities and only irregular events are transferred and analyzed for verification. This approach saves bandwidth and storage and more importantly requires human intervention only when needed.

- Our unique to the industry IVA / VMD has been developed to meet the challenge of the outdoor environment (such as weather effects, moving objects like trees, glare and flashing lights).

- Our video solutions have a proven track record in high-end vertical markets that require outdoor security such as military bases, government organizations, airports, seaports, mass transportation, correctional facilities, utilities and industrial sites.

StarNet 1000

StarNet 1000, an SMS, is suitable to manage basic sites, consisting of a PIDS with a few other devices.

StarNet2

StarNet2 is –a new version of the basic StarNet system. It is derived from the Fortis4G and thus will significantly improve its ancestor (StarNet 1000).

Network Manager

Network Manager is a middleware (software) package that is as an interface between our family of PIDS sensors and any command and control solution, be it our own system or an external third party application. It is provided to integrators with a full software development kit to enable fast integration of our PIDS into any other SMS and physical security information system.

Miscellaneous Systems

Life Safety / Duress Alarm Products

Our products include high reliability, personal, portable duress alarm systems to protect personnel in prisons. These products identify individuals in distress and can pinpoint the location of the distress signal with an indoor-to-outdoor and floor-to-floor accuracy unmatched by any other product.

Flash and flare personal emergency locating systems use radio frequency technology to provide a one touch emergency system that is so small it can be worn on a belt. The systems, sold to prisons, consist of transmitters that send distress signals to receivers mounted throughout the building. Receivers relay the signal to a central location, indicating that someone requires assistance and their location in the building. The systems employ automated testing procedures that help to reduce maintenance costs. The hardware and software was developed and researched in the United States and competes against infrared and other similar technologies.

PAS is another personal alarm system that uses an ultrasonic based emergency notification system. The system, sold mainly to prisons in the United States, allows individuals moving throughout a facility to quickly indicate their exact location in a crisis situation.

Cyber Protection Solutions

In January 2013, we acquired CyberSeal and started to initiate our strategy to expand our product offerings to include cyber protection solutions. These new solutions will monitor, detect and protect against abnormal network activity, both landline and wireless, within and close to protected sites. Following the acquisition of CyberSeal, we have developed the following new products:

- Tungsten – A hardened managed switch with built in security capabilities to monitor unauthorized traffic which is optimized for outdoors security networks;

- Cobalt – A Ruggedized Unidirectional Ethernet Data Diode, designed to control the flow of information between distinct networks and protect against cyber attacks;

- Yttrium - IMSI (International Mobile Subscriber Identity) Catcher Appliance that is capable of enforcing a cellular usage policy at a site by using a configurable set of rules;

- Vanadium - IMSI Catcher Detector designed to protect cellular subscribers within a secured site against diversion of their mobile devices (calls and data) through unauthorized pseudo operators;

- Rubidium – An easily operated SIEM (Security Information & Event Management) application, designed to manage CyberSeal's products as well as third party network and cyber monitoring devices.

During 2014, we intend to launch these products into our existing channels as well as through new channels, and to integrate them together for end users.

Marketing, Sales and Distribution

We believe that our reputation as a vendor of high-security products in one of the world's most security conscious countries often provides us and our sales representatives with direct access to senior government and corporate officials in charge of security matters elsewhere.

Our sales efforts focus on:

- Products (mainly PIDS and cyber). Products are sold indirectly through system integrators and distribution channels. Due to the sophistication of our products, we often need to approach end-users directly and be in contact with system integrators, however the sale is directed through a third party; and

- Solutions. This part of the business deals with end-customers or high-end system integrators. We offer a full comprehensive solution, which includes our in-house portfolio of products and products manufactured by third parties. Solutions are focused around our core competency (outdoor and cyber security, safety and site management). In many cases we take responsibility for the full turnkey solution and we integrate and deliver a full solution, including civil works, installation, training, warranty and after sale support. Cyber security is now offered as an integrated part of our comprehensive solutions.

In addition to our two main sales offices in Israel and Canada, we have sales offices in the United States, the United Kingdom, Germany, Mexico, China, Romania, Colombia and Spain. In India we have a joint venture covering this emerging market.

Customers

The following table shows the geographical breakdown of our consolidated revenues for the three years ended December 31, 2013:

	Year Ended December 31,		
	2011	2012	2013
	(In thousands)		
Israel	$ 10,091	$ 10,152	$ 11,517
North America	13,373	10,732	13,614
Europe	10,913	12,809	7,311
South and Latin America	12,145	15,159	3,118
Africa	35,499	21,642	8,182
Others	6,570	7,203	7,775
Total	$ 88,591	$ 77,697	$ 51,517

For the years ended December 31, 2011, 2012 and 2013, revenues generated from sales to the MOD and IDF accounted for 7.8%, 9% and 15% respectively, of our revenues. The Mexican Federal Prisons Authority, or CNS, a client in Mexico, accounted for 10.7%, 7.7% of our revenues in the years ended December 31, 2011 and 2012, respectively. In addition, our Gabonese Republic Project accounted for 34.8% of our revenues in 2011 and 6.7% of our revenues in 2012. The revenues from the provision of the perimeter security solution to the port of Mombasa, Kenya accounted for 2%, 19.3% and 14.2% of our revenues in the years ended December 31, 2011, 2012 and 2013, respectively. We cannot assure you that any of our major customers will maintain their level of business with us or that, if such business is reduced, other customers generating similar revenues will replace the lost business. For example, we completed the Gabonese Republic Project and do not expect to receive any future revenues from this project. The failure to replace these customers with one or more customers generating similar revenues will have a material adverse effect on our financial results.

Installation, Support and Maintenance

Our systems are installed by us or by the customer after appropriate training, depending on the size of the specific project and the location of the customer's facilities, as well as on the customer's prior experience with our systems. We generally provide our customers with training on the use and maintenance of our systems, that we conduct either on-site or at our facilities. In addition, some of our local perimeter security systems customers have signed maintenance contracts with us. For systems installed outside of Israel, maintenance is provided by an independent third party, by distributors or by the end-user. We also provide services, maintenance and support on an "as needed" basis.

The life expectancy of a high-security perimeter system is approximately ten years. Consequently, many miles of perimeter systems need to be replaced each year.

During the years ended December 31, 2011, 2012 and 2013, we derived approximately 6.6%, 8.9% and 16.7% of our total revenues, respectively, from maintenance and services.

Research and Development; Royalties

We place considerable emphasis on research and development to improve our existing products and technology and to develop new products and technology. We believe that our future success will depend upon our ability to enhance our existing products and technology and to introduce on a timely basis new commercially viable products and technology addressing the needs of our customers. We intend to continue to devote a significant portion of our personnel and financial resources to research and development. As part of our product development process, we seek to maintain close relationships with our customers to identify market needs and to define appropriate product specifications. Our development activities are a direct result of the input and guidance we receive from our marketing personnel during our annual meetings with such personnel. In addition, the heads of research and development for each of our development centers discussed below meet annually to identify market needs for new products.

Our research and development expenses during 2011, 2011 and 2013 were $3.9 million, $4 million and $4.4 million, respectively. In addition to our own research and development activities, we also acquire know-how from external sources. We cannot assure you that any of our research and development projects will yield profitable results.

We have the following two development centers, each of which develops products and technologies based on its area of expertise:

- In Israel - we develop a wide range of perimeter products including our taut wire, mechanical vibration, electronically vibration, video, perimeter security Robot and high-end SMS, command and control systems and PipeGuard, as well as the Cyber products.

- In Canada - we develop our buried cable sensors, fence mounted vibration detection systems, mechanical, copper and fiber-optic fence sensors, electrostatic volumetric detection, medium to high-end control systems, microwave detection, personal alarm systems and small to medium control systems.

Manufacturing and Supply

Our manufacturing operations consist of designing and developing our products, fabricating and assembling components and finished products, quality control and final testing. Substantially all of our perimeter manufacturing operations are currently performed at our facilities in Yehud, Israel and Ottawa, Canada. See Item 4D. “Information on the Company - Property, Plants and Equipment.” Our cyber manufacturing operations are currently performed at our facilities in Tel Aviv, Israel.

We acquire most of the components utilized in our products, including our turnkey products, and certain services from a limited number of suppliers and subcontractors. We cannot assure you that we will continue to be able to obtain such items from these suppliers on satisfactory terms. Alternative sources of supply are available, and therefore we are not dependent upon these suppliers and subcontractors. We also maintain an inventory of systems and spare parts in order to enable us to overcome potential temporary supply shortages until an alternate source of supply is available. Nevertheless, temporary disruptions of our manufacturing operations would result if we were required to obtain materials from alternative sources, which may have an adverse effect on our financial results.

Competition

PIDS Sensors. The principal factors affecting competition in the market for security systems are a system’s high probability for detection and low probability of false and nuisance alarms. We believe that a manufacturer’s reputation for reliable equipment is a major competitive advantage, and that such a reputation will usually be based on the performance of the manufacturer’s installed systems. Additional competitive factors include quality of customer support, maintenance and price.

The PIDS market is very fragmented. According to Frost & Sullivan and IMS Research reports which were published in the first half of 2012, we rank first based on market share with 10.2% - 15% of the market (the difference results from inclusion or exclusion of different technologies, such as radar and CCTV). Our competition includes Elfar Ltd. and RB-Tec Ltd. in Israel, and South West Microwave Inc., Future Fiber Technologies, Detection Security Systems Inc., Fiber Sensys Inc. Geoquip Ltd., GPS Standard SpA and Cias Elettronica Srl outside of Israel.

We don't see any competition for the RoboGuard right now.

We believe that our principal competitors for the PipeGuard system are Future Fibre Technologies Pty. Ltd., Optellios inc., Quinetic and FOTech and that our principal competitors for personal emergency location systems are Actall

Corp. and Visonic Networks.

The cyber market is still in its embryonic phase. We believe that this market will mature during the next three years at which time we will be in a better position to analyze it.

Turn Key Projects and Solutions. Thousands of solution providers offer security products and services. Most of the integrators focus on indoor applications, but some also offer outdoor solutions. Most of the market players are local to their countries; however some are global, such as ADT, Honeywell and Siemens. In some cases we may cooperate with global integrators or may supply equipment to them. We believe that our principal competitors in Israel for security solutions are Elbit Systems Ltd., C. Mer Industries Ltd., Afcon Industries Ltd. and Orad Ltd.

Some of our competitors and potential competitors have greater research, development, financial and personnel resources, including governmental support, or more extensive business experience than we do. We cannot assure you that we will be able to maintain the quality of our products relative to those of our competitors or continue to develop and market new products effectively.

Intellectual Property Rights

We have 14 patents issued and have 5 patent applications pending in the U.S. and in several other countries and have obtained licenses to use proprietary technologies developed by third parties. We cannot assure you:

- that patents will be issued from any pending applications, or that the claims allowed under any patents will be sufficiently broad to protect our technology;
- that any patents issued or licensed to us will not be challenged, invalidated or circumvented; or
- as to the degree or adequacy of protection any patents or patent applications may or will afford.

In addition, we claim proprietary rights in various technologies, know-how, trade secrets and trademarks relating to our principal products and operations. We cannot assure you as to the degree of protection these claims may or will afford. It is our policy to protect our proprietary rights in our products and operations through contractual obligations, including confidentiality and non-disclosure agreements with certain employees and distributors. We cannot assure you as to the degree of protection these contractual measures may or will afford. Although we are not aware that we are infringing upon the intellectual property rights of others, we cannot assure you that an infringement claim will not be asserted against us in the future. We believe that our success is less dependent on the legal protection that our patents and other proprietary rights may or will afford than on the knowledge, ability, experience and technological expertise of our employees. We cannot provide any assurance that we will be able to protect our proprietary technology. The unauthorized use of our proprietary technology by third parties may impair our ability to compete effectively. We could become subject to litigation regarding intellectual property rights, which could seriously harm our business.

We have registered trademarks for ULTRAWAVE, E-FIELD, FLARE, FLEXPI, FLEXPS, GUIDAR, INTELLI-FIELD, LOGO DESIGN (old Senstar), MISCELLANEOUS DESIGN (Stellar logo), OMNITRAX, PANTHER, PERIMITRAX, PINPOINTER, REPELS, S DESIGN, SENNET, SENSTAR, SENSTAR & DESIGN, SENSTAR-STELLAR, SENSTAR-STELLAR & DESIGN, SENTIENT, XFIELD, MAGAL, DTR, FORTIS, DREAMBOX, PIPEGUARD AND MAESTRO DB.

INTELLI-FLEX, INTELLIFIBER, STARLED, STARNET, ARMOURFLEX, FLASH, FLEXZONE, ROBOGUARD, FENSOR, CYBERSEAL, the Magal logo and all other marks used to identify particular products and services associated with our businesses are unregistered trademarks. Any other trademarks and trade names appearing in this annual report are owned by their respective holders.

Government Regulations

Current Israeli governmental policy encourages the export of security related products to approved customers, as long as the export is consistent with Israeli government policy. We are also subject to regulations related to the export of "dual use" items (items that are typically sold in the commercial market, but which may also be used for military use). Israel enhanced enforcement of export control legislation under the Defense Export Control Law, 2007, under which a license is required to initiate marketing activities and a specific export license is required for any hardware exported from Israel. The law provides for certain exemptions from the licensing requirement and broadens certain areas of licensing, particularly with respect to transfer of technology. We cannot assure that we will receive all the required permits and licenses for which we may apply in the future.

In addition, our participation in governmental procurement processes in Israel and other countries is subject to specific regulations governing the conduct of the process of procuring defense contracts. Furthermore, solicitations for procurements by governmental purchasing agencies in Israel and other countries are governed by laws, regulations and procedures relating to procurement integrity, including avoiding conflicts of interest and corruption in the procurement process.

In addition, antitrust laws and regulations in Israel and other countries often require governmental approvals for transactions that are considered to limit competition. Such transactions may include cooperative agreements for specific programs or areas, as well as mergers and acquisitions.

C. Organizational Structure.

We have wholly owned subsidiaries that operate in Israel (CyberSeal), Canada, the United States, Colombia, Brazil, Germany, Mexico, the United Kingdom, Romania and Spain. We also own 51% of the outstanding capital stock of our Indian subsidiary. Set forth below are our significant subsidiaries.

Subsidiary Name	Country of Incorporation/Organization	Ownership Percentage
Senstar Corp	Canada	100%
Senstar Inc.	United States	100%

D. Property, Plants and Equipment.

We own a two-story 2,533 square meter facility located on a 4,352 square meter parcel in the Yehud Industrial Zone, Israel, which is used as our principal facility. Approximately 600 square meters are devoted to administrative, marketing and management functions and approximately 700 square meters are used for engineering, system integration and customer service. We use the remaining area of approximately 1,200 square meters for production management and production operations, including manufacturing, assembly, testing, warehousing, shipping and receiving. We also lease a one-story 810 square meter facility located on a 1,820 square meter parcel in the Yehud Industrial Zone for $96,000 per year for use in production and operations. The lease terminates in 2029. The products that we manufacture at our facilities in the Yehud Industrial Zone include our taut-wire intrusion detection systems, our vibration detection systems, our video-motion detection systems, Fortis4G, Maestro DB, PipeGuard, MTC-1500, MSS-1500 and other perimeter systems.

We own a 33,000 square foot facility in Carp, Ontario, Canada. Approximately 9,000 square feet are devoted to administrative, marketing and management functions, and approximately 8,000 square feet are used for engineering, system integration and customer service. We use the remaining area of approximately 16,000 square feet for production operations, including cable manufacturing, assembly, testing, warehousing, shipping and receiving. We own an additional 182,516 square feet of vacant land adjacent to this property, which is being held for future expansion. We also rent 358,560 square feet of land near this facility for use as an outdoor sensor test and demonstration site for our products including the Omnitrex buried cable intrusion detection system, the X-Field volumetric system, the Intelli-FLEX and FlexPS microphonic fence detection system, Flash and Flare, and various perimeter monitoring and control systems. The rent for this site is approximately $3,500 per year plus taxes under a lease that expires in November 2014. In addition, we lease a 1,900 square feet facility adjacent to our Carp, Ontario property for use as additional storage and system integration space under a month to month tenancy costing approximately $1,500 per month.

In June 2012, we purchased 1,408 square meter of vacant land in Cuernavaca, Mexico, on which we established a facility for our Mexican subsidiary. This facility was officially opened on August, 2013. Since the beginning of 2013 till we have entered our new facility, we have paid approximately $28,000 for the previous offices in Mexico.

We also lease small office spaces in China, Colombia, Germany, Romania, Spain, the United Kingdom, India, Israel and Virginia and California in the United States, for our remaining entities. The aggregate annual rent for such offices was approximately $ 350,000 in 2013.

We believe that our facilities are suitable and adequate for our current operations and the foreseeable future.

ITEM 4A. Unresolved Staff Comments

Not applicable.

ITEM 5. Operating and Financial Review and Prospects

The following discussion of our results of operations and financial condition should be read in conjunction with our consolidated financial statements and the related notes thereto included elsewhere in this annual report. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors, including, but not limited to, those set forth in Item 3.D. "Key Information–Risk Factors."

A. Operating Results.

Overview

We develop, manufacture, market and sell complex computerized security systems. Our systems are used in more than 80 countries to protect aircraft, national borders and sensitive facilities, including military bases, power plant installations, airports, postal facilities, prisons, Olympic villages and stadiums and industrial locations from terrorism, theft and other security threats.

Our revenues are derived from our three operating segments:

- Perimeter Products segment - sales of perimeter products, including services and maintenance that are performed either on a fixed-price basis or pursuant to time-and-materials based contracts, and

- Turnkey Projects segment - installation of comprehensive turnkey solutions for which revenues are generated from long-term fixed price contracts.

- Cyber segment - provides hardware and software products, in the field of Cyber Security, for monitoring, securing, and the active management of wired, wireless, and fiber optic communication networks.

Perimeter Products Segment

The Perimeter Products segment sells its products worldwide and this segment includes the operations of Senstar Canada, Senstar Germany, Senstar UK and Senstar Inc. as one reporting unit within the Perimeter Products segment. The Israeli operations of the Perimeter Products segment as well as the Spanish operations are considered as two separate reporting units within that segment.

Turnkey Projects Segment

The Turnkey Projects segment has operations worldwide and the segment includes a number of reporting units operating in Israel, Mexico, Romania, Colombia and a division of Senstar Canada.

Cyber Segment

The Cyber segment has operation mainly in the US and in Israel. As of December 31, 2013, this segment includes the operations of CyberSeal Ltd.

Business Challenges/Areas of Focus

Our primary business challenges and areas of focus include:

- continuing the growth of revenues and profitability of our perimeter security system line of products;
- enhancing the introduction and recognition of our new products into the markets;
- penetrating new markets and strengthening our presence in existing markets; and
- succeeding in selling our comprehensive turnkey solutions.

Our business is subject to the effects of general global economic conditions. If general economic conditions or economic conditions in key markets remain uncertain or weaken further, demand for our products could be adversely affected.

Key Performance Indicators and Sources of Revenues

Our management believes that our revenues and operating income are the two key performance indicators for our business.

Our revenues from our perimeter products and turnkey projects segments for the three years ended December 31, 2013 and our revenues from our Cyber segment for the year ended December 31, 2013 were as follows:

	Year Ended December 31,		
	2011	2012	2013
	(in thousands)		
Perimeter products	$ 30,012	$ 33,941	$ 30,551
Turnkey projects	59,707	45,038	20,137
Cyber	-	-	1,638
Eliminations	(1,128)	(1,282)	(809)
Total	$ 88,591	$ 77,697	$ 51,517

The decrease in revenues from turnkey projects was primarily due to the early 2012 completion of the Gabonese Republic Project, which we received in 2011 with respect to the 2012 Africa Cup of Nations.

Our operating income (loss) from our perimeter products and turnkey projects segments for the three years ended December 31, 2013 and our operating income (loss) from our Cyber segment for the year ended December 31, 2013 were as follows:

	2011	2012	2013
	(In thousands)		
Perimeter products	$ 2,665	$ 4,409	$ 542
Turnkey projects	5,224	1,634	(3,571)
Cyber	-	-	(1,184)
Other income	2,304	-	-
Eliminations	(382)	(486)	(306)
Total	$ 9,811	$ 5,557	$ (4,519)

The profit in 2011 and 2012 is mainly attributable to increased government spending in certain territories which led to new projects in 2011 and 2012, while in 2013 the market was depressed due to the European economic slowdown and the reduction in government spending in certain territories.

Key Factors Affecting our Business

Our operations and the operating metrics discussed below have been, and will likely continue to be affected by certain key factors as well as certain historical events and actions. The key factors affecting our business and results of operations include among others, reliance on large orders from a small number of customers, the 2013 growth strategy plan, reliance on government contracts and competition. For further discussion of the factors affecting our results of operations, see “Risk factors.”

Reliance on large orders from a small number of customers

We receive relatively large orders for products from a relatively small number of customers. Consequently, a single order from one customer may represent a substantial portion of our sales in any one period and significant orders by any customer during one period may not be followed by further orders from the same customer in subsequent periods. Our sales and operating results are subject to very substantial periodic variations. Since quarterly performance is likely to vary significantly, our results of operations for any quarter or calendar year are not necessarily indicative of the results that we might achieve for any subsequent period. Accordingly, quarter-to-quarter and year-to-year comparisons of our operating results may not be meaningful. In addition, we have a limited order backlog that is generally composed of orders that are fulfilled within a period of three to twelve months after receipt, which makes revenues in any quarter substantially dependent upon orders received in prior quarters.

Growth Strategy Plan

In last quarter of 2013 we adopted a growth strategy beyond the core of our PIDS activity. Pursuant to this growth strategy, we will seek to acquire a security products or cyber company that will expand our portfolio in the security business (HLS) both in the physical and logical field. In addition, we determined to focus our business on our sensor activity, expand our sales channels and close certain technology gaps in response to new demands in the market place. We intend to implement the plan though organic growth or the acquisition of, or investment in, businesses, products and technologies that complement our security business within the PIDS or Cyber fields.

We may not be able to implement our growth strategy plan and may not be able to successfully expand our business activity and increase our sales. If we are successful in the implementation of our strategic plan, we may be required to hire additional employees in order to meet customer demands, and if we are unable to attract or retain qualified employees, our business could be adversely affected.

We may not be able to consummate any acquisitions or investments in the future or realize the benefits of such acquisitions and investments, if consummated.

Our failure to successfully integrate the operations of an acquired business or to retain key employees of acquired businesses and integrate and manage our growth may have a material adverse effect on our business, financial condition, results of operation or prospects. We may not be able to realize the anticipated benefits of any acquisition. Moreover, future acquisitions by us could result in potentially dilutive issuances of our equity securities, the incurrence of debt and contingent liabilities and amortization expenses related to identifiable intangible assets, any of which could materially adversely affect our operating results and financial position. Acquisitions also involve other risks, including risks inherent in entering markets in which we have no or limited prior experience.

Reliance on government contracts

Our products are primarily sold to governmental agencies, governmental authorities and government-owned companies, many of which have complex and time consuming procurement procedures. A substantial period of time often elapses from the time we begin marketing a product until we actually sell that product to a particular customer. In addition, our sales to governmental agencies, authorities and companies are directly affected by these customers' budgetary constraints and the priority given in their budgets to the procurement of our products. A decrease in governmental funding for our customers' budgets would adversely affect our results of operations. This risk is heightened during periods of global economic slowdown. Accordingly, governmental purchases of our systems, products and services may decline in the future if governmental purchasing agencies terminate, reduce or modify contracts.

Competition

The global market for safety, security, site management solutions and products is highly fragmented and intensely competitive. It is characterized by rapidly changing technology, frequent new product introductions and rapidly changing customer requirements. We compete principally in the market for perimeter intrusion detection systems, or PIDS, and turnkey projects and solutions. Some of our competitors and potential competitors have greater research, development, financial and personnel resources, including governmental support. We cannot assure you that we will be able to maintain the quality of our products relative to those of our competitors or continue to develop and market new products effectively. Continued competitive pressures could cause us to lose significant market share.

Explanation of Key Income Statement Items

Cost of revenues. Our cost of revenues for perimeter products consists of component and material costs, direct labor costs, subcontractor costs, shipping expenses, overhead related to manufacturing and depreciation. Our cost of revenues for turnkey projects consists primarily of component and material costs, subcontractor costs, direct labor costs and overhead related to the turnkey projects. Our cost of revenues for Cyber sales consists primarily of direct labor costs, some component, material and subcontractor costs and overhead related to those sales.

Our gross margin is affected by the proportion of our revenues generated from perimeter products, turnkey projects. Our revenues from perimeter products generally have higher gross margins than our other segment.

Research and development expenses, net. Research and development expenses, net consists primarily of expenses for on-going research and development activities and other related costs.

Selling and marketing expenses. Selling and marketing expenses consist primarily of commission payments, compensation and related expenses of our sales teams, attendance at trade shows and advertising expenses and related costs for facilities and equipment.

General and administrative expenses. Our general and administrative expenses consist primarily of salary and related costs associated with our executive and administrative functions, legal and accounting expenses, allowances for doubtful accounts and bad debts and other miscellaneous expenses. Staff costs include direct salary costs and related costs, such as severance pay, social security and retirement fund contributions, vacation and other pay.

Depreciation and Amortization. The amount of depreciation and amortization attributable to our business segments for the three years ended December 31, 2013 are as follows:

	Years Ended December 31,		
	2011	2012	2013
	(in thousands)		
Perimeter products	$ 722	$ 624	$ 606
Turnkey projects	497	554	629
Cyber	-	-	484
Total	$ 1,219	$ 1,178	$ 1,719

Financial Expenses, Net. Financial expenses, net include exchange rate differences arising from changes in the value of monetary assets and monetary liabilities stated in currencies other than the functional currency of each entity, currency and hedge transactions, interest charged on loans from banks as well as interest income on our cash and cash equivalents and short term investments.

Tax expense. Tax expense consists of federal, state and local taxes on the income of our business. We paid income taxes in Germany, Colombia and Mexico in each of the years ended December 31, 2011 and 2012.In 2013 we did not pay income taxes on those territories due to losses. In addition, we paid income taxes in Canada and the United States in 2012 and 2013. We did not pay taxes elsewhere because of our operating loss carry forwards.

Discussion of Critical Accounting Policies

The preparation of financial statements in conformity with U.S. GAAP requires us 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. Actual results could differ from those estimates and the use of different assumptions would likely result in materially different results of operations. Critical accounting policies are those that are both most important to the portrayal of our financial position and results of operations and require management's most difficult, subjective or complex judgments. Although not all of our significant accounting policies require management to make difficult, subjective or complex judgments or estimates, the following policies and estimates are those that we deem most critical.

Revenue Recognition

We generate our revenues mainly from (i) long-term fixed price contracts for installation of comprehensive turnkey systems; (ii) sales of perimeter products, including services and maintenance that are performed either on a fixed-price basis or as time-and-materials based contracts; and (iii) services and maintenance, which are performed either on a fixed-price basis or as time-and-materials based contracts.

Revenues from installation of comprehensive turnkey systems are generated from fixed-price contracts according to which the time between the signing of the contract and the final customer acceptance is usually over one year. Such contracts require significant customization for each customer's specific needs and, as such, revenues from this type of contract are recognized in accordance with ASC, 605-35 "Revenue Recognition -Construction-Type and Production-Type Projects," using contract accounting on a percentage of completion method. Accounting for long-term contracts using the percentage-of-completion method stipulates that revenue and expense are recognized throughout the life of the contract, even though the project is not completed and the purchaser does not have possession of the project. Percentage of completion is calculated based on the "Input Method."

Turnkey projects costs include materials purchased to produce the solutions, related labor and overhead expenses and subcontractor's costs. The percentage to completion is measured by monitoring costs and efforts devoted using records of actual costs incurred to date in the project compared to the total estimated project requirement, which corresponds to the costs related to earned revenues. The amounts of revenues recognized are based on the total fees under the agreements and the percentage of completion achieved. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are first determined, in the amount of the estimated loss on the entire contract.

Estimated gross profit or loss from long-term contracts may change due to changes in estimates resulting from differences between actual performance and original forecasts. Such changes in estimated gross profit are recorded in results of operations when they are reasonably determinable by management, on a cumulative catch-up basis.

We believe that the use of the percentage of completion method is generally appropriate as we have the ability to make reasonably dependable estimates of the extent of progress towards completion, contract revenues and contract costs. In addition, executed contracts include provisions that clearly specify the enforceable rights regarding services to be provided and received by the parties to the contracts, the consideration to be exchanged and the manner and the terms of settlement, including in cases of termination for convenience. In most cases we expect to perform our contractual obligations and our customers are expected to satisfy their obligations under the contract.

Fees are payable upon completion of agreed upon milestones and subject to customer acceptance. Revenues recognized in advance of contractual billing are recorded as unbilled accounts receivable. The period between most instances of advanced recognition of revenues and the billing of the customers generally ranges between one to six months. As of December 31, 2013, we had recorded $2.4 million of such unbilled receivables.

We also sell security products to customers according to customer orders without performing any installation work. Revenues from security product sales are recognized in accordance with Staff Accounting Bulletin No. 104, "Revenue Recognition in Financial Statements," or SAB No. 104, when delivery has occurred, persuasive evidence of an agreement exists, the vendor's fee is fixed or determinable, no further obligation exists and collectability is probable. Customers do not have a right to return the products.

Services and maintenance are performed under either fixed-price based or time-and-materials based contracts. Under fixed-price contracts, we agree to perform certain work for a fixed price. Under time-and-materials contracts, we are reimbursed for labor hours at negotiated hourly billing rates and for materials. Such service contracts are not in the scope of ASC 605-35, and accordingly, related revenues are recognized in accordance with SAB No. 104, as those services are performed or over the term of the related agreements provided that, an evidence of an arrangement has been obtained, fees are fixed and determinable and collectability is reasonably assured.

Deferred revenue includes unearned amounts under installation service contracts, service contracts and maintenance agreements.

Inventories

Inventories are stated at the lower of cost or market value. We periodically evaluate the quantities on hand relative to historical and projected sales volumes, current and historical selling prices and contractual obligations to maintain certain levels of parts. Based on these evaluations, inventory write-offs are provided to cover risks arising from slow-moving items, discontinued products, excess inventories, market prices lower than cost and adjusted revenue forecasts. Cost is determined as follows:

- Raw materials, parts and supplies - using the “first-in, first-out” method.
- Work-in-progress and finished products - on the basis of direct manufacturing costs with the addition of allocable indirect manufacturing costs.

During 2011, 2012 and 2013 we recorded inventory write-offs from continuing operations in the amounts of $1.0 million, $0.6 million and $0.6 million, respectively. Such write-offs were included in cost of revenues.

Income taxes

We account for income taxes in accordance with ASC 740 “Income Taxes.” This statement prescribes the use of the liability method whereby deferred tax asset and liability account balances are determined based on differences between financial reporting and 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. We provide a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and we must establish a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. Increases in the valuation allowance result in additional expense to be reflected within the tax provision in the consolidated statement of income.

As of December 31, 2013, we had a net deferred tax asset of $0.3 million attributable to our subsidiaries. We had total estimated available tax loss carryforwards of $13 million with respect to our operations in Israel and our subsidiaries, outside Israel, had estimated total available tax loss carryforwards of $11.9 million, of which $7.4 million was attributable to our U.S. subsidiary, which may be used as an offset against future taxable income for periods ranging between 6 and 18 years. As of December 31, 2013, we recorded a full valuation allowance on these carryforward tax losses due to the uncertainty of their future realization. Utilization of U.S. net operating losses may be subject to a substantial annual limitation due to the “change in ownership” provisions of the Internal Revenue Code of 1986 and similar state provisions. The annual limitation may result in the expiration of net operating losses before utilization.

Goodwill

We have recorded goodwill as a result of acquisitions, which represents the excess of the cost over the net fair value of the assets of the businesses acquired. We follow ASC 350, “Intangibles – Goodwill and Other,” which requires goodwill to be tested for impairment, at the reporting unit level, at least annually or between annual tests in certain circumstances, and written down when impaired, rather than being amortized. We perform our annual goodwill impairment test at December 31 of each year, or more often if indicators of impairment are present.

ASC 350 prescribes a two phase process for impairment testing of goodwill. The first phase screens for impairment, while the second phase (if necessary) measures impairment. In the first phase of impairment testing, goodwill attributable to each of the reporting units is tested for impairment by comparing the fair value of each reporting unit with its carrying value. If the carrying value of the reporting unit exceeds its fair value, the second phase is then performed. The second phase of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. Fair value is determined using discounted cash flows, based on the income approach, as we believe that this approach best approximates the reporting unit's fair value at this time. Significant estimates used in the methodologies include estimates of future cash flows, future short-term and long-term growth rates and weighted average cost of capital for each of the reportable units.

The goodwill on our balance sheet as of December 31, 2013 relates to certain of our subsidiaries within the Perimeter Products segment and to our last acquisition of CyberSeal. During 2011, 2012 and 2013 no impairment losses were identified.

The material assumptions used for the goodwill annual impairment test for the Perimeter Products segment, according to the income approach for 2013 were five years of projected net cash flows, a weighted average cost of capital rate of 14.3% and a long-term growth rate of 1%. 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 material assumptions used for the goodwill annual impairment test for the Cyber segment (which comprises a one reporting unit), according to the income approach for 2013 were five years of projected net cash flows, a weighted average cost of capital rate of 15% and a long-term growth rate of 2%. The Company considered 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.

Impairment of long lived assets

Our long-lived assets and certain identifiable intangibles are reviewed for impairment in accordance with ASC 360 "Property, Plant, and Equipment" whenever events or changes in circumstances indicate that the carrying amount of a group of assets may not be recoverable. Recoverability of a group of assets to be held and used is measured by a comparison of the carrying amount of the group to the future undiscounted cash flows expected to be generated by the group. If such group of assets is considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds their fair value. During 2011, 2012 and 2013, no impairment losses were identified.

Functional Currency and Financial Statements in U.S. Dollars

While our functional currency in Israel is the NIS, our reporting currency is the U.S. dollar. Translation adjustments resulting from translating our financial statements from NIS to the U.S. dollar are reported as a separate component in shareholders' equity. As of December 31, 2011, 2012 and 2013, our foreign currency translations totaled $0.6 million $2.2 million and $1.3 million, respectively.

During the years ended December 31, 2012 and 2013, we recorded accumulated foreign currency translation income of approximately $0.3 million and $2.4 million, respectively. During the year ended December 31, 2011 we recorded accumulated foreign currency translation expense of approximately $0.6 million, included in our balance sheets as part of "accumulated other comprehensive income." As of December 31, 2011, 2012 and 2013, foreign currency translation adjustments, net of $4.5 million, $4.7 million and $7.1 million, respectively, were included under "accumulated other comprehensive income."

The first step in the translation process is to identify the functional currency for each entity included in the financial statements. The accounts of each entity are then "re-measured" in its functional currency. All transaction gains and losses from the re-measurement of monetary balance sheet items are reflected in the statement of operations as financial income or expenses, as appropriate.

After the re-measurement process is complete the financial statements are translated into our reporting currency, which is the U.S. dollar, using the current rate method. Equity accounts are translated using historical exchange rates. All other balance sheet accounts are 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 year. The resulting translation adjustments are reported as a component of shareholders' equity in accumulated other comprehensive income (loss).

Concentrations of credit risk

Financial instruments that are potentially subject to concentrations of credit risk consist principally of cash and cash equivalents, short and long-term bank deposits, unbilled accounts receivable, trade receivables, long-term trade receivables and long-term loans.

Of our cash and cash equivalents and short-term, restricted and long-term bank deposits at December 31, 2013, $35.2 million was deposited with major Israeli banks. An additional $9.3 million was deposited mainly with the Deutsche Bank, Royal Bank of Canada, BBVA Bankcomer, Helm Bank and Westpac Bank of Canada. Cash and cash equivalents deposited with U.S. banks or other banks may be in excess of insured limits and are not insured in other jurisdictions. Generally these deposits maybe redeemed upon demand and therefore bear low risk.

The short-term and long-term trade receivables and the unbilled accounts receivable of our company and our subsidiaries are derived from sales to large and solid organizations located mainly in Israel, the United States, Canada, Africa, Mexico and Europe. We perform ongoing credit evaluations of our customers and to date have not experienced any material losses. An allowance for doubtful accounts is determined with respect to those amounts that we have determined to be doubtful of collection and in accordance with an aging policy. In certain circumstances, we may require letters of credit, other collateral or additional guarantees. During the years ended December 31, 2011, 2012 and 2013 we recorded $411,000, $413,000 and $165,000 of expenses related to doubtful accounts, respectively. As of December 31, 2013, our allowance for doubtful accounts amounted to $809,000.

We have no significant off-balance sheet concentration of credit risks, such as foreign exchange contracts or foreign hedging arrangements, except derivative instruments, which are detailed below.

Results of Operations

In 2013, we continued to suffer from the decrease in governmental spending in certain territories. We believe that this trend is continuing and that government spending in certain territories will stay low compare to previous levels.

Due to the nature of our customers and products, our revenues are often generated from a relatively small number of large orders. Consequently, individual orders from individual customers can represent a substantial portion of our revenues in any one period and significant revenues from a customer during one period may not be followed by additional significant revenues from the same customer in subsequent periods. Accordingly, our revenues and operating results may vary substantially from period to period. Consequently, we do not believe that our revenues and operating results should necessarily be judged on a quarter-to-quarter comparative basis.

The following table presents certain financial data expressed as a percentage of revenues for the periods indicated:

	Year Ended December 31,		
	2011	2012	2013
Revenues	100 %	100 %	100 %
Cost of revenues	55.4	56.8	60.3
Gross profit	44.6	43.2	39.7
Operating expenses:			
Research and development, net	4.4	5.2	8.6
Selling and marketing, net	21.9	21.3	24.8
General and administrative	9.8	9.5	15.1
Other income	(2.6)	-	-
Operating income (loss)	11.1	7.2	(8.8)
Financial income (expenses), net	0.9	(0.6)	0.1
Income (loss) before income taxes	12.0	6.5	(8.7)
Income taxes	0.9	1.3	0.1
Net income (loss)	11.1	5.3	(8.8)

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

Revenues. Revenues decreased by 33.7% to $51.5 million for the year ended December 31, 2013 from $77.7 million for the year ended December 31, 2012. Revenues from sales of perimeter systems decreased by 10% to $30.6 million in 2013 from $33.9 million in 2012, primarily due to economy slowdown in Europe and governmental spending cutbacks. Revenues from security turnkey projects decreased by 55.3% to $20.1 million in 2013 from $45 million in 2012, primarily due to government budgets that were frozen. We anticipate that our revenues will increase in 2014, as a result of anticipated improvements in economic conditions in certain territories and increases in governmental spending.

Cost of revenues. Cost of revenues decreased by 29.7% to $31.1 million for the year ended December 31, 2013 from $44.2 million for the year ended December 31, 2012. This decrease was primarily due to the decrease in revenues. Cost of revenues as a percentage of revenues increased to 60.3% in 2013 from 56.8% in 2012, primarily due to the decreased sales without a matching decrease in fixed costs and due to a mix of projects. Our cost of revenues as a percentage of revenues was negatively impacted by the appreciation of the NIS against the U.S. dollar in 2013.

Research and development expenses, net. Research and development expenses, net increased by 9.1% to $4.4 million for the year ended December 31, 2013 from $4 million for the year ended December 31, 2012. The increase in research and development expenses in 2013 was primarily due to the CyberSeal acquisition.

Selling and marketing expenses, net. Selling and marketing expenses, net decreased by 22.7% to $12.8 million for the year ended December 31, 2013 from $16.5 million for the year ended December 31, 2012. The decrease in selling and marketing expenses in 2013 was primarily due to decreased sales commissions in 2013 compared with 2012, as well as lower associated expenses such as royalties. The decrease is offset by an increase in expenses attributable to the average exchange rate of the NIS against the U.S. dollar in 2013. Selling and marketing expenses amounted to 24.8% and 21.3% of revenues in 2013 and 2012, respectively.

General and administrative expenses. General and administrative expenses increased by 5.1% to $7.8 million for the year ended December 31, 2013 from $7.4 million for the year ended December 31, 2012. The increase in general and administrative expenses in 2013 was primarily due to the CyberSeal acquisition, as well as the impact of the average exchange rate appreciation of the NIS against the U.S. dollar in 2013. General and administrative expenses amounted to 15.1% of revenues in 2013 compared to 9.5% in 2012.

Other income. In 2011, we collected an arbitration award of approximately $2.5 million and recorded income of $2.3 million from the arbitration, net of legal expenses. We did not record any other income in 2012 and 2013.

Operating profit. We had an operating loss of $4.5 million for the year ended December 31, 2013 compared to an operating profit of $5.6 million for the year ended December 31, 2012. The operating profit (loss) of our business segments for the years ended December 31, 2013 and 2012 were as follows:

	Year Ended December 31,	
	2012	2013
	(In thousands)	
Perimeter products	$ 4,409	$ 542
Turnkey projects	1,634	(3,571)
Cyber	-	(1,184)
Eliminations	(486)	(306)
Total	$ 5,557	$ (4,519)

Our perimeter products segment recorded operating income of $0.5 million for the year ended December 31, 2013 compared to operating income of $4.4 million for the year ended December 31, 2012, primarily as a result of decreased sales of perimeter products due to continued economy slowdown in Europe and governmental spending cutbacks. In addition, the decrease results from the combination of low sales in 2013 and fixed operating costs. Our turnkey project segment recorded operating loss of $3.6 million in the year ended December 31, 2013 compared to operating income of $1.6 million for the year ended December 31, 2012 primarily as a result of decreased sales of turnkey projects due to government budgets that were frozen. Our Cyber segment recorded operating loss of $1.2 million in the year ended December 31, 2013.

Financial expenses (income), net. Our financial income, net, for the year ended December 31, 2013 was $0.1 million compared to financial expenses, net of $0.5 million for the year ended December 31, 2012. The change was primarily attributable to foreign exchange gain, net of $0.1 million in the year ended December 31, 2013 compared to foreign exchange loss, net of $0.5 million in the year ended December 31, 2012.

Income taxes. We recorded income tax expense of $0.1 million for the year ended December 31, 2013 compared to income tax expense of $1 million for the year ended December 31, 2012. Tax expenses primarily relate to the tax expenses of our foreign subsidiaries.

Year Ended December 31, 2012 Compared with Year Ended December 31, 2011

Revenues. Revenues decreased by 12.3% to $77.7 million for the year ended December 31, 2012 from $88.6 million for the year ended December 31, 2011. Revenues from sales of perimeter systems increased by 13.1% to $33.9 million in 2012 from $30 million in 2011, primarily due to continued governmental spending, Revenues from security turnkey projects decreased by 24.6% to $45 million in 2012 from $59.7 million in 2011, primarily due to the early 2012 completion of the Gabonese Republic Project. We anticipate that our revenues will increase in 2013, as a result of anticipated improvements in economic conditions in certain territories and increases in governmental spending.

Cost of revenues. Cost of revenues decreased by 10% to $44.2 million for the year ended December 31, 2012 from $49.1 million for the year ended December 31, 2011. This decrease was primarily due to the decrease in revenues. Cost of revenues as a percentage of revenues increased to 56.8% in 2012 from 55.4% in 2011, primarily due to the decreased sales without a matching decrease in fixed costs and due to a mix of projects. Our cost of revenues as a percentage of revenues was positively impacted by the appreciation of the NIS against the U.S. dollar in 2012.

Research and development expenses, net. Research and development expenses, net increased by 3.7% to $4 million for the year ended December 31, 2012 from $3.9 million for the year ended December 31, 2011.

Selling and marketing expenses, net. Selling and marketing expenses, net decreased by 14.9% to $16.5 million for the year ended December 31, 2012 from $19.4 million for the year ended December 31, 2011. The decrease in selling and marketing expenses in 2012 was primarily due to decreased sales commissions in 2012 compared with 2011, as well as lower associated expenses such as royalties. The decrease is also attributable to the average exchange rate appreciation of the NIS and the Mexican Peso against the U.S. dollar in 2012, which decreased the U.S. dollar value of our NIS and Mexican Peso denominated expenses. Selling and marketing expenses, net amounted to 21.3% and 21.9% of revenues in 2012 and 2011, respectively.

General and administrative expenses. General and administrative expenses decreased by 14.7% to $7.4 million for the year ended December 31, 2012 from $8.7 million for the year ended December 31, 2011. The decrease in general and administrative expenses in 2012 was primarily due to the decreased compensation paid to our management, as well as the impact of the average exchange rate appreciation of the NIS against the U.S. dollar in 2012, which increased the U.S. dollar value of our NIS and Canadian dollar denominated general and administrative expenses. General and administrative expenses amounted to 9.5% of revenues in 2012 compared to 9.8% in 2011.

Other income. In 2011, we collected an arbitration award of approximately $2.5 million and recorded income of $2.3 million from the arbitration, net of legal expenses. We did not record any other income in 2012.

Operating profit. We had an operating profit of $5.6 million for the year ended December 31, 2012 compared to an operating profit of $9.8 million for the year ended December 31, 2011. The operating profit of our business segments for the years ended December 31, 2012 and 2011 were as follows:

	Year Ended December 31,	
	2011	2012
	(In thousands)	
Perimeter products	$ 2,665	$ 4,409
Turnkey projects	5,224	1,634
Other income	2,304	-
Eliminations	(382)	(486)
Total	$ 9,811	$ 5,557

Our perimeter products segment recorded operating income of $4.4 million for the year ended December 31, 2012 compared to operating income of $2.7 million for the year ended December 31, 2011, primarily as a result of increased sales of perimeter products due to continued governmental spending. Our turnkey project segment recorded operating income of $1.4 million in the year ended December 31, 2012 compared to operating income of $5.2 million for the year ended December 31, 2011. We experienced extraordinary results in 2011 mainly due to the revenues generated by the African Cup of Nations Football Championship project.

Financial expenses (income), net. Our financial expenses, net, for the year ended December 31, 2012 were $0.5 million compared to financial income, net of $0.8 million for the year ended December 31, 2011. The change was primarily attributable to foreign exchange losses, net of $0.5 million in the year ended December 31, 2012 compared to foreign exchange gains, net of $1.4 million in the year ended December 31, 2011, which was partially set off by $0.4 million of income attributable to forward transaction.

Income taxes. We recorded income tax expense of $1 million for the year ended December 31, 2012 compared to income tax expense of $0.7 million for the year ended December 31, 2011. Tax expenses primarily relate to the tax expenses of our foreign subsidiaries in Mexico and Germany, uncertain tax provisions and a valuation allowance recorded with respect to tax withheld by our clients in 2012.

Seasonality

Our operating results are characterized by a seasonal pattern, with a higher volume of revenues towards the end of the year and lower revenues in the first part of the year. This pattern, which is expected to continue, is mainly due to two factors:

- our customers are mainly budget-oriented organizations with lengthy decision processes, which tend to mature late in the year; and

- due to harsh weather conditions in certain areas in which we operate during the first quarter of the calendar year, certain projects and services are put on hold and consequently payments are delayed.

Our revenues are dependent on government procurement procedures and practices, and because we receive large product orders from a relatively small number of customers, our revenues and operating results are subject to substantial periodic variations.

Impact of Inflation and Currency Fluctuations on Results of Operations, Liabilities and Assets

We sell most of our products in Africa, Latin America, North America, Europe and Israel. Our financial results, which are reported in U.S. dollars, are affected by changes in foreign currency. Our revenues are primarily denominated in U.S. dollars, Euros and NIS, while a portion of our expenses, primarily labor expenses, is incurred in NIS and Canadian dollars. Additionally, certain assets, especially trade receivables, as well as part of our liabilities are denominated in NIS. As a result, fluctuations in rates of exchange between the U.S. dollar and non-U.S. dollar currencies may affect our operating results and financial condition. The dollar cost of our operations in Israel and Canada may be adversely affected by the appreciation of the NIS and the Canadian dollar against the U.S. dollar. In addition, the value of our non-U.S. dollar revenues could be adversely affected by the depreciation of the U.S. dollar against such currencies.

The appreciation of the NIS, the Mexican Pesos and the Canadian dollar in relation to the U.S. dollar has the effect of increasing the U.S. dollar value of any unlinked assets and the U.S. dollar amounts of any unlinked liabilities and increasing the U.S. dollar value of revenues and expenses denominated in other currencies. Conversely, the depreciation of the NIS, the Mexican Peso and the Canadian dollar in relation to the U.S. dollar has the effect of reducing the U.S. dollar value of any of our liabilities which are payable in NIS, Mexican Pesos or in Canadian dollars (unless such costs or payables are linked to the U.S. dollar). Such depreciation also has the effect of decreasing the U.S. dollar value of any asset that is denominated in NIS, Mexican Pesos and Canadian dollars or receivables payable in NIS, Mexican Pesos or Canadian dollars (unless such receivables are linked to the U.S. dollar). In addition, the U.S. dollar value of revenues and expenses denominated in NIS, Mexican Pesos or Canadian dollars would increase. Because foreign currency exchange rates fluctuate continuously, exchange rate fluctuations may have an impact on our profitability and period-to-period comparisons of our results. The effects of foreign currency re-measurements are reported in our consolidated financial statements in current operations.

The following table presents information about the rate of inflation in Israel, the rate of devaluation or appreciation of the NIS against the dollar, and the rate of inflation in Israel adjusted for the devaluation:

Year ended December 31,	Israeli inflation rate %	NIS devaluation (appreciation) rate %	Israeli inflation adjusted for devaluation (appreciation) %
2009	3.9	(0.7)	4.6
2010	2.7	(6.0)	8.7
2011	2.2	7.7	(5.5)
2012	1.6	(2.3)	3.9
2013	1.8	(7.0)	8.8

In addition, the U.S. dollar cost of our operations in Canada is influenced by the exchange rate between the U.S. dollar and the Canadian dollar. In 2012, the Canadian dollar depreciated against the U.S. dollar by 2.6% and in 2013 the Canadian dollar appreciated against the U.S. dollar by 6.8%.

In 2013, foreign currency fluctuations had a small positive impact on our results of operations as we recorded foreign exchange income, net of $0.1 million, compared to $0.5 million of foreign exchange losses, net in 2012. We expect that our results of operations will continue to be affected by currency fluctuations in the future.

To manage this risk, from time to time, we have entered into forward exchange contracts to hedge some of our foreign currency exposure relating to bank deposits and unbilled accounts receivable denominated in foreign currencies. During 2012 and 2013, we recorded $410,000 and $39,000, respectively, in financial income. During 2011, these forward transactions had no impact on our results.

Conditions in Israel

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

Effective Corporate Tax Rate

The Israeli corporate tax rate was 24% in 2011 and 25% in 2012 and 2013.

On December 5, 2011, the "Knesset" (Israeli parliament) passed the Law for Tax Burden Reform (Legislative Amendments), 2011 ("the Law") which, among others, cancels effective from 2012, the scheduled reduction in the corporate tax rate. The Law also increases the corporate tax rate to 25% in 2012. In view of this increase in the corporate tax rate to 25%, as above, the real capital gain tax rate and the real betterment tax rate were also increased accordingly.

On August 5, 2013, the "Knesset" issued the Law for Changing National Priorities (Legislative Amendments for Achieving Budget Targets for 2013 and 2014), 2013 ("the Budget Law"), which consists, among others, of fiscal changes whose main aim is to enhance the collection of taxes in those years.

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

Our effective corporate tax rate may substantially exceed the Israeli tax rate since our U.S.-based subsidiaries will generally be subject to applicable federal, state, local and foreign taxation, and we may also be subject to taxation in the other foreign jurisdictions in which we own assets, have employees or conduct activities. Because of the complexity of these local tax provisions, it is not possible to anticipate the actual combined effective corporate tax rate, which will apply to us.

As of December 31, 2013, we had net deferred tax assets of $0.3 million attributable to our subsidiaries. We had total estimated available carryforward tax losses of $12 million with respect to our operations in Israel to offset against future taxable income. We have recorded a full valuation allowance for such carryforward tax losses due to the uncertainty of their future realization. As of December 31, 2013, our subsidiaries had estimated total available carryforward tax losses of $12.9 million, which may be used as an offset against future taxable income for periods ranging between 1 and 19 years. Utilization of U.S. net operating losses may be subject to a substantial annual limitation due to the “change in ownership” provisions of the Internal Revenue Code of 1986 and similar state tax law provisions. The annual limitation may result in the expiration of net operating losses before utilization.

Trade Relations

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

Israel and the European Union Community, known as the "European Union," concluded a Free Trade Agreement in July 1975 that confers some advantages with respect to Israeli exports to most European countries and obligates Israel to lower its tariffs with respect to imports from these countries over a number of years. In 1985, Israel and the United States entered into an agreement to establish a Free Trade Area. The Free Trade Area has eliminated all tariff and some non-tariff barriers on most trade between the two countries. On January 1, 1993, an agreement between Israel and the European Free Trade Association, known as the "EFTA," established a free-trade zone between Israel and the EFTA nations. In November 1995, Israel entered into a new agreement with the European Union, which includes a redefinition of rules of origin and other improvements, such as allowing Israel to become a member of the Research and Technology programs of the European Union. In recent years, Israel has established commercial and trade relations with a number of other nations, including Russia, China, India, Turkey and other nations in Eastern Europe and the Asia-Pacific region. In addition, Israel has entered into a free trade agreement with the MercoSur countries (Brazil, Paraguay, Argentina and Uruguay) which became fully effective in September 2011. Generally, the purpose of this agreement is to reduce the custom rates between Israel and these countries and to abolish them completely in certain cases. Israel is the first country outside of Latin America to enter into such an agreement with the MercoSur countries.

B. Liquidity and Capital Resources

Our working capital at December 31, 2012 and 2013 was $49.2 million and $47 million, respectively. Cash and cash equivalents amounted to $36.8 million at December 31, 2012 compared to $32.2 million at December 31, 2013. Short-term and long-term bank deposits, restricted bank deposits and escrow deposits amounted to $9.6 million at December 31, 2012 compared to $12.2 million at December 31, 2013. Our cash and cash equivalents, short and long-term bank deposits are held in various banks, mainly in U.S. dollars, Euros, NIS and Canadian dollars.

From our inception until our initial public offering in March 1993, we financed our activities mainly through cash flow from operations and bank loans. In March 1993, we received proceeds of $9.8 million from our initial public offering of 1,380,000 ordinary shares. Subsequently, we made follow-on public offerings, in February 1997 (of 2,085,000 ordinary shares) and in April 2005 (of 1,700,000 ordinary shares), in which we raised $9.4 million and $14.9 million, respectively. To allow us to begin to implement our 2010 strategic plan, on September 8, 2010, Ki Corporation Limited, or Ki Corporation, a company affiliated with Mr. Nathan Kirsh, our principal shareholder, provided us with a bridge loan of $10.0 million. To repay the loan and to raise permanent capital for general working capital purposes including facilitating the implementation of our new business strategy, in July and August 2011 we raised $16.2 million from a rights offering of 5,273,274 ordinary shares and a private placement of 150,000 of our ordinary shares.

On August 7, 2013 we took a bank loan in the amount of $2.5 million bearing annual interest of Libor + 3.4%. The loan is being repaid by 20 equal quarterly installments until August 7, 2018. The proceeds of such exercise, if any, will be used for working capital purposes.

We expect that our total research and development expenses in 2014 will be approximately $4.4 million. Our research and development plan for 2014 covers the following main areas:

- Sensor development - We intend to continue the development of new and innovative sensors and Cyber products based on existing, new and hybrid technologies. Most of the development will be based on in-house competencies; however, we may acquire some know-how externally.

- Sensor improvements – We are conducting an ongoing program of improvement of our existing sensors in order to enhance performance, reliability and capability to source and produce and reduce cost. Security Management Systems – We intend to continue to develop our two levels of security management systems:

- High-end systems – PSIM systems, mainly used as part of a turnkey solution, is a comprehensive command and control solution, designed for entities requiring management of security, safety, site management and dispatching. These systems are designed to manage both daily routines and crisis situations. Cyber security management is being developed as part of our PSIM system with the concept of integrated logical and physical security solutions.

- o Low-end systems – Basic SMS typically used for managing and controlling the PIDS of a site.

- o We are also developing an interface package to facilitate integration of our sensors into a third party SMS/command and control system.

- o Video systems – We will continue to develop our video management software to improve the IVA and cope with advanced video protocols such as regular IP streaming, megapixel and high definition video cameras.

We believe that our cash and cash equivalents, bank facilities, bank deposits and our expected cash flows from operations in 2014 will be sufficient to meet our ongoing cash requirements through 2015. However, our liquidity could be negatively affected by a decrease in demand for our products, including the impact of potential reductions in customer purchases that may result from the current general economic climate.

Cash Flows

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

	Year ended December 31,		
	2011	2012	2013
		(in thousands)	
Net cash provided by (used in) operating activities	20,418	5,706	(2,590)
Net cash used in investing activities	(6,406)	(1,048)	(5,760)
Net cash provided by financing activities	1,833	961	2,583
Effect of exchange rate changes on cash and cash equivalents	(2,436)	1,160	1,218
Increase (decrease) in cash and cash equivalents	13,409	6,779	(4,549)
Cash and cash equivalents at the beginning of the year	16,596	30,005	36,784
Cash and cash equivalents at the end of the year	$30,005	$36,784	$32,235

Net cash used in operating activities was approximately $2.6 million in the year ended December 31, 2013 compared to net cash provided by operating activities of $5.7 million in the year ended December 31, 2012 and net cash provided by operating activities of $20.4 million in the year ended December 31, 2011. Net cash used in operating activities in the year ended December 31, 2013 was primarily attributable to 2013 loss as well as to the decrease of $3.1 million in customer advances, decrease of $3 million in trade payables and decrease of $1.5 million in other accounts payable and accrued expenses. This was offset in part by a decrease of $6.2 million in short and long term trade receivables, net, $1.7 million of depreciation and amortization expenses and $0.5 million of stock based compensation.

Net cash provided by operating activities in the year ended December 31, 2012 was primarily attributable to 2012 income as well as to the $1.2 million of depreciation and amortization expenses, $0.2 million of stock based compensation, a decrease in other accounts receivable and prepaid expenses of $2.9 million, unbilled accounts receivables of $2.6 million, inventory of $1.4 million, long term trade receivables of $0.4 million and an increase of $0.8 million in customer advances. This was offset in part by an increase of $4.1 million in trade receivables, a decrease in other accounts payable and accrued expenses of $3.3 million and a decrease of $0.4 million in accrued severance pay.

Net cash provided by operating activities in the year ended December 31, 2011 was primarily attributable to 2011 income as well as to the $1.2 million of depreciation and amortization expense, $0.4 million of stock based compensation, a decrease in trade accounts receivables and inventories of $1.2 million and $0.2 million, respectively, an increase of $6.1 million in other accounts payable and accrued expenses, an increase of $3.2 million in trade payables, an increase of $3.9 million in customer advances and an increase of $0.3 million in accrued severance pay. This was offset in part by an increase of $2.4 million in unbilled accounts receivables, an increase of $3.3 million in other accounts receivable and prepaid expenses, an increase of $0.2 million in accrued interest and exchange differences on short term and long term deposits and long term loans and an increase in deferred income taxes of $0.1 million. The significant increase in net cash provided by operating activities was due in part to the special terms and timing of the receipts and payments of projects performed in 2011 and may not be indicative of future operating performance.

Net cash used in investing activities was approximately $5.8 million for the year ended December 31, 2013 compared to net cash used in investing activities of approximately $1 million for the year ended December 31, 2012 and net cash used in investing activities of approximately $6.4 million for the year ended December 31, 2011. In the year ended December 31, 2013, our net cash used in investing activities was primarily attributable to short-term deposits net of sale of short-term bank deposits for $4.4 million, payments for business acquisitions of CyberSeal for $2.6 million and a purchase of property and equipment for $1.2 million. These amounts were offset in part by the release of long-term bank deposits and restricted deposit of $2.3 million.

In the year ended December 31, 2012, our investments in restricted long term and short term bank deposits were $0.2 million and $1.5 million, respectively, and we purchased $1.7 million of property and equipment. These amounts were offset in part by the sale of short term bank deposits of $0.2 million and the realization of $2.1 million from the release of funds from a restricted deposit.

In the year ended December 31, 2011, our investments in restricted long term and short term bank deposits were $7.6 million and $0.4 million, respectively and we purchased $1.2 million and $28,000, respectively, of property and equipment and know-how and patents. These amounts were offset in part by the sale of short term bank deposits of $31,000, the realization of $2.8 million from the release of funds from a restricted deposit and proceeds of $50,000 from sale of property and equipment.

In the year ended December 31, 2013, net cash provided by financing activities was $2.6 million, primarily attributable to $2.5 million proceeds from long-term bank debt.

In the year ended December 31, 2012, net cash provided by financing activities was $1 million, primarily attributable to the $1.1 million proceeds from issuance of shares upon exercise of options and employee stock purchase plan.

In the year ended December 31, 2011, net cash provided by financing activities was $1.8 million, primarily attributable to the $16.2 million derived from the previously mentioned rights offering and private placement. This was offset by the repayment of the $10.4 million bridge loan received from Ki Corporation (including accrued interest) and the repayment of short term and long term bank credit of $3.5 million and $0.5 million, respectively.

We had capital expenditures of approximately $1.2 million, $1.7 and 1.2 million in the years ended December 31, 2011, 2012 and 2013, respectively. These capital expenditures were principally for computers, other machinery, land and building construction for one of our subsidiaries' offices and equipment and for expanding and renovating our facilities. We estimate that our capital expenditures for 2014 will total approximately $1.1 million. We expect to finance these expenditures primarily from our cash and cash equivalents and our operating cash flows. However, the actual amount of our capital expenditures will depend on a variety of factors, including general economic conditions and changes in the demand for our products. In addition, part of CyberSeal acquisition was paid in cash of approximately $2.6M.

Credit Lines and Other Debt

Short-term and long-term bank credit at December 31, 2012 and 2013 was $5.4 million and $8.2 million, respectively. Our highest level of short-term and long-term bank borrowings in the years ended December 31, 2012 and 2013 was $5.4 million and $8.3 million, respectively.

As of December 31, 2013, we had credit lines with Bank Leumi Le-Israel B.M., or Bank Leumi, Union Bank of Israel Ltd., or Union Bank, and Bank Hapoalim B.M., or Bank Hapoalim, totaling $28.4 million in the aggregate (of which $7.2 million is reserved exclusively for guarantees out of which $3.3 million was available as of December 31, 2013). Our credit lines at Bank Leumi and Union Bank have no restrictions as to our use of the credit, while our credit line at Bank Hapoalim is restricted to projects execution. Some of the loans under these credit lines are denominated in NIS and one is denominated in US dollar. We are not under any obligation to maintain financial ratios or other terms in respect of our credit lines. In addition, as of December 31, 2013, our subsidiaries had credit lines with the Royal Bank of Canada, Deutsche Bank and Helm Bank of $3.1 million in the aggregate, of which $2.3 million was available at December 31, 2013.

Our Canadian subsidiary, which is primarily engaged in sale of perimeter products and turnkey projects, has undertaken to maintain general covenants and the following financial ratios and terms in respect of its outstanding credit lines: a quick ratio of not less than 1.25:1; a ratio of total liabilities to tangible net worth of not greater than 0.75:1; and tangible net worth of at least $10.0 million. As of December 31, 2013, our Canadian subsidiary was in compliance with these ratios and terms.

As of December 31, 2013, our outstanding balances under our credit lines in Israel consisted of:

- Short-term NIS-denominated loans of approximately $5.8 million, bearing interest at an average rate of 1.5%;
- Several bank performance, advance payment and bid guarantees totaling approximately $3.9 million, at an annual cost of 1%-1.5%; and
- An immaterial amount of long-term NIS-denominated loans.
- Long term USD dominated loan of approximately $ 2.5 million bearing interest at an average rate of Libor + 3.4%;

As of December 31, 2013, the outstanding balances under the credit lines of our subsidiaries consisted of several bank performance, advance payment and bid guarantees totaling approximately $0.8 million, at an annual cost of 1.5% -1.8%.

C. Research and Development, Patents and Licenses.

Government Grants

We participate in programs sponsored by the Israeli Government for the support of research and development activities. In the past we have received royalty-bearing grants from the OCS for certain of our research and development projects for perimeter security products. We did not obtain any grants from the OCS in the past three years. We are obligated to pay royalties to the OCS amounting to 3.5% of revenues derived from sales of the products funded with these grants and ancillary services, up to 100% of the grants received, linked to the U.S. dollar. All grants received after January 1, 1999 also bear interest equal to the 12 month LIBOR rate. The obligation to pay these royalties is contingent on actual sales of the products, and in the absence of such sales no payment is required.

For the three years ended December 31, 2013, we paid the OCS royalties in the amount of $68,000, $178,000 and $123,000, respectively. These royalties related to sales of perimeter security products and management security systems and to some of the sales of our Israeli Subsidiary. As of December 31, 2013, we had a contingent obligation to pay royalties to the OCS in the amount of approximately $1.8 million upon the successful sale of perimeter security products developed under research and development programs sponsored by the OCS.

Investment Tax Credit

Our Canadian subsidiary is eligible for investment tax credits for its research and development activities and for certain current and capital expenditures. For the years ended December 31, 2013, 2012 and 2011, our Canadian subsidiary recognized $270,000, $280,000 and $268,000, respectively, of investment tax credits.

In addition, as of December 31, 2013, our Canadian and U.S. subsidiaries had available investment tax credits of approximately $1.4 million in Canada and $0.1 million in the U.S. to reduce future federal and provincial income taxes payable. These credits will expire in 2027 through 2032 in Canada and 2019 through 2023 in the U.S. As of December 31, 2013, our subsidiaries made a full valuation allowance in respect of such investment tax credits.

D. Trend Information.

We recorded a loss in 2013 compare with a profit in 2011 and 2012. The shift to loss in 2013 from profits in 2011 and 2012 is mainly attributable to held back in governmental spending in certain territories which led to delay in new projects in 2013, while in 2011 and 2012 the market was less influenced by the global economic slowdown and the reduction in governmental spending.

To the extent this trend will be change in 2014, we believe that we will face increased revenues which will result in continued profitable operations.

E. Off-Balance Sheet Arrangements.

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

F. Tabular Disclosure of Contractual Obligations.

The following table summarizes our minimum contractual obligations and commercial commitments as of December 31, 2013 and the effect we expect them to have on our liquidity and cash flow in future periods.

		Payments due by period			
Contractual Obligations	Total	Less than 1 year	1-2 years	3-5 years	More than 5 years
			(in thousands)		
Long-term bank debt obligations	$ 2,381	$ 506	$ 1,000	$ 875	-
Operating lease obligations	$ 3,468	$ 817	$ 744	$ 753	$ 1,154
Other long-term liabilities reflected on our balance sheet under U.S. GAAP	$ 3,813	-	-	-	$ 3,813
Total	$ 9,662	$ 1,323	$ 1,744	$ 1,628	$ 4,967

In addition, we have guaranteed advance payments, the performance of our work and provided warranties for the performance of our work to certain of our customers (usually governmental entities). Such guarantees are required by contract for our performance during the installation and operational period of projects throughout Israel and the rest of the world. The performance guarantees typically expire soon after certain milestones are met and warranty guarantees typically expire at the end of the warranty period. The maximum potential amount of future payments we could be required to make under our guarantees at December 31, 2013 was $4.8 million. We have not recorded any liability for such amounts as we believe our performance will not result in any claims.

ITEM 6. Directors, Senior Management and Employees

A. Directors and Senior Management.

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

Name	Age	Position
Barry Stiefel	64	Chairman of the Board of Directors
Shaul Kobrinsky (1)(2)(3)(4)	61	External Director
Eitan Livneh	60	Director, President and Chief Executive Officer
Mark Rosenberg	50	Director
Liza Singer (1)(2)(3)(4)	43	External Director

Doron Steiger (1)(3)	56	Director
Yitzhak Zoran (4)	70	Director
Jacob Berman	66	Director
Yehonatan Ben-Hamozeg	55	Senior Vice President – Product Development and Projects
Hagai Katz	63	Senior Vice President – Marketing and Business Development
Ilan Ovadia	47	Senior Vice President – Finance, Chief Financial Officer and Secretary
Eli Sananes	49	Senior Vice President – Global Sales
Rinat Gazit	45	Vice President – Mergers & Acquisitions

(1) Member of our audit committee.
(2) Member of our investment committee.
(3) Member of our Compensation Committee
(4) Member of our mergers and acquisitions committee

Messrs. Kobi Even-Ezra and Jacob Perry submitted their resignations as directors in January 2013.

Barry Stiefel has served as the chairman of our board of directors since February 2013 and as a director since November 2008. Mr. Stiefel serves as the Manager of the Kirsh Family Office in London, England, since 2006. The Kirsh Family Office administers and monitors the investments made by the Kirsh Group worldwide. Ki Corporation, which is owned by the Kirsh Group, is the largest shareholder of our company. Mr. Stiefel also serves as a Director of Ki Corporation Limited since 2013. Since 2001, Mr. Stiefel served as a consultant for a number of companies, including Premedia Limited and its subsidiaries. Previously, Mr. Stiefel was the chief executive officer of Meridian VAT Reclaim Group, which he founded, as a consultant in the field of trade finance and as finance director of Fisher Brothers Lumber Company Limited, a South African company. Mr. Stiefel holds a B.Sc. degree in Mathematics and Chemistry and a B.A. degree in Accounting, both from the University of the Witwatersrand. Mr. Stiefel is a chartered accountant in South Africa and is registered as an auditor (not in public practice) in the United Kingdom.

Shaul Kobrinsky has served as an external director since July 2004 and is the chairman of our Audit Committee and Compensation Committee. Mr. Kobrinsky has served as the President and Chief Executive Officer of Urdan Industries Ltd., an investment and holding company since 1997. Since 2003 and until 2011 Mr. Kobrinsky served as senior managing director of The Alagem Capital Group, a Beverly Hills based investment group. Mr. Kobrinsky serves as an active Chairman of and a partner in "Pharm-Up/Novolog/Trylog" - Israel largest Ethical Pharma & Clinical trials distribution Company. Previously, Mr. Kobrinsky served as chief executive officer of Cargal Ltd., an Israeli company that manufactures corrugates and as deputy managing director of Clal Industries Ltd., a holding and investment company. Mr. Kobrinsky was a member of the Antitrust Court and he now serves as a Chairman of the Israeli Manufacturers' Association Antitrust Committee. Mr. Kobrinsky holds a B.A. degree in Economics from Tel Aviv University.

Eitan Livneh has served as our president and chief executive officer since August 2009 and was appointed a director by our Board of Directors on November 27, 2012. Prior to joining our company and from February 2007, Mr. Livneh served as President and chief executive officer of Tadiran Telecom Ltd., a leading Israel-based telecommunications company. Between January 2000 and February 2007, Mr. Livneh was the chief executive officer of Elgo Irrigation Ltd., and prior to that, a general manager at Packer Plada Group Ltd and vice president, marketing and assistant to the President of Elisra Electronic Systems Ltd. Mr. Livneh holds a B.A. degree in Economics and Business Administration from Bar-Ilan University, Tel Aviv, Israel.

Mark Rosenberg has served as a director since August 2011 and as an alternate director on behalf of Mr. Kirsh on the Board of Directors since 2008. Since May 2007, Mr. Rosenberg has served in various senior positions with the Kirsh Family Office. From 2001 until 2007, Mr. Rosenberg served as the managing director of JDR Reactive Limited, a property maintenance company that he founded and subsequently sold. Previously, Mr. Rosenberg served as Director of New Business Development and legal officer of Leaf (Pty) Ltd., a South African mobile telecommunications company, Director of the Private Equity, M&A and Black Empowerment Investment Division of Fusion Capital Limited, a South African listed financial services group and as a Senior Manager, Investment Banking Division of Standard Bank of SA Limited. Mr. Rosenberg also served as an Articled Clerk and then as a senior professional with Edward Nathan & Friedland, Attorneys in South Africa and was a University Law Lecturer. Mr. Rosenberg holds a Bachelor of Commerce degree, a Bachelor of Law degree and a Higher Diploma in Company Law, all of which were granted by the University of the Witwatersrand in South Africa.

Liza Singer has served as an external director since June 2010. Since 2003, Ms. Singer has served as the owner's representative of the Lewis Trust Group, an investment assessment and development entity that focuses on tourist projects and the development of marine and hotels resorts. During 2007, Ms. Singer also served as the chief operating officer and country manager of Brack Capital Real Estate. Previously, Ms. Singer served as the Vice President of Business Development of the Baran Group, a provider of engineering and construction services, as investment director of Syntek Capital, a private-equity investment company and as an associate at APAX Partners & Co., a venture capital fund. Previously Ms. Singer worked at Kesselman & Kesselman, the Israeli member firm of PriceWaterhouseCoopers and at Gornitzky & Co. a leading Israeli law firm. Ms. Singer has an LL.B degree, a B.A. degree in accounting and an M.B.A. degree, all from Tel Aviv University. Ms. Singer is a certified public accountant (Israel) and a registered lawyer with the Israeli Bar Association.

Doron Steiger has served as an independent director since August 2012. Mr. Steiger works as a self-employed business consultant. Since 2007, Mr. Steiger has also served as the Chairman of the Board of Directors of Kerur Holdings Ltd., an Israeli public company traded on the Tel Aviv Stock Exchange, or TASE. Since April 2012, Mr. Steiger has also served as the Executive Chairman and business adviser of Kibutz Revivim. From 1998 through 2012, Mr. Steiger was a co-founder and managing partner of Dirad Investments Ltd., a private equity investment firm. since 1997 Mr. Steiger serves as managing partner of Darid Holdings Ltd., a private holding firm since 2006 Mr. Steiger serves as managing partner and director of Rin S. Management and Entrepreneurship (2006) Ltd. a private firm. Mr. Steiger, also serves as a board member in various companies including, Industrial Buildings Corporation Ltd. (IBC), Jafora-Tabori Ltd. and Darid Holdings Ltd. Mr. Steiger holds a B.A. in Economics and an M.B.A. in finance, both from Tel Aviv University.

Yitzhak Zoran has served as an independent director since August 2012. Since 2003, Mr. Zoran has served as the Chairman of the Board of A.D.T. (Advanced Dicing Technologies) Ltd. Previously, he served as a director of Elisra Electronic Systems Ltd. (from 2006 until 2011), Sagantec Ltd. (from 2004 to 2005); R.S.L, a publicly traded company on the TASE (from 2001 to 2004) and as Chairman of the Board of MEA Testing Systems Ltd. (from 2007 to 2009). From 1999 to 2004, Mr. Zoran was the Chairman of the Board of Directors of Solid Applied Technologies Ltd. and before than he was the Managing Director of Marathon V.C., a venture capital fund publicly traded on the TASE, and acted on Marathon's behalf as the Chairman of the Board of various companies, including, Optibase Ltd. (NASDAQ: OBAS), Pegasus Ltd., Nanomotion Ltd., Zinukim Ltd, IRLAN Ltd., Optinetix Ltd and Celltronix Ltd., as well as serving as a member of the Board of Directors of B.O.S. Better Online Solutions Ltd. (NASDAQ: BOSC) and Arel Communications & Software Ltd. (NASDAQ: ARLCF) and several privately held companies. From 1994 until 1995, Mr. Zoran was the President and CEO of Iturit Communication Industries Ltd. Mr. Zoran served as the President and CEO of Elisra. From 1989 to 1993. Mr. Zoran was an officer in the Israeli Navy from 1966 to 1970 and the recipient of the Israel Defense Prize from the Ministry of Defense for the development of naval electronic warfare systems for the Israeli Navy. Mr. Zoran also received the "Itur Mofet," a prestigious military decoration. Mr. Zoran holds a degree of B.Sc.E.E. from the Technion-the Israeli Institute of Technology.

Jacob Berman was elected by our board of directors on November 2013 to serve as a board member until the 2014 Annual General Meeting of the Company. Mr. Berman has been President of JB Advisors, Inc., a New York based financial advisory firm with extensive experience in international private banking, real estate investment counseling, and commercial/retail banking since 2002. Mr. Berman serves as a director of Micronet Enertec Technologies, Inc. Previously, Mr. Berman was the founder, President and CEO of Commercial Bank of New York.

Yehonatan Ben-Hamozeg has served as our senior vice president – product development and projects since January 2009. Mr. Ben Hamozeg joined our company in December 2002 and served as our vice president - integrated systems development until January 2009. Before joining our company, Mr. Ben Hamozeg served in the Israel Defense Forces, or IDF, for 24 years and retired as a Colonel. Mr. Ben Hamozeg holds a B.A. degree in Economics and Statistics and an M.B.A. degree in Business Management, both from Haifa University.

Hagai Katz has served as our senior vice president - marketing and business development since July 2010, and previously served as our general manager, Israel division and corporate vice president - marketing and products from January 2009. Prior to joining our company and from 2007, Mr. Katz served as the chief executive officer of Transtech Airport Solutions Ltd. From 2004 to 2007, Mr. Katz served as the chief executive officer of UAV Tactical Systems Ltd., based in the United Kingdom. Prior to that, Mr. Katz served in a number of leading technology companies, including NICE Systems (NASDAQ: NICE), where he served in various senior positions including chief operating officer and President of its video division. Mr. Katz holds a B.A. degree in Computer Sciences from the Technion - Israel Institute of Technology and a M.Sc. degree in Business Engineering from the Ben-Gurion University of the Negev.

Ilan Ovadia joined our company in December 2009 as our chief financial officer and secretary and has served as our senior vice president - finance, chief financial officer and secretary since February 2010. Prior to joining our company, Mr. Ovadia served for four years as executive vice president, chief financial officer and vice president of human resources of Haifa Chemicals Ltd. Previously, Mr. Ovadia served as the chief financial officer and vice president of Operations of Elgo Irrigation Ltd. and as financial manager of Shapir Marine and Civil Engineering Ltd., an infrastructure and contracting company. Mr. Ovadia is qualified as a Chartered Public Accountant (Israel) and served as a senior portfolio coordinator at PriceWaterhouseCoopers. Mr. Ovadia holds a B.A. degree in Accounting and Economics and an M.B.A. degree (magna cum laude), both from the Hebrew University of Jerusalem.

Eli Sananes joined our company in April 2012 as our senior vice president –global sales. Prior to joining our company and since June 2011, Mr. Sananes was the co-founder and manager of SmartHome Solutions Ltd., a start-up in the smart home consumer space. Between January 2010 and November 2011, Mr. Sananes served as the General Manager of Ethos Networks (currently known as Tejas Israel Ltd.), a hi-tech company which was acquired by Tejas Networks India. Previously and from 2007, Mr. Sananes acted as the VP Sales and Business Development of Ethos Networks Ltd. Prior to that, Mr. Sananes served as Mobile Business Unit Manager at Nokia-Siemens Networks, Israel; as Line of Business Manager at Siemens, Germany; as Director, Product Manager at Seabridge Ltd.; and as SC & Planning Manager at Intel Semiconductors Ltd. Mr. Sananes has a B. Sc in Information Systems Engineering from Ben Gurion University and an MBA degree from the Hebrew University in Jerusalem.

Rinat Gazit joined our company in February 2014 as our vice president- Mergers and Acquisitions. Rinat has over 13 years of business experience in the international arena dealing mainly in large transactions in the natural resources sector as well as in the energy and water sectors. Prior to joining Magal Rinat served as the head of M&A of Shikun & Binui of the Arison Group of Companies dealing mainly in large acquisitions of water and renewable energy related companies. During 2008 and 2009 Rinat served as VP at Poalim Capital Markets leading large M&A processes as well as private equity investments in various Israeli and international companies. Between the years 2000 to 2007 Rinat served in various senior positions within the Beny Steinmetz Group where she gained an extensive experience in the international capital markets arena. Rinat led and was involved in several IPO’s of natural resources related companies, mainly on AIM of London Stock Exchange. Rinat holds an MBA from the Recanati Business School at Tel Aviv University and a double Bachelor degree in Political Science and Sociology and Anthropology from Haifa University.

Messrs. Livneh, Rosenberg, Steiger, Stiefel and Zoran will serve as directors until our 2014 annual general meeting of shareholders. Mr. Kobrinsky and Ms. Singer were elected, in the annual general meeting of the shareholders which took place on June 13, 2013, to serve as external directors within the meaning of the Israeli Companies Law, for an additional three year term expiring on June 12, 2016.

B. Compensation

During the year ended December 31, 2013, we paid an aggregate compensation of approximately $2.4 million to all of our executive officers and directors as a group. As of December 31, 2013, the aggregate amount set aside or accrued for pension, retirement, recreation payments and vacation or similar benefits for our directors and executive officers was approximately $0.5 million. In addition, we have provided automobiles to our executive officers at our expense. Pursuant to the approval of our shareholders in 2007, Mr. Jacob Even-Ezra, our former board member, is provided with an automobile and is reimbursed for the costs of a chauffeur.

In June 2013, following shareholder approval, the base monthly salary of our president and chief executive officer, Mr. Eitan Livneh, was increased to NIS 120,000 commencing as of April 1, 2013. In addition, Mr. Livneh was granted options to purchase 250,000 Ordinary shares, exercisable at $4.35 per Ordinary share, that vest over a three year period.

We pay our external directors and our independent directors (directors who are not employees of our company or officers or employees of any entity that beneficially owns 5% or more of our ordinary shares) an annual fee of NIS 90,000 (approximately $24,926) and a fee of NIS 4,000 (approximately $1,108) for each board or committee meeting that they attend. Such amounts are linked to the Israeli consumer price index, or CPI, and are updated on a semi-annual basis and accordingly, were adjusted to reflect changes in the CPI in February and August 2013 and February 2014.

As of December 31, 2013, our directors and executive officers as a group, then consisting of 11 persons, held options to purchase an aggregate of 902,332 ordinary shares, having exercise prices ranging from $3.48 to $4.35. Generally, the options vest over a two to four years period. Of such options, ; options to purchase 73,500 ordinary shares expire in three equal portions of 24,500 each, in April 2014, 2015 and 2016, respectively; options to purchase 25,000, and 55,500 ordinary shares expire in December 2014 and 2015, respectively; options to purchase 20,833 ordinary shares expire in each of November 2015, February 2016, May 2016 and August 2016; Options to purchase 85,000 ordinary shares expire in three equal portions in each May 2016, 2017 and 2018; Options to purchase 232,000, 203,000 and 145,000 ordinary shares expired in March 2017, 2018 and 2019 respectively, or earlier upon termination of employment as an executive officer or service as a director of our company. 237,332 of such options were granted under our 2003 Stock Option Plan and 665,000 of such options were granted under 2010 Stock Option Plan. See this Item 6E. "Directors, Senior Management and Employees - Share Ownership - Stock Option Plans."

Pursuant to the Israeli Companies Law, we have adopted a compensation policy and are required to follow certain approval requirements with respect to the compensation of our directors and executive officers. See below "Board of Directors – Compensation Committee" and Item 10. Additional Information — Office Holders.

We follow Israeli law and practice instead of the requirements of the NASDAQ Stock Market Rules regarding the compensation of our chief executive office and other executive officers. See Item 16G. "Corporate Governance."

C. Board Practices

Introduction

According to the Israeli Companies Law and our articles of association, the management of our business is vested in our board of directors. The board of directors may exercise all powers and may take all actions that are not specifically granted to our shareholders. Our executive officers are responsible for our day-to-day management. The executive officers have individual responsibilities established by our chief executive officer and board of directors. Executive officers are appointed by and serve at the discretion of the board of directors, subject to any applicable agreements.

Election of Directors

Our articles of association provide for a board of directors of not less than three and not more than 11 members, as may be determined from time to time at our annual general meeting. Our board of directors is currently composed of eight directors.

Our directors (except the external directors, as detailed below), are elected by our shareholders at our annual general meeting and hold office until the next annual general meeting. All the members of our board of directors (except the external directors), may be reelected upon completion of their term of office. Our annual general meetings of shareholders are held at least once every calendar year, but not more than 15 months after the last preceding annual general meeting. In the intervals between our annual general meetings of shareholders, the board of directors may from time to time appoint a new director to fill a casual vacancy or to add to their number, and any director so appointed will remain in office until our next annual general meeting of shareholders and may be re-elected.

Under the Israeli Companies Law, our board of directors is required to determine the minimum number of directors who must have "accounting and financial expertise," as such term is defined in regulations promulgated under the Israeli Companies Law. Our board of directors has determined that at least one director must have "accounting and financial expertise." Our board of directors has further determined that Ms. Liza Singer has the requisite "accounting and financial expertise."

We do not follow the requirements of the NASDAQ Stock Market Rules regarding the nomination process of directors, and instead, we follow Israeli law and practice, in accordance with which our directors are recommended by our board of directors for election by our shareholders. See Item 16G. "Corporate Governance."

External and Independent Directors

External directors. The Israeli Companies Law requires Israeli companies with shares that have been offered to the public in or outside of Israel to appoint at least two external directors. The Israeli Companies Law provides that a person may not be appointed as an external director if the person, or the person's relative, partner, employer or an entity under that person's control, has or had during the two years preceding the date of appointment any affiliation with the company, or any entity controlling, controlled by or under common control with the company. The term "relative" means a spouse, sibling, parent, grandparent, child or child of spouse or spouse of any of the above as well as a sibling, brother, sister or parent of the foregoing relatives. In general, the term "affiliation" includes an employment relationship, a business or professional relationship maintained on a regular basis, control and service as an office holder. Furthermore, if the company does not have a controlling shareholder or a shareholder holding at least 25% of the voting rights, "affiliation" also includes a relationship, at the time of the appointment, with the chairman of the board, the chief executive officer, a substantial shareholder or the most senior financial officer of such company. Regulations promulgated under the Israeli Companies Law include certain additional relationships that would not be deemed an "affiliation" with a company for the purpose of service as an external director. In addition, no person may serve as an external director if the person's position or other activities create, or may create a conflict of interest with the person's responsibilities as director or may otherwise interfere with the person's ability to serve as director or if such person is an employee of the Israel Securities Authority or of an Israeli stock exchange. If, at the time an external director is appointed, all current members of the board of directors are of the same gender, then that external director must be of the other gender. A director of one company may not be appointed as an external director of another company if a director of the other company is acting as an external director of the first company at such time.

At least one of the elected external directors must have "accounting and financial expertise" and any other external director must have "accounting and financial expertise" or "professional qualification," as such terms are defined by regulations promulgated under the Israeli Companies Law.

The external directors are elected by shareholders at a general meeting. The shareholders voting in favor of their election must include at least a majority of the shares voted by shareholders other than controlling shareholders or shareholders who have a personal interest in the election of the outside director (unless such personal interest is not related to such persons relationship with the controlling shareholder) present and voting at such meeting (excluding abstentions). This majority requirement will not be required if the total number of shares of such non-controlling shareholders and disinterested shareholders who vote against the election of the outside director represent 2% or less of the voting rights in the company.

In general, under the Israeli Companies Law, external directors serve for a three-year term and may be reelected to two (2) additional three-year terms. However, Israeli companies listed on certain stock exchanges outside Israel, including The NASDAQ Global Market, such as our company, may appoint an external director for additional terms of not more than three years subject to certain conditions. Such conditions include the determination by the audit committee and board of directors, that in view of the director's professional expertise and special contribution to the company's board of directors and its committees, the appointment of the external director for an additional term is in the best interest of the company. External directors can be removed from office only by the same special percentage of shareholders that can elect them, or by a court, 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.

Pursuant to the Israeli Companies Law, external directors up for re-election are nominated either by the board of directors or by any shareholder(s) holding at least 1% of the voting rights in the company. If the board of directors proposed the nominee, the reelection must be approved by the shareholders in the same manner required to appoint external directors for an initial term, as described above. If such reelection is proposed by shareholders, such reelection requires the approval of the majority of the shareholders voting on the matter, and satisfaction of all of the following requirements: (i) In calculating the majority votes, the votes of the controlling shareholders and other shareholders that have personal interest in such reelection (unless such personal interest is not related to such persons relationship with the controlling shareholder) as well as abstentions are not included; (ii) the votes of the non-controlling shareholders in favor of the reelection and of the shareholders who do not have personal interest in the reelection (unless such personal interest is not related to such person's relationship with the controlling shareholder) is greater than 2% of the voting rights in the company and (iii) the external director is not, at the time of such reelection, a related shareholder or competitor or a relative thereof and does not have any affiliation to any related shareholder, competitor or any relative thereof during the two years prior to such re-election. A related shareholder or a competitor are defined as the shareholder proposing the reelection, any substantial shareholder (within the meaning of the Israeli Companies Law) if at the time of reelection either such shareholder, its controlling shareholder or any company controlled by either of them has business relations with the company or that either such shareholder, its controlling shareholder or the a company controlled by either of them is a competitor of the company.

Each committee of the board of directors that is authorized to exercise powers vested in the board of directors must include at least one external director and the audit committee must include all the external directors. An external director is entitled to compensation as provided in regulations adopted under the Israeli Companies Law and is otherwise prohibited from receiving any other compensation, directly or indirectly, in connection with such service.

Independent Directors. Pursuant to the Israeli Companies Law, a director may be qualified as an independent director if such director is either (i) an external director; or (ii) or a director who is appointed or classified as such, and who meets the qualifications of an external director (other than the professional qualifications/accounting and financial expertise requirement), who the audit committee has confirmed meets the external director qualifications, and who has not served as a director for more than nine consecutive years (with any period of up to two years during which such person does not serve as a director not being viewed as interrupting a nine-year period)

In general, NASDAQ Stock Market Rules require that the board of directors of a NASDAQ-listed company has a majority of independent directors and that its audit committee has at least three members and be comprised only of independent directors, each of whom satisfies the “independence” requirements of NASDAQ and the SEC. However, foreign private issuers, such as our company, may follow certain home country corporate governance practices instead of certain requirements of the NASDAQ Stock Market Rules. On June 30, 2006, we provided NASDAQ with a notice that instead of maintaining a majority of independent directors, we follow Israeli law, under which we are required to appoint at least two external directors, within the meaning of the Israeli Companies Law, to our board of directors. In addition, in accordance with the rules of the SEC and NASDAQ, our audit committee is composed of three independent directors, as defined in the rules of the SEC and NASDAQ.

Our board of directors has determined that our external directors, Ms. Singer and Mr. Kobrinsky, qualify as independent directors under the requirements of the SEC and NASDAQ. Our board of directors has further determined that Messrs. Steiger and Zoran both qualify as independent directors under the requirements of the SEC, NASDAQ and the Israeli Companies Law.

Audit Committee

Under the Israeli Companies Law, the board of directors of any public company must establish an audit committee. The audit committee must consist of at least three directors and must include all of the external directors, the majority of which must be independent directors. The audit committee may not include the chairman of the board of directors; any director employed by the company or providing services to the company on an ongoing basis (other than as a director); a controlling shareholder or any of the controlling shareholder’s relatives; and any director who is employed by, or rendered services to, the controlling shareholder or an entity controlled by the controlling shareholder, or a director whose main livelihood is from the controlling shareholder. Any person who is not permitted to be a member of the audit committee may not be present in the meetings of the audit committee unless the chairman of the audit committee determines that such person’s presence is necessary in order to present a specific matter. However, an employee who is not a controlling shareholder or relative of a controlling shareholder may participate in the audit committee’s discussions but not in any vote, and at the request of the audit committee, the secretary of the company and its legal counsel may be present during the meeting. The chairman of the audit committee must be an external director.

The role of the audit committee, pursuant to the Israeli Companies Law, includes:

- monitoring deficiencies in the management of the company, including in consultation with the independent auditors or the internal auditor, and to advise the board of directors on how to correct such deficiencies. If the audit committee finds a material deficiency, it will hold at least one meeting regarding such material deficiency, with the presence of the internal auditor or the independent auditors but without the presence of the senior management of the company. However, a member of the company’s senior management can participate in the meeting in order to present an issue which is under his or her responsibility;

- determining, on the basis of detailed arguments, whether to classify certain engagements or transactions as material or extraordinary, as applicable, and therefore as requiring special approval under the Israeli Companies Law. The audit committee may make such determination according to principles and guidelines predetermined on an annual basis;

- determining if transactions (excluding extraordinary transactions) with a controlling shareholder, or in which a controlling shareholder has a personal interest, are required to be rendered pursuant to a competitive procedure;

- deciding whether to approve engagements or transactions that require the audit committee approval under the Israeli Companies Law;

- determining the approval procedure of non-extraordinary transactions, following classification as such by the audit committee, including whether such specific non-extraordinary transactions require the approval of the audit committee;

- examining and approving the annual and periodical working plan of the internal auditor;

- overseeing the company's internal auditing and the performance of the internal auditor; confirm that the internal auditor has sufficient tools and resources at his disposal, taking into account, among other, the special requirements of the company and its size;

- examining the scope of work of the independent auditor and its pay, and bringing such recommendations on these issue before the Board;

- determining the procedure of addressing complaints of employees regarding shortcomings in the management of the company and ensure the protection of employees who have filed such complaints;

- determining with respect to transactions with the controlling shareholder or in which such controlling shareholder has personal interest, whether such transactions are extraordinary or not, an obligation to conduct competitive process under supervisions of the audit committee or determination that prior to entering into such transactions the company shall conduct other process as the audit committee may deem fit, all taking into account the type of the company. The audit committee my set such qualifications for one year in advance; and

- determining the manner of approval of transactions with the controlling shareholder or in which it has personal interest which (i) are not negligible transactions (pursuant to the committee's determination) and (ii) are not qualified by the committee as extraordinary transactions.

In addition, the NASDAQ Stock Market Rules require us to establish an audit committee consisting of at least three members, each of whom must be financially literate and satisfy the respective ‘‘independence’’ requirements of the SEC and NASDAQ and one of whom has accounting or related financial management expertise.

Our audit committee is currently composed of Messrs. Kobrinsky and Steiger and Ms. Singer, who satisfy the respective “independence” requirements of the SEC, NASDAQ and the Israeli law. Our board of directors has determined that Ms. Singer has the requisite accounting and financial expertise to serve as our audit committee financial expert. The audit committee meets at least once each quarter. Our audit committee charter is available on our website at www.magal-s3.com.

Compensation Committee

Pursuant to the Israeli Companies Law, each publicly traded company is required to establish a compensation committee which must be comprised of at least three directors, including all of the external directors. The additional members of the compensation committee must be directors that receive compensation in accordance with the provisions and limitations set forth in the regulations promulgated under the Israeli Companies Law with respect to external directors. An external director shall serve as the chairman of the compensation committee. Under the Israeli Companies Law, the external directors shall constitute a majority of the compensation committee.

The compensation committee is responsible for (i) recommending the compensation policy to the board of directors for its approval (and subsequent approval by shareholders) and (ii) duties related to the compensation policy and to the approval of the terms of engagement of office holders, including: recommending whether a compensation policy should continue in effect, if the then-current policy has a term of greater than three (3) years (approval of either a new compensation policy or the continuation of an existing compensation policy must in any case occur every three years), recommending to the board of directors periodic updates to the compensation policy, assessing implementation of the compensation policy; determining whether the compensation terms of a proposed new Chief Executive Officer of the company need not be brought to approval of the shareholders; and determining whether to approve transactions concerning the terms of engagement and employment of the company’s officers and directors that require compensation committee approval under the Israeli Companies Law or the company’s compensation plans and policies.

We have established a compensation committee that is currently composed of Messrs. Kobrinsky and Steiger and Ms. Singer.

Investment Committee

Our board of directors has established an investment committee, which is responsible for the investment of our cash and our hedging transactions. The investment committee is currently composed of Messrs. Kobrinsky and Ms. Singer.

Mergers and Acquisitions Committee

Our board of directors has established a mergers and acquisitions committee, which is responsible for the examination and review of merger and acquisition opportunities and making recommendations to the board of directors with respect to such opportunities. The mergers and acquisitions committee is currently composed of Messrs. Kobrinsky and Zoran, and Ms. Singer.

Internal Auditor

Under the Israeli Companies Law, the board of directors of a publicly traded company must appoint an internal auditor nominated by the audit committee. The role of the internal auditor is to examine whether the company’s actions comply with the law, integrity and orderly business practice. Under the Israeli Companies Law, the internal auditor may not be an interested party, an office holder, or an affiliate, or a relative of an interested party, office holder or affiliate, nor may the internal auditor be the company’s independent accountant or its representative. Mr. Daniel Shapira, Certified Public Accountant (Israel) was our internal auditor until July 23, 2012. Fahn Kanne & Co. acted as our Internal Auditor as of July 23, 2012 and until February 22, 2014. On February 23, 2014, we have appointed Chaikin, Cohen, Rubin & Co. as our Internal Auditor.

Directors’ Service Contracts

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

Approval of Related Party Transactions Under Israeli Law

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" is defined in the Israeli Companies Law as a director, general manager, chief business manager, deputy general manager, vice general manager, other manager directly subordinate to the general manager or any other person assuming the responsibilities of any of the foregoing positions without regard to such person's title. An office holder's fiduciary duties consist of a duty of care and a fiduciary duty. 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 appropriateness 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 fiduciary duty includes (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 due to 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 position, in connection with any existing or proposed transaction by us. 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, 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.

Some 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 also be required. A director who has a personal interest in a transaction that is considered at a meeting of the board of directors or the audit committee may not be present during the board of directors or audit committee discussions and may not vote on the transaction, unless the transaction is not an extraordinary transaction or the majority of the members of the board or the audit committee have a personal interest, as the case may be. In the event the majority of the members of the board of directors or the audit committee have a personal interest, then the approval of the general meeting of shareholders is also required.

Approval of a Compensation Policy for Office Holders

The Israeli Companies Law and the regulations adopted thereunder require the compensation committee to adopt a policy for director and office holders. In adopting the compensation policy, the compensation committee must take into account factors such as the office holder's education, experience, past compensation arrangements with the company, and the proportional difference between the person's cost of compensation and the average cost of compensation of the company's employees.

The compensation policy must be approved at least once every three years at the company's general meeting of shareholders, and is subject to the approval of a majority vote of the votes of the shareholders present and voting at a shareholders' meeting, provided that either: (i) such majority includes at least a majority of the votes of all shareholders who are not controlling shareholders and do not have a personal interest in the approval of the compensation policy, present and voting at such meeting (excluding abstentions); or (ii) the total number of ordinary shares of non-controlling shareholders and shareholders who do not have a personal interest in the approval of the compensation policy, voting against the resolution does not exceed 2% of the aggregate voting rights in the company.

The Board may approve the compensation policy even if such policy was not approved by the shareholders, provided that the compensation committee and the board of directors resolve, based on detailed consideration of the compensation policy that approval of the policy, is in the best interest of the company, despite the fact that it was not approved at the shareholders' meeting.

The compensation policy shall serve as the basis for decisions concerning the financial terms of employment or engagement of officer holders, including exculpation, insurance, indemnification or any monetary payment or obligation of payment in respect of employment or engagement. The compensation policy must relate to certain factors, including advancement of the company's objectives, the company's business and its long-term strategy, and creation of appropriate incentives for executives. It must also consider, among other things, the company's risk management, size and the nature of its operations. The compensation committee must also consider among others, the ratio between the cost of terms offered to the relevant director or office holder and the average and median cost of compensation of the other employees of the company, including those employed through manpower companies, the effect of disparities in salary upon work relationships in the company, the possibility of reducing variable compensation at the discretion of the board of directors; the possibility of setting a limit on the exercise value of non-cash variable compensation; and as to severance compensation (in excess of those promulgated by applicable labor law), the period of service of the director or office holder, the terms of his or her compensation during such service period, the company's performance during that period of service, the person's contribution towards the company's achievement of its goals and the maximization of its profits, and the circumstances under which the person is leaving the company.

The compensation policy must also include the link between variable compensation and long-term performance and measurable criteria, the relationship between variable and fixed compensation, and the upper limit for the value of variable compensation, the conditions under which a director or an office holder would be required to repay compensation paid to him or her if it was later shown that the data upon which such compensation was based was inaccurate and was required to be restated in the company's financial statements, the minimum holding or vesting period for variable, equity-based compensation whilst referring to appropriate a long-term perspective based incentives; and maximum limits for severance compensation.

Once a compensation policy is properly adopted, the Israeli Companies Law requires the compensation policy to be approved by the company's compensation committee, with subsequent approval of the board of directors. In addition, compensation of the directors and the chief executive officer is also subject to the approval of the shareholders at a general meeting. The approval of the compensation of the chief executive officer that complies with the compensation policy is subject to the same majority requirements as the approval of a transaction between a company and its controlling shareholder. Where the director is also a controlling shareholder, the requirements for approval of transactions with controlling shareholders apply. The terms of employment of the company's directors and executive officers must satisfy the requirements of the compensation policy in respect of matters relating to compensation. Any deviations from the compensation policy in respect of the compensation of the office holders require the approval of the compensation committee, the board of directors and the shareholders. If the deviation is with respect to the compensation of the chief executive office then such approval must be made by the majority of the shareholders provided that such majority includes the majority of the votes of the non-controlling shareholder and other shareholders who have personal interest in the proposal (unless such personal interest is not related to the controlling shareholder) present and voting (excluding abstention). Such special majority is not required if the number of votes of the non-controlling shareholders and shareholder who do not have personal interest in the proposal as aforesaid is lower than 2% of the aggregate voting rights in the company.

Under the Israeli Companies Law, all arrangements as to compensation of office holders who are not directors require the approval of the compensation committee prior, and in addition, to the approval of the board of directors. However, if the Company duly adopts a compensation plan for its office holders, the approval of the board of directors is not required if the new arrangement only modifies an existing arrangement and the compensation committee determines that such modification is not material. Generally, the compensation of the CEO must be approved by the compensation committee, the board and of directors and by the majority of the shareholders provided that either: (i) such majority includes a majority of the total votes of shareholders who are not controlling shareholders and do not have a Personal Interest in the approval of the compensation policy and who participate in the voting, in person, by proxy or by written ballot, at the meeting (abstentions not taken into account); or (ii) the total number of votes of shareholders mentioned in (i) above that are voted against the approval of the compensation policy do not represent more than 2% of the total voting rights in the company. The compensation of office holders who are directors must be approved by the compensation committee, board of directors and simple majority vote of the shareholders.

External directors of the company are prohibited from receiving, directly or indirectly, any compensation from the company, other than for their services as external directors pursuant to the provisions and limitations set forth in regulations promulgated under the Israeli Companies Law, which compensation is determined prior to their appointment and may not be changed throughout the term of their service as external directors (except for certain exceptions set forth in such regulations).

Disclosure of Personal Interests of a Controlling Shareholder; Approval of Transactions with Controlling Shareholders

Pursuant to the Israeli Companies Law, the disclosure requirements regarding personal interests that apply to directors and executive officers also apply to a controlling shareholder of a public company. A controlling shareholder is a shareholder who has the ability to direct the activities of a company, but excludes a shareholder whose power derives solely from its position on the board of directors or any other position at the company. A person is presumed to be a “controlling shareholder” if it holds or controls, by itself or together with others, one half or more of any one of the “Means of Control” of the company. “Means of Control” is defined as any one of the following: (i) the right to vote at a General Meeting of the company, or (ii) the right to appoint directors of the company or its chief executive officer. For the purpose of related party translations, under the Israeli Companies Law, a controlling shareholder is also a shareholder who holds 25% or more of the voting rights if no other shareholder who holds more than 50% of the voting rights. For this purpose, the holdings of all shareholders who have a personal interest in the same transaction will be aggregated. As of Admission, the company does not have a controlling shareholder.

Certain shareholders also have a duty of fairness toward the company. These shareholders include any controlling shareholder, together with any shareholder who knows that it has the power to determine the outcome of a shareholder vote and any shareholder who has the power to appoint or to prevent the appointment of an office holder of the company or exercise any other rights available to it under the company’s articles of association with respect to the company. The Israeli Companies Law does not define the substance of this duty of fairness, except to state that the remedies generally available upon a breach of contract will also apply in the event of a breach of the duty of fairness.

An extraordinary transaction between a public company and a controlling shareholder, or in which a controlling shareholder has a personal interest, including a private placement in which the controlling shareholder has a personal interest, and the terms of engagement of the company, directly or indirectly, with a controlling shareholder or a controlling shareholder’s relative (including through a corporation controlled by a controlling shareholder), regarding the company’s receipt of services from the controlling shareholder, and if such controlling shareholder is also an office holder of the company, regarding his or her terms of employment, require the approval of a company’s audit committee (or compensation committee with respect to compensation arrangements), board of directors and shareholders, in that order. Such transaction must be elected by a majority vote of the Ordinary Shares present and voting at a shareholders’ meeting, provided that either: (i) such majority includes at least a majority of votes held by all shareholders who do not have a personal interest in such transaction, present and voting at such meeting (excluding abstentions); or (ii) the total number of votes of shareholders who do not have a personal interest in such transaction voting against the approval of the transaction, does not exceed 2% of the aggregate voting rights in the company.

Pursuant to the Israeli Companies Law, the audit committee of the company should determine in connection with such transaction if it requires rendering pursuant to a competitive procedure or pursuant to other proceedings. See "Audit Committee" above..

To the extent that any such transaction with a controlling shareholder or his relative is for a period extending beyond three years, shareholder approval is required once every three years, unless, in respect to certain transactions, the audit committee determines that the longer duration of the transaction is reasonable under the circumstances.

Pursuant to regulations promulgated pursuant to the Israeli Companies Law, a transaction with a controlling shareholder that would otherwise require approval of the shareholders is exempt from shareholders’ approval if each of the audit committee and the board of directors determine that the transaction meets certain criteria that are set out in specific regulations promulgated under the Israeli Companies Law. Under these regulations, a shareholder holding at least 1% of the issued share capital of the company may require, within 14 days of the publication of such determination, that despite such determination by the audit committee and the board of directors, such transaction will require shareholder approval under the same majority requirements that otherwise apply to such transactions.

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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 25% or greater shareholder of the company. This rule does not apply if there is already another 25% or greater shareholder of the company. Similarly, the Israeli Companies Law provides that an acquisition of shares in a public company must be made by means of a tender offer if as a result of the acquisition the purchaser would hold greater than a 45% interest in the company, unless there is another shareholder holding more than a 45% interest in the company. These requirements do not apply if, in general, (i) the acquisition was made in a private placement that received shareholder approval, (ii) was from a 25% or greater shareholder of the company which resulted in the acquirer becoming a 25% or greater shareholder of the company, if there is not already a 25% or greater shareholder of the company, or (iii) was from a shareholder holding a 45% interest in the company which resulted in the acquirer becoming a holder of a 45% interest in the company if there is not already a 45% or greater shareholder of the company.

If, as a result of an acquisition of shares, the acquirer will hold more than 90% of a public company's outstanding shares or a class of shares, the acquisition must be made by means of a tender offer for all of the outstanding shares or a class of shares. If less than 5% of the outstanding shares are not tendered in the tender offer, all the shares that the acquirer offered to purchase will be transferred to the acquirer. 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. The Israeli 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, in the event of a full tender offer, the offeror may determine that any shareholder who accepts the offer will not be entitled to appraisal rights. Such determination will be effective only if the offeror or the company has timely published all the information that is required to be published in connection with such full tender offer pursuant to all applicable laws.

Exculpation, Indemnification and Insurance of Directors and Officers

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

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

Indemnification of Office Holders. Under Israeli law a company may, if permitted by its articles of association, indemnify an office holder for acts performed by the office holder in such capacity for (i) a monetary liability imposed upon the office holder in favor of another person by any court judgment, including a settlement or an arbitration award approved by a court; (ii) reasonable litigation expenses, including attorney's fees, actually incurred by the office holder as a result of an investigation or proceeding instituted against him by a competent authority, provided that such investigation or proceeding concluded without the filing of an indictment against the office holder or the imposition of any monetary liability in lieu of criminal proceedings, or concluded without the filing of an indictment against the office holder and a monetary liability was imposed on him or her in lieu of criminal proceedings with respect to a criminal offense that does not require proof of criminal intent; and (iii) reasonable litigation expenses, including attorneys' fees, actually incurred by the office holder or imposed upon the office holder by a court: in an action, suit or proceeding brought against the office holder by or on behalf of the company or another person, or in connection with a criminal action in which the office holder was acquitted, or in connection with a criminal action in which the office holder was convicted of a criminal offence that does not require proof of criminal intent.

Israeli law provides that a company's articles of association may permit the company to (a) indemnify an office holder retroactively, following a determination to this effect made by the company after the occurrence of the event in respect of which the office holder will be indemnified; and (b) undertake in advance to indemnify an office holder, except that with respect to a monetary liability imposed on the office holder by any judgment, settlement or court-approved arbitration award, the undertaking must be limited to types of occurrences, which, in the opinion of the company's board of directors, are, at the time of the undertaking, foreseeable due to the company's activities and to an amount or standard that the board of directors has determined is reasonable under the circumstances.

Limitations on Exculpation, Insurance and Indemnification. The Israeli Companies Law provides that neither a provision of the articles of association permitting the company to enter into a contract to insure the liability of an office holder, nor a provision in the articles of association or a resolution of the board of directors permitting the indemnification of an office holder, nor a provision in the articles of association exculpating an office holder from duty to the company shall be valid, where such insurance, indemnification or exculpation relates to any of the following: (i) a breach by the office holder of his fiduciary duty unless, with respect to insurance coverage or indemnification, the office holder acted in good faith and had a reasonable basis to believe that the act would not prejudice the company; (ii) a breach by the office holder of his duty of care if such breach was committed intentionally or recklessly, unless the breach was committed only negligently; (iii) any act or omission done with the intent to unlawfully yield a personal benefit; or (iv) any fine or forfeiture imposed on the office holder.

Pursuant to the Israeli Companies Law, exculpation of, procurement of insurance coverage for, and an undertaking to indemnify or indemnification of, our office holders must be approved by our audit committee and board of directors and, if the office holder is a director, also by our shareholders.

Our articles of association allow us to insure, indemnify and exempt our office holders to the fullest extent permitted by Israeli law. We maintain a directors' and officers' liability insurance policy with a per claim and aggregate coverage limit of $20 million, including legal costs incurred in Israel. In addition, our audit committee, board of directors and shareholders resolved to indemnify our office holders, pursuant to a standard indemnification agreement that provides for indemnification of an office holder in an amount up to $5 million. To date, we have provided letters of indemnification to certain of our officers and directors.

Pursuant to the Law for Efficient Enforcement Process in the Securities Authority (Legislation Amendment) 5771-2011, or the Enforcement Law, the Israel Securities Authority, or ISA, may impose fines on public companies, their senior office holders and employees, for certain actions or omissions stipulated in the Enforcement Law. In addition, pursuant to the Companies Law the ISA has administrative and enforcement authority with respect to certain breaches of corporate governance rules enumerated in the Israeli Companies Law, and the restrictions and limitations on insurance and indemnification of officeholders apply also to proceedings conducted by the ISA pursuant to the Israeli Companies Law. Generally, the Enforcement Law applies only to companies whose shares are listed on the TASE, including dual listed companies. Although we are currently listed only on the NASDAQ Global Market, ISA has enforcement authority pursuant to the Enforcement Law with respect to the period in which we were dual listed. While almost all of the enumerated actions and omissions that are subject to fines do not apply to dual listed companies, the ISA may impose fines on us or our office holders if we did not make a public filing in Israel of any information or report that was publicly filed with the SEC, or if we did not furnish any information that was required by the ISA. Furthermore, since our rights offerings was also made pursuant to a prospectus under the Israeli Securities Law, ISA has full enforcement authority with respect to the disclosure made by us in such prospectus. Pursuant to the Enforcement Law, a company may not purchase, directly or indirectly, insurance for these proceedings and such insurance if purchased is void. The Enforcement Law further provides that a company or its controlling shareholder may not, directly or indirectly, indemnify the office holders or employee against, or otherwise pay, fines that were imposed on them pursuant to the Enforcement Law. However, under the Enforcement Law, if permitted by a company's articles of association, a company is entitled to purchase insurance and indemnify for payment of damages to any injured person and for expenses incurred by office holders or employees in connection with proceedings conducted against them, including reasonable litigation expenses such as legal fees. A company may undertake to provide such indemnification in advance. Accordingly, at our 2011 annual general meeting, our shareholders approved amendments to our Articles of Association allowing us to indemnify and insure our office holders against certain expenses and payments incurred by them or imposed on them as a result regulatory administrative enforcement actions, and also approved an amended indemnification letter to our office holders to implement such changes.

D. Employees

As of December 31, 2013, we employed 309 full-time employees, of whom 47 were employed in general management and administration, 55 were employed in selling and marketing, 13 were employed in production management, 146 were employed in production, installation and maintenance, and 48 were employed in engineering and research and development. Of such full-time employees, 152 were located in Israel, 14 were in the United States, 79 were in Canada and 64 were in various other countries.

As of December 31, 2012, we employed 294 full-time employees, of whom 49 were employed in general management and administration, 47 were employed in selling and marketing, 13 were employed in production management, 146 were employed in production, installation and maintenance, and 39 were employed in engineering and research and development. Of such full-time employees, 133 were located in Israel, 14 were in the United States, 75 were in Canada and 72 were in various other countries.

As of December 31, 2011, we employed 279 full-time employees, of whom 39 were employed in general management and administration, 45 were employed in selling and marketing, 16 were employed in production management, 140 were employed in production, installation and maintenance, and 39 were employed in engineering and research and development. Of such full-time employees, 130 were located in Israel, 12 were in the United States, 82 were in Canada and 55 were in various other countries.

Our relationships with our employees in Israel are governed by Israeli labor legislation and regulations, extension orders of the Israeli Ministry of Labor and personal employment agreements. We are subject to various Israeli labor laws, collective bargaining agreements entered into from time to time between the Manufacturers Association and the New General Federation of Workers (the Histadrut), as well as collective bargaining arrangements. Such laws, agreements and arrangements cover a wide range of areas, including minimum employment standards, such as working hours, minimum wages, vacation, procedures for dismissing employees, severance pay and pension plans and special issues, such as equal pay for equal work, equal opportunity in employment and employment of youth and army veterans. Israeli law requires severance pay upon certain circumstances, including upon the retirement or death of an employee or termination of employment without due cause. Furthermore, Israeli employees and employers are required to pay predetermined sums to the National Insurance Institute, which is similar to the U.S. Social Security Administration, which amounts also include payments for national health insurance. In addition, certain of our employees are parties to individual employment agreements. We generally provide our employees with benefits and working conditions beyond the required minimums. Each of our subsidiaries provides a benefits package and working conditions which we believe are competitive with other companies in their field of operations.

E. Share Ownership.

The following table sets forth certain information regarding the ownership of our ordinary shares by our directors and executive officers as of March 24, 2014.

Name	Number of Ordinary Shares Owned (1)	Percentage of Outstanding Ordinary Shares (2)	
Barry Stiefel	20,000	*	
Shaul Kobrinsky	-	-	
Eitan Livneh (3)	188,967	1.2	%
Mark Rosenberg	-	-	
Liza Singer	-	-	
Doron Steiger	-	-	
Zoran Yitzhak	-	-	
Jacob Berman	10,000	-	
Yehonatan Ben-Hamozeg (4)	111,000	*	
Hagai Katz (5)	117,500	*	
Ilan Ovadia (6)	74,500	*	
Eli Sananes (7)	56,667	*	
Rinat Gazit	-	*	
All directors and executive officers as group (13 persons)	578,634	3.6	%

* Less than 1%

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

(2) The percentages shown are based on 16,147,522 ordinary shares issued and outstanding as of March 24, 2014.

(3) Includes 183,332 ordinary shares issuable upon the exercise of currently exercisable options, having an exercise price of $4.35 per share that expire in November 2015, February 2016, May 2016, August 2016 and March 2017.

(4) Includes 50,000 ordinary shares issuable upon the exercise of currently exercisable options, having an exercise price of $3.53 per share that will expire in December 2014 and in December 2015 and 44,000 ordinary shares issuable upon the exercise of currently exercisable options, having an exercise price of $4.35 per share that will expire in March 2017.

(5) Includes 73,500 ordinary shares issuable upon the exercise of currently exercisable options, having an exercise price of $4.09 per share that will expire in April 2014, 2015 and 2016 and 44,000 ordinary shares issuable upon the exercise of currently exercisable options, having an exercise price of $4.35 per share that will expire in March 2017.

(6) Includes 30,500 ordinary shares issuable upon the exercise of currently exercisable options, having an exercise price of $3.53 per share that will expire in December 2015 and 44,000 ordinary shares issuable upon the exercise of currently exercisable options, having an exercise price of $4.35 per share that will expire in March 2017.

(7) Includes 56,667 ordinary shares issuable upon the exercise of currently exercisable options, having an exercise price of $5.14 per share that will expire in May 2016 and 2017.

Share Option Plans

2003 Israeli Share Option Plan

On October 27, 2003, our board of directors adopted our 2003 Israeli Share Option Plan, or the 2003 Plan, which was approved by our shareholders in July 2004. Under the 2003 Plan, stock options could be granted to our employees, directors, officers and consultants, in accordance with the decision of our board of directors. Our board of directors had the authority to determine the vesting schedule of such options and the exercise price. Under the 2003 Plan, unless determined otherwise by the Board, no option may be exercised before the second anniversary of the date on which it was granted. Pursuant to the 2003 Plan, any options that are cancelled or not exercised within the option period will become available for future grants. Our board of directors has elected to allot options to Israeli employees under Israel's capital gain tax treatment. Pursuant to the provisions of the 2003 Plan, if we issue a stock dividend, the number of shares purchasable by any grantee upon the exercise of options that were granted prior to the issuance of the stock dividend will be correspondingly increased. In August 2008, our shareholders approved an amendment to the 2003 Plan, pursuant to which the number of ordinary shares available for issuance under the 2003 Plan was increased by 1,000,000 shares. In addition, the term of the 2003 Plan was extended from October 2013 to October 2018. Following the adoption of our 2010 Israeli Share Option Plan in June 2010, no additional options will be granted under the 2003 Plan.

As of December 31, 2013, options to purchase 347,332 ordinary shares were outstanding under the 2003 Plan, exercisable at an average exercise price of $3.84 per share. Options to purchase 49,500 Ordinary shares under the 2003 Plan were exercised during 2013.

2010 Israeli Share Option Plan

In June 2010, we adopted our 2010 Israeli Share Option Plan, or the 2010 Plan. Under the 2010 Plan, stock options to purchase 510,575 ordinary shares may be granted to our employees, officers, directors and consultants of our company and subsidiaries. In addition, an aggregate 450,575 ordinary shares that remained available for future option grants under the 2003 Plan and any ordinary shares that become available in the future under the 2003 Plan as a result of expiration, cancellation or relinquishment of any option were rolled over to the 2010 Plan. In June 2013, our shareholders approved an increase to the number of ordinary shares available for issuance under the 2010 Plan by additional 500,000 shares. The 2010 Plan has a term of ten years.

The 2010 Plan is designed to allow the grantees to benefit from the tax benefits under Section 102 of the Israeli Income Tax Ordinance [New Version], 1961. Our Board of Directors has resolved that all options that will be granted to Israeli residents under the 2010 Plan will be taxable under the "capital gains route." Pursuant to this route, the profit realized by an employee is taxed as a capital gain (25%) if the options or underlying shares are held by a trustee for at least 24 months from their date of the grant or issuance. Any difference between the exercise price of the options and the average price of the company's shares during the 30 trading days before the date of grant of the options will be treated as ordinary income and will be taxed according to the employee's marginal tax rates plus social contribution. If the underlying shares are sold before the elapse of such period, the profit is re-characterized as ordinary income. As of December 31, 2013, options to purchase 791,000 ordinary shares were outstanding under the 2010 Plan, exercisable at an average exercise price of $4.43 per share. 706,000 options were awarded under the 2010 Plan during 2013.

ITEM 7. Major Shareholders and Related Party Transactions

A. Major Shareholders

The following table sets forth certain information as of March 24, 2014 regarding the beneficial ownership of our ordinary shares, by each person or entity known to us to own beneficially 5.0% or more of our ordinary shares.

Name	Number of Ordinary Shares Beneficially Owned (1)	Percentage of Outstanding Ordinary Shares (2)	
Nathan Kirsh (3)	7,107,290	44.01	%
BMI Capital Corporation (4)	1,475,178	9.14	%
Grace & White, Inc. (5)	1,135,158	7.03	%

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

(2) The percentages shown are based on 16,147,522 ordinary shares issued and outstanding as of March 24, 2014.

(3) Based upon a Schedule 13D/A filed with the SEC on February 11, 2013 and other information available to the company. All of the ordinary shares are held of record by Ki Corporation, a Jersey, Channel Islands corporation. The Eurona Foundation, a Liechtenstein trust controlled by Mr. Kirsh, who also serves as its trustee, holds 100% of Ki Corporation. Mr. Kirsh may be deemed to have beneficial ownership of the ordinary shares held of record by Ki Corporation.

(4) Based solely upon, and qualified in its entirety with reference to, a Schedule 13G filed with the SEC on February 7, 2014. The Schedule 13G indicates that BMI Capital Corporation is a registered investment advisor.

(5) Based solely upon, and qualified in its entirety with reference to, a Schedule 13G/A filed with the SEC on January 30, 2014. The Schedule 13G/A indicates that Grace & White, Inc. is a registered investment adviser.

Significant Changes in the Ownership of Major Shareholders

On August 9, 2011, Ki Corporation filed a Schedule 13D/A reflecting beneficial ownership of 5,981,585, or 24.20%, of our ordinary shares. On June 28, 2012, Ki Corporation filed a Schedule 13D/A reflecting beneficial ownership of 5,981,597, or 37.26% of our ordinary shares. On December 21, 2012, Ki Corporation filed a Schedule 13D/A reflecting beneficial ownership of 7,151,597, or 44.43% of our ordinary shares. On February 11, 2013, Ki Corporation filed a Schedule 13D/A reflecting beneficial ownership of 7,107,290, or 44.15% of our ordinary shares.

On June 17, 2010, Clough Capital Partners, L.P. filed a Schedule 13D reflecting beneficial ownership of 704,042 or 6.8% of our ordinary shares. On March 23, 2011, Clough Capital Partners, L.P. filed an amendment to Schedule 13G, on Schedule 13G/A, reflecting that it ceased to beneficially own any of our ordinary shares.

On February 16, 2010, Diker GP, LLC, Diker Management LLC and Messrs. Charles M. Diker and Mark N. Diker filed with the SEC an amendment to their Schedule 13G, on Schedule 13G/A, reflecting beneficial ownership of 786,854 or 7.57% of our ordinary shares. On June 21, 2010, the foregoing reporting persons filed a Schedule 13D reflecting beneficial ownership of 604,495 or 5.8% of our ordinary shares. On February 14, 2011, the foregoing reporting persons filed an amendment to the Schedule 13G, on Schedule 13G/A, reflecting beneficial ownership of less than 5% of our ordinary shares.

On February 1, 2010, Grace & White, Inc. filed with the SEC an amendment to their Schedule 13G, on Schedule 13G/A, reflecting beneficial ownership of 607,526 or 5.84% of our ordinary shares. On January 31, 2011, Grace & White, Inc. filed an amendment to its Schedule 13G, on Schedule 13G/A, reflecting beneficial ownership of 521,102 or 5.01% of our ordinary shares. On February 6, 2012, Grace & White, Inc. filed an amendment to the Schedule 13G, on Schedule 13G/A, reflecting beneficial ownership of 1,053,606, or 6.06% of our ordinary shares. On January 30, 2013, Grace & White, Inc. filed an amendment to the Schedule 13G, on Schedule 13G/A, reflecting beneficial ownership of 1,038,281, or 6.44% of our ordinary shares. On January 30, 2014 Grace & White, Inc. filed an amendment to its Schedule 13G, on Schedule 13G/A, reflecting beneficial ownership of 1,135,158 or 7.05% of our ordinary shares

On January 31, 2012, BMI Capital Corporation filed a Schedule 13G with the SEC reflecting beneficial ownership of 1,954,267 or 12.25% of our ordinary shares. On February 15, 2013, BMI Capital Corporation filed a Schedule 13G reflecting beneficial ownership of 1,621,582, or 10.06% of our ordinary shares. On February 7, 2014, BMI Capital Corporation filed a Schedule 13G reflecting beneficial ownership of 1,475,178, or 9.13% of our ordinary shares.

Major Shareholders Voting Rights

The voting rights of our major shareholders do not differ from the voting rights of other holders of our ordinary shares.

Record Holders

Based on a review of the information provided to us by our transfer agent, as of March 25, 2014, there were 44 holders of record of our ordinary shares, of which 39 record holders holding approximately 91.8% of our ordinary shares had registered addresses in the United States. These numbers are not representative of the number of beneficial holders of our shares nor is it representative of where such beneficial holders reside since many of these ordinary shares were held of record by brokers or other nominees, including CEDE & Co., the nominee for the Depositary Trust Company (the central depositary for the U.S. brokerage community), which held approximately 91.6% of our outstanding ordinary shares as of such date.

B. Related Party Transactions.

Not applicable.

C. Interests of Experts and Counsel.

Not applicable.

ITEM 8. Financial Information

A. Consolidated Statements and Other Financial Information.

Consolidated Financial Statements

See the consolidated financial statements included under Item 18, “Financial Statements.”

Export Sales

In the years ended December 31, 2011, 2012 and 2013, our operations based outside of Israel generated income to customers outside of Israel of approximately $35.6 million, $35.9 million and $25 million, respectively, or 40.2%, 46.2% and 48.5 % of our total revenues, respectively. In the years ended December 31, 2011, 2012 and 2013, the total amount of our export revenues generated by our Israeli facilities to countries outside of Israel was approximately $42.9 million, $31.6 million and $15 million, respectively, or 48.4%, 40.7% and 29.1%, of our total revenues, respectively.

Legal Proceedings

Following a cancelation of a project agreement by a customer in 2006 we have conducted various arbitration proceedings with the client. Eventually, in March 2010, the Court of Arbitration determined that the customer is liable for certain expenses incurred by us in connection with the negotiation and execution of the agreement due to the customer's wrongful behavior during the negotiations. In addition, the Court of Arbitration determined that the customer is liable for damages caused to us due to the customer's unjust enrichment resulting from its failure to pay for certain deliveries made by us. Accordingly, on October 25, 2011 we collected an arbitration award of approximately $2.5 million and recorded income of $2.3 million from the arbitration, net of legal expenses. On November 21, 2011 the customer filed a claim seeking the cancellation of the arbitration award by disputing the merits of the case. On January 31, 2014 the court has dismissed the claim. The customer has advised us that he will not appeal the dismissal and the judgment is therefore final.

In addition, we are subject to legal proceedings arising in the normal course of business. Based on the advice of our legal counsel, management believes that these proceedings will not have a material adverse effect on our financial position or results of operations.

Dividend Distribution Policy

We currently intend to retain future earnings for use in our business and do not anticipate paying cash dividends on our ordinary shares in the foreseeable future. Future dividend distributions are subject to the discretion of our board of directors and will depend on a number of factors, including our operating results, future capital resources available for distribution, capital requirements, financial condition, the tax implications of dividend distributions on our income, future prospects and any other factors our board of directors may deem relevant.

The distribution of dividends also may be limited by Israeli law, which permits the distribution of dividends only out of profits (as defined by the Israeli Companies Law) or otherwise upon the permission of the court, and only if the Board of Directors determines that such distribution will not jeopardize the ability of the company to repay its debts on the due date thereof. "Profits'' are defined in the Israeli Companies Law as the balance of surpluses, or the surpluses accumulated over the past two years, whichever is the greater, in accordance with the latest adjusted financial statements, audited or reviewed, prepared by the company, provided that the date in respect of which the statements were prepared is no earlier than six months prior to the date of distribution. ''Surplus'' means sums included in a company's shareholders' equity originating from the net profit of the company, as determined according to generally accepted accounting principles, and sums other than share capital or premiums that are included in shareholders' equity under generally accepted accounting principles and that the Minister of Justice has prescribed to be considered surplus.

B. Significant Changes.

Since the date of the annual consolidated financial statements included in this annual report, no significant changes have occurred.

ITEM 9. The Offer and Listing

A. Offer and Listing Details.

Annual Stock Information

The following table sets forth, for each of the years indicated, the high and low market prices of our ordinary shares on the NASDAQ Global Market. Until November 30, 2011, our ordinary shares were also traded on the Tel Aviv Stock Exchange.

	NASDAQ Global Market	
	High	Low
2009	$ 6.40	$ 3.08
2010	$ 4.70	$ 2.50
2011	$ 5.10	$ 2.18
2012	$ 5.68	$ 3.26
2013	$ 4.93	$ 3.16

Quarterly Stock Information

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

	NASDAQ Global Market	
	High	Low
2012		
First Quarter	$ 4.83	$ 3.87
Second Quarter	$ 5.68	$ 3.26
Third Quarter	$ 4.00	$ 3.30
Fourth Quarter	$ 4.40	$ 3.31
2013		
First Quarter	$ 4.93	$ 4.11
Second Quarter	$ 4.90	$ 3.61
Third Quarter	$ 4.02	$ 3.41
Fourth Quarter	$ 3.80	$ 3.16
2014		
First Quarter (through March 24, 2014)	$ 4.15	$ 3.56

Monthly Stock Information

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

	NASDAQ Global Market	
	High	Low
October 2013	$ 3.53	$ 3.16

November 2013	$ 3.80	$ 3.21
December 2013	$ 3.75	$ 3.50
January 2014	$ 4.13	$ 3.56
February 2014	$ 4.04	$ 3.87
March 2014 (through March 24, 2014)	$ 4.15	$ 3.91

B. Plan of Distribution.

Not applicable.

C. Markets.

Our ordinary shares have traded on the NASDAQ Global Market under the symbol "MAGS" since our initial public offering in 1993. Our ordinary shares also traded on the TASE from July 1, 2001 to November 30, 2011.

D. Selling Shareholders.

Not applicable.

E.Dilution.

Not applicable.

F.Expenses of the Issue.

Not applicable.

ITEM 10. Additional Information

A. Share Capital.

Not applicable.

B. Memorandum and Articles of Association.

Purposes and Objects of the Company

We are a public company registered with the Israeli Companies Registrar and have been assigned company number 52-003892-8. Under our memorandum of association, we were established for the purposes of acquiring from IAI a plant, known as the Magal Plant, engaged in the development, manufacture, sale and support of alarm devices and dealing in the development, manufacturing and support of security alarm devices and other similar products. In addition, the purpose of our Company is to be eligible to perform and act in connection with any right or obligation of whatever kind or nature permissible under Israeli law.

Board of Directors

The strategic management of our business (as distinguished from the daily management of our business affairs) is vested in our board of directors, which may exercise all such powers and do all such acts as our company is authorized to exercise and do, and which are not required to be exercised by a resolution of the general meeting of our shareholders. The board of directors may, subject to the provisions of the Israeli Companies Law, delegate some of its powers to committees, each consisting of one or more directors, provided that at least one member of such committee is an external director.

According to the Israeli Companies Law, we may stipulate in our articles of association that the general meeting of shareholders is authorized to assume the responsibilities of the board of directors. In the event the board of directors is unable to act or exercise its powers, the general meeting of shareholders is authorized to exercise the powers of the board of directors, even if the articles of association do not stipulate so. Our board of directors has the power to assume the responsibilities of our chief executive officer if he is unable to act or exercise his powers or if he fails to fulfill the instructions of the board of directors with respect to a specific matter.

Our articles of association do not impose any mandatory retirement or age limit requirements on our directors and our directors are not required to own shares in our company in order to qualify to serve as directors.

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

For a discussion of Israeli law concerning a director's fiduciary duties and the approval of transactions with office holders, see Item 6.C. "Directors, Senior Management and Employees-Board Practices - Approval of Related Party Transactions under Israeli Law."

Rights Attached to Shares

Our authorized share capital consists of NIS 39,748,000 ordinary shares, par value NIS 1.00 each. All our ordinary shares have the same rights, preferences and restrictions, some of which are detailed below. At the general meeting of shareholders, our shareholders may, subject to certain provisions detailed below, create different classes of shares, each class bearing different rights, preferences and restrictions.

The rights attached to the ordinary shares are as follows:

Dividends Rights. Holders of ordinary shares are entitled to participate in the payment of dividends in accordance with the amounts paid-up or credited as paid up on the nominal value of such ordinary shares at the time of payment (without taking into account any premium paid thereon). However, under article 13 of our articles of association no shareholder will be entitled to receive any dividends until the shareholder has paid all calls then currently due and payable on each ordinary share held by such shareholder.

The board of directors may declare interim dividends and propose the final dividend with respect to any fiscal year only out of the retained earnings, in accordance with the provisions of the Israeli Companies Law. Declaration of a final dividend requires the approval by ordinary resolution of our shareholders at a general meeting of shareholders. Such resolution may reduce but not increase the dividend amount recommended by the board of directors. Dividends may be paid, in whole or in part, by way of distribution of dividends in kind. See "Item 8A. Financial Information – Consolidated Statements and Other Financial Information – Dividend Distributions Policy."

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

Generally, resolutions are adopted at the general meeting of shareholders by an ordinary resolution, unless the Israeli Companies Law or our articles of association require an extraordinary resolution. An ordinary resolution, such as a resolution approving the declaration of dividends or the appointment of auditors, requires approval by the holders of a simple majority of the shares represented at the meeting, in person or by proxy, and voting on the matter. An extraordinary resolution requires approval by the holders of at least 75% of the shares represented at the meeting, in person or by proxy, and voting on the matter. The primary resolutions required to be adopted by an extraordinary resolution of the general meeting of shareholders are resolutions to:

- amend the memorandum of association or articles of association;
- change the share capital, for example by increasing or canceling the authorized share capital or modifying the rights attached to shares; and
- approve mergers, consolidations or winding up of our company.

Our articles of association do not contain any provisions regarding a classified board of directors or cumulative voting for the election of directors. Pursuant to our articles of association, our directors (except the external directors) are elected at our annual general meeting of shareholders by a vote of the holders of a majority of the voting power represented and voting at such meeting and hold office until the next annual general meeting of shareholders and until their successors have been elected. All the members of our board of directors (except the external directors) may be reelected upon completion of their term of office. For information regarding the election of external directors, see "Item 6C. Directors, Senior Management and Employees – Directors and Senior Management - Board Practices - External and Independent Directors - External Directors."

Rights to Share in the Company's Profits. Our shareholders have the right to share in our profits distributed as a dividend or any other permitted distributions. See this Item 10B. "Additional Information – Memorandum and Articles of Association – Rights Attached to Shares – Dividend Rights."

Liquidation Rights. Article 111 of our articles of association provides that upon any liquidation, dissolution or winding-up of our company, our remaining assets shall be distributed pro-rata to our ordinary shareholders.

Redemption. Under Article 38 of our articles of association, we may issue redeemable stock and redeem the same.

Capital Calls. Under our memorandum of association and the Israeli Companies Law, the liability of our shareholders is limited to the par value of the shares held by them.

Substantial limitations on shareholders. See Item 6.C. "Directors, Senior Management and Employees-Board Practices–Approval of Related Party Transactions."

Modifications of Share Rights

The rights attached to a class of shares may be altered by an extraordinary resolution of the general meeting of shareholders, provided the holders of 75% of the issued shares of that class approve such change by the adoption of an extraordinary resolution at a separate meeting of such class, subject to the terms of such class. The provisions of the articles of association pertaining to general meetings of shareholders also apply to a separate meeting of a class of shareholders. Shares which confer preferential or subordinate rights relating to, among other things, dividends, voting, and payment of capital may be created only by an extraordinary resolution of the general meeting of shareholders.

General Meetings of Shareholders

Under the Israeli Companies Law a company must convene an annual meeting of shareholders at least once every calendar year and within 15 months of the last annual meeting. Depending on the matter to be voted upon, notice of at least 21 days or 35 days prior to the date of the meeting is required. Our board of directors may, in its discretion, convene additional meetings as "special general meetings." In addition, the board must convene a special general meeting upon the demand of two of the directors, 25% of the nominated directors, one or more shareholders having at least 5% of the outstanding share capital and at least 1% of the voting power in the company, or one or more shareholders having at least 5% of the voting power in the company. See this Item 10B. "Additional Information - Memorandum and Articles of Association- Rights Attached to Shares-Voting Rights."

A shareholder present, in person or by proxy, at the commencement of a general meeting of shareholders may not seek the cancellation of any proceedings or resolutions adopted at such general meeting of shareholders on account of any defect in the notice of such meeting relating to the time or the place thereof. Shareholders who are registered in our register of shareholders at the record date may vote at the general meeting of shareholders. The record date is set in the resolution to convene the general meeting of shareholders, provided, however, that such record date must be between 14 to 21 days or, in the event of a vote by ballots, between 28 to 40 days prior the date the general meeting of shareholders is held.

The quorum required for a general meeting of shareholders consists of at least two record shareholders, present in person or by proxy, who hold, in the aggregate, at least one third of the voting power of our outstanding shares. A general meeting of shareholders will be adjourned for lack of a quorum after half an hour from the time appointed for such meeting to the same day in the following week at the same time and place or any other time and place as the board of directors designates in a notice to the shareholders. At such reconvened meeting, if a quorum is not present within half an hour from the time appointed for such meeting, two or more shareholders, present in person or by proxy, will constitute a quorum. The only business that may be considered at an adjourned general meeting of shareholders is the business that might have been lawfully considered at the general meeting of shareholders originally convened and the only resolutions that may be adopted are the resolutions that could have been adopted at the general meeting of shareholders originally convened.

Limitations on the Right to Own Our Securities

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

Provisions Restricting a Change in Control of Our Company

The Israeli Companies Law requires that mergers between Israeli companies be approved by the board of directors and general meeting of shareholders of both parties to the transaction. The approval of the board of directors of both companies is subject to such boards' confirmation that there is no reasonable doubt that after the merger the surviving company will be able to fulfill its obligations towards its creditors. Each company must notify its creditors about the contemplated merger. Under our articles of association, such merger must be approved by a resolution of the shareholders, as explained above. The approval of the merger by the general meetings of shareholders of the companies is also subject to additional approval requirements as specified in the Israeli Companies Law and regulations promulgated thereunder. For purposes of the shareholders' approval, the merger shall not be deemed as granted unless the court determines otherwise, if it is not supported by the 75% of the shares represented and voting at the general meeting, provided that such majority includes a simple majority of the non-interested shareholders. See also Item 6C. "Directors, Senior Management and Employees – Board Practices – Approval of Related Party Transactions Under Israeli Law."

The Israeli Companies Law also provides that an acquisition of shares of a public company must be made by means of a special tender offer if as a result of the acquisition the purchaser would become a 25% or greater shareholder of the company and there is no existing 25% or greater shareholder in the company. An acquisition of shares of a public company must also be made by means of a tender offer if as a result of the acquisition the purchaser would become a 45% or greater shareholder of the company and there is no existing 45% or greater shareholder in the company. These requirements do not apply if the acquisition (i) was made through a private placement that received shareholder approval, (ii) was from a 25% shareholder of the company and resulted in the acquirer becoming a 25% shareholder of the company or (iii) was from a 45% shareholder of the company and resulted in the acquirer becoming a 45% shareholder of the company. The special tender offer must be extended to all shareholders but, the offer may include explicit limitations allowing the offeror not to purchase shares representing more than 5% of the voting power attached to the company's outstanding shares, regardless of how many shares are tendered by shareholders. The special tender offer may be effected only if (i) at least 5% of the voting power attached to the company's outstanding shares will be acquired by the offeror and (ii) the number of shares tendered in the offer exceeds the number of shares whose holders objected to the offer.

If, as a result of an acquisition of shares, the acquirer will hold more than 90% of the outstanding shares, the acquisition must be made by means of a tender offer for the entire outstanding shares. In such event, if less than 5% of the outstanding shares are not tendered in the tender offer, all the shares of the company will be deemed as tendered and sold. However, if more than 5% of the outstanding shares are not tendered in the tender offer, then the acquirer may not acquire any shares at all. The law provides for appraisal allowing any shareholder to file a motion to the court within six months following the consummation of a full tender offer. However, in the event of a full tender offer, the offer or may determine that any shareholder who accepts the offer will not be entitled to appraisal rights. Such determination shall be effective only if the offeror or the company has timely published all the information that is required to be published in connection with such full tender offer pursuant to all applicable laws.

In addition, the purchase of 25% or more of the outstanding share capital of a company or the purchase of substantial assets of a company requires, under certain conditions, the approval of the Restrictive Practices Authority. Furthermore if the target company has received tax incentives of grants from the Office of the Chief

Scientist, changes in ownership may require also the approval of the tax authorities or the Office of the Chief Scientist, as applicable.

C. Material Contracts.

None.

D. Exchange Controls.

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

E. Taxation.

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

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

Israeli Tax Considerations

The following is a summary of the material Israeli tax laws applicable to us, and some Israeli Government programs benefiting us. This section also contains a discussion of material Israeli tax consequences concerning the ownership of and disposition of our ordinary shares. This summary does not discuss all the acts of Israeli tax law that may be relevant to a particular investor in light of his or her personal investment circumstances or to some types of investors subject to special treatment under Israeli law. Examples of this kind of investor include residents of Israel or traders in securities who are subject to special tax regimes not covered in this discussion. Since some parts of this discussion are based on new tax legislation that has not yet been subject to judicial or administrative interpretation, we cannot assure you that the appropriate tax authorities or the courts will accept the views expressed in this discussion.

The discussion below should not be construed as legal or professional tax advice and does not cover all possible tax considerations. Potential investors are urged to consult their own tax advisors as to the Israeli or other tax consequences of the purchase, ownership and disposition of our ordinary shares, including in particular, the effect of any foreign, state or local taxes.

General Corporate Tax Structure

Generally, Israeli companies are subject to “Corporate Tax” on their taxable income at the rate of 24% for the 2011 tax year and 25% for the 2012 and 2013 tax years. On August 5, 2013, the "Knesset" issued the Law for Changing National Priorities (Legislative Amendments for Achieving Budget Targets for 2013 and 2014), 2013 ("the Budget Law"), which consists, among others, of fiscal changes whose main aim is to enhance the collection of taxes in those years. These changes include, among others, increasing the corporate tax rate from 25% to 26.5%, cancelling the reduction in the tax rates applicable to privileged enterprises (9% in development area A and 16% elsewhere) and, in certain cases, increasing the rate of dividend withholding tax within the scope of the Law for the Encouragement of Capital Investments to 20% effective from January 1, 2014. Israeli companies are generally subject to Capital Gains Tax at the corporate tax rate. However, the effective tax rate payable by a company which derives income from an approved enterprise (as further discussed below) may be considerably less. See "–Tax Benefits under the Law for the Encouragement of Capital Investments, 1959."

Israeli Transfer Pricing Regulations

On November 29, 2006, Income Tax Regulations (Determination of Market Terms), 2006, promulgated under Section 85A of the Israeli Tax Ordinance, came into effect, or the TP Regs. Section 85A of the Tax Ordinance and the TP Regs generally require that all cross-border transactions carried out between related parties be conducted on an arm's length principle basis and will be taxed accordingly. The TP Regs are not expected to have a material effect on us.

Tax Benefits for Research and Development

Israeli tax law allows, under specified conditions, a tax deduction for expenditures, including capital expenditures, in the year incurred relating to scientific research and development projects, if the expenditures are approved by the relevant Israeli Government ministry, determined by the field of research, and the research and development is for the promotion of the company and is carried out by or on behalf of the company seeking such deduction. However, the amount of such deductible expenses shall be reduced by the sum of any funds received through government grants for the finance of such scientific research and development projects. Expenditures that were not approved (as described above) are deductible over a three-year period.

Encouragement of Capital Investments Law, 1959

The Investments Law Prior to the 2005 Amendment

The Law for the Encouragement of Capital Investments, 1959, or the Investments Law, as in effect prior to April 1, 2005 provided that a proposed capital investment in eligible facilities may, upon application to the Investment Center of the Ministry of Industry and Commerce of the State of Israel, be designated as an approved enterprise. The Investment Center based its decision as to whether or not to approve an application, among other things, on the criteria set forth in the Investments Law and regulations, the then prevailing policy of the Investment Center, and the specific objectives and financial criteria of the applicant. Each certificate of approval for an approved enterprise relates to a specific investment program delineated both by its financial scope, including its capital sources, and by its physical characteristics, such as the equipment to be purchased and utilized pursuant to the program.

The Investments Law provides that an approved enterprise is eligible for tax benefits on taxable income derived from its approved enterprise programs. The tax benefits under the Investments Law also apply to income generated by a company from the grant of a usage right with respect to know-how developed by the approved enterprise, income generated from royalties, and income derived from a service which is auxiliary to such usage right or royalties, provided that such income is generated within the approved enterprise’s ordinary course of business. If a company has more than one approved enterprise or only a portion of its capital investments are approved, its effective tax rate is the result of a weighted average of the applicable rates. The tax benefits under the Investments Law are not, generally, available with respect to income derived from products manufactured outside of Israel. In addition, the tax benefits available to an approved enterprise are contingent upon the fulfillment of conditions stipulated in the Investments Law and regulations and the criteria set forth in the specific certificate of approval, as described above. In the event that a company does not meet these conditions, it would be required to refund the amount of tax benefits, plus a CPI linkage adjustment and interest.

The Investments Law also provides that an approved enterprise is entitled to accelerated depreciation on its property and equipment that are included in an approved enterprise program.

Taxable income of a company derived from an approved enterprise is subject to corporate tax at the maximum rate of 25%, rather than the regular corporate tax rate, for the benefit period. This period is ordinarily seven years commencing with the year in which the approved enterprise first generates taxable income (after the commencement of production), and is limited to 12 years from commencement of production or 14 years from the date of approval, whichever is earlier, referred to as the “Years Limitation.”

A company may elect to receive an alternative package of benefits. Under the alternative package of benefits, a company’s undistributed income derived from the approved enterprise will be exempt from corporate tax for a period of between two and ten years from the first year the company derives taxable income under the program, depending on the geographic location of the approved enterprise within Israel, and such company will be eligible for a reduced tax rate for the remainder of the benefits period. The Years Limitation does not apply to the exemption period. A company that has elected the alternative package of benefits, such as us, that subsequently pays a dividend out of income derived from the approved enterprise during the tax exemption period will be subject to corporate tax in respect of the gross amount distributed, including any taxes thereon, at the rate which would have been applicable had it not elected the alternative package of benefits, generally 10%-25%, depending on the percentage of the company's ordinary shares held by foreign shareholders. The dividend recipient is subject to withholding tax at the rate of 15% applicable to dividends from approved enterprises, if the dividend is distributed during the tax exemption period or within twelve years thereafter. The company must withhold this tax at source.

A company that has an approved enterprise program is eligible for further tax benefits if it qualifies as a foreign investors' company. A foreign investors' company is a company which more than 25% of its share capital and combined share and loan capital is owned by non-Israeli residents. A company that qualifies as a foreign investors' company and has an approved enterprise program is eligible for tax benefits for a ten-year benefit period. As specified above, depending on the geographic location of the approved enterprise within Israel, income derived from the approved enterprise program may be exempt from tax on its undistributed income for a period of between two to ten years, and will be subject to a reduced tax rate for the remainder of the benefits period. The tax rate for the remainder of the benefits period will be 25%, unless the level of foreign investment exceeds 49%, in which case the tax rate will be 20% if the foreign investment is more than 49% and less than 74%; 15% if more than 74% and less than 90%; and 10% if 90% or more.

Subject to applicable provisions concerning income under the alternative package of benefits, dividends paid by a company are considered to be attributable to income received from the entire company and the company's effective tax rate is the result of a weighted average of the various applicable tax rates, excluding any tax-exempt income. Under the Investments Law, a company that has elected the alternative package of benefits is not obliged to distribute retained profits, and may generally decide from which year's profits to declare dividends. We currently intend to reinvest any income derived from our approved enterprise program and not to distribute such income as a dividend.

The Israeli government may reduce or eliminate tax benefits available to approved enterprise programs in the future. We cannot assure you that our approved program and the benefits thereunder shall continue in the future at its current level or at any level.

Currently, we have two valid expansion programs that were granted approved enterprise status under the Investments Law prior to its amendment.

2005 Amendment to the Investments Law

An amendment to the Investments Law, which was published on April 1, 2005, or the Amendment, has changed certain provisions of the Investments Law. As a result of the Amendment, a company is no longer obliged to acquire approved enterprise status in order to receive the tax benefits previously available under the alternative benefits provisions, and therefore generally there is no need to apply to the Investment Center for this purpose (approved enterprise status remains mandatory for companies seeking grants). Rather, a company may claim the tax benefits offered by the Investments Law directly in its tax returns, provided that its facilities meet the criteria for tax benefits set out by the Amendment. A company is also granted a right to approach the Israeli Tax Authority for a pre-ruling regarding their eligibility for benefits under the Amendment.

Tax benefits are available under the Amendment to production facilities (or other eligible facilities), which are generally required to derive more than 25% of their business income from export, referred to as a "Benefited Enterprise." In order to receive the tax benefits, the Amendment states that the company must make an investment in the Benefited Enterprise exceeding a certain percentage or a minimum amount specified in the Investments Law. Such investment may be made over a period of no more than three years ending at the end of the year in which the company requested to have the tax benefits apply to the Benefited Enterprise, referred to as the Year of Election. Where the company requests to have the tax benefits apply to an expansion of existing facilities, then only the expansion will be considered a Benefited Enterprise and the company's effective tax rate will be the result of a weighted combination of the applicable rates. In this case, the minimum investment required in order to qualify as a Benefited Enterprise is required to exceed a certain percentage or a minimum amount of the company's production assets before the expansion.

The duration of tax benefits is subject to a limitation of the earlier of seven to ten years from the commencement year, or 12 years from the first day of the Year of Election. The tax benefits granted to a Benefited Enterprise are determined, as applicable to its geographic location within Israel, according to one of the following new tax routes, which may be applicable to us:

- Similar to the currently available alternative route, exemption from corporate tax on undistributed income for a period of two to ten years, depending on the geographic location of the Benefited Enterprise within Israel, and a reduced corporate tax rate of 10% to 25% for the remainder of the benefits period, depending on the level of foreign investment in each year. Benefits may be granted for a term of seven to ten years, depending on the level of foreign investment in the company. If the company pays a dividend out of income derived from the Benefited Enterprise during the tax exemption period, such income will be subject to corporate tax at the applicable rate (10%-25%) with respect to the gross amount of dividend distributed. The company is required to withhold tax at the source at a rate of 15% from any dividends distributed from income derived from the Benefited Enterprise; and

- A special tax route, which enables companies owning facilities in certain geographical locations in Israel to pay corporate tax at the rate of 11.5% on income of the Benefited Enterprise. The benefits period is ten years. Upon payment of dividends, the company is required to withhold tax at source at a rate of 15% for Israeli residents and at a rate of 4% for foreign residents.

Generally, a company that is “Abundant in Foreign Investment,” as defined in the Investments Law, is entitled to an extension of the benefits period by an additional five years, depending on the rate of its income that is derived in foreign currency.

The Amendment changes the definition of “foreign investment” in the Investments Law so that the definition now requires a minimal investment of NIS 5 million by foreign investors. Furthermore, such definition now also includes the purchase of shares of a company from another shareholder, provided that the company’s outstanding and paid-up share capital exceeds NIS 5 million. Such changes to the aforementioned definition are retroactive from 2003.

The Amendment applies to approved enterprise programs in which the year of election under the Investments Law is 2004 or later, unless such programs received “Approved Enterprise” approval from the Investment Center on or prior to December 31, 2004, in which case the Amendment provides that terms and benefits included in any certificate of approval already granted will remain subject to the provisions of the Investments Law as they were on the date of such approval.

Should we elect to utilize tax benefits under the Amendment to the Investments Law, any such tax exempt profits might be subject to future taxation on the corporate level upon distribution to shareholders by a way of dividend or liquidation. Accordingly, we may be required to recognize deferred tax liability with respect to such tax exempt profits.

A substantial portion of our taxable operating income is derived from our benefited enterprise program and we expect that a substantial portion of any taxable operating income that we may realize in the future will be also derived from such program. There is no assurance that our facilities will continue to enjoy such status in the future.

In March, 2007, we received a pre-ruling from the Israeli Tax Authority confirming that our most recent development program will be deemed a Benefiting Enterprise under the amended Investments Law. Our income from this program is tax-exempt for a period of two years, and is subject to a reduced tax rate of 10%-25% for a period of five to eight years (depending upon the percentage of foreign ownership of the Company). We have not enjoyed any tax benefits under this program to date.

Reform of the Investments Law

An additional amendment to the Investment Law became effective in January 2011, or the 2011 Amendment. Under the 2011 Amendment, income derived by ‘Preferred Companies’ from ‘Preferred Enterprises’ (both as defined in the 2011 Amendment) would be subject to a uniform rate of corporate tax as opposed to the incentives prior to the 2011 Amendment that were limited to income from Approved or Benefiting Enterprises during their benefits period. According to the 2011 Amendment, the uniform tax rate on such income, referred to as ‘Preferred Income’, would be 10% in areas in Israel that are designated as Development Zone A and 15% elsewhere in Israel during 2011-2012, 7% and 12.5%, respectively, in 2013-2014, and 6% and 12%, respectively, thereafter. Income derived by a Preferred Company from a ‘Special Preferred Enterprise’ (as defined in the Investment Law) would enjoy further reduced tax rates for a period of ten years of 5% in Zone A and 8% elsewhere. As with dividends distributed from taxable income derived from an Approved Enterprise or Benefiting Enterprise during the applicable benefits period, dividends distributed from Preferred Income would be subject to a 15% tax (or lower, if so provided under an applicable tax treaty), which would generally be withheld by the distributing company, provided however that dividends distributed from ‘Preferred Income’ from one Israeli corporation to another, would not be subject to tax. While a company may incur additional tax liability in the event of distribution of dividends from tax exempt income generated from its Approved and Benefiting Enterprises, no additional tax liability will be incurred by in the event of distribution of dividends from income taxed in accordance with the 2011 Amendment. Under the transitional provisions of the 2011 Amendment, we could have elected whether to irrevocably implement the 2011 Amendment with respect to our existing Approved and Benefiting Enterprises while waiving benefits provided under the legislation prior to the 2011 Amendment or keep implementing the legislation prior to the 2011 Amendment during the next years. The 2011 Amendment had no material effect on the tax payable in respect of our operations and therefore, we did not elect to implement the 2011 Amendment in 2011, 2012 or 2013.

In November 2012, the Knesset passed Amendment No. 69 to the Investment Law, or the Trapped Earnings Law, which provides a temporary, partial, relief from taxation on a distribution from exempt income for companies which elect the relief through November 2013. The Trapped Earnings Law allows companies to qualify a portion of its exempt income, or Elected Earnings, for a reduced tax rate ranging between 17.5% and 6%. While the reduced tax is payable within 30 days of election, an electing company is not required to actually distribute the Elected Earnings within a certain period of time. The applicable rate is based on a linear formula involving the portion of Elected Earnings to exempt income and the applicable tax rate prescribed in the Investment Law. A company electing to qualify its exempt income must undertake to make designated investments in productive fixed assets, research and development, or wages of new employees. The amount of such designated investments is defined by a formula which considers the portion of Elected Earnings to the exempt income and the applicable tax rate prescribed by the Investment Law.

In addition to the reduced tax rate a distribution of Elected Earnings would be subject to a 15% withholding tax. The Trapped Earnings Law provides an exemption from the 15% withholding tax for a distribution to an Israeli resident company from companies which have elected the Privileged Enterprise status and waived their Approved Enterprise and privileged Enterprise Status through June 2015.

We are currently evaluating the implications that the Trapped Earnings Law will have on the tax payable in respect of our operations.

Amendment to the Law for the Encouragement of Capital Investments, 1959 (Amendment 71):

On August 5, 2013, the "Knesset" issued the Law for Changing National Priorities (Legislative Amendments for Achieving Budget Targets for 2013 and 2014), 2013 which consists of Amendment 71 to the Law for the Encouragement of Capital Investments ("the Amendment"). According to the Amendment, the tax rate on preferred income form a preferred enterprise in 2014 and thereafter will be 16% (in development area A - 9%). The Amendment also prescribes that any dividends distributed to individuals or foreign residents from the preferred enterprise's earnings as above will be subject to tax at a rate of 20%. The Company has evaluated the effect of the adoption of the Amendment on its financial statements, and as of the date of the approval of the financial statements, the Company believes that it will not apply the Amendment. The Company's may change its position in the future. The Company's Israeli Subsidiary applied the Amendment effective from the 2011 tax year.

Encouragement of Industry (Taxes) Law, 5729-1969

Under the Encouragement of Industry (Taxes) Law, 5729-1969, or the Industry Encouragement Law, “Industrial Companies” are entitled to certain corporate tax benefits, including, among others:

- Amortization, under certain conditions, of purchases of know-how and patents and of rights to use a patent and know-how which are used for the development or advancement of the company, over an eight-year period for tax purposes;

- Right to elect, under specified conditions, to file a consolidated tax return with additional related Israeli industrial companies; and
- Accelerated depreciation rates on equipment and buildings; and
- Deductions over a three-year period of expenses in connection with the issuance and listing of shares on a recognized stock market.

Eligibility for benefits under the Industry Encouragement Law is not subject to the prior approval of any governmental authority. Under the Industry Encouragement Law, an “Industrial Company” is a company resident in Israel, at least 90% of the income of which, in any tax year, determined in Israeli currency, exclusive of income from government loans, capital gains, interest and dividends, is derived from an “Industrial Enterprise” owned by it. An “Industrial Enterprise” is an enterprise owned by an Industrial Company, whose major activity in a given tax year is industrial production activity.

We believe that we currently qualify as an industrial company as defined by the Industry Encouragement Law. We cannot assure you that we will continue to qualify as an industrial company or that the benefits described above will be available to us in the future.

Encouragement of Industrial Research and Development Law, 5744-1984

Under the Encouragement of Industrial Research and Development Law, 5744-1984, or the Research Law, research and development programs that meet specified criteria and are approved by a governmental committee of the OCS, are eligible for grants between 20%-50% of certain of the project’s expenditures, as determined by the research committee of the OCS. In exchange, the recipient of such grants is required to pay the OCS royalties from the revenues derived from products incorporating technology developed within the framework of the approved research and development program or derived from such program (including ancillary services in connection with such program), usually up to 100% of the U.S. dollar-linked value of the total grants received in respect of such program, plus LIBOR interest.

The terms of the Israeli government participation also require a declaration regarding the location of manufacturing of supported products by the recipients of the grants. Under regulations promulgated under the Research Law, upon the approval of the OCS, some of the manufacturing volume may be transferred outside of Israel, beyond the aforementioned declared rate of production abroad, provided that the grant recipient pays royalties at an increased rate and in addition may incur an increased payment cap of up to 300% of the received grant, depending on the percentage of manufacturing being transferred abroad. The Research Law also provides that know-how developed under an approved research and development program and any derivatives of this know-how may not be transferred to third parties in Israel without the prior approval of the research committee of the OCS. 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. No approval is required for the sale or export of any products resulting from such research and development.

In June 2005, an amendment to the Research Law became effective, which amendment was intended to make the Research Law more compatible with the global business environment by, among other things, relaxing restrictions on the transfer of manufacturing rights outside Israel and on the transfer of OCS funded know-how outside of Israel. The amendment permits the OCS, among other things, to approve the transfer of manufacturing rights outside Israel in exchange for an import of different manufacturing into Israel as a substitute, in lieu of demanding the recipient to pay increased royalties as described above. The amendment further permits, under certain circumstances and subject to the OCS’s prior approval, the transfer outside Israel of know-how that has been funded by OCS, generally in the following cases: (a) the grant recipient pays to the OCS a portion of the consideration paid for such funded know-how (according to certain formulas), (b) the grant recipient receives know-how from a third party in exchange for its funded know-how, or (c) such transfer of funded know-how arises in connection with certain types of cooperation in research and development activities under agreements of cooperation programs between Israel and an additional country.

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 OCS on any change in control of the recipient or a change in the holdings of the means of control of the recipient and obtaining the approval of the OCS in case such a change results in a foreign resident becoming an interested party directly in the recipient and requires the new interested party to undertake to the OCS to comply with the Research Law. In addition, the rules of the OCS may require prior approval of the OCS or additional information or representations in respect of certain of such events. For this purpose, “control” is defined as the ability to direct the activities of a company other than any ability arising solely from serving as an officer or director of the company. A person is presumed to have control if such person holds 50% or more of the means of control of a company. “Means of control” refers to voting rights or the right to appoint directors or the chief executive officer. An “interested party” of a company includes a holder of 5% or more of its outstanding share capital or voting rights, its chief executive officer and directors, someone who has the right to appoint its chief executive officer or at least one director, and a company with respect to which any of the foregoing interested parties owns 25% or more of the outstanding share capital or voting rights or has the right to appoint 25% or more of the directors. Accordingly, any foreign resident who acquires 5% or more of our ordinary shares will be required to notify the OCS that it has become an interested party and to sign an undertaking to comply with the Research Law.

The Israeli authorities have indicated that the government may reduce or abolish grants from the OCS in the future. Even if these grants are maintained, we cannot assure you that we will receive OCS grants in the future. In addition, each application to the OCS is reviewed separately, and grants are based on the program approved by the research committee. Generally, expenditures supported under other incentive programs of the State of Israel are not eligible for grants from the OCS.

Taxation under Inflationary Conditions

The Inflationary Adjustments Law was abolished, effective as of January 1 2008, and subject to transitional provisions and special provisions to prevent a distortion in the tax calculations. In February 2008, the Knesset passed an amendment to the Income Tax (Inflationary Adjustments) Law, 1985, which limits the scope of the law with effect from 2008 and thereafter. From 2008, the results for tax purposes will be measured in nominal values, excluding certain adjustments for changes in the CPI carried out in the period up to December 31, 2007. The amended law includes, among other things, the elimination of the inflationary additions and deductions and the additional deduction for depreciation with effect from 2008.

Capital Gains Tax on Sales of Our Ordinary Shares by Foreign Holders

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, unless a specific exemption is available or unless a tax treaty between Israel and the shareholder’s country of residence provides otherwise. The law distinguishes between real gain and inflationary surplus. The inflationary surplus is a portion of the total capital gain which is equivalent to the increase of the relevant asset’s purchase price which is attributable to the increase in the CPI or, in certain circumstances, a foreign currency exchange rate, between the date of purchase and the date of sale. The real gain is the excess of the total capital gain over the inflationary surplus.

Generally, as of January 1, 2012, the tax rate 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 do 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). Israeli companies are subject to the Corporate Tax rate on capital gains derived from the sale of listed shares.

The tax basis of our ordinary shares acquired prior to January 1, 2003 will generally be determined in accordance with the average closing share price in the three trading days preceding January 1, 2003. However, a request may be made to the tax authorities to consider the actual adjusted cost of the shares as the tax basis if it is higher than such average price.

Non-Israeli residents are exempt from Israeli capital gains tax on any gains derived from the sale of shares of Israeli companies publicly traded on a recognized stock exchange or regulated market outside of Israel, provided however that such capital gains are not derived from a permanent establishment in Israel and such shareholders did not acquire their shares prior to an initial public offering. However, non-Israeli corporations will not be entitled to such exemption if Israeli residents (i) have a controlling interest of 25% or more in such non-Israeli corporation, or (ii) are the beneficiaries or are entitled to 25% or more of the revenues or profits of such non-Israeli corporation, whether directly or indirectly.

In some instances where our shareholders may be liable to Israeli tax on the sale of their ordinary shares, the payment of the consideration may be subject to the withholding of Israeli tax at the source.

Pursuant to the Convention Between the government of the United States of America and the government of Israel with Respect to Taxes on Income, as amended, or 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, or a Treaty U.S. Resident, and (iii) is entitled to claim the benefits afforded to such person by the U.S.-Israel Tax Treaty, generally, will not be subject to the Israeli capital gains tax. Such exemption will not apply if (i) such Treaty U.S. Resident holds, directly or indirectly, shares representing 10% or more of our voting power during any part of the 12-month period preceding such sale, exchange or disposition, subject to certain conditions, or (ii) the capital gains from such sale, exchange or disposition can be allocated to a permanent establishment in Israel. In such case, the sale, exchange or disposition of ordinary shares would be subject to Israeli tax, to the extent applicable; however, under the U.S.-Israel Tax Treaty, such Treaty U.S. Resident would be permitted to claim a credit for such taxes against the 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 U.S. state or local taxes.

Taxation of Dividends paid to Non-Resident Holders of Shares

Non-residents of Israel are subject to income tax on income accrued or derived from sources in Israel. Such sources of income include passive income such as dividends. On distributions of dividends other than bonus shares or stock dividends, income tax is applicable at the rate of 25%, or 30% for a shareholder that is considered a “significant shareholder” at any time during the 12-month period preceding such distribution, unless a different rate is provided in a treaty between Israel and the shareholder’s country of residence. However, under the Investments Law, dividends generated by an Approved Enterprise (or Benefited Enterprise) are taxed at the rate of 15%.

Under the U.S.-Israel Tax Treaty, the maximum tax on dividends paid to a holder of ordinary shares who is a Treaty U.S. Resident is 25%. However, if the income out of which the dividend is paid is not generated by an Approved Enterprise (or Benefited Enterprise), and not more than 25% of our gross income consists of interest or dividends, dividends paid to a U.S. corporation holding at least 10% of our issued voting power during the part of the tax year which precedes the date of payment of the dividend and during the whole of its prior tax year, are generally taxed at a rate of 12.5%. Dividends generated by an Approved Enterprise (or Benefited Enterprise) are taxed at the rate of 15% under the U.S.-Israel Tax Treaty.

United States Federal Income Tax Consequences

The following is a summary of certain material U.S. federal income tax consequences that apply to U.S. Holders (as defined below) who hold ordinary shares as capital assets. This summary is based on the United States Internal Revenue Code of 1986, as amended, (the “Code) Treasury regulations promulgated thereunder, judicial and administrative interpretations thereof, and the U.S.-Israel Tax Treaty, all as in effect on the date hereof and all of which are subject to change either prospectively or retroactively. This summary does not address all tax considerations that may be relevant with respect to an investment in ordinary shares. This summary does not account for the specific circumstances of any particular investor, such as:

- broker-dealers,
- financial institutions,
- certain insurance companies,

- investors liable for alternative minimum tax,

- tax-exempt organizations,
- non-resident aliens of the United States or taxpayers whose functional currency is not the U.S. dollar,
- persons who hold the ordinary shares through partnerships or other pass-through entities,
- persons who acquire their ordinary shares through the exercise or cancellation of employee stock options or otherwise as compensation for services,
- investors that actually or constructively own 10% or more of our voting shares, and
- investors holding ordinary shares as part of a straddle, or appreciated financial position or a hedging or conversion transaction.

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

This summary does not address the effect of any U.S. federal taxation other than U.S. federal income taxation. In addition, this summary does not include any discussion of state, local or foreign taxation.

You are urged to consult your tax advisors regarding the foreign and U.S. federal, state and local tax consequences of an investment in ordinary shares.

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

- an individual who is a citizen or, for U.S. federal income tax purposes, a resident of the United States;
- a corporation or other entity taxable as a corporation created or organized in or under the laws of the United States or any political subdivision thereof;
- an estate whose income is subject to U.S. federal income tax regardless of its source; or
- a trust that (a) is subject to the primary supervision of a court within the United States and the control of one or more U.S. persons or (b) has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person.

Taxation of Dividends

Subject to the discussion, below, under the heading “Passive Foreign Investment Companies,” the gross amount of any distributions received with respect to ordinary shares, including the amount of any Israeli taxes withheld therefrom, will constitute dividends for U.S. federal income tax purposes to the extent of our current and accumulated earnings and profits, as determined for U.S. federal income tax purposes. You will be required to include this amount of dividends in gross income as ordinary income. Distributions in excess of our current and accumulated earnings and profits will be treated as a non-taxable return of capital to the extent of your tax basis in the ordinary shares and any amount in excess of your tax basis will be treated as gain from the sale of ordinary shares. See “-Disposition of Ordinary Shares” below for a discussion of the taxation of capital gains. Our dividends will not qualify for the dividends-received deduction generally available to corporations under section 243 of the Code.

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

Subject to complex limitations, any Israeli withholding tax imposed on such dividends will be a foreign income tax eligible for credit against a U.S. Holder's U.S. federal income tax liability (or, alternatively, for deduction against income in determining such tax liability). The limitations set out in the Code include computational 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. Dividends generally will be treated as foreign-source passive category income for U.S. foreign tax credit purposes. Further, there are special rules for computing the foreign tax credit limitation of a taxpayer who receives dividends subject to a reduced tax rate, see discussion below. A U.S. Holder will be denied a foreign tax credit with respect to Israeli income tax withheld from dividends received on the ordinary shares to the extent such 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 or to the extent such U.S. Holder is under an obligation to make related payments with respect to 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 16-day holding period required by the statute. The rules relating to the determination of the foreign tax credit are complex, and you should consult with your personal tax advisors to determine whether and to what extent you would be entitled to this credit.

Subject to certain limitations, including the Medicare tax, discussed below, “qualified dividend income” received by a non-corporate U.S. Holder will be subject to tax at a reduced maximum tax rate of 20 %. Distributions taxable as dividends paid on the ordinary shares should qualify for the 20 % rate provided that either: (i) we are entitled to benefits under the income tax treaty between the United States and Israel (the “Treaty”) or (ii) the ordinary shares are readily tradable on an established securities market in the United States and certain other requirements are met. We believe that we are entitled to benefits under the Treaty and that the ordinary shares currently are readily tradable on an established securities market in the United States. However, no assurance can be given that the ordinary shares will remain readily tradable. The rate reduction does not apply unless certain holding period requirements are satisfied. With respect to the ordinary shares, the U.S. Holder must have held such shares for at least 61 days during the 121-day period beginning 60 days before the ex-dividend date. The rate reduction also does not apply to dividends received from a passive foreign investment company, see discussion below, or in respect of certain hedged positions or in certain other situations. The legislation enacting the reduced tax rate on qualified dividends contains special rules for computing the foreign tax credit limitation of a taxpayer who receives dividends subject to the reduced tax rate. U.S. Holders of ordinary shares should consult their own tax advisors regarding the effect of these rules in their particular circumstances.

Additional Tax on Investment Income

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

Disposition of Ordinary Shares

If you sell or otherwise dispose of ordinary shares, you will recognize gain or loss for U.S. federal income tax purposes in an amount equal to the difference between the amount realized on the sale or other disposition and the adjusted tax basis in ordinary shares. Subject to the discussion below under the heading "Passive Foreign Investment Companies," such gain or loss will generally be capital gain or loss and will be long-term capital gain or loss if you have held the ordinary shares for more than one year at the time of the sale or other disposition. In general, any gain that you recognize on the sale or other disposition of ordinary shares will be U.S.-source for purposes of the foreign tax credit limitation; losses will generally be allocated against U.S. source income. Deduction of capital losses is subject to certain limitations under the Code.

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

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

Passive Foreign Investment Companies

For U.S. federal income tax purposes, we will be considered a passive foreign investment company (a “PFIC”), for any taxable year in which either (i) 75% or more of our gross income is passive income, or (ii) at least 50% of the average value of all of our assets for the taxable year produce or are held for the production of passive income. For this purpose, passive income generally includes dividends, interest, royalties, rents, annuities and the excess of gains over losses from the disposition of assets that produce passive income. Included in the calculation of our income and assets is a pro rata portion of the income and assets of each corporation in which we own, directly or indirectly, at least a 25% interest, by value. If we were determined to be a PFIC for U.S. federal income tax purposes, unfavorable and highly complex rules would apply to U.S. Holders owning ordinary shares directly or indirectly. Accordingly, you are urged to consult your tax advisors regarding the application of such rules.

Based on our current and projected income, assets and activities, we believe that we are not currently a PFIC, nor do we expect to become a PFIC in the foreseeable future. However, because the determination of whether we are a PFIC is based upon the composition of our income and assets from time to time, there can be no assurance that we will not become a PFIC for any future taxable year.

If we are treated as a PFIC for any taxable year, dividends would not qualify for the reduced tax rate on qualified dividend income, discussed above, you may be required to file IRS Form 8621 with your tax return, and, unless you elect either to treat your investment in ordinary shares as an investment in a "qualified electing fund", by making a “QEF election” or to "mark-to-market" your ordinary shares, as described below,

- you would be required to allocate income recognized upon receiving certain dividends or gain recognized upon the disposition of ordinary shares ratably over your holding period for such ordinary shares,

- the amount allocated to each year during which we are considered a PFIC, other than the year of the dividend payment or disposition, would be subject to tax at the highest individual or corporate tax rate, as the case may be, and an interest charge would be imposed with respect to the resulting tax liability allocated to each such year, and

- the amount allocated to the current taxable year and any taxable year before we became a PFIC would be taxable as ordinary income in the current year.

If you make either a timely QEF election or a timely mark-to-market election in respect of your ordinary shares, you would not be subject to the rules described above. If you make a timely QEF election, you would be required to include in your income for each taxable year your pro rata share of our ordinary earnings as ordinary income and your pro rata share of our net capital gain as long-term capital gain, whether or not such amounts are actually distributed to you. You would not be eligible to make a QEF election unless we comply with certain information reporting requirements.

Alternatively, assuming the ordinary shares qualify as “marketable stock” within the meaning of section 1296(e) of the Code, if you elect to “mark to market” your ordinary shares, you will generally include in income, in each year in which we are considered a PFIC, any excess of the fair market value of the ordinary shares at the close of each tax year over your adjusted basis in the ordinary shares. If the fair market value of the ordinary shares had depreciated below your adjusted basis at the close of the tax year, you may generally deduct the excess of the adjusted basis of the ordinary shares over its fair market value at that time. However, such deductions would generally be limited to the net mark-to-market gains, if any, that you included in income with respect to such ordinary shares in prior years. Income recognized and deductions allowed under the mark-to-market provisions, as well as any gain or loss on the disposition of ordinary shares with respect to which the mark-to-market election is made, is treated as ordinary income or loss (except that loss on a disposition of ordinary shares is treated as capital loss to the extent the loss exceeds the net mark-to-market gains, if any, that you included in income with respect to such ordinary shares in prior years). Gain or loss from the disposition of ordinary shares (as to which a mark-to-market election was made) in a year in which we are no longer a PFIC, will be capital gain or loss.

Backup Withholding and Information Reporting

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

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

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

Any U.S. holder who holds 10% or more in vote or value of our ordinary shares will be subject to certain additional U.S. information reporting requirements.

F.Dividends and Paying Agents.

Not applicable.

G. Statements by Experts.

Not applicable.

H. Documents on Display.

We are subject to certain of the reporting requirements of the Securities and Exchange Act of 1934, as amended, or the Exchange Act, as applicable to "foreign private issuers" as defined in Rule 3b-4 under the Exchange Act. As a foreign private issuer, we are exempt from certain provisions of the Exchange Act. Accordingly, our proxy solicitations are not subject to the disclosure and procedural requirements of Regulation 14A under the Exchange Act, and transactions in our equity securities by our officers and directors are exempt from reporting and the "short-swing" profit recovery provisions contained in Section 16 of the Exchange Act. In addition, we are not required to file quarterly reports including financial statements. We file with the SEC an annual report on Form 20-F containing financial statements audited by an independent accounting firm. We also submit to the SEC reports on Form 6-K containing, among other things, press releases and unaudited financial information. We post our annual report on Form 20-F on our website (www.magal-s3.com) promptly following the filing of our annual report with the SEC. The information on our website is not incorporated by reference into this annual report.

This annual report and the exhibits thereto and any other document we file pursuant to the Exchange Act may be inspected without charge and copied at prescribed rates at the SEC public reference room at 100 F Street, N.E., Room 1580, Washington, D.C. 20549. You may obtain information on the operation of the SEC's public reference room in Washington, D.C. by calling the SEC at 1-800-SEC-0330. The Exchange Act file number for our SEC filings is 000-21388.

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

The documents concerning our company that are referred to in this annual report may also be inspected at our executive offices in Israel.

I. Subsidiary Information.

Not applicable.

ITEM 11. Quantitative and Qualitative Disclosures about Market Risk

We are exposed to a variety of risks, including changes in interest rates and foreign currency fluctuations.

Interest Rate Risk

Our exposure to market risk for changes in interest rates is related to our short-term and long-term loans. Our financial expenses are sensitive to prime interest rate, since our short-term loans as well as our long-term loans, bear prime-based interest rates.

The table below presents principal amounts and related weighted average interest rates by date of maturity for our loans:

Interest Rate Sensitivity
Principal Amount by Expected Maturity Date and Weighted Average Interest Rate
(U.S. dollars in thousands)

Liabilities	2014	2015	2016	2017	2018	Total	Fair Value at December 31, 2013
Short-term loans	$ 5,764	-	-	-	-	$ 5,764	$ 5,764
Weighted average interest rate (%)	1.45					1.45	
Long-term loans	$ 506	$ 500	$ 500	$ 500	$ 375	$ 2,381	$ 2,381
Weighted average interest rate (%)	3.65	3.65	3.65	3.65	3.65	3.65	

Foreign Currency Exchange Risk

We sell most of our products in North America, Europe, Africa, Latin America and Israel. Our revenues are primarily denominated in U.S. dollars, Euros and NIS, while a portion of our expenses, primarily labor expenses, is incurred in NIS and Canadian Dollars. Additionally, certain assets, especially trade receivables, as well as part of our liabilities are denominated in NIS. As a result, fluctuations in rates of exchange between the U.S. dollar and non-U.S. dollar currencies may affect our operating results and financial condition. The dollar cost of our operations in Israel may be adversely affected by the appreciation of the NIS against the U.S. dollar. In addition, the value of our non-U.S. dollar revenues could be adversely affected by the depreciation of the U.S. dollar against such currencies. In 2012 and 2013, the NIS appreciated by approximately 2.3% and 7.0%, respectively, against the U.S. dollar, while in 2011 the NIS depreciated by approximately 7.7% against the U.S. dollar. In 2012 and 2013, the Euro appreciated against the U.S.

dollar by 2.0% and 4.3%, respectively, while in 2011 the Euro depreciated against the U.S. dollar by 3.3%.

In addition, the U.S. dollar cost of our operations in Canada is influenced by the exchange rate between the U.S. dollar and the Canadian dollar. In 2012 the Canadian dollar appreciated against the U.S. dollar by 2.6%, respectively, while in 2011 and 2013 the Canadian dollar depreciated by approximately 2.3% and 6.8%, respectively, against the U.S. dollar.

During the year ended December 31, 2012, foreign currency fluctuations had an adverse impact on our results of operations and we recorded foreign exchange losses, net of $0.5 million. During the years ended December 31, 2011 and 2013, foreign currency fluctuations had a positive impact on our results of operations and we recorded foreign exchange income, net of $1.4 million and $0.1 million, respectively. We cannot assure you that in the future our results of operations may not be materially affected by currency fluctuations.

We try to use natural hedges in order protect against fluctuations in the exchange rates. From time to time, we have entered into forward contracts to hedge portions of balances denominated in currencies other than our functional currency. In 2012 and 2011, we entered into forward “extra” contracts. These forward contracts are a combination of the purchase of a foreign exchange option and the sale of a foreign exchange option with a “knock in.” A foreign exchange option with a “knock in” is a product that gives the holder the right but not the obligation to exchange one currency for another at a predetermined rate once an agreed “knock in” rate trades. During 2013 and 2012, we recorded $39,000 and $410,000 as financial income. During 2011, these forward “extra” transactions had no impact on our results as none of the “knock in” rates were met.

For derivative instruments designated as cash flow hedges (i.e., hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings in the same line item associated with the forecasted transaction in the same period or periods during which the hedged transaction affects earnings.

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

Disclosure Controls and Procedures

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

Management's Report on Internal Control over Financial Reporting

Our management, including our chief executive officer and chief financial officer, is responsible for establishing and maintaining adequate internal control over financial reporting, as defined under Exchange Act Rules 13a-15(f) and 15d-15(f). Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States. Internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets, (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with appropriate authorizations; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2013. In conducting its assessment of internal control over financial reporting, management based its evaluation on the framework in “Internal Control – Integrated Framework” issued by the Committee of Sponsoring Organizations, or the COSO, of the Treadway Commission. Based on that assessment, our management has concluded that our internal control over financial reporting was effective as of December 31, 2013.

Changes in Internal Control over Financial Reporting

During the period covered by this Annual Report on Form 20-F, no changes in our internal control over financial reporting have occurred that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 16. [Reserved]

ITEM 16A. Audit Committee Financial Expert

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

ITEM 16B. Code of Ethics

Our amended and restated code of ethics, which was adopted in April 2010, applies to our chief executive officer and all senior financial officers of our company, including our chief financial officer, chief accounting officer or controller, and persons performing similar functions. The amended and restated code of ethics reflects our growing emphasis on international operations and better addresses issues related with such activities by providing clear instructions in connection with commercial international activities. The code of ethics is publicly available on our website at www.magal-s3.com. Written copies are available upon request. If we make any substantive amendment to the code of ethics or grant any waivers, including any implicit waiver, from a provision of the code of ethics, we will disclose the nature of such amendment or waiver on our website.

ITEM 16C. Principal Accountant Fees and Services

Independent Public Accountant Fees and Services

The following table sets forth, for each of the years indicated, the fees billed by our principal independent registered public accounting firm, Kost Forer Gabbay & Kasierer. All of such fees were pre-approved by our Audit Committee.

	Year Ended December 31,	
Services Rendered	2012	2013
Audit (1)	$ 296,300	$ 278,200
Tax (2)	14,000	48,000
Other (3)	119,100	235,200
Total	$ 429,400	$ 561,400

(1) Audit fees are for audit services for each of the years shown in the table, including fees associated with the annual audit (including audit of our internal control over financial reporting), consultations on various accounting issues and audit services provided in connection with other statutory or regulatory filings.

(2)

Tax fees are for professional services rendered by our auditors for tax compliance, tax planning and tax advice on actual or contemplated transactions, tax consulting associated to international taxation, tax assessment deliberation, transfer pricing and withholding tax assessments.

(3) Other fees primarily relate to out of pocket reimbursement of expenses, primarily traveling expenses of our auditors. In 2012, these fees also relate to fees associated with the purchase of Cyberseal and due diligence of other potential acquisitions that we conducted during the year. In 2013 these fees these fees also relate to fees associated with due diligence of potential acquisitions that we conducted during the year.

Pre-Approval Policies and Procedures

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

ITEM 16D. Exemptions from the Listing Standards for Audit Committees

Not applicable.

ITEM 16E. Purchase of Equity Securities by the Issuer and Affiliated Purchasers

We did not purchase any ordinary shares of our company nor did an affiliated purchaser purchase any shares of our company on our behalf during 2013. Although we do not believe that Ki Corporation may be deemed to be an affiliated purchaser as defined in the Exchange Act, we were notified on December 14, 2012 that Ki Corporation acquired 1,170,000 of our ordinary shares, the entire shareholdings of the Even-Ezra family, at $5.00 per share (a 26% premium to our closing share price on December 14, 2012). This brought Ki Corporation's ownership interest in our shares to 44.4%.

ITEM 16F. Changes In Registrant's Certifying Accountant

None.

ITEM 16G. Corporate Governance

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

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

- the requirement regarding the process of nominating directors. Instead, we follow Israeli law and practice in accordance with which our directors are recommended by our board of directors for election by our shareholders. See Item 6.C. "Directors, Senior Management and Employees - Board Practices - Election of Directors."

- the requirement regarding the compensation of our chief executive officer and all other executive officers. Instead, we follow Israeli law and practice in accordance with which our board of directors must approve all compensation arrangements for our chief executive officer and all compensation arrangements for officers are subject to the chief executive officer's approval. See Item 6.C. "Directors, Senior Management and Employees - Compensation."

- the requirement that our independent directors have regularly scheduled meetings at which only independent directors are present. Under Israeli law independent directors are not required to hold executive sessions.

- the requirement that we maintain a majority of independent directors, as defined under NASDAQ Stock Market Rules. Under Israeli law and practice we are required to appoint at least two external directors, within the meaning of the Israeli Companies Law, to our board of directors.

ITEM 16H. MINE SAFETY DISCLOSURE

Not applicable.

PART III

ITEM 17. Financial Statements

We have elected to furnish financial statements and related information specified in Item 18.

ITEM 18. Financial Statements

The financial statements required by this item are found at the end of this annual report, beginning on page F-1.

Consolidated Financial Statements

ITEM 19. Exhibits

Exhibit No.	Description
1.1	Memorandum of Association of the Registrant (1)
1.2	Articles of Association of the Registrant (2)
2.1	Specimen Share Certificate for Ordinary Share (3)
2.2	Registrant's Amended and Restated 2003 Israeli Share Option Plan (4)
2.3	Registrant's 2010 Israeli Share Option Plan (5)
2.4	Amendment to Registrant's 2010 Israeli Share Option Plan
8.1	List of Subsidiaries of the Registrant
12.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act, as amended
12.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act, as amended
13.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
13.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
15.1	Consent of Kost Forer Gabbay & Kasierer
101.INS	XBRL Instance Document.*
101.SCH	XBRL Taxonomy Extension Schema Document.*
101.PRE	XBRL Taxonomy Presentation Linkbase Document.*
101.CAL	XBRL Taxonomy Calculation Linkbase Document.*
101.LAB	XBRL Taxonomy Label Linkbase Document.*
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.*

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

(1) Filed as an exhibit to our Registration Statement on Form F-1 (File No. 33-57438), filed with the Securities and Exchange Commission on January 26, 1993, as amended, and incorporated herein by reference.

(2) Filed as an exhibit to our Registration Statement on Form F-1 (No. 33-57438), filed with the Securities and Exchange Commission on January 26, 1993, as amended, and incorporated herein by reference, as amended by an amendment filed as an exhibit to our Registration Statement on Form S-8 (File No. 333-6246), filed with the Commission on January 7, 1997 and incorporated herein by reference, and as further amended by an amendment filed as an exhibit to our Annual Report on Form 20-F for the fiscal year ended December 31, 2000, filed with the

Securities and Exchange Commission on June 29, 2001 and incorporated herein by reference.

(3) Filed as an exhibit to our Registration Statement on Form 8-A, filed with the Securities and Exchange Commission on March 18, 1993, as amended, and incorporated herein by reference.

(4) Filed as Exhibit 4.3 to our Registration Statement on Form S-8 (File No. 333-164696), filed with the Securities and Exchange Commission on August 9, 2005, and incorporated herein by reference.

(5) Filed as Exhibit 2.3 to the Registrant's Annual Report on Form 20-F for the year ended December 31, 2010, and incorporated herein by reference.

MAGAL SECURITY SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2013

IN U.S. DOLLARS

INDEX

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of

MAGAL SECURITY SYSTEMS LTD.

We have audited the accompanying consolidated balance sheets of Magal Security Systems Ltd. and its subsidiaries ("the Company") as of December 31, 2012 and 2013, and the related consolidated statements of operations, consolidated statements of comprehensive income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2013. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our 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 consolidated financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, based on our audits, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2012 and 2013, and the consolidated results of their operations, their comprehensive income and their cash flows for each of the three years in the period ended December 31, 2013, in conformity with U.S. generally accepted accounting principles.

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

Tel-Aviv, Israel
March 27, 2014

MAGAL SECURITY SYSTEMS LTD.
AND ITS SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	December 31, 2012	December 31, 2013
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$36,784	$32,235
Short-term bank deposits	1,789	6,147
Restricted deposit	7,818	6,101
Trade receivables (net of allowance for doubtful accounts of $959 and $809 at December 31, 2012 and 2013, respectively)	17,920	12,634
Unbilled accounts receivable	2,394	2,388
Other accounts receivable and prepaid expenses (Note 3)	2,671	2,379
Inventories (Note 4)	8,535	8,352
Deferred income taxes (Note 14)	502	599
Total current assets	78,413	70,835
LONG-TERM INVESTMENTS AND RECEIVABLES:		
Long-term trade receivables	1,048	690
Long-term deposits and restricted bank deposits	48	35
Severance pay fund	2,220	2,589
Deferred income taxes (Note 14)	-	46
Total long-term investments and receivables	3,316	3,360
PROPERTY AND EQUIPMENT, NET (Note 5)	7,122	7,280
OTHER INTANGIBLE ASSETS, NET (Note 6)	171	895
GOODWILL (Note 7)	2,014	5,417
Total assets	$91,036	$87,787

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

MAGAL SECURITY SYSTEMS LTD.
AND ITS SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands (except share and per share data)

	December 31, 2012	December 31, 2013
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Short-term bank credit (Note 8)	$5,358	$5,764
Current maturities of long-term bank debt (Note 10)	33	506
Trade payables	6,725	3,916
Customer advances	6,895	4,226
Other accounts payable and accrued expenses (Note 9)	10,200	9,431
Deferred income taxes (Note 14)	-	34
Total current liabilities	29,211	23,877
LONG-TERM LIABILITIES:		
Long-term bank debt and other long-term payables (Note 10)	6	1,912
Deferred income taxes (Note 14)	210	301
Accrued severance pay	3,283	4,157
Total long-term liabilities	3,499	6,370
COMMITMENTS AND CONTINGENT LIABILITIES (Note 11)		
SHAREHOLDERS' EQUITY (Note 12):		
Share capital -		
Ordinary shares of NIS 1 par value -		
Authorized: 39,748,000 shares at December 31, 2012 and December 31, 2013; Issued and outstanding: 16,098,022 shares at December 31, 2012 and 16,147,522 shares at December 31, 2013	4,887	4,901
Additional paid-in capital	66,183	68,371
Accumulated other comprehensive income	4,749	7,114
Foreign currency translation adjustments (Company's standalone financial statements)	2,224	1,349
Accumulated deficit	(19,717)	(24,180)
Total Magal shareholders' equity	58,326	57,555
Non controlling interest	-	(15)
Total shareholders' equity	58,326	57,540
Total liabilities and shareholders' equity	$91,036	$87,787

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

MAGAL SECURITY SYSTEMS LTD.
AND ITS SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

U.S. dollars in thousands (except per share data)

	Year ended December 31, 2011	2012	2013
Revenues	$88,591	$77,697	$51,517
Cost of revenues	49,089	44,163	31,059
Gross profit	39,502	33,534	20,458
Operating expenses:			
Research and development, net	3,898	4,041	4,409
Selling and marketing	19,415	16,528	12,781
General and administrative	8,682	7,408	7,787
Other income (Note 11f)	(2,304)	-	-
Total operating expenses	29,691	27,977	24,977
Operating income (loss)	9,811	5,557	(4,519)
Financial expenses (income), net (Note 17)	(756)	472	(59)
Income (loss) before income taxes	10,567	5,085	(4,460)
Income taxes (Note 14)	723	991	69
Net income (loss)	9,844	4,094	(4,529)
Less - loss attributable to non-controlling interests	-	-	66
Net income (loss) attributable to Magal shareholders'	$9,844	$4,094	$(4,463)
Basic and diluted income (loss) per share (Note 13)	$0.78	$0.26	$(0.28)

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

MAGAL SECURITY SYSTEMS LTD.
AND ITS SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

U.S. dollars in thousands (except per share data)

	Year ended December 31,		
	2011	2012	2013
Net income (loss)	$9,844	$4,094	$(4,529)
Realized foreign currency translation adjustments from subsidiary	-	(421)	-
Foreign currency translation adjustments	(589)	684	2,365
Total comprehensive income (loss)	$9,255	$4,357	$(2,164)
Total comprehensive loss attributable to non-controlling interests	-	-	(66)
Total comprehensive income (loss) attributable to Magal shareholders'	$9,255	$4,357	$(2,098)

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

MAGAL SECURITY SYSTEMS LTD.
AND ITS SUBSIDIARIES
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. dollars in thousands (except share data)

	Number of shares	Ordinary shares	Additional paid-in capital	Accumulated other comprehensive income (loss)	Foreign currency translation adjustment - the Company	Retained earnings (accumulated deficit)	Non-controlling interests	Total shareholders' equity
Balance as of January 1, 2011	10,396,548	$ 3,225	$ 49,971	$ 5,075	$ 3,400	$ (33,655)	$ -	$ 28,016
Issuance of share capital, net	5,423,274	1,588	14,640	-	-	-	-	16,228
Stock-based compensation	-	-	344	-	-	-	-	344
Stock-based compensation - granted by related party	-	-	54	-	-	-	-	54
Loan granted by a related party	-	-	(89)	-	-	-	-	(89)
Foreign currency translation adjustments- the Company	-	-	-	-	(2,797)	-	-	(2,797)
Comprehensive income (loss):								
Net income	-	-	-	-	-	9,844	-	9,844
Foreign currency translation adjustments	-	-	-	(589)	-	-	-	(589)
Balance as of December 31, 2011	15,819,822	4,813	64,920	4,486	603	(23,811)	-	51,011
Issuance of shares upon exercise of employee stock options	278,200	74	1,041	-	-	-	-	1,115
Stock-based compensation	-	-	203	-	-	-	-	203
Stock-based compensation - granted by related party	-	-	19	-	-	-	-	19
Foreign currency translation adjustments- the	-	-	-	-	1,621	-	-	1,621

Company								
Comprehensive income (loss):								
Net income	-	-	-	-	-	4,094	-	4,094
Realized foreign currency translation adjustments	-	-	-	(421)	-	-	-	(421)
Foreign currency translation adjustments	-	-	-	684	-	-	-	684