

ELTEK LTD
Form 20-F
April 18, 2019

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

FORM 20-F

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

OR

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

For the fiscal year ended December 31, 2018

OR

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

For the transition period from _____ to _____

OR

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

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

Commission file number 0 28884

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

Israel
(Jurisdiction of incorporation or organization)

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

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

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

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Title of each class	Name of each exchange on which registered
Ordinary Shares, NIS 3.00 Nominal Value	NASDAQ Capital Market

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

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

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

2,028,552 Ordinary Shares, nominal value NIS 3.00 per share (as of December 31, 2018)

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

Yes ☐ No ☒

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

Yes ☐ No ☒

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

Yes ☒ No ☐

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

Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐ Accelerated filer ☐
Emerging growth company ☐ Non-accelerated filer ☒

If an emerging growth company that prepares its financial statements in accordance with U.S. GAAP, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards[†] provided pursuant to Section 13(a) of the Exchange Act.

[†] The term “new or revised financial accounting standard” refers to any update issued by the Financial Accounting Standards Board to its Accounting Standards Codification after April 5, 2012.

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

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

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

Item 17 ☐ Item 18 ☐

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

Yes ☐ No ☒

INTRODUCTION

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

Our functional currency is New Israeli Shekel while our reporting currency is the U.S. dollar. All references in this annual report to “dollars” or “\$” are to U.S. dollars and all references in this annual report to “NIS” are to New Israeli Shekels. Our consolidated financial statements appearing in this annual report are prepared in accordance with U.S. GAAP. The consolidated financial statements appearing in this annual report are translated into dollars at the representative rate of exchange under the current rate method. Under such method, the income statement and cash flows statement items for each year (or period) stated in this report are translated into dollars using the average exchange rates in effect at each period presented, and assets and liabilities for each year (or period) are translated using the exchange rate as of the balance sheet date as published by the Bank of Israel (\$1.00 = NIS 3.748 as of December 31, 2018), and except for equity accounts, which are translated using the rates in effect at the date of the transactions. All resulting exchange differences that do not affect our earnings are reported in the accumulated other comprehensive income as a separate component of shareholders’ equity.

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

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

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PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. Selected Financial Data

The selected financial data, set forth in the table below, have been derived from our audited historical financial statements for the five years ended December 31, 2018. The selected consolidated financial data as of December 31, 2018 and 2017 and for each of the three years ended December 31, 2018 have been prepared in accordance with U.S. GAAP, and are derived from our audited consolidated financial statements and accompanying notes included in Item 18, "Financial Statements." Our selected consolidated financial data as of December 31, 2014, 2015 and 2016 and for the years ended December 31, 2014 and 2015 have been derived from audited consolidated financial statements not included in this annual report. The selected financial data set forth below should be read in conjunction with and are qualified entirely by reference to Item 5. "Operating and Financial Review and Prospects" and our consolidated financial statements and notes thereto included elsewhere in this annual report.

CONSOLIDATED STATEMENT OF OPERATIONS DATA

Year ended December 31,	2018	2017	2016	2015	2014
	(\$ and share data in thousands, except per share data)				
Revenues	33,939	32,754	37,065	41,350	46,626
Cost of revenues	(31,342)	(31,427)	(34,248)	(34,802)	(40,604)
Gross profit	2,597	1,327	2,817	6,548	6,022
R&D expenses	-	(41)	(117)	(90)	(72)
Selling, general and administrative expenses	(4,669)	(4,704)	(4,699)	(4,961)	(6,773)
Impairment of goodwill	-	-	-	-	(80)
Total operating expenses	(4,669)	(4,744)	(4,816)	(5,051)	(6,925)
Operating profit (loss)	(2,072)	(3,418)	(1,999)	1,497	(903)
Financial expenses, net	(475)	(298)	(309)	(259)	(356)
Other income (loss), net	3	15	(259)	6	38
Profit (loss) before income tax expense	(2,544)	(3,701)	(2,567)	1,244	(1,221)
Income tax (expense) benefit	(63)	(74)	(1,158)	(218)	(1,634)
Net profit (loss)	(2,607)	(3,775)	(3,725)	1,026	(2,855)
Net profit (loss) attributable to non-controlling interest	-	-	101	17	190
Net profit (loss) attributable to Eltek Ltd. shareholders	(2,607)	(3,775)	(3,624)	1,043	(2,665)
Basic and diluted net profit (loss) per ordinary share attributable to Eltek Ltd.	(1.28)	(1.58)	(1.82)	0.51	(0.26)
Weighted average number of ordinary shares used to compute basic and diluted net profit (loss) per ordinary share	2,029	2,029	2,029	2,029	2,029

CONSOLIDATED BALANCE SHEETS DATA :

	As at December 31,				
	2018	2017	2016	2015	2014
	(\$ and share data in thousands)				
Working capital (deficit)	(5,314)	(4,565)	(93)	1,982	(72)
Total assets	18,160	22,145	20,145	25,419	26,266
Long-term liabilities	519	911	2,098	3,194	2,087
Total shareholders' equity	882	3,459	6,634	10,335	9,307
Number of issued and outstanding shares	2,029	2,029	2,029	2,029	2,029

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors

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

Risks Related to Our Business and Our Industry

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

In the year ended December 31, 2018, we incurred a net loss of \$2.6 million, and have not maintained consistent profitable operations in the past. We have incurred an accumulated deficit of approximately \$21.5 million since inception and our working capital deficiency amounted to \$5.3 million as of December 31, 2018. There can be no assurance that we will be able to operate profitably in the future. To the extent that we incur operating losses in the future, we may have insufficient working capital to fund our operations. If we do not generate sufficient cash from operations, we will be required to obtain additional financing or reduce our level of expenditure. Such financing may not be available in the future, or, if available, may not be on terms favorable to us. If adequate funds are not available to us, our business, and results of operations and financial condition will be materially and adversely affected.

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

As of December 31, 2018, we had \$1.0 million in cash and cash equivalents and had a working capital deficit of \$5.3 million. The lack of sufficient working capital could negatively impact our ability to compete effectively in the future. To the extent that we incur operating losses in the future or are unable to generate free cash flows from our business, we may not have sufficient working capital to fund our operations and will be required to obtain additional financing. Our working capital requirements and cash flow provided by our operating and financing activities are likely to vary greatly from quarter to quarter, depending on the following factors: (i) the timing of orders and deliveries; (ii) net profit in the period; (iii) the purchase of new equipment; (iv) the build up of inventories; (v) the payment terms offered to our customers; (vi) the payment terms offered by our suppliers; and (vii) approval of the current or additional lines of credit and long-term loans from banks.

As of December 31, 2018, we had revolving lines of credit aggregating NIS 27.5 million (approximately \$7.3 million) with our banks and from a non-banking financial institution, of which \$5.8 million was utilized as of such date, and \$1.6 million of long-term loans (including current maturities) from banks and fixed assets suppliers. In addition, as of December 31, 2018 we had shareholders' loans in the amount of NIS 10 million (\$2.7 million) not including accrued interest, from entities within the Nistec group controlled by the Chairman of our Board of Directors, Yitzhak Nissan. As of April 16, 2019 the total principal amounts of the loans received by us from Nistec is NIS 12 million (approximately \$ 3.3 million). As of December 31, 2018, we were not in compliance with our banks' covenants. As a result, long term bank loans in the amount of \$34,000 were reclassified from long term to short term. These credit facilities may not remain available to us in the future. Furthermore, under certain circumstances the banks may require us to accelerate or make immediate payment in full of our credit facilities. All of our assets are pledged as security for our liabilities to our banks, whose consents are required for any future pledge of such assets.

In November 2017, Nistec Ltd. provided a guarantee for a NIS 3.0 million (approximately \$840,000) loan from a bank, and in August 2018 it also provided a guarantee for a NIS 7.0 million (approximately \$ 1,930,000) loan from a non-banking financial institution. In the event that such guarantees will be exercised by the bank or by the non-banking financial institution, we will be required to repay Nistec Golan (the successor to Nistec Ltd.) by May 1, 2020. In addition, Nistec Golan guaranteed NIS 2.0 million (approximately \$530,000) of our existing line of credit to a bank, which we are required to repay by April 30, 2019. During February 2019, our audit committee approved the exercise of the option that Nistec Golan will repay the debt owed to the bank, and in such event, the guarantee will convert into a loan from Nistec Golan. which is due on May 1, 2020. In February 2019, Nistec Golan (which acquired the loans issued by and assumed the guarantees of Nistec Ltd.) informed us that it intends to convert approximately \$2.5 million of these loans in connection with a planned rights offering. Subsequently, we were informed that instead of the conversion of debt owed to it, Nistec Golan would participate in the rights offering by way of a cash investment of at least \$2.5 million.

In March 2019, we issued at no charge to the holders of our ordinary shares subscription rights to purchase up to an aggregate of 3,380,920 shares, such that each shareholders received five (5) subscription rights for every three (3) ordinary shares owned on the record date, at a price of \$1.464 per ordinary share. We raised \$3.4 million in gross proceeds from this offering (the “Rights Offering”). The proceeds of the Rights Offering will be used for the repayment of the NIS 3.0 million (approximately \$840,000) loan from Mizrahi Bank and the repayment of the NIS 2.0 million (approximately \$530,000) line of credit from Bank Leumi, as well as for working capital and other general corporate purposes, including the possible investment in plant and equipment.

We are not in compliance with financial covenants in our loan agreements

We are subject to financial covenants in our loan agreements with the banks that provide us with our credit facilities and long-term loans. Our compliance with the financial covenants is measured annually based on our annual audited financial statements. As of December 31 of each of the three years ended December 31, 2018, we were not in compliance with these covenants; however, one bank granted us a waiver for such non-compliance until the publication of financial statements as of December 31, 2018. As of December 31, 2018, we were not in compliance with our bank covenants. As a result, long term bank loans in the amount of \$34,000 were reclassified from long term to short term. On February 2019, the banks granted us a waiver from such non-compliance. We are required by one bank to meet these covenants in our financial statements for December 31, 2019 (to be issued no later than May 1, 2020) and the other bank granted us a waiver from such non-compliance, and adjusted the financial covenants, to be met in our financial statements for December 31, 2019 (to be issued not later than 120 days from December 31, 2019).

These credit facilities may not remain available to us in the future. Furthermore, under certain circumstances the banks may require us to accelerate or make immediate payment in full of our credit facilities. All of our assets are encumbered as security for our liabilities to our banks, whose consents are required for any future pledge of such assets. The borrowings from our banks are secured by specific liens on certain assets, by a first priority charge on the rest of our now-owned or after-acquired assets and by a fixed lien on goodwill (intangible assets) and insurance rights (rights to proceeds on insured assets in the event of damage). In addition, the agreements prohibit us from selling or otherwise transferring any assets except in the ordinary course of business or from placing a lien on our assets without the banks' consent.

Both banks have the right to demand immediate repayment of the loans and lines of credit in the event of non-compliance with the financial covenants or a change of control in our company, if such a change occurred without their prior approval. Our failure to remain in compliance with each of the banks' covenants, obtain waivers, negotiate agreements with new covenant terms, or obtain additional financing, if required, may adversely affect our business, results of operations and financial position. There is considerable doubt that we will retain compliance with the bank covenants during 2019.

We are dependent on one-of-a-kind machinery that may malfunction and may not be easily replaced.

The proper function of our manufacturing equipment is an important element for effectively operating our business. We own and use several unique manufacturing machines, some of which are aging and sometimes malfunction, causing disruptions and occasionally even cessation of our manufacturing activities, which adversely affects our business. It is possible that substantial funds may be required to repair or replace our unique machinery, which may not be available to us. Further, the replacement of certain machinery could be a long process. Machinery failure could cause a cessation of our manufacturing activities for a significant period of time, which may have a material adverse effect on our business, financial condition, results of operations and cash flows.

Key customers account for a significant portion of our revenues. The loss of a key customer would have an adverse impact on our business results.

In the years ended December 31, 2018, 2017 and 2016, a group of nine (9) affiliated companies accounted for 12.0%, 14.6%, and 16.3% of our total revenues, respectively and another group of four (4) affiliated companies accounted for 9.3%, 10.2%, and 5.9% of our total revenue, respectively. We expect that a significant portion of our future revenues will continue to be dependent on a small number of customers. If we are unable to retain our key customers, or maintain our level of business with such customers, or, if we are unable to attract sufficient new business to compensate for the loss of or reduction in business from any of our key customers, our results of operations and financial condition would be adversely affected.

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

Our revenues and expenses are denominated in NIS, dollars and euros. Due to the different proportions of currencies our revenues and expenses are denominated in, fluctuations in rates of exchange between NIS and other currencies may affect our operating results and financial condition. The NIS value of our dollar and euro denominated revenues are negatively impacted by the depreciation of the dollar and the Euro against the NIS. The average exchange rate for the NIS against the dollar was 0.1% lower in 2018 than in 2017, which had a minor impact on our operating results in 2018. In the past, the NIS exchange rate against the dollar and other foreign currencies fluctuated, generally reflecting inflation rate differentials. We cannot predict any future trends in the rate of inflation in Israel or the rate of depreciation or appreciation of the NIS against the dollar. If NIS value of our dollar or Euro denominated revenues decreases, our results of operations will be adversely affected.

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

Unfavorable national and global economic conditions could adversely affect our business, operating results and financial condition.

During periods of slowing economic activity, our customers may reduce their demand for our products, technology and professional services, which would reduce our sales, and our business, operating results and financial condition may be adversely affected. The global and domestic economies continue to face a number of economic challenges, including threatened sovereign defaults, credit downgrades, restricted credit for businesses and consumers and potentially falling demand for a variety of products and services. These developments, or the perception that any of them could occur, could result in longer sales cycles, slower adoption of new technologies and increased price competition for our products and services. We could also be exposed to credit risk and payment delinquencies on our accounts receivable, which are not covered by collateral.

Significant portions of our business 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.

We may also be required in the future to increase our reserves for doubtful accounts. 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 are subject to environmental laws and regulations. Compliance with those laws and regulations requires us to incur costs and we are subject to fines or other sanctions for non-compliance.

Our operations are regulated under various environmental laws and regulations that govern, among other things, the discharge of hazardous materials into the air and water, as well as the handling, storage and disposal of such materials. Compliance with these laws and regulations is a major consideration for PCB manufacturers because metals and chemicals classified as hazardous substances are used in the manufacturing process. Since May 2003, our environmental management system has been ISO 14001 certified. This certification was based on successful

implementation of environmental management requirements and includes ongoing monitoring of our processes, raw materials and products. The certification is subject to periodic compliance audits conducted by the Standards Institution of Israel. If, in the future, we are found to be in violation of environmental laws or regulations, we could be liable for damages, costs of remedial actions, may be subject to criminal prosecution including a range of potential penalties, and could also be subject to revocation of permits necessary to conduct our business or any part thereof. Any such liability or revocation could have a material adverse effect on our business, financial condition and results of operations. Environmental laws could become more stringent over time, imposing greater compliance costs and increasing risks and penalties associated with a violation. A shortage of water in Israel may reduce the allocation of water available to manufacturing plants, including ours, which could affect the concentrations of pollutants in our wastewater, making it harder to comply with the foregoing regulations, in which event we would be required to invest additional funds to improve our wastewater treatment systems.

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

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

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

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

During 2014, 2015 and 2016, we received notices from Meitav, the water company of the Petach Tikva municipality, requiring payment of fees totaling NIS 3.8 million (\$980,000) excluding VAT, for discharges of industrial wastewater allegedly not meeting the applicable standards into the municipal sewage system. The payment demands were made on the basis of several samplings conducted by Meitav in our premises during 2013-2015. In December 2015, we completed the construction of a new wastewater treatment facility. In 2016, six wastewater samples were inspected by Meitav and were found to be in compliance with applicable standards. We reached a settlement with Meitav in July 2016.

In October 2015, we filed an application for an emissions permit with the Israeli Ministry of Environmental Protection, or the Ministry. In January 2016, we received a notice of non-compliance from the Ministry stating that the application was incomplete and that we are in breach of the Clean Air Law, 5768-2008 and the Licensing of Businesses Law, 5728-1968. We submitted amended applications and conducted several discussions with the Ministry in 2016 and 2017 and received the emissions permit in July 2017.

If we are found to be in violation of environmental laws, then in addition to fines, we could be liable for damages, costs of remedial actions and a range of potential penalties, and could also be subject to a shutdown of our factory. Such sanctions could have a material adverse effect on our business, financial condition and results of operations.

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

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

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

The global PCB industry is highly fragmented and intensely competitive. It is characterized by rapidly changing technology, frequent new product introductions and rapidly changing customer requirements. We compete principally in the market for complex, flex-rigid and rigid multi-layer PCBs. In the Israeli market we mainly compete with PCB Technologies Ltd. and major international PCB exporters, mainly from South East Asia, Europe and North America. In March 2018 it was published that PCB Technologies signed an agreement for a significant investment of NIS 124.2 million (approximately \$35 million) investment in the company, which could improve its competitiveness.

In the European market we mainly compete with Advanced Circuit Boards NV (Belgium), AT&S Austria Technologie & Systemtechnik AG (Austria), Dyconex and Cicor (Switzerland), Graphics, Exception PCB and Invotec (United Kingdom), Cistelaier and Somacis (Italy), Schoeller-Electronics GmbH (formerly Ruwel Werke GmbH) (Germany) and certain other German companies. In the North American market we mainly compete with TTM, Inc. (previously known as DDi Corp. and Viasystems), KCA Electronics Inc., Lenthor Engineering, Printed Circuits, Inc., Teledyne and certain other American companies.

Many of these competitors have significantly greater financial and marketing resources than us. Our current competition in the rigid PCB segment is mainly from PCB manufacturers in South East Asia (mainly in China), which have substantially lower production costs than us. Continued competitive pressures could cause us to lose significant market share.

In addition, these competitors may respond more quickly to new or emerging technologies or adapt more quickly to changes in customer requirements than we do. We must continually develop improved manufacturing processes to meet our customers' needs for complex products, and our manufacturing process technology is generally not subject to significant proprietary protection. During recessionary periods in the electronics industry, our strategy of providing quick-turn services, an integrated manufacturing solution, and responsive customer service may take on reduced importance to our customers. As a result, we may need to compete more on the basis of price, which would cause our gross margins to decline.

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

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

As the majority of PCB manufacturing is centered in South East Asia, raw material suppliers may focus their attention and give higher priority to manufacturers in those areas, which may interrupt the supply of raw materials to us. In addition, these suppliers could discontinue the manufacture or supply of these raw materials at any time. During the years ended December 31, 2017, 2016 and 2015, our purchases from one supplier accounted for 22.6%, 22.4% and 17.9% of our total consolidated raw material costs, respectively. During the year ended December 31, 2018, our purchases from two (2) suppliers accounted for 24.7% and 19.4% of our total of consolidated raw material costs, respectively. We may not be able to identify and integrate alternative sources of supply in a timely fashion. Any transition to alternate suppliers may result in delays in production and shipment and increased expenses and may limit our ability to deliver products to our customers.

If a raw material or component supplier fails to satisfy our product quality standards, including standards relating to “conflict minerals” it could harm our customer relationships. Furthermore, if we are unable to identify an alternative source of supply, we may have to modify our products or a large portion of our production process to use a substitute raw material, which may cause delays in production and shipments, increased design and manufacturing costs and increased prices for our products.

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

Our business plan assumes an increase in revenues to the U.S. market. However, our efforts to increase sales to the U.S. market may not succeed and sales to the medical, defense and aerospace industries may be affected by several factors, including cutbacks in U.S. government spending, and this may not become a substantial market for us. If we are unsuccessful in such efforts, our future revenues and profitability would be adversely affected. In order to sell PCBs to the U.S. defense market we were required to obtain International Traffic in Arms Regulations (ITAR) registration from the U.S. Department of State, which is subject to periodic extension. There can be no assurance that we will be able to retain our ITAR certification. In the event of a change in control of our company, the U.S. Department of State may investigate the transfer of control and oppose the transaction. The loss of our ITAR certification could adversely affect our future revenues and profitability.

We may be subject to the requirements of the National Industrial Security Program Operating Manual for our facility security clearance, which is a prerequisite to our ability to work on classified contracts for the U.S. government.

A facility security clearance is required in order to be awarded and perform classified contracts for the U.S. Department of Defense, or the DoD, and certain other agencies of the U.S. government. To become a cleared entity, we must comply with the requirements of the National Industrial Security Program Operating Manual, or the NISPOM, and any other applicable U.S. government industrial security regulations. Further, due to the fact that a significant portion of our voting equity is owned by a non-U.S. entity, we are required to be governed by and operate in accordance with the terms and requirements of a Special Security Agreement, or the SSA.

If we were to violate the terms and requirements of the SSA, the NISPOM, or any other applicable U.S. government industrial security regulations (which may apply to us under the terms of classified contracts), we could lose our security clearance. We cannot be certain that we will be able to maintain our security clearance. If for some reason our security clearance is invalidated or terminated, we may not be able to continue to perform on classified contracts and would not be able to enter into new classified contracts, which could materially adversely affect our business, financial condition, and results of operations.

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

Contracts with U.S. military agencies, as well as military equipment manufacturers in Europe, are subject to certain regulatory restrictions and approvals, which we may not be able to comply with or obtain. We may not be able to maintain or increase international market demand for our products. To the extent that we cannot do so, our business, operating results and financial condition may be adversely affected.

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

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

Significant political developments could also have a materially adverse effect on us. In the United States, potential or actual changes in fiscal, defense appropriations, tax and labor policies could have uncertain and unexpected consequences that materially impact our business, results of operations and financial condition. In the U.K., “Brexit,” the referendum in which voters approved an exit from the European Union, or E.U., could lead to legal uncertainty and potentially divergent national laws and regulations which could adversely affect our business and financial condition. While the U.K. and the E.U. are expected to reach an agreement in 2019 regarding the U.K.’s formal exit from the E.U., political changes in the U.K. following the “Brexit” referendum and other factors leave it unclear when exactly the U.K. will exit and on what terms.

Compliance with the conditions of a new business permit we received in 2018 may be costly.

In connection with the change of control of our company that resulted from Nistec Ltd.'s acquisition of a controlling stake in our company, Israeli law required us to obtain a new business permit in order to continue operating our business. We received a new permit in 2018 for the period ending December 31, 2099. We are currently in the process of contacting the municipality in which our plant is located to review the necessity of amending the new business permit as a result of the transfer of shares from Nistec Ltd. to Nistec Golan. The permit contains certain conditions, including conditions imposed by the Israeli Ministry for Environmental Protection, and a building permit, which includes additional conditions, which we are required to comply with as a condition for its renewal. Compliance with these conditions may be costly. If we are unable to comply with such requirements, certain sanctions may be imposed, including significant fines and possibly an order shutting down the factory.

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

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

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

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

Quarterly sales and operating results are also difficult to forecast because they are dependent almost exclusively on the volume and timing of orders during the quarter and our customers generally operate with a short delivery cycle and expect delivery of a significant portion of the order within 30 working days. The delivery of such

orders is subject to the number of available working days during the quarter, which can fluctuate significantly from quarter to quarter due to holidays and vacations. Certain prototype and pre-production runs require even shorter turn-around times stemming from customers' product launches and design changes. In addition, there might be sudden increases, decreases or cancellations of orders for which there are commitments, which further characterize the electronics industry and the companies that operate in it. The industry practice is to make such changes without any penalties, except for the time and materials expended on the order.

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

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

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

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

In recent years, our suppliers have increased their prices for most of our principal raw materials. We have faced pressure to raise our prices for our products to compensate for supplier price increases in order to maintain our operating margins, which we may not be able to achieve due to the competitive market. We have been taking steps to increase our prices since the third quarter of 2018, however, such price increases may result in reduced orders for our products. Additional price increases for our principal raw materials may materially affect our operating margins and future profitability.

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

We have engaged in a multi-year process of conforming the majority of our operations onto one global enterprise resource planning system, or ERP. The ERP is designed to improve the efficiency of our supply chain and financial transaction processes, accurately maintain our books and records, and provide information important to the operation of the business to our management team. In the third quarter of 2017 we decided, due to lack of human and financial resources and unfavorable cost-benefits, to withhold implementation of ERP system. The ERP system was then fully amortized and is not fully supported. In addition, we were notified that the hardware that the ERP runs on, will not be supported after the end of 2019. In addition the operating system of the hardware is at high risk of not being supported in the near future. The implementation of the ERP may continue in the future, which will require significant investment of human and financial resources, and we may experience significant delays, increased costs and other difficulties as a result. Any significant disruption or deficiency in the design and implementation of the ERP could have a material adverse effect on our ability to fulfill and invoice customer orders, apply receipts, place purchase orders with suppliers, and make disbursements, and could negatively impact data processing and electronic communications among business locations, which may have a material adverse effect on our business, consolidated financial condition or results of operations. While we have invested significant resources in planning and project management, significant implementation issues may arise.

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

Breaches of network or information technology (IT) security, natural disasters, pandemics, terrorist acts or acts of war may cause equipment failures or disrupt our systems and operations. Although we have not become aware

of any of these events as of the date of this annual report, we expect that our inability to operate our facilities as a result of such events, even for a limited period of time, may result in significant expenses and/or loss of market share to other competitors in the global PCB industry. While we maintain insurance coverage for some of these events, the potential liabilities associated with these events could exceed the insurance coverage we maintain. In addition, a failure to protect the privacy of customer and employee confidential data against breaches of network or IT security could result in damage to our reputation. Any of these occurrences could adversely affect our results of operations and financial condition.

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

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

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

We are required to comply with "conflict minerals" rules which impose costs on us, may make our supply chain more complex, and could adversely impact our business.

We are subject to the requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, or the Dodd-Frank Act, that will require us to perform due diligence, disclose and report whether our products contain conflict minerals. President Trump's administration has indicated that the Dodd-Frank Act will be under further scrutiny and some of the provisions of the Dodd-Frank Act may be revised, repealed or amended. In April 2017, the U.S. Securities and Exchange Commission, or the SEC, announced that it was suspending enforcement of portions of the conflict minerals regulations enacted under the Dodd-Frank Act following a ruling by the U.S. Court of Appeals for the District of Columbia Circuit. The implementation of these requirements and any changes effected by the Trump administration could adversely affect the sourcing, availability and pricing of the materials used in the manufacture of components used in our products. In addition, we will likely incur additional costs to comply with the disclosure requirements, including costs related to conducting diligence procedures to determine the sources of conflict minerals that may be used in or necessary to the production of our products and, if applicable, potential changes to our products, processes or sources of supply as a consequence of such verification activities. It is also possible that we may face reputational harm if we determine that certain of our products contain minerals not determined to be conflict-free or if we are unable to alter our products, processes or sources of supply to avoid use of such materials. Furthermore, we may encounter challenges in satisfying those customers that require that all of the components of our products be certified as conflict free, and if we cannot satisfy these customers, they may choose a competitor's products.

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

Various governments and governmental agencies have adopted or are contemplating statutory and regulatory changes in response to the potential impacts of climate change and emissions of greenhouse gases. International treaties or agreements may also result in increasing regulation of climate change and greenhouse gas emissions, including the introduction of greenhouse gas emissions trading mechanisms. Any such law or regulation regarding climate change and greenhouse gas emissions could impose significant costs on our operations and on the operations of our customers and suppliers, including increased energy, capital equipment, environmental monitoring, reporting and other compliance costs. The potential costs of "allowances," "offsets" or "credits" that may be part of potential cap-and-trade programs or similar proposed regulatory measures are still uncertain. Any adopted future

climate change and greenhouse gas laws or regulations could negatively impact our ability, and that of our customers and suppliers, to compete with companies situated in areas not subject to such laws or regulations. These statutory and regulatory initiatives, if enacted, may impact our operations directly or indirectly through our suppliers or customers. Until the timing, scope and extent of any future law or regulation becomes known, we cannot predict the effect on our business, financial condition, results of operations or cash flows.

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

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

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

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

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

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

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

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

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

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

of production may be substantially lower than ours. This competition may limit our ability to price our products profitably, which could significantly harm our financial condition and results of operations. In addition, we distinguish ourselves by focusing on developing cutting edge technologies for high-end products, in order to serve our sophisticated defense, aerospace and medical customers. This may limit our ability to reach certain clientele, which demands lower-end products in order to reduce its costs.

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

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

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

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

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

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

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

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

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

We have agreements with our directors and senior officers which may require us, subject to Israeli law and certain limitations in the agreements, to indemnify our directors and senior officers for certain liabilities and expenses that may be imposed on them due to acts performed, or failures to act, in their capacity as office holders as defined in the Israeli Companies Law, 5759-1999, or the Israeli Companies Law. These liabilities may include financial liabilities imposed by judgments or settlements in favor of third parties, and reasonable litigation expenses imposed by a court in relation to criminal charges from which the indemnitee was acquitted or criminal proceedings in which the indemnitee was convicted of an offense that does not require proof of criminal intent. Furthermore, we agreed to exculpate our directors and officers with respect to a breach of their duty of care towards our company. On October 17, 2017, our shareholders approved an updated indemnification agreement to be entered to with our directors and officers.

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

Risks Related to Our Ordinary Shares

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

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

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

- future sales of our ordinary shares;
- our involvement in litigation;
- general stock market price and volume fluctuations;
- changes in the prices of our products and services; and
- devaluation of the dollar against the NIS.

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

Low trading volume may also increase the price volatility of our ordinary shares. A thin trading market could cause the price of our ordinary shares to fluctuate significantly more than the stock market as a whole.

The voting interest of Mr. Nissan, individually and through Nistec Golan, our controlling shareholder, may conflict with the interests of other shareholders.

Mr. Yitzhak Nissan, our Chairman of the Board, beneficially owns 69.9% of our outstanding ordinary shares. In December 2018, Mr. Nissan transferred the shares of our company held by Nistec Ltd. to Nistec Golan, a company beneficially held by him. In March 2019, Nistec Golan exercised its rights in the Rights Offering and purchased 1,707,364 additional ordinary shares. Mr. Nissan also owns 330,740 of our ordinary shares in his own name, which he acquired in the market in 2016 and in the Rights Offering. Accordingly, Mr. Nissan and Nistec Golan have the ability to exercise a significant influence over our business and affairs and generally have the power to determine all matters submitted to a vote of our shareholders where our shares vote together as a single class, including the election of directors and approval of significant corporate transactions. Mr. Nissan and Nistec Golan may make decisions regarding Eltek and our business that are opposed to other shareholders' interests or with which other shareholders may disagree. Nistec Golan's and Mr. Nissan's voting power could have the effect of deterring or preventing a change in control of our Company that might otherwise be beneficial to our other shareholders.

We were not in compliance with NASDAQ's continued listing requirements until recently, and if we fail to maintain compliance with NASDAQ's continued listing requirements our shares may be delisted from the NASDAQ Capital Market.

Our ordinary shares are listed on the NASDAQ Capital Market under the symbol "ELTK." To continue to be listed on NASDAQ, we need to satisfy a number of requirements, including a minimum bid price for our ordinary shares of \$1.00 per share for 30 consecutive business days and shareholders' equity of at least \$2.5 million, or \$35 million market value of listed securities or \$500,000 of net income from continuing operations for the most recently completed fiscal year or two of the three most recently completed fiscal years.

Our ordinary shares have experienced significant market price and volume fluctuations in the past and for certain periods have traded below the \$1.00 threshold requirement for continued trading. On June 23, 2015 we received notification from Nasdaq advising us that we were not in compliance with the \$1.00 threshold requirement for continued trading. On August 26, 2015, we regained compliance with the listing rules, and the matter was then closed. On December 28, 2016, for the second time, we received notification from Nasdaq advising us that we were not in compliance with the \$1.00 threshold requirement for continued trading. Following a reverse split of our ordinary shares, on November 22, 2017, we regained compliance with Listing Rule 5550(a)(2) and our shares continue to be listed on the NASDAQ Capital Market.

On October 2, 2018, we received notification from Nasdaq advising us that as of October 1, 2018, we did not maintain stockholders' equity of \$2.5 million, nor did we meet the alternatives of market value of listed securities or net income from continuing operations, and therefore were not in compliance with the stockholders' equity listing rule. On December 7, 2018, we received a notice from Nasdaq advising that we were granted an extension of time to regain compliance with the shareholders' equity requirement until March 31, 2019. As a result of the receipt of approximately \$2.5 million from our Rights Offering prior to March 31, 2019, we regained compliance with Listing Rule 5550(b)(1) and our shares continue to be listed on the NASDAQ Capital Market. Nasdaq has advised us that it will continue to monitor our ongoing compliance with the shareholders' equity requirement and, if at the time of our next periodic report we do not evidence compliance, we may be subject to delisting. If we are ultimately delisted from NASDAQ, trading in our ordinary shares would be conducted on a market where an investor would likely find it significantly more difficult to dispose of, or to obtain accurate quotations as to the value of, our ordinary shares.

Penny stock rules may limit the ability of our stockholders to sell their stock.

The SEC has adopted regulations which generally define "penny stock" to be any equity security that has a market price (as defined) less than \$5.00 per share or an exercise price of less than \$5.00 per share, subject to certain exceptions. If we lose our listing on NASDAQ Capital Market our securities will be covered by the penny stock rules, which impose

additional sales practice requirements on broker-dealers who sell to persons other than established customers and “accredited investors.” The term “accredited investor” refers generally to institutions with assets in excess of \$5,000,000 or individuals with a net worth in excess of \$1,000,000 or annual income exceeding \$200,000 or \$300,000 jointly with their spouse. The penny stock rules require a broker-dealer, prior to a transaction in a penny stock not otherwise exempt from the rules, to deliver a standardized risk disclosure document in a form prepared by the SEC, which provides information about penny stocks and the nature and level of risks in the penny stock market. The broker-dealer also must provide the customer with current bid and offer quotations for the penny stock, the compensation of the broker-dealer and its salesperson in the transaction and monthly account statements showing the market value of each penny stock held in the customer’s account. The bid and offer quotations, and the broker-dealer and salesperson compensation information, must be given to the customer orally or in writing prior to effecting the transaction and must be given to the customer in writing before or with the customer’s confirmation. In addition, the penny stock rules require that prior to a transaction in a penny stock not otherwise exempt from these rules, the broker-dealer must make a special written determination that the penny stock is a suitable investment for the purchaser and receive the purchaser’s written agreement to the transaction. These disclosure requirements may have the effect of reducing the level of trading activity in the secondary market for the stock that is subject to these penny stock rules. Consequently, these penny stock rules may affect the ability of broker-dealers to trade our securities. We believe that the penny stock rules discourage investor interest in and limit the marketability of our common stock.

The Financial Industry Regulatory Authority, or FINRA, has adopted sales practice requirements which may also limit a shareholder's ability to buy and sell our stock.

In addition to the penny stock rules described above, FINRA has adopted rules that require that, in recommending an investment to a customer, a broker-dealer must have reasonable grounds for believing that the investment is suitable for that customer. Prior to recommending speculative, low-priced securities to their non-institutional customers, broker-dealers must make reasonable efforts to obtain information about the customer's financial status, tax status, investment objectives and other information. Under interpretations of these rules, FINRA believes that there is a high probability that speculative, low-priced securities will not be suitable for at least some customers. FINRA requirements make it more difficult for broker-dealers to recommend that their customers buy our ordinary shares, which may limit their ability to buy and sell our shares and have an adverse effect on the market for our shares.

We may in the future be classified as a passive foreign investment company, or PFIC, which would subject our U.S. investors to adverse tax rules.

U.S. holders of our ordinary shares may face income tax risks. There is a risk that we will be treated as a "passive foreign investment company" ("PFIC"). Our treatment as a PFIC could result in a reduction in the after-tax return to U.S. Holders (as defined below in "Material U.S. Federal Income Tax Considerations") of our ordinary shares and would likely cause a reduction in the value of such shares. A foreign corporation will be treated as a PFIC for U.S. federal income tax purposes if either (1) at least 75% of its gross income for any taxable year consists of certain types of "passive income," or (2) at least 50% of the average value of the corporation's gross assets produce, or are held for the production of, such "passive income." For purposes of these tests, "passive income" includes dividends, interest, gains from the sale or exchange of investment property and rents and royalties other than rents and royalties that are received from unrelated parties in connection with the active conduct of a trade or business. For purposes of these tests, income derived from the performance of services does not constitute "passive income." If we are treated as a PFIC, U.S. Holders of ordinary shares would be subject to a special adverse U.S. federal income tax regime with respect to the income derived by us, the distributions they receive from us, and the gain, if any, they derive from the sale or other disposition of their ordinary shares. In particular, dividends paid by us, if any, would not be treated as "qualified dividend income," eligible for preferential tax rates in the hands of non-corporate U.S. shareholders. We believe that we were not a PFIC for the 2018 tax year. However, since PFIC status depends upon the composition of our income and the market value of our assets from time to time, there can be no assurance that we will not become a PFIC in any future taxable year. U.S. Holders should carefully read "Material U.S. Federal Income Tax Considerations" for a more complete discussion of the U.S. federal income tax risks related to owning and disposing of our ordinary shares.

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

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

Risks Related to Our Incorporation and 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, production, 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. Conflicts in North Africa and the Middle East, including Syria which border Israel, have resulted in continued political uncertainty and violence in the region. Efforts to improve Israel's relationship with the Palestinian Authority have failed to result in a permanent solution, and there have been numerous periods of hostility in recent years. In addition, relations between Israel and Iran continue to be seriously strained, especially with regard to Iran's nuclear program. Such instability may affect the local and global economy, could negatively affect business conditions and, therefore, could adversely affect our operations. 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.

Our commercial insurance does not cover losses that may occur as a result of an event associated with the security situation in the Middle East. Although the Israeli government has in the past covered the reinstatement value of certain damages that were caused by terrorist attacks or acts of war, we cannot assure you that this government coverage will be maintained, or if maintained, will be sufficient to compensate us fully for damages incurred. Any losses or damages incurred by us could have a material adverse effect on our operations.

Parties with whom we do business have sometimes declined to travel to Israel during periods of heightened unrest or tension, forcing us to make alternative arrangements when necessary in order to meet our business partners face to face. In addition, the political and security situation in Israel may result in parties with whom we have agreements involving performance in Israel claiming that they are not obligated to perform their commitments under those agreements pursuant to force majeure provisions in such agreements. Furthermore, several countries and companies restrict business with Israel and Israeli companies, and additional countries may impose restrictions on doing business with Israel and Israeli companies. Restrictive laws or policies directed towards Israel or Israeli businesses may have an adverse impact on our operations, our financial results or the expansion of our business.

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.

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

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

Our operations may be affected by negative labor conditions in Israel.

Strikes and work stoppages occur relatively frequently in Israel. If Israeli trade unions threaten additional strikes or work stoppages and such strikes or work stoppages occur, these may, if prolonged, have a material adverse effect on the Israeli economy and on our business, including our ability to deliver products to our customers in a

timely manner.

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

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

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

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

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

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

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

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

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

We are incorporated under Israeli law. The rights and responsibilities of holders of our ordinary shares are governed by our memorandum of association, articles of association and by Israeli law. These rights and responsibilities differ in some respects from the rights and responsibilities of shareholders in typical U.S.

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

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

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

The termination or reduction of tax and other incentives that the Israeli government provides to domestic companies may increase the costs involved in operating a company in Israel.

The Israeli government currently provides tax and capital investment incentives to domestic companies, as well as grant and loan programs relating to research and development and marketing and export activities. In recent years, the Israeli government has reduced the benefits available under these programs and the Israeli governmental authorities have indicated that the government may in the future further reduce or eliminate the benefits of those programs. We have taken in the past and may take advantage of these benefits and programs again in the future, however, there is no assurance that such benefits and programs will continue to be available to us in the future. If such benefits and programs were terminated or further reduced, it could have an adverse effect on our business, operating results and financial condition. The government tax benefits that we currently are entitled to receive require us to meet several conditions and may be terminated or reduced in the future.

Some of our operations in Israel may entitle us to certain tax benefits under the Law for the Encouragement of Capital Investments, 5719-1959, or the Investment Law, once we are profitable. If we do not meet the requirements for maintaining these benefits, they may be reduced or canceled and the relevant operations would be subject to Israeli corporate tax at the standard rate, which is set at 23% in 2018 and thereafter. In addition to being subject to the standard corporate tax rate, we could be required to refund any tax benefits that we have already received, plus interest and penalties thereon. Even if we continue to meet the relevant requirements, the tax benefits that our current "Benefited Enterprise" is entitled to may not be continued in the future at their current levels or at all. If these tax benefits were reduced or eliminated, the amount of taxes that we pay would likely increase, as all of our operations would consequently be subject to corporate tax at the standard rate, which could adversely affect our results of operations. Additionally, if we increase our activities outside of Israel, for example, by way of acquisitions, our increased activities may not be eligible for inclusion in Israeli tax benefits programs.

ITEM 4. INFORMATION ON THE COMPANY

A. History and Development of the Company

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

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

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

In June 2002, we acquired a majority ownership interest in Kubatronik-Leiterplatten GmbH (“Kubatronik”), a European manufacturing and marketing company located in Geislingen, Germany. In December 2016, we sold all our shares of Kubatronik to Kubatronik’s only other shareholder and founder. For additional information see Item 4C “Organizational Structure”.

In July 2007, we established Eltek USA Inc. (“Eltek USA”), a wholly-owned subsidiary incorporated in Delaware, to manage our sales and marketing in the North American market. In June 2015, we relocated Eltek USA into a new and better-located facility. In December 2008, we established Eltek Europe GmbH, a wholly-owned subsidiary organized in Germany, to manage our sales and marketing activities for certain European customers.

In November 2013, Nistec acquired 50.5% of our issued share capital and gained control of our company. In June 2016, Mr. Nissan, the controlling shareholder of Nistec, and our Chairman and CEO, acquired in the market 124,028 ordinary shares of our company, increasing his direct and indirect voting interest from 50.5% to 56.6%.

In December 2018, Nistec Ltd., transferred its ownership interest in our company to Nistec Golan Ltd. Nistec Golan and Nistec Ltd. are privately held companies indirectly controlled by Mr. Nissan, through Nistec Holdings Ltd.

In March 2019, we issued at no charge to the holders of our ordinary shares subscription rights to purchase up to an aggregate of 3,380,920 shares, such that each shareholder received five (5) subscription rights for every three (3) ordinary shares owned on the record date, at a price of \$1.464 per share. Our shareholders purchased 2,351,701 ordinary shares, for an aggregate of \$3.4 million. Of such shares, Nistec acquired 1,707,364 shares and Mr. Nissan individually acquired 206,712 of our ordinary shares, increasing his direct and indirect voting interest from 56.6% to 69.9%.

During the three years ended December 31, 2018, we cash invested approximately \$619,000 in new equipment and the expansion of our facilities and infrastructure. Subject to availability of financial resources, we expect to invest approximately \$1.2 million in capital expenditures in 2019, mainly for manufacturing equipment to expand our manufacturing capacity and to upgrade our technological capabilities. We intend to finance these expenditures with suppliers' credit, cash flow from operations and bank loans; however, external financing may not be available, or, if available, may not be on terms favorable to us.

B. Business Overview

Industry Overview

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

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

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

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

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

Industry Trends

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

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

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

Increasing concentration of global PCB production in Asia. In recent years, many electronics manufacturers have moved their commercial production to Asia to take advantage of its exceptionally large, relatively low-cost labor pool. In particular, the trend has favored China, which according to industry sources has the largest PCB market in terms of both revenue and number of suppliers. The overall technical capability of suppliers in China has improved dramatically in recent years, and China has emerged as a global production center for cellular phones, smartphones, tablet PCs, computers and computer peripherals, and high-end consumer electronics. The continued outsourcing of production to China should result in additional commercial market share potential for PCB manufacturers with a strong presence and reputation in China.

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

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

Reduction in backlog. Due to the costs involved, our customers are increasingly reluctant to maintain inventory and refrain from placing orders significantly in advance. As a result, we have experienced a reduction in order backlog and uncertainty in respect of future orders.

Introduction of new disruptive technologies. Semi-additive and fully-additive technologies are arising and are expected to affect conventional industries in the future.

Manufacturing and Engineering Processes

Significant investments in equipment are necessary in order to maintain technological competitiveness in the PCB industry. During the three years ended December 31, 2018, we cash invested approximately \$1.6 million in machinery and equipment for that purpose.

Manufacturing Capabilities. We have the capability to manufacture PCBs having in excess of 36 layers, flex-rigid boards, blind and buried vias and designs using materials as thin as 1 mil. We receive orders for production with turnaround times of generally between several days to two months. We are able to produce short runs of five to 30 units of simple type PCBs within four to five working days, and a few hundred units within ten working days, and are capable of producing such number of boards within five working days when production line scheduling permits. During 2007, we applied new technologies to enable us to manufacture “via-in-pad” multilayer PCBs, microvia filling, through hole via filling and copper overplating. In July 2012, we purchased a new Orbotech Paragon™ Laser Direct Imaging, or LDI, system for increasing capacity and shortening production time and improving product time-to-market. In 2012, we also acquired and installed a new Hakuto Cut-Sheet-Laminator and the latest Chemplate Indubond model. In 2014 and in the beginning of 2015 we acquired a complete set of two Lauffer hot presses and one cold press, a line for outer layer surface preparation, a laser router and a second Hakuto cut-sheet-laminator (refurbished). These machines improve the outer layer accuracy and the registration between the inner-layers. During

2015, we installed the new Orbotech Diamond DI for solder mask imaging, which improves the solder mask registration and accuracy.

During 2018 we incurred water damage to a major piece of equipment in our production facility. We replaced the damaged machine with a new Nuvogo™ LDI machine shortly thereafter, utilizing \$500,000 received from our insurance company as an advance payment. The advance payment was recorded as a deduction in the cost of acquiring the new machine and to offset some of the loss incurred as a result of the damage. We are negotiating a final resolution with the insurance company. While we believe that we will receive additional funds from the insurance company on our claims, we cannot be sure that such negotiations will be successfully completed.

Our new equipment enables us to offer our customers solutions and participate in bids in which we were not able to participate in the past. We continue to utilize advanced registration technologies and to improve the copper etching accuracy to comply with new specifications and requirements of our customers and potential customers.

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

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

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

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

Enterprise Resources Planning (ERP) Software. During 2017 we withheld the implementation process of the enterprise resource planning system ("ERP") which we previously had been engaged in.. In 2014 we acquired a new ERP system dedicated to the PCB industry from Proms. In the third quarter of 2017 we decided, due to lack of human and financial resources and unfavorable cost-benefit, to withhold implementation of ERP system. The ERP system was then fully amortized.

Sales, Customers and Marketing

Sales. In the years ended December 31, 2018, 2017 and 2016, the primary industries for which we produced PCBs were defense and aerospace equipment (43.1%, 48.0% and 44.8% of production, respectively), medical equipment (9.5%, 14.3% and 16% of production, respectively), industrial equipment (6.0%, 4.2% and 9.2% of production, respectively), distributors, contract electronic manufacturers and others (41.4%, 33.6% and 30.0% of production, respectively).

Customers. During the year ended December 31, 2018, we provided PCBs to approximately 154 customers in Israel and approximately 99 customers outside of Israel. Our customers outside of Israel are located primarily in North America, the Netherlands, India, Italy, Romania, Uruguay, China, and South Africa. Sales to non-Israeli customers were \$15.0 million (44.2% of revenues) for the year ended December 31, 2018, \$13.0 million (39.8% of revenues) for the year ended December 31, 2017 and \$19.5 million (52.7% of revenues) for the year ended December 31, 2016. In the years ended December 31, 2018, 2017 and 2016, a group of nine affiliated companies accounted for 12.0%, 14.6%, and 16.3% of our total revenues, respectively, and another group of four affiliated companies accounted for 9.3%, 10.2%, and 5.9% of our total revenue, respectively.

Marketing. We market and sell our products primarily through our direct sales personnel, sales representatives and through PCB trading and manufacturing companies. We currently have nine persons involved in sales, of which six persons are located in Israel and three persons are located in the United States. In North America, we market and sell our products through Eltek USA as well as through independent local sales representatives. We also have sales representatives in Germany, Finland and Spain. PCB trading and manufacturing companies act as distributors of our products in the Netherlands, Italy, and South Africa. In India, we market our products through a local sales representative. We maintain technical support services for our customers worldwide. We also maintain customer service support centers that handle all logistical matters relating to the delivery of our products and receive and handle complaints relating to delivered products. Our customer service personnel currently consist of seven persons.

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

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

Materials and Supplies

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

During recent years, price negotiations with our suppliers resulted in lower price increases than requested by our suppliers; however, we may not continue to be successful in such negotiations in the future. We have also faced pressure to raise our prices for our products to compensate for these price increases and although we have managed to date to maintain our sales prices with moderate price increases, we may not be able to do so in the future. Last year the price for raw materials increased drastically due to the Copper demand in the world and the price rise for resin and glass.

Competition

The global PCB industry is highly fragmented and intensely competitive, trends that we believe will continue. The global PCB industry is characterized by rapidly changing technology, frequent new product introductions and rapidly changing customer requirements. We compete principally in the market for complex, flex-rigid multi-layer PCBs. In the Israeli market, we mainly compete with major PCB exporters, mainly from South East Asia, North America and Europe, and the Israeli firm PCB Technologies Ltd. In March 2018, it was reported that PCB Technologies signed an agreement with a local fund for significant investment in PCB Technologies Ltd. which could improve its

competitiveness. In the European market we mainly compete with Advanced Circuit Boards NV (Belgium), AT&S Austria Technologie & Systemtechnik AG (Austria), Dyconex and Cicor (Switzerland), Graphics, Exception PCB and Invotec (United Kingdom), Cistelaier and Somacis (Italy), Schoeller-Electronics GmbH (formerly Ruwel Werke GmbH) (Germany) and certain other German companies. In the North American market, we mainly compete with TTM, Inc. (previously known as DDi Corp and Viasystems), KCA Electronics Inc., Lenthor Engineering, Printed Circuits, Inc., Teledyne. Many of these competitors have significantly greater financial, technical and marketing resources than us. Although capital requirements are a significant barrier to entry for manufacturing complex PCBs, the basic interconnect technology is generally not protected by patents or copyrights. Our current competition in the rigid PCB segment is mainly from PCB manufacturers in the Far-East (mainly in China), which have substantially lower production costs than us. Continued competitive pressures could cause us to lose market share and reduce prices.

Backlog

We estimate that our backlog of unfilled orders as of December 31, 2018, was approximately \$7.0 million compared to a backlog of approximately \$9.1 million at December 31, 2017. We include in our backlog all purchase orders scheduled for delivery within the next 12 months. The backlog outstanding at any point in time is not necessarily indicative of the level of business to be expected in the ensuing period.

Environmental Matters

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

PCB manufacturing requires the use of metals and chemicals classified as hazardous substances. Water used in the manufacturing process must be treated to remove metal particles and other contaminants before it can be discharged into the local sewer systems. We operate and maintain effluent water treatment systems and use approved testing procedures at our manufacturing facilities. There is no assurance, however, that violations will not occur in the future. We are also subject to environmental laws and regulations relating to the storage, use and disposal of chemicals, solid waste and other hazardous materials, as well as air quality regulations. Environmental laws and regulations could become more stringent over time, and the costs of compliance with more stringent laws could be substantial. Environmental regulations enacted in Israel in September 2000 provide that a company that is found to have discharged water containing contaminants will be liable for quadruple the amount normally charged for its water consumption. Over the years, we have undertaken various actions to reduce the use of water in our manufacturing facilities, and invested in improving our effluent wastewater treatment system to lower the amounts of inorganic salts and copper concentration in the discharged water.

In January 2014, July 2014 and September 2015, we received notices from Meitav, the water company of the Petach Tikva municipality, requiring payment of fees totaling NIS 3.8 million (\$980,000) excluding VAT, for discharges of industrial wastewater allegedly not meeting the applicable standards into the municipal sewage system. The payment demands were made on the basis of several samplings conducted by Meitav on our premises during 2013-2015. We presented plans for a new wastewater treatment facility to Meitav in an effort to have Meitav rescind or reduce its demand for payment.

In December 2015, we completed the construction of a new wastewater treatment facility. In 2016, six wastewater samples were inspected by Meitav and were found to be in compliance with applicable standards. In July 2016, we reached a settlement agreement with Meitav, according to which we paid them NIS 200,000 (\$50,000).

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

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

In October 2015, we filed an application for an emissions permit with the Ministry. In January 2016, we received notice of non-compliance from the Ministry, stating that the application was incomplete and that we were in breach of the Clean Air Law, 5768-2008 and the Licensing of Businesses Law, 5728-1968. Following communications with the

Ministry, we submitted an amended application and received our emissions permit in July 2017.

Intellectual Property Rights

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

C. Organizational Structure

In June 2002, we acquired a 76% interest in Kubatronik, a PCB manufacturer that specializes in short run and prototype boards, including multi-layer, flex-rigid and HDI boards. The founder held the remaining 21% interest in Kubatronik (after we acquired an additional 3% of shares of Kubatronik from him in May 2012). The founder had the right to require us to purchase, and we had the right to require him (or his permitted transferee) to sell to us, his remaining interest in Kubatronik. In May 2012, the founder exercised his option with respect to 3% of the shares for approximately Euro 69,000 and reduced his ownership percentage from 24% to 21%. The price for the remaining holdings in Kubatronik under the put option was Euro 483,000, while the price for such holdings under the call option was Euro 513,000. Subsequently, Kubatronik incurred losses which were financed by us. Although we took measures to improve Kubatronik's results, we were not successful in our efforts. Therefore, on December 19, 2016, we sold all of the Kubatronik shares held by us to the founder. As part of the transaction, we paid him Euro 483,000 on account of his option and provided Kubatronik with an Euro 110,000 advance, to support its cash flow. This advance, together with Kubatronik's debt to us in the amount of Euro 1,031,000, was forgiven as part of the transaction. In consideration for the sale, we are entitled to certain contingent consideration.. Kubatronik will continue to manage Eltek Europe GmbH.

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

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

In November 2013, Nistec acquired a controlling 50.5% stake in our company. In June 2016, Mr. Nissan, our Chairman and CEO and the controlling shareholder of Nistec, acquired 124,028 additional ordinary shares of our company, increasing his direct and indirect voting interest from 50.5% to 56.6%.

In December 2018, Nistec Ltd., transferred its ownership interest in our company to Nistec Golan Ltd. Nistec Golan and Nistec Ltd., are privately held companies indirectly controlled by Mr. Nissan, through Nistec Holdings Ltd.

In March 2019, we distributed at no charge to the holders of our ordinary shares subscription rights to purchase up to an aggregate of 3,380,920 shares, such that each shareholder received five (5) subscription rights for every three (3) ordinary shares owned on the record date, at a price of \$1.464 per share. Nistec acquired 1,707,364 additional ordinary shares and Mr. Nissan directly acquired 206,712 additional ordinary shares, increasing his beneficial ownership from 56.6% to 69.9%.

D. Property, Plants and Equipment

Leased Facilities

Our executive offices, as well as our design, production, storage and shipping facilities, aggregating approximately 90,000 square feet, are located in an industrial building in the Sgoola Industrial Zone of Petach Tikva, Israel. In 2017, we exercised our option to extend the lease for an additional five years period, which will expire in February 2022. In the year ended December 31, 2018, we incurred \$903,000 of leasing expenses for these premises.

Our U.S. subsidiary, Eltek USA Inc., leases approximately 1,682 square feet of office space in New Hampshire under a lease that expires in February 2020. During February 2019 we entered into amendment to the lease contract in which we reduced the lease space to 938 square feet of office space commencing March 1, 2019 through February 2024. In the year ended December 31, 2018, we paid an aggregate of \$24,000 in lease payments for these premises.

Leased Equipment

We lease manufacturing equipment under an agreement that obligates us to pay a total of \$1.2 million through October 2024. Our monthly lease expense in 2018 under this agreement was \$49,000.

ITEM 4A. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

A. Operating Results

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

Overview

We were incorporated under the laws of the State of Israel in 1970. Following our initial public offering in January 1997, our ordinary shares were listed on the NASDAQ Stock Market (symbol: ELTK) and are presently listed on the NASDAQ Capital Market. We develop, manufacture, market and sell PCBs, including HDI multi-layered and flex-rigid boards for electronic devices. Our principal customers include manufacturers of medical equipment, defense and aerospace equipment, industrial equipment, and telecom and networking equipment, as well as contract electronic manufacturers. We have production facilities in Israel and marketing subsidiaries in the United States and Germany.

In November 2013, Nistec Ltd. acquired 50.5% of our issued share capital and gained control of our company. In June 2016, Mr. Nissan, our Chairman and CEO and the controlling shareholder of Nistec, acquired 124,028 additional ordinary shares of our company in the open market, increasing his direct and indirect voting interest from 50.5% to 56.6%. In December 2018, Nistec Ltd. transferred its ownership interest in our company to Nistec Golan Ltd. Nistec Golan and Nistec Ltd. are privately held companies indirectly controlled by Mr. Nissan, through Nistec Holdings Ltd.

In March 2019, we distributed, at no charge, to the holders of our ordinary shares, subscription rights to purchase up to an aggregate of 3,380,920 shares, such that each shareholder received five (5) subscription rights for every three (3) ordinary shares owned on the record date, at a price of \$1.464 per share. Nistec acquired 1,707,364 additional ordinary shares and Mr. Nissan directly acquired 206,712 additional ordinary shares, increasing his beneficial ownership interest from 56.6% to 69.9%.

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

Critical Accounting Policies

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

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

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

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

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

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

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

carrying amount of the assets exceeds the fair value of the assets.

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

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

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

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

Results of Operations

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

	Year Ended December 31,		
	2018	2017	2016
	100 %	100 %	100 %
Revenues	100 %	100 %	100 %
Cost of revenues	(92.3)	(95.9)	(92.4)
Gross profit	7.7	4.1	7.6
R&D expenses	-	(0.1)	(0.3)
Selling, general and administrative expenses	(13.8)	(14.4)	(12.7)
Operating loss	(6.1)	(10.4)	(5.4)
Financial expenses, net	(1.4)	(0.1)	(0.8)
Other income (loss), net	*	*	(0.7)
Loss before income tax (expense) benefit	(7.5)	(11.3)	(6.9)
Income tax (expense)	(0.2)	(0.2)	(3.1)
Net loss	(7.7)	(11.5)	(10)
Net loss attributable to non-controlling interest	-	-	0.2
Net loss attributable to Eltek Ltd.	(7.7)	(11.5)	(9.8)

* Less than 0.1%

Year Ended December 31, 2018 Compared with Year Ended December 31, 2017

Revenues. Revenues increased by 3.4% to \$33.9 million in the year ended December 31, 2018, from \$32.8 million in the year ended December 31, 2017. The increase in revenues is primarily attributable to increased demand for our products, mainly from international customers.

Cost of Revenues. Cost of revenues decreased by 0.3% to \$31.3 million for the year ended December 31, 2018, from \$31.4 million for the year ended December 31, 2017. The decrease in cost of revenues is primarily attributable to cost savings measures we made during the second half of the year. Cost of revenues as a percentage of revenues decreased to 92.3% for the year ended December 31, 2018, from 95.9% for the year ended December 31, 2017. The decrease in cost of revenues as a percentage of revenues is primarily attributable to the increase in revenues and our efforts to reduce fixed costs.

Gross Profit. Gross profit increased by 100% to \$2.6 million for the year ended December 31, 2018, from \$1.3 million for the year ended December 31, 2017. Gross profit as a percentage of revenues increased to 7.7% for the year ended December 31, 2018, from 4.1% for the year ended December 31, 2017. The increase in gross profit is primarily due to the increase in revenues and reduction in fixed costs.

Selling, General and Administrative Expenses. Selling, general and administrative expenses were \$4.7 million in the year ended December 31, 2018 and 2017. Selling, general and administrative expenses primarily consist of labor-related costs, marketing and sales activities and other consulting and administrative expenses.

R&D Expenses. We did not incur R&D expenses in 2018. In 2017, we recorded R&D expenses of \$41,000 in connection with our participation in the Printel program, a consortium within the framework of the MAGNET program of the Israeli National Authority for Technological Innovation (previously known as the Office of the Chief Scientist in the Israeli Ministry of Economy and Industry of the State of Israel) (the "NATI").

Operating Loss. We recorded an operating loss of \$2.1 million in the year ended December 31, 2018 compared to an operating loss of \$3.4 million in the year ended December 31, 2017. The decrease in our operating loss is primarily attributable to the increase in revenues and cost savings in our operations.

Financial Expenses, Net. Financial expenses, net increased by \$177,000 to \$475,000 in the year ended December 31, 2018, from \$298,000 in the year ended December 31, 2017. The increase in financial expenses in 2018 compared to 2017 is primarily attributable to the increase in our financial liabilities and the impact of the NIS exchange rate on outstanding dollar and Euro denominated balances of our receivables from customers and debts to our suppliers.

Other Income, Net. We had other income, net of \$3,000 in the year ended December 31, 2018, compared to other income, net of \$15,000 in the year ended December 31, 2017.

Income Tax Expense. During the year ended December 31, 2018 we recorded a tax expense of \$63,000 compared to a tax expense of \$74,000 in 2017. Tax expenses in 2018 were mainly attributable to our subsidiary in the United States.

Year Ended December 31, 2017 Compared with Year Ended December 31, 2016

Revenues. Revenues decreased by 11.7% to \$32.8 million in the year ended December 31, 2017, from \$37 million in the year ended December 31, 2016 (\$33.2 million excluding Kubatronik). The decrease in revenues (excluding Kubatronik) is primarily attributable to manufacturing obstacles we encountered and to decreased demand for our products, mainly from foreign customers.

Cost of Revenues. Cost of revenues decreased by 8.3% to \$31.4 million for the year ended December 31, 2017, from \$34.2 million for the year ended December 31, 2016 (\$30.4 million excluding Kubatronik). The decrease in cost of revenues is primarily attributable to the exclusion of Kubatronik's results and the decreased revenues. Cost of revenues as a percentage of revenues increased to 95.9% for the year ended December 31, 2017, from 92.4% for the year ended December 31, 2016. The increase in cost of revenues as a percentage of revenues is primarily attributable to our inability to reduce fixed costs to the extent necessary to offset the reduction in revenues in 2017.

Gross Profit. Gross profit decreased by 51.2% to \$1.3 million for the year ended December 31, 2017, from \$2.8 million for the year ended December 31, 2016. The decrease in gross profit is primarily due to the decrease in revenues. Gross profit as a percentage of revenues decreased to 4.1% for the year ended December 31, 2017, from 7.6% for the year ended December 31, 2016 (\$2.8 million or 8.3% of revenues excluding Kubatronik). The decrease in gross profit as a percentage of revenues is primarily attributable to the decrease in revenues and the negative impact of the decline of the dollar exchange rate.

Selling, General and Administrative Expenses. Selling, general and administrative expenses were \$4.7 million in the year ended December 31, 2017, similar to the \$4.7 million in the year ended December 31, 2016 (\$4.2 million excluding Kubatronik). The increase in selling, general and administrative expenses excluding Kubatronik is primarily attributable to a lower exchange rate of the dollar.

R&D Expenses. In 2017 we recorded R&D expenses of \$41,000 in connection with our participation in the Printel program, a consortium within the framework of the MAGNET program of the Israeli National Authority for Technological Innovation (previously known as the Office of the Chief Scientist in the Israeli Ministry of Economy and Industry of the State of Israel) (the “NATI”). We recorded \$117,000 of R&D expenses in 2016.

Operating Loss. We recorded an operating loss of \$3.4 million in the year ended December 31, 2017, compared to an operating loss of \$2 million in the year ended December 31, 2016 (\$1.6 million excluding Kubatronik). The operating loss is primarily attributable to the decrease in our revenues.

Financial Expenses, Net. Financial expenses, net decreased by 4% to \$298,000 in the year ended December 31, 2017, from \$309,000 in the year ended December 31, 2016 (\$253,000 excluding Kubatronik). Our financial expenses in 2017 were primarily attributable to interest paid on short-term and long-term debt and the impact of the NIS exchange rate on outstanding dollar and Euro denominated balances of our receivables from customers and debt to our suppliers. The increase in financial expenses in 2017 compared to 2016 excluding Kubatronik is primarily attributable to the increase in our financial liabilities, and the impact of the NIS exchange rate on outstanding dollar and Euro denominated balances of our receivables from customers and debts to our suppliers.

Other Income (Loss), Net. We had other income, net of \$15,000 in the year ended December 31, 2017, compared to other loss, net of \$259,000 in the year ended December 31, 2016, primarily as a result of the sale of our interest in Kubatronik in 2016.

Income Tax Expense. During the year ended December 31, 2017 we recorded a tax expense of \$74,000 compared to a tax expense of \$1.2 million in 2016. Tax expenses in 2017 were mainly attributable to our subsidiary in the United States. In 2016, we wrote off the entire amount of our deferred tax assets based on uncertainty about our ability to realize it in the foreseeable future. Such uncertainty resulted from a reduced demand for our products, a change in the PCB buying patterns of our domestic military customers, which shifted some PCB acquisitions overseas, increased competition coupled with reduced prices in the local market, on-going manufacturing challenges, and possible devaluation of the U.S. dollar against the NIS.

Net Loss Attributable to Non-Controlling Interest. We did not have any loss attributable to non-controlling interest in 2017 since we sold our interest in Kubatronik at the end of 2016. Net loss attributable to non-controlling interest of \$101,000 in the year ended December 31, 2016 reflects the other shareholder’s proportionate share in Kubatronik’s net loss. We sold our entire interest in Kubatronik in December 2016.

Impact of Currency Fluctuations and Inflation

Our revenues and expenses are denominated in the NIS, dollars and Euros. Due to the different proportions of currencies our revenues and expenses are denominated in, fluctuations in rates of exchange between NIS and other currencies may affect our operating results and financial condition. For example, the NIS value of our dollar or Euro denominated revenues are negatively impacted in case of a depreciation of the dollar and the Euro against the NIS. The average exchange rate for the NIS against the dollar was 0.1% lower in 2018 than 2017 and the average exchange rate of the NIS against the Euro was 4.5% higher in 2018 than 2017, and in total, these changes had a minor positive impact on our operating results in 2018. The average exchange rate for the NIS against the dollar was 6.3% lower in 2017 than 2016 and the average exchange rate of the NIS against the Euro was 4.4% lower in 2017 than 2016, and in total, these changes had a negative impact on our operating results in 2017.

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

	Year Ended December 31,				
	2018	2017	2016	2015	2014
Dollar	8.1 %	(9.8) %	(1.5) %	0.3 %	12 %
Euro	3.3 %	2.7 %	(4.8) %	(10.1) %	(1.2) %
Israeli CPI	0.8 %	0.4 %	(0.2) %	(1.0) %	(0.2) %

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

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

Conditions in Israel

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

Trade Relations

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

Israel and the E.U. concluded a Free Trade Agreement in July 1975 that confers some advantages with respect to Israeli exports to most European countries and obligated Israel to lower its tariffs with respect to imports from these countries over a number of years. In 1985, Israel and the United States entered into an agreement to establish a Free Trade Area. The Free Trade Area has eliminated all tariff and some non-tariff barriers on most trade between the two countries. On January 1, 1993, an agreement between Israel and the European Free Trade Association, known as the EFTA, established a free-trade zone between Israel and the EFTA nations. In November 1995, Israel entered into a new agreement with the E.U., 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 E.U. In June 2014, Israel joined the E.U.’s Horizon 2020 Research and Innovation program. In recent years, Israel has established commercial and trade relations with a number of other nations, including Russia, China, India, Turkey and other nations in Eastern Europe and Asia.

Effective Corporate Tax Rate

Israeli companies are generally subject to income tax on their taxable income under the Income Tax Ordinance, 5721-1961. The regular corporate tax rate in Israel for 2018 and 2019 is 23% and for the years 2016 and 2017 was 25% and 24%, respectively. However, one of our production facilities qualifies as a “benefited enterprise” under the Law for the Encouragement of Capital Investments, 5719-1959, as amended. Subject to certain time limitations, a certain portion of our income derived from such benefited enterprise will be subject to a zero tax rate, while the remainder will be taxed at a rate of up to 23%. Alternatively we may select a “preferred enterprise” status, which will allow us to be taxed at a rate of 16% on all of our income. For additional information see Item 10E. “Additional Information – Taxation - Tax Benefits Under the Law for the Encouragement of Capital Investments, 5719-1959” and Note 14 to our consolidated financial statements.

As of December 31, 2018, we had approximately \$24.3 million in tax operating loss carryforwards and \$9.3 million in capital loss carry forwards in Israel, which can be offset against future income in Israel without time limitation. In Israel, we have received final tax assessments through the 1995 tax year and the tax assessments we received for the 1996-2008 tax years are considered final due to the statute of limitations. Our European subsidiary, Eltek Europe, has received final tax assessments through the 2010 tax year. Our U.S. subsidiary has not yet received any final tax assessments since its incorporation.

During 2018, we recorded tax expenses of \$63,000. In 2017, we recorded tax expenses of \$74,000, mainly in respect of our subsidiary in the United States. In 2016, we wrote-off the entire amount of our deferred tax assets based on uncertainty about our ability to realize it in the foreseeable future. Such uncertainty resulted from a reduced demand for our products, a change in the PCB buying patterns of our domestic military customers, which shifted some PCB acquisitions overseas, increased competition coupled with reduced prices in the local market, on-going manufacturing challenges, and possible devaluation of the U.S. dollar against the NIS, all of which may adversely affect our future profitability.

Recently Issued Accounting Standards

In February 2016, the Financial Accounting Standard Board ("FASB") issued ASU No. 2016-02, Leases (Topic 842). The standard requires lessees to recognize almost all leases on the balance sheet as a right-of-use asset and a lease liability and requires leases to be classified as either an operating or a finance type lease. The standard excludes leases of intangible assets or inventory. In July 2018, the FASB issued amendments in ASU 2018-11, which provide another transition method in addition to the existing transition method, by allowing entities to initially apply the new leases standard at the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption, and to not apply the new guidance in the comparative periods they present in the financial statements. The Company has elected to apply the standard retrospectively at the beginning of the period of adoption through a cumulative-effect adjustment. The Company also expects to elect certain relief options offered in ASU 2016-02 including certain available transitional practical expedients. The standard has become effective for us on January 1, 2019. We are in the process of evaluating this guidance to determine the impact it will have on our financial statements and related disclosures.

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (Topic 606) (ASU 2014-09), which amends the existing accounting standards for revenue recognition. In July 2015, FASB deferred the effective date by one year to December 15, 2017 and permitting early adoption of the standard, but not before the original effective date of December 15, 2016. The FASB also agreed to allow entities to choose to adopt the standard as of the original effective date. In March 2016, the FASB issued Accounting Standards Update No. 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net) (ASU 2016-08) which clarifies the implementation guidance on principal versus agent considerations. The guidance includes indicators to assist an entity in determining whether it controls a specified good or service before it is transferred to the customers. The new standard also permits two methods of adoption: retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (the modified retrospective method).

In November 2017, FASB issued ASU No. 2017-14, Income Statement—Reporting Comprehensive, Income (Topic 220), Revenue Recognition (Topic 605), and Revenue from Contracts with Customers (Topic 606). ASU No. 2017-14 incorporates into the Accounting Standards Codification recent Securities Exchange Commission ("SEC") guidance related to revenue recognition. ASU No. 2017-14 was effective upon issuance. We reviewed the effects of the adoption of ASC-606 and do not expect material effects on the consolidated financial statement.

In August 2018, the FASB issued Accounting Standards Update 2018-15, Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That is a Service Contract ("ASU 2018-15"). The amendments in

ASU 2018-15 provide guidance to align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). The new guidance is effective for fiscal years beginning after December 15, 2019. Early adoption is permitted. We are still evaluating the effect that this guidance will have on our consolidated financial statements

In June 2018, the FASB issued ASU 2018-07 to expand the scope of ASC Topic 718, Compensation - Stock Compensation, to include share-based payment transactions for acquiring goods and services from nonemployees. The pronouncement is effective for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2018, with early adoption permitted. We are evaluating the effects of this standard on our consolidated financial statements.

In June 2016, the FASB issued Accounting Standards Update No. 2016-13 (ASU 2016-13) "Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments" which requires the measurement and recognition of expected credit losses for financial assets held at amortized cost. ASU 2016-13 replaces the existing incurred loss impairment model with an expected loss methodology, which will result in more timely recognition of credit losses. ASU 2016-13 is effective for annual reporting periods, and interim periods within those years, beginning after December 15, 2019. We are evaluating the effect that this guidance will have on our consolidated financial statements.

B. Liquidity and Capital Resources

Historically, we have financed our operations through cash generated by operations, shareholder loans, long-term and short-term bank loans, borrowings under available credit facilities and the proceeds from our initial public offering in 1997 (approximately \$5.8 million). In August 2013, we entered into a definitive investment agreement with Nistec pursuant to which Nistec purchased 706,531 of our ordinary shares (approximately 34.8% of our issued share capital on a fully diluted basis) in consideration of \$4.2 million.

As of December 31, 2018, we had \$992,000 in cash and cash equivalents and a working capital deficit of \$5.3 million compared to \$887,000 in cash and cash equivalents and a working capital deficit of \$3.7 million at December 31, 2017.

In March 2019, we distributed at no charge to the holders of our ordinary shares subscription rights to purchase up to an aggregate of 3,380,920 shares, such that each shareholders received five (5) subscription rights for every three (3) ordinary shares owned on the record date at a price of \$1.464 per share. Our shareholders purchased 2,351,701 ordinary shares, for aggregate gross proceeds of \$3.4 million received from this offering.

Cash Flows

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

Year ended December 31,	(\$ in thousands)		
	2018	2017	2016
Net cash provided by (used in) operating activities	(813)	(3,444)	165
Net cash used in investing activities	(619)	(275)	(750)
Net cash provided by financing activities	1,527	3,244	473
Net cash from proceeds from sale of investments	-	-	271
Effect of translation adjustments	10	128	37
Net increase (decrease) in cash and cash equivalents	105	(347)	196
Cash and cash equivalents at beginning of year	887	1,234	1,038
Cash and cash equivalents at end of year	992	887	1,234

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

Net cash used in operating activities was \$813,000 in the year ended December 31, 2018. This amount was primarily attributable to our net loss of \$2.6 million, a decrease in trade payables of \$871,000, and a decrease in other liabilities and accrued expenses of \$443,000. This amount was partially offset by a depreciation of fixed assets of \$1.6 million, a decrease in trade receivables of \$790,000 and a decrease in other accounts receivables and prepaid expenses of \$467,000.

Net cash used in operating activities was \$3.4 million in the year ended December 31, 2017. This amount was primarily attributable to our net loss of \$3.8 million, an increase in other receivables of \$1.2 million, an increase in trade receivables of \$597,000, a decrease in trade payables of \$330,000 and a decrease in other liabilities and accrued expenses of \$107,000. This amount was partially offset by a depreciation of fixed assets of \$1.7 million, an amortization of intangible asset of \$348,000, a decrease in inventories of \$471,000, a change in employee severance benefits of \$69,000 and a revaluation of long term loans of \$17,000.

Net cash provided by operating activities was \$165,000 in the year ended December 31, 2016. This amount was primarily attributable to our net loss of \$3.6 million, adjustments for a decrease in trade receivables of \$2.1 million, a non-cash item of depreciation of \$1.9 million, a decrease in deferred tax benefits of \$1.1 million, and the decrease in inventories of \$289,000. This amount was offset in part by a decrease in trade payables of \$561,000, an increase of \$97,000 in other receivables and prepaid expenses, a decrease in other liabilities and accrued expenses of \$664,000 and a change in severance benefits of \$150,000.

Net cash used in investing activities was \$619,000 in the year ended December 31, 2018 compared to \$275,000 in the year ended December 31, 2017 and \$750,000 in the year ended December 31, 2016. Net cash used in investing activities in the years ended December 31, 2018, 2017, and 2016 was primarily for the purchase of fixed assets for our production lines, and leasehold improvements.

Net cash provided by financing activities was \$1.5 million in the year ended December 31, 2018, which was primarily attributable to increase in short-term credit of \$986,000, an increase in a short-term shareholder loan of \$1.4 million and proceeds from long term loans of \$378,000. These amounts were partially offset by a repayment of long term loan of \$910,000, and a repayment of credit from fixed asset payables of \$317,000.

Net cash provided by financing activities was \$3.2 million in the year ended December 31, 2017, which was primarily attributable to an increase in short-term credit of \$2.8 million, an increase in short-term shareholder loan of \$1.4 million and proceeds from long term loans of \$167,000. These amounts were partially offset by a repayment of long term loans of \$870,000, and a repayment of credit from fixed asset payables of \$239,000.

Net cash provided by financing activities was \$473,000 in the year ended December 31, 2016, which was primarily attributable to repayments of long term loans of \$680,000 and repayments of credit from fixed asset payables of \$671,000. These amounts were partially offset by an increase in short-term credit of \$1.6 million, and proceeds from a long term loan of \$235,000.

As of December 31, 2018, we had revolving lines of credit of approximately \$2.6 million with Bank Hapoalim B.M, \$2.1 million with Bank Leumi B.M, \$800,000 with Bank Hamizrahi B.M and \$1.9 million with non-banking institutions, and long-term loans of \$532,000 from Bank Hapoalim B.M, and \$311,000 from Bank Leumi B.M. As of December 31, 2018, we also had long-term loans from suppliers of fixed assets in the aggregate amount of \$724,000. Of such amount, \$503,000 is linked to the dollar and \$213,000 is not linked.

Our credit lines and short-term loans bear annual interest at Prime + 0.85% - 2.7%.

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

- linked to the dollar - from 0% to 5.0%.

·NIS not linked 2.6% to 5.6%.

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

Bank Hapoalim and Bank Leumi require us to maintain a specific set of covenants each fiscal year. We are required to meet all of the following financial covenants: (i) maintaining adjusted shareholders' equity equal to the greater of \$4.5 million or 17% of our consolidated total assets; and (ii) a debt service ratio of 1.5. For this purpose, adjusted shareholders' equity excludes certain intangible and other assets. Debt service ratio is defined as the ratio of EBITDA to current maturities of long-term debt plus interest expenses. As of December 31, 2018, we were not in compliance with the covenants; however, one bank granted us a waiver from such non-compliance. We will be required to meet these covenants in our financial statements for December 31, 2019 (to be issued no later than May 1, 2020) and the other bank granted us a waiver from such non-compliance, and adjusted the financial covenants, to be met in our financial statements for December 31, 2019 (to be issued not later than 120 days from December 31, 2019). The adjusted covenants include: (i) adjusted shareholders' equity (excluding certain intangible and other assets) of at least \$ 2.5 million; and (ii) positive EBITDA (greater than zero).

In June 2017, we obtained a loan of NIS 5.0 million (approximately \$1.4 million) from Nistec, our controlling shareholder. On April 29, 2018, the loan terms were amended. Following the amendment, the main terms of the loan, with retroactive effect to June 2017, are:

- interest at a rate of 2.6% per annum;

- principal shall be repaid in eight (8) equal installments, over a period of two (2) years, and interest shall be repaid on a quarterly basis, as of the date of its extension. Notwithstanding anything to the contrary, we shall not be obligated to repay the loan and the applicable interest if the banks who have lent monies to us do not approve such repayment; and

- prepayment is at our discretion.

In July 2017, we received a line of credit dedicated to a specific project of up to NIS 4.5 million (approximately \$1.3 million) from Bank HaPoalim, guaranteed by Nistec Ltd., for a period of up to one year.

In November 2017, we obtained a loan of NIS 3 million (approximately \$840,000) from Mizrahi-Tefahot Bank, guaranteed by Nistec Ltd.

In March 2018, we obtained another loan from Nistec Ltd. of NIS 4.0 million (approximately \$1.1 million).

In April 2018, Nistec Ltd. provided a letter of commitment to us to provide additional financing in the amount of up to \$2.5 million, valid until one year following the date of the approval of our financial statements for December 31, 2017 (the "Commitment Letter").

In April 2018, our Board of Directors approved the additional funding extended by Nistec Ltd. in March 2018 and the Commitment Letter, either through a bank loan guaranteed by Nistec Ltd., a loan extended directly by Nistec Ltd. to our company, or a combination thereof. In July 2018, we obtained another loan from Nistec Ltd. of NIS 1.0 million (approximately \$270,000). Nistec Ltd. is beneficially controlled by the Chairman of our Board of Directors, Yitzhak Nissan.

In August 2018 Nistec Ltd. also provided a guarantee for a NIS 7.0 million loan (approximately \$ 1,930,000) from a non-banking financial institution.

In December 2018, the loans, together with Nistec Ltd.'s shares, were transferred within the Nistec group to Nistec Golan. In January 2019, Nistec Golan guaranteed NIS 2.0 million (approximately \$530,000) of our existing line of credit to a bank, which is payable on April 30, 2019. During February 2019, our audit committee approved the exercise of the option that Nistec will repay the debt owed to the bank, and in such event, the guarantee will convert

into a loan to us, which will be due on May 1, 2020.

In February 2019, Nistec Golan informed us that it intended to convert approximately \$2.5 million of these loans as part of the Rights Offering. In March 2019, Nistec Golan informed us that instead of converting the debt owed to it, it will participate in the rights offering by way of a cash investment of \$2.5 million.

A portion of the proceeds of the Rights Offering were used for the repayment of the NIS 3.0 million (approximately \$840,000) loan from Mizrahi Bank and will be used for the repayment of the NIS 2.0 million (approximately \$530,000) line of credit from Bank Leumi.

As of April 16, 2019 the total principal amount of the loans payable by us to Nistec was NIS 12.0 million (approximately \$3.3 million).

Capital expenditures on a cash basis for the years ended December 31, 2018 and 2017 were approximately \$619,000 and \$275,000, respectively. In addition, purchases of fixed assets not yet paid as at December 31, 2018 amounted to \$118,000. Our capital expenditures in such periods mainly related to our investments in production and manufacturing equipment, and in leasehold improvements. We intend to finance our 2019 capital expenditures mainly with bank loans, suppliers' credit and operational cash flow; however, such financing may not be available, or, if available, may not be on terms favorable to us. Our principal commitments consist of obligations outstanding under our bank loans and credit facilities, suppliers' credit and operating leases.

We expect to finance our 2019 budget from the remaining proceeds of the Rights Offering, operational cash flow, revolving bank credit lines and long-term bank loans, supplier financing and loans provided by our controlling shareholder, Nistec, in an amount of up to \$3.3 million, which were committed to the Company. Although we anticipate that these capital resources will be adequate to satisfy our liquidity requirements through 2019, our liquidity could be negatively affected by a continued operational difficulties in our manufacturing and a decrease in demand for our products, including the impact of changes in customer buying that may result from the general economic downturn, the stability of the dollar/NIS exchange rate, our results of operations, our suppliers' payment terms, our customers' demand for extending their payment terms and other factors detailed in Item 3D. "Key Information - Risk Factors." If available liquidity is not sufficient to meet our operating and debt service obligations as they come due, we would need to pursue alternative financing arrangements or reduce expenditures to meet our cash requirements through 2019. Such additional financing may not be available to us or, if available, may not be obtained on terms favorable to us, and there is no assurance that we would be able to reduce discretionary spending to provide the required liquidity.

C. Research and Development, Patents and Licenses

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

D. Trend Information

In recent years, we faced a reduced demand for our products, and experienced operational difficulties in 2017 and 2018. Our backlog at December 31, 2018 was approximately \$7.0 million compared to a backlog of approximately \$9.1 million at December 31, 2017. We include in our backlog all purchase orders scheduled for delivery within the next 12 months. The decrease in our backlog was primarily due to the decrease in demand for our products. For a variety of reasons, including the timing of orders, delivery intervals, customer and product mix and the possibility of customer changes in delivery schedules, backlog as of any particular date may not be a reliable measure of sales for any succeeding period. Cancellation charges generally vary depending upon the time of cancellation and, therefore, a substantial portion of our backlog may be subject to cancellation without penalty.

E. Off-Balance Sheet Arrangements

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

F. Tabular Disclosure of Contractual Obligations

The following table summarizes our minimum contractual obligations as of December 31, 2018.

Contractual Obligations	Payments due by period (\$ in thousands)				
	Total	less than 1 year	2-3 years	4-5 years	more than 5 years
Short-term bank credit ⁽¹⁾	9,274	9,274	-	-	-
Long-term debt obligations ⁽¹⁾	724	416	308	-	-
Operating lease	2,852	883	1,766	203	-
Other contractual obligations	1,538	581	652	305	-
Purchase obligations	848	848	-	-	-
Other short-term liabilities reflected on the company's balance sheet ¹	3,377	3,377	-	-	-
Other long-term liabilities reflected on the company's balance sheet	211	-	-	-	211
Estimate of interest payments on long-term debt obligations ⁽²⁾	52	42	10	-	-
Total	18,876	15,421	2,736	508	211

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

⁽²⁾ The estimate of interest payments on long-term debt obligations is based on current interest rates as of December 31, 2018 (including current variable rates on the existing long-term debt obligations) and on the current volume of debt obligations, assuming loan repayment in future years as disclosed in Note 7 to the consolidated financial statements.

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

A. Directors and Senior Management

Directors

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

Name	Age	Position
Yitzhak Nissan ⁽³⁾	69	Chairman of the Board of Directors

Mordechai Marmorstein ⁽¹⁾⁽²⁾	72	Director
Gavriel David Meron	66	Director
David Rubner ⁽⁴⁾	79	Director
Erez Meltzer ⁽⁴⁾	61	Director
Gad Dovev ⁽¹⁾⁽²⁾⁽³⁾⁽⁴⁾	72	External Director
Ilana Lurie ⁽¹⁾⁽²⁾⁽³⁾⁽⁴⁾	46	External Director

(1) Member of the Audit Committee

(2) Member of the Compensation Committee

(3) Member of the Banking Committee

(4) Member of the Special Independent Committee for M&A purposes

Ms. Lian Goldstein resigned as external director, effective July 20, 2018. At our 2018 annual general meeting of shareholders held on September 6, 2018, our shareholders elected Ms. Ilana Lurie to serve as an external director for an initial three-year term, re-elected Messrs. Yitzhak Nissan, Mordechai Marmorstein, Gavriel David Meron, David Rubner and Erez Meltzer to serve as a directors until our 2019 annual general meeting of shareholders. Mr. Gad Dovev was elected to serve as an external director for a second three-year term, at our 2017 meeting of shareholders held on October 17, 2017.

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

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

Gavriel David Meron was elected to serve on our Board of Directors in October 2013. Mr. Meron currently serves as the chairman and the chief executive officer of Hygieacare Inc., and provides managerial services to numerous companies as the chairman and chief executive officer of M.G.D. Management Services & Investments Ltd. since November 2006. Mr. Meron was the founder, president and chief executive officer of Given Imaging Ltd. from 1998 to 2006. Mr. Meron holds a B.A. degree in Economics and Statistics from the Hebrew University of Jerusalem and an MBA degree in International Business from Tel Aviv University.

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

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

Gad Dovev was re-elected to serve as an external director in October 2017 and is a member of our audit, compensation and banking committees. Mr. Dovev retired from the Israeli Ministry of Defense in August 2012. Mr. Dovev served as head of the Israeli Ministry of Defense Mission to the United States from August 2008 to August 2011. From August 2005 to August 2008, Mr. Dovev served as head of the Israeli Ministry of Defense Mission to Germany. Prior to that, from 2001 to 2005, Mr. Dovev acted as Deputy General Manager of the Israeli Ministry of Defense and Head of the Rehabilitation Department. From 1993 to 2001, Mr. Dovev served as Director of the Finance Department and the Financial Comptroller of the Israeli Ministry of Defense. Mr. Dovev served as member of the Board of Directors of Bank Otsar Ha-Hayal Ltd., IMI-Israel Military Industries Ltd., Shekem Ltd. and Gapim Ltd. Mr. Dovev holds a BSc in Financial and Agricultural Administration from the Hebrew University of Jerusalem.

Ms. Ilana Lurie was elected to serve as an external director in September 2018 and is a member of our audit and compensation committees. Ms. Lurie has over 15 years of experience in international finance and operations, predominantly in management positions within large, regulated technology companies. Since 2012, Ms. Lurie has been CFO of NovelSat, a world leader in satellite transmission technology. Prior to her tenure at NovelSat, in 2012, Ms. Lurie served as Finance Manager for the Enterprise Services business unit (formerly EDS) of Hewlett Packard (NYSE:HPQ). From 2006 to 2011, Ms. Lurie held a number of financial management positions at Ness Technologies (NASDAQ/TASE:NSTC), which, at the time, was a public company. Earlier in her career, from 2001 to 2006, Ms. Lurie served as Controller for Amdocs (NASDAQ:DOX). Ms. Lurie earned her B.A. degree and an MBA degree with a specialization in Finance and Marketing from Hebrew University of Jerusalem.

Executive Officers

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

Name	Age	Position
Eli Yaffe	64	Chief Executive Officer
Alon Mualem	51	Chief Financial Officer
Gill Riff	43	VP Quality Assurance
Shmuel Wider	60	VP of Sales and Marketing
Yitzhak Zemach	43	Director of Operations
Assaf Bachar	51	Procurement and Chief Information Officer
Axel Herrmann	60	General Manager, Eltek Europe GmbH

Eli Yaffe joined us in July 2018, as our Chief Executive Officer. Prior to joining our company, Mr. Yaffe was the CEO of Carmel Forge Ltd. (Aerospace) from August 1996 to May 2012. Prior thereto Mr. Yaffe served as the CEO of Urdan Industries Ltd. (Defense). Previously, Mr. Yaffe served as VP of Business Development & Strategic Planning, responsible for strategy, M&A, and business development at Ormat Industries Ltd., including a number of years in the U.S. Mr. Yaffe holds a B.Sc. degree (with distinction) from the Technion- Israel Institute of Technology, M.Sc. degree in Mechanical Engineering from Tel Aviv University and an MBA degree (with distinction) in Finance & Marketing from Bar Ilan University.

Alon Mualem joined us in January 2019, as our Chief Financial Officer. Mr. Mualem served as the CFO of Mer Telemanagement Solutions Ltd., a company traded on NASDAQ, from 2007 to 2018. Prior thereto, between 2005 and 2007, Mr. Mualem served as the CFO of Xfone, Inc. (AMEX and TASE: XFN), an international communications services company and its subsidiary, Xfone 018 Ltd. Previously, Mr. Mualem served as a controller and CFO of hi-tech companies, and as an audit manager at Somekh-Chaikin – KPMG. Mr. Mualem holds a B.A. degree in Accounting and Economics from Tel Aviv University, and is a licensed CPA (Israel).

Gil Riff joined us in November 2018 as VP Quality Assurance and Continuous Improvement. Mr. Riff previously served as the Director of Process Engineering and Printed Circuits Boards of the aviation division of Elbit Systems from June 2013 until October 2018 and prior thereto he was a factory technologist in Elbit System's printed circuits boards department from August 2008 to May 2013. Previously, Mr. Riff was a printed circuits boards technologist for Melta Printed Circuits Boards and was a senior process engineer for Tower Semiconductors. Mr. Riff holds a B.Sc. degree in chemical engineering from the Technion- Israel Institute of Technology and an MBA degree from the Open University of Israel.

Shmuel Wider joined us in August 2019 as our VP of Sales. Previously, Mr. Wider served as the COO and CBO of Bio-Nexus Ltd. from May 2017 to August 2018 and prior thereto he served as the Vice President of Sales of AudioCodes Ltd. from January 2005 to May 2017. Previously, Mr. Wider served as Director of Sales APAC in ECI – Innwave Ltd. Mr. Wider holds a Practical Engineering degree from the Technion- Israel Institute of Technology.

Yitzhak Zemach joined us in September 2019 as Director of Operations. Previously, Mr. Zemach served as the Plant Manager of Kahane Group Ltd. from February 2011 to September 2018 and prior thereto he served as the VP Operations of Bental Electronics Systems Ltd. Previously, Mr. Zemach served as Plant Manager of Aladdin Knowledge Systems and prior thereto he served as the Production Manager of the Nistec group. Mr. Zemach holds a B.Sc. degree in Electronic Engineering from Ariel University and an MBA degree with distinction in IT from Bar Ilan University.

Assaf Bachar joined us as Information Technology Officer and Procurement Officer in October 2018. Prior to joining us, Mr. Bachar worked at Comtal Group as a CIO from 2010 to 2018 and at the Trans Innovation group as a CIO from 2001 to 2010. From 1993 to 2001 Mr. Bachar worked our company in various positions. Mr. Bachar holds a BA degree in economics from Bar Ilan University and an Executive MBA degree in Finance & Marketing from Bradford University.

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

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

B. Compensation

The following table sets forth all compensation we paid with respect to all of our directors and executive officers as a group for the year ended December 31, 2018.

	Salaries, fees, commissions and bonuses	Pension, retirement and similar benefits
All directors and executive officers as a group (then consisting of 17 persons)	\$1.2 million ⁽¹⁾	\$ 302,000 ⁽²⁾

⁽¹⁾ During the year ended December 31, 2018, we paid each of our directors an annual fee of \$8,100 and an attendance fee of \$261 per meeting. These fees are included in the above amount.

⁽²⁾ The benefits amount includes expenses for automobiles and other benefits that we provide to certain of our executive officers.

As of December 31, 2018, options to purchase 60,857 ordinary shares granted to our current directors and executive officers were outstanding under our equity incentive plans at a weighted average exercise price of \$4.17 per share.

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

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The table below reflects the compensation granted to our five most highly compensated office holders during or with respect to the year ended December 31, 2018. All amounts reported in the table reflect the cost to the company, as recognized in our financial statements for the year ended December 31, 2018.

Name of Officer	Position of Officer	Holdings	Compensation for services (USD) ⁽¹⁾					Total compensation
			Base salary	Benefits ⁽²⁾	Cash bonuses ⁽³⁾	Equity-Based		
Yitzhak Nissan ⁽⁴⁾	Chairman of the Board and Former Chief Executive Officer	56.6 %	300,250	11,850			312,100	
Kathy Nargi-Toth	Former President of Eltek USA Inc	-	222,247	15,066	-	-	237,313	
Eli Yaffe	Chief Executive Officer	-	110,826	48,747	-	56,569	216,142	
Amnon Shemer	Former Chief Financial Officer	-	142,339	62,834	-	-	205,173	
Avraham Gal	Former VP Operations Information Technology, and Chief Information Officer	-	125,847	32,376	-	-	158,223	
Roberto Tulman	Former Deputy CEO	-	103,940	25,137	-	-	129,077	

(1) Cash compensation amounts denominated in NIS were converted into U.S. dollars at the rate of NIS 3.597 per \$1.00 (the average exchange rate in 2018).

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

(3) Represents the equity-based compensation expenses recorded in the company's consolidated financial statements for the year ended December 31, 2018 based on the options' grant date fair value in accordance with accounting guidance for equity-based compensation.

(4) Paid to Nistec as management fees.

C. Board Practices

Introduction

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

Election of Directors

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

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

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

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

External and Independent Directors

External directors. Under the Israeli Companies Law, Israeli companies whose shares have been offered to the public are required to appoint at least two external directors. A person may not be appointed as an external director if (i) the person is a relative of a controlling shareholder; (ii) the person, or the person’s relative, partner, employer or an entity under that person’s control, has or had during the two years preceding the date of appointment any affiliation with the company, or the controlling shareholder or its relative; (iii) in a company that does not have a controlling shareholder, such person has an affiliation (as such term is defined in the Israeli Companies Law), at the time of his appointment, to the chairman of the board of directors, chief executive officer, a shareholder holding at least 5% of the share capital of the company or the chief financial officer; (iv) such person is an employee of the Israeli Securities Authority or an Israeli stock exchange; and (v) such person’s relative, partner, employer, supervisor, or an entity he controls, has other than negligible business or professional relations with any of the persons mentioned in subsection (ii) above, even if such relations are not maintained on a regular basis. The term “relative” means a spouse, sibling, parent, grandparent, child or child, sibling or parent of spouse or spouse of any of the above. The term “affiliation” includes an employment relationship, a material business or professional relationship maintained on a regular and continuous basis, control and service as an office holder excluding service as an external director of a company that is offering its shares to the public for the first time. In addition, no person may serve as an external director if the person’s position or other activities create or may create a conflict of interest with the person’s responsibilities as director or may otherwise interfere with the person’s ability to serve as director. If, at the time an external director is appointed all members of the board of directors who are not the controlling shareholders or their relatives, are of the same gender, then that external director must be of the other gender. A director of one company may not be appointed as an external director of another company if a director of the other company is acting as an external director of the first company at such time.

At least one of the external directors elected must have “accounting and financial expertise” and any other external director must have “accounting and financial expertise” or “professional qualification,” as such terms are defined by Israeli Companies Law regulations. We have determined that our external directors, Mr. Gad Dovev and Ms. Ilana Lurie,

have the requisite “accounting and financial expertise”.

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

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

- (i) the board of directors proposed the nominee and his appointment was approved by the shareholders in the manner required to appoint external directors for their initial term;

a shareholder holding 1% or more of the voting rights proposed the nominee, and the nominee is approved by a majority of the votes cast by the shareholders of the company on the matter, excluding the votes of controlling shareholders and those who have a personal interest in the matter as a result of their relationship with any controlling shareholder and excluding abstentions, provided that the aggregate votes cast by shareholders who are not controlling shareholders and do not have a personal interest in the matter as a result of their relationship with

- (ii) the controlling shareholders voted in favor of the reelection of the nominee constitute more than 2% of the voting rights in the company, and provided further that at the time of such nomination or in the two years preceding such nomination, such external director or his relative are neither the shareholder who proposed such nomination, or a shareholder holding 5% or more of the company's issued share capital or voting power, in each case who, or whose controlling shareholder or any entity controlled by them (i) has business relations with the company, or (ii) is a competitor of the company; or

such external director nominates himself or herself for each such additional term and his or her election is

- (iii) approved at a shareholders meeting by the same disinterested majority as required for the election of an external director nominated by a 1% or more shareholder (as described above).

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

Following Ms. Lian Goldstein's resignation due to other commitments, which was effective as of July 20, 2018, at our 2018 annual general meeting of shareholders, our shareholders elected Ms. Ilana Lurie to serve as an external director, effective September 6, 2018, for a three-year term. At the 2017 annual general meeting of shareholders, Mr. Gad Dovev was re-elected, for a second three-year term, to serve as an external director.

Independent Directors. In general, NASDAQ Stock Market Rules require that the board of directors of a NASDAQ-listed company have a majority of independent directors and its audit committee must have at least three members and be comprised only of independent directors, each of whom satisfies the respective "independence" requirements of NASDAQ and the SEC. As permitted by NASDAQ home country rules, we do not maintain a majority of independent directors on our Board, but instead we choose to follow Israeli law and practice which requires that we appoint at least two external directors, as discussed above. Our Audit Committee however is comprised of three directors, all of whom are independent directors under the requirements of the Israeli Companies Law, the NASDAQ and the SEC rules.

Chairman of the Board

Our articles of association provide that the chairman of the board is appointed by the members of the board of directors. The chief executive officer (referred to as a “general manager” under the Israeli Companies Law) or a relative of the chief executive officer may not serve as the chairman of the board of directors, and the chairman or a relative of the chairman may not be vested with authorities of the Chief Executive Officer without shareholder approval consisting of a majority vote of the shares present and voting at a shareholders meeting, provided that either (i) such majority includes at least two-thirds of the shares held by all shareholders who are not controlling shareholders and do not have a personal interest in such appointment, present and voting at such meeting; or (ii) the total number of shares of non-controlling shareholders and shareholders who do not have a personal interest in such appointment voting against such appointment does not exceed two percent of the aggregate voting rights in the company. Abstaining shareholders shall not be counted as part of the non-controlling shareholders, or shareholders with no personal interest.

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

On December 29, 2016, our shareholders approved that our Chairman of the Board would also serve as our Chief Executive Officer. In July 2018, Mr. Eli Yaffe was appointed Chief Executive Officer and Mr. Nissan continues to serve as the Chairman of the Board of Directors of our company.

Committees of the Board of Directors

Audit Committee

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

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

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

Our audit committee meets at least once each quarter. Under the Israeli Companies Law, the roles of the audit committee are (i) to identify deficiencies in the management of our business, including in consultation with the internal auditor and our independent auditors, and to suggest appropriate courses of action to amend such deficiencies; (ii) to define whether certain acts and transactions that involve conflicts of interest are material or and to define

whether transactions that involve interested parties are extraordinary or not, and to approve such transactions (which may be approved according to certain criteria set out by our audit committee on an annual basis); (iii) to establish procedures to be followed in respect of related party transactions with a controlling shareholder (where such are not extraordinary transactions), which may include, where applicable, the establishment of a competitive process for such transaction, under the supervision of the audit committee, or individual, or other committee or body selected by the audit committee, in accordance with criteria determined by the audit committee; (iv) to determine whether to approve related party transactions, that are subject to the audit committee's approval according to the Israeli Companies Law; (v) to determine procedures for approving certain related party transactions with a controlling shareholder, which having been determined by the audit committee not to be extraordinary transactions, were also determined by the audit committee not to be negligible transactions; (vi) in companies where the internal auditor's work plan is subject to Board of Directors approval, to examine and propose revisions to the internal auditor's work plan before it is presented to the Board of Directors; (vii) to examine the performance of our internal auditor and whether he is provided with the required resources and tools necessary for him to fulfill his role, considering, among others, the company's size and special needs, and to review his annual plan and approve it should the company's articles of association require the approval of the Board for such plan; (viii) to oversee and approve the retention, performance and compensation of our independent auditors and to establish and oversee the implementation of procedures concerning our systems of internal accounting and auditing control; and (ix) to set procedures for handling of complaints made by company's employees in connection with management deficiencies and the protection to be provided to such employees.

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

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

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

Compensation Committee

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

On September 6, 2018, our shareholders approved an amended compensation policy for our company. The compensation policy must be approved every three years by our compensation committee, board of directors and shareholders, voting with a special majority (in that order). The compensation policy is based on and references certain matters and provisions set forth in the Israeli Companies Law, which include: (i) promoting our company's goals, work plan and policy with a long-term view; (ii) creating appropriate incentives for our company's office holders, considering, among other things, our company's risk management policy; (iii) our company's size and nature of operations; and (iv) with respect to variable elements of compensation (such as annual cash bonuses), the office holder's contribution to achieving company objectives and maximization of our company's profits, with a long-term view and in accordance with his or her position.

Our compensation committee is currently composed of Ms. Lurie and Messrs. Dovev and Marmorstein.

Banking Committee

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

Special Independent Committee for M&A purposes

In November 2017, our Board of Directors established a Special Independent Committee, separate and independent from our controlling shareholder, Mr. Nissan. The Special Independent Committee received the Board's mandate to examine and review any issue that may arise with respect to a possible consummation of an M&A transaction, at the Special Independent Committee's sole discretion, including, among other things, the authority to retain and consult with financial and legal advisors, negotiate such transaction and recommend to our Board of Directors, which retains the authority on the decision of final execution of such agreement. For the avoidance of any doubt, the Special Independent Committee may determine that the company will not be party to an M&A Transaction. The Special Independent Committee is currently composed of Mr. Dovev, Ms. Lurie, Mr. Rubner and Mr. Meltzer.

Special Independent Committee for the Rights Offering

In December 2018, our Board of Directors established a committee, which received the Board's mandate to examine, review and recommend to the Board the terms including the price per share to be offered to the Company's shareholders in the Rights Offering. The Committee, which was composed of Mr. Dovev, Ms. Lurie, and Mr. Meltzer., was dissolved after the completion of the Rights Offering.

Internal Audit

The Israeli Companies Law requires the Board of Directors of a public company to appoint an internal auditor nominated by the audit committee. The internal auditor must meet certain statutory requirements of independence. The role of the internal auditor is to examine, among other things, the compliance of the company's conduct with applicable law and orderly business practice.

In March 2016, we appointed Mr. Doron Cohen of Fahn Kanne as our internal auditor.

Directors' Service Contracts

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

Exculpation, Indemnification and Insurance of Directors and Officers

Exculpation of Office Holders

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

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

Insurance of Office Holders

The Israeli Companies Law provides that a company may, if permitted by its articles of association, enter into a contract to insure office holders in respect of liabilities incurred by the office holder with respect to an act or omission

performed in his or her capacity as an office holder, as a result of: (i) a breach of the office holder's duty of care to the company or to another person; (ii) a breach of the office holder's duty of loyalty to the company, provided that the office holder acted in good faith and had reasonable grounds to assume that his or her act would not prejudice the company's interests; and (iii) a monetary liability imposed upon the office holder in favor of another person.

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

Without derogating from the above, we may enter into a contract to insure the liability of an office holder for an obligation imposed on such office holder in consequence of an act or omission done in such office holder's capacity as an office holder, in the following case: (i) expenses, including reasonable litigation expenses and legal fees, incurred by the office holder as a result of a proceeding instituted against such office holder in relation to (A) infringements that may result in imposition of financial sanction pursuant to the provisions of Chapter H'3 under the Israeli Securities Law, 5728-1968 (as amended), or the "Israeli Securities Law", or (B) administrative infringements pursuant to the provisions of Chapter H'4 under the Israeli Securities Law or (C) infringements pursuant to the provisions of Chapter I'1 under the Israeli Securities Law; and (ii) payments made to the injured parties of such infringement under Section 52ND(a)(1)(a) of the Israeli Securities Law.

On September 6, 2018, our shareholders approved the D&O Policy described in Exhibit A to Exhibit 99.1 to our Report of Foreign Issuer on Form 6-K filed on July 26, 2018, including the order of payment, for the benefit of the directors and officers of the Company (excluding its controlling shareholder), currently serving and as may serve from time to time.

Indemnification of Office Holders

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

The Israeli Companies Law provides that a company's articles of association may permit the company to indemnify an office holder following a determination to this effect made by the company after the occurrence of the event in respect of which the office holder will be indemnified. It also provides that a company's articles of association may permit the company to undertake in advance to indemnify an office holder, except that with respect to a monetary liability imposed on the office holder by any judgment, settlement or court-approved arbitration award, the undertaking must be limited to types of events which the company's board of directors deems foreseeable considering the company's actual operations at the time of the undertaking, and to an amount or standard that the board of directors has determined as reasonable under the circumstances.

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

i. a monetary obligation imposed on the office holder in favor of another person pursuant to a judgment, including a judgment given in settlement or an arbitrator's award that has been approved by a court;

reasonable litigation expenses, including advocates' professional fees, incurred by the office holder pursuant to an investigation or a proceeding commenced against the office holder by a competent authority and that was terminated without an indictment and without having a monetary charge imposed on the office holder in exchange for a criminal procedure (as such terms are defined in the Israeli Companies Law), or that was terminated without an indictment but with a monetary charge imposed on the office holder in exchange for a criminal procedure in a crime that does not require proof of criminal intent or in connection with a financial sanction;

iii. reasonable litigation expenses, including advocates' professional fees, incurred by the office holder or which the office holder is ordered to pay by a court, in proceedings filed against the office holder by the company or on its behalf or by another person, or in a criminal indictment in which the office holder is acquitted, or in a criminal indictment in which the office holder is convicted of an offence that does not require proof of criminal intent;

iv. expenses, including reasonable litigation expenses and legal fees, incurred by an office holder as a result of a proceeding instituted against such office holder in relation to (A) infringements that may result in imposition of financial sanction pursuant to the provisions of Chapter H'3 under the Israeli Securities Law or (B) administrative infringements pursuant to the provisions of Chapter H'4 under the Israeli Securities Law or (C) infringements pursuant to the provisions of Chapter I'1 under the Israeli Securities Law; and

v. payments to an injured party of infringement under Section 52ND(a)(1)(a) of the Israeli Securities Law.

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

According to our compensation policy, the total amount of indemnification that our company undertakes towards all persons whom it has resolved to indemnify, jointly and in the aggregate, shall not exceed an amount equal 25% of the net equity of our company.

On October 17, 2017, our shareholders approved an updated indemnification agreement to be entered into with our directors and officers.

Limitations on Exculpation, Insurance and Indemnification

The Israeli Companies Law provides that neither a provision of the articles of association permitting the company to enter into a contract to insure the liability of an office holder, nor a provision in the articles of association or a resolution of the board of directors permitting the indemnification of an office holder, nor a provision in the articles of association exempting an office holder from duty to the company shall be valid, where such insurance, indemnification or exemption relates to any of the following: (i) a breach by the office holder of his duty of loyalty, except with respect to insurance coverage or indemnification if the office holder acted in good faith and had reasonable grounds to assume that the act would not prejudice the company; (ii) a breach by the office holder of his

duty of care if such breach was committed intentionally or recklessly, unless the breach was committed only negligently; (iii) any act or omission committed with intent to derive an unlawful personal gain; and (iv) any fine or forfeiture imposed on the office holder.

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

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

D. Employees

As of December 31, 2018, we employed 316 full-time employees in Israel, of which 195 were employed in manufacturing services, 40 in process and product engineering, 48 in quality assurance and control, 15 in sales and marketing and 18 in finance, accounting, information service and administration.

As of December 31, 2017, we employed 329 full-time employees in Israel, of which 206 were employed in manufacturing services, 40 in process and product engineering, 51 in quality assurance and control, 14 in sales and marketing and 18 in finance, accounting, information service and administration.

As of December 31, 2016, we employed 354 full-time employees in Israel, of which 228 were employed in manufacturing services, 39 in process and product engineering, 54 in quality assurance and control, 14 in sales and marketing and 19 in finance, accounting, information service and administration.

In addition, Eltek USA, a wholly-owned Delaware subsidiary, employed 4 full-time employees as of December 31, 2018, as of December 31, 2017 and December 31, 2016.

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

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

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

Pursuant to Israeli law, we are legally required to pay severance benefits upon certain circumstances, including the retirement or death of an employee or the termination of employment of an employee without due cause, equivalent to a one month salary for each year of employment with the company. Most of our employees are covered by pension plans providing customary benefits including retirement and severance benefits. Some of our employees are covered by life and pension insurance policies providing similar benefits. We contribute 8.33% of base salaries to the employees' pension funds or life pension insurance policies to cover our liability for severance pay. Pursuant to Section 14 of the Israeli Severance Pay Law, 5729-1963, if a company contributes to an employee's pension fund or severance fund, then the employee is entitled only to the severance amounts accumulated in such fund(s) upon resignation from the company or termination by the company, and the company is not obligated to make additional payments to the employee upon termination of employment with the company.

With respect to pension benefits, we contribute between 6.5% to 7.5% of base salaries to the employees' pension plans and 7.5% to those employees who have life insurance policies. The employees who have pension plans contribute between 6% to 7% of base salaries to their pension plans, and the employees who have life insurance policies contribute 6% of their base salaries to their policies. In addition, we contribute 8.33% for severance pay into the employees' life insurance policies, pension plans or similar funds of their choice.

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

Israeli employers and employees are required to pay predetermined sums to the National Insurance Institute of Israel, which is similar to the United States Social Security Administration. Subject to minimum thresholds, the employer contribution to the National Insurance Institute is at the rate of 7.5% of the salary (same in 2017) and the employee contribution to the National Insurance Institute is at the rate of 12% of the salary (of which 5% relates to payments for national health insurance), both of which are limited to a maximum monthly salary of NIS 43,370 (approximately \$12,100) in 2018, NIS 43,370 in 2017 and NIS 43,240 in 2016). In the year ended December 31, 2018, our aggregate payments as an employer to the National Insurance Institute amounted to approximately 5.1% of the salaries.

E. Share Ownership

Beneficial Ownership of Executive Officers and Directors

The following table sets forth certain information as of April 16, 2019 regarding the beneficial ownership of our ordinary shares by our directors and executive officers and all of our executive officers and directors as a group:

Name	Number of Ordinary Shares Beneficially Owned	Percentage of Outstanding Ordinary Shares ⁽²⁾	
Yitzhak Nissan ⁽¹⁾	3,062,523	69.9	%
All executive officers and directors as a group (19 persons) ⁽³⁾	3,062,523	69.9	%

(1) Except for Mr. Nissan, none of our directors or executive officers holds any of our ordinary shares. Mr. Nissan is the beneficial owner of 2,731,783 shares held by Nistec Golan, a company controlled by him and holds 330,740 shares as an individual.

(2) The percentages shown are based on 4,380,268 ordinary shares issued and outstanding as of April 16, 2019.

(3) Our Chief Executive Officer, Mr. Eli Yaffe, holds options to purchase 60,857 of our ordinary shares and Mr. Alon Mualem, our Chief Financial Officer holds options to purchase 10,500 of our ordinary shares. None of the options are within 60 days of the date of this report.

Stock Option Plan

Our 2018 share incentive plan authorized the grant of options to purchase shares and restricted shares units to officers, employees, directors and consultants of the company and its subsidiaries. Awards granted under the plan to participants in various jurisdictions may be subject to specific terms and conditions for such grants as may be approved by our board from time to time.

Each option granted under the Plan is exercisable for a period of ten years from the date of the grant of the option or the expiration dates of the option plan. The options primarily vest gradually over four years of employment.

During 2018, 60,857 options were granted under the plan and no options were exercised. At December 31, 2018, options to purchase 60,857 ordinary shares were outstanding under the plan, exercisable at an average exercise price of \$4.17 per share.

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

A. Major Shareholders

The following table sets forth certain information as of April 16, 2019 regarding the beneficial ownership by all shareholders known to us to own beneficially 5% or more of our ordinary shares:

Name	Number of Ordinary Shares Beneficially Owned ⁽¹⁾	Percentage of Ownership ⁽²⁾	
Nistec Golan Ltd. ⁽³⁾	2,731,783	62.4	%
Yitzhak Nissan ⁽³⁾⁽⁴⁾	330,740	7.5	%

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

(1) percentage of the person holding such securities but are not deemed outstanding for computing the percentage of any other person. Except as indicated by footnote, and subject to community property laws where applicable, the persons named in the table above have sole voting and investment power with respect to all shares shown as beneficially owned by them.

(2) The percentages shown are based on 4,380,268 ordinary shares issued and outstanding as of April 16, 2019.

Nistec Ltd. transferred its shares to Nistec Golan in December 2018. Nistec Golan is an Israeli private company (3) controlled by Yitzhak Nissan. Accordingly, Mr. Nissan may be deemed to be the beneficial owner of the ordinary shares held directly by Nistec.

Significant Changes in the Ownership of Major Shareholders

All of the share price information provided below has been adjusted to give effect to a 1 share for 5 shares reverse share split effected on November 22, 2017.

On August 19, 2013, we entered into an agreement to issue and sell 706,531 ordinary shares of our company, nominal value NIS 3.0 each, to Nistec for \$4.2 million. Nistec is controlled by Yitzhak Nissan, who beneficially owns all of

the shares owned by Nistec. On the same date, Nistec purchased 317,888 of our ordinary shares from Merhav M.N.F. Ltd., which at the time held 24.1% of our outstanding ordinary shares. The total consideration paid by Nistec in the two transactions was \$6.5 million. Nistec obtained a portion of those funds from a loan extended by Bank Leumi Le'Israel, and the shares that Nistec acquired constitute collateral for the loan.

As a result of these transactions, which were closed on November 1, 2013, Nistec acquired 50.5% of our ordinary shares, which constitute 50.5% of our issued share capital on a fully diluted basis, and Nistec gained control of our company. Several of our directors resigned, and four new directors were nominated and elected, including Yitzhak Nissan, who was elected Chairman of our Board of Directors. We also approved compensation terms for the directors, indemnification agreements between our company and our new directors, granted exculpation letters to our directors and officers, granted waiver and release letters to our then-current directors and officers, and purchased a run-off insurance policy for our then-current directors and officers. We also amended our Articles of Association along with our issuance of the shares to Nistec. On June 2, 2016, Mr. Nissan acquired 124,028 of our ordinary shares in market transactions. In December 2018, Nistec Ltd., transferred its ownership interest in our company to Nistec Golan Ltd. Nistec Golan and Nistec Ltd., are privately held companies indirectly controlled by Mr. Nissan, through Nistec Holdings Ltd.

In March 2019, we distributed, at no charge to the holders of our ordinary shares subscription rights to purchase up to an aggregate of 3,380,920 shares. Nistec acquired 1,707,364 additional ordinary shares of our company and Mr. Nissan acquired 206,712 additional ordinary shares of our company in the Rights Offering. Nistec and Mr. Yitzhak Nissan have the shared power to vote, dispose of, direct the vote of, and direct the disposition of the 3,062,523 ordinary shares of our company, of which 2,731,783 shares are held by Nistec and 330,740 are owned directly by Mr. Nissan.

Major Shareholders Voting Rights

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

Record Holders

Based on the information provided to us by our transfer agent, as of April 16, 2019, there were 13 holders of record of our ordinary shares, of which 10 record holders holding approximately 37.6% of our ordinary shares had registered addresses in the United States. These numbers are not representative of the number of beneficial holders of our shares nor are they representative of where such beneficial holders reside, since many of our ordinary shares were held of record by brokers or other nominees (including one U.S. nominee company, CEDE & Co., which held approximately 37.5% of our outstanding ordinary shares as of such date).

B. Related Party Transactions

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

- i. A registration rights agreement with Nistec;
- ii. A management agreement with Nistec;
- iii. A finder's fee paid to Merhav M.N.F. Ltd.; and

- iv. Approvals of compensation, indemnification, exculpation, waiver and release, run-off insurance, and directors' and officers' insurance policies, related to directors and officers of our company.

In November 2016, our Audit Committee, Compensation Committee and Board of Directors, as applicable, approved the following transactions:

v. The extension and amendment of the Management Agreement with Nistec Ltd. as follows:

a. Nistec shall receive a monthly management fee of NIS 90,000 (approximately \$25,000).

Commencing in 2017 and each calendar year thereafter, in the event that the Company's Consolidated Financial Statements reflect that the Company has reached both sales and profit targets as set for the applicable year in the Company's Officers Bonus Plan, Nistec Ltd. shall be entitled to a bonus equal to two percent (2%) of the Company's annual profit before taxes for such year, up to NIS 200,000 per year;

In accordance with the Company's policy approved by the Audit Committee, Mr. Nissan shall receive reimbursement, against receipts, of travel expenses paid directly by him (other than food and beverage expenses) while traveling internationally on behalf of the Company provided that such reimbursement shall not exceed an aggregate amount of NIS 10,000 per calendar quarter.

Mr. Nissan shall receive reimbursement of food and beverage expenses while traveling internationally on behalf of the Company, in accordance with the Israeli Income Tax Regulations (Deduction of Certain Expenses) 5732-1972.

For as long as Mr. Nissan shall serve as both the Company's Chief Executive Officer and Chairman of the Board of Directors, the Company shall pay for the lease of a car for Mr. Nissan with a list price not to exceed NIS 250,000. Mr. Nissan ceased to serve as the Company CEO on June 2018.

vi. The extension of the Directors and Officers Indemnity Agreement with Mr. Yitzhak Nissan.

These transactions were approved by our shareholders in the annual general meeting, held on December 29, 2016.

In August 2017, our Audit Committee, Compensation Committee and Board of Directors, as applicable, approved:

i. The extension of the Amended PCB Purchase Procedure with Nistec Ltd.;

ii. The extension of the amended general engagement terms, processes and restrictions of the Soldering and Assembly Services Procedure with Nistec Ltd.;

iii. The extension of the procedure under which the Company may jointly acquire certain services together with Nistec Ltd. related to employees social activities, marketing services and insurance; and

iv. The extension to the exculpation letter granted to Mr. Yitzhak Nissan.

These transactions were approved by our shareholders at our annual general meeting, held on September 6, 2018. For details regarding these transactions, see the notice furnished to the SEC under Form 6-K on July 26, 2018.

In August 2017, our Audit Committee, Compensation Committee and Board of Directors, as applicable, also approved the following transactions:

v. The amendment to the terms of and the extension of Ms. Revital Cohen-Tzemach's employment;

vi. The amended general engagement terms, processes and restrictions of the Soldering and Assembly Services Procedure with Nistec Ltd.; and

vii. The amended general engagement terms, processes and restrictions of the PCB Purchase Procedure with Nistec Ltd.

These transactions were approved by our shareholders in the annual general meeting, held on October 17, 2017. For details regarding these transactions, see the notice furnished to the SEC under Form 6-K on September 6, 2017.

C. Interests of Experts and Counsel

Not applicable.

ITEM 8. FINANCIAL INFORMATION

A. Consolidated Statements and Other Financial Information

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

Legal Proceedings

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

Employee Related Matters

In May 2008, a lawsuit was filed by one of a former employee alleging that he had suffered personal injuries during his employment and he is seeking aggregate financial compensation of approximately \$71,000 for past damages and additional amounts for future lost income, pain and suffering as the court may determine. Four other employees notified us between January 2011 and July 2013 that they allegedly suffered personal injuries during their employment with us. Of these four employees, one is seeking compensation of \$162,000 and the others did not state their claim amount. We submitted the claims to our insurance company, which informed us that it is reviewing the statements of claim without prejudicing its rights to deny coverage.

During the period November 2015 through March 2019, four former employees filed law suits seeking additional payments in connection with their employment with the Company and subsequent termination. On August 2018 a court decision was provided for one of the labor suits, and a provision was recorded accordingly. On October 2018, both we and this former employee appealed on the labor court's previous decision. The aggregate amount claimed for the above mention labor suits is approximately \$900,000. The Company recorded a provision according to its legal advisor's opinion.

Software License

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

Dividend Distribution Policy

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

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

B. Significant Changes

None.

ITEM 9. THE OFFER AND LISTING

A. Offer and Listing Details

Our ordinary shares are traded on the NASDAQ Capital Market under the ticker symbol “ELTK.”

B. Plan of Distribution

Not applicable.

C. Markets

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

D. Selling Shareholders

Not applicable.

E. Dilution

Not applicable.

F. Expense of the Issue

Not applicable.

ITEM 10. ADDITIONAL INFORMATION

A. Share Capital

Not applicable.

B. Memorandum and Articles of Association

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

Purposes and Objects of the Company

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

The Powers of the Directors

Under the provisions of the Israeli Companies Law and our articles of association, a director cannot vote on a proposal, arrangement or contract in which he or she has personal interest in, nor be present in the discussion relating to such transaction is considered. In addition, our directors' compensation is approved through special procedures prescribed in the Israeli Companies Law. In general, with respect to a director's compensation, approval is required by the (i) compensation committee; (ii) board of directors; and (iii) company's shareholders with a regular majority (in that order).

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

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

Rights Attached to Shares

Following our 1-for-5 reverse stock split in November 2017, our authorized share capital consists of NIS 30,000,000 divided into 10,000,000 ordinary shares, nominal value of NIS 3.00 each. All outstanding ordinary shares are validly issued, fully paid and non-assessable. The rights attached to the ordinary shares are as follows:

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

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

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

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

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

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

Changing Rights Attached to Shares

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

Annual and Extraordinary Meetings of Shareholders

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

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

Limitations on the Rights to Own Securities in Our Company

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

Provisions Restricting Change in Control of Our Company

Full Tender Offer. A person wishing to acquire shares of a publicly traded Israeli company who would as a result hold over 90% of the company’s issued and outstanding share capital, or of a certain class of shares, is required by the Israeli Companies Law to make a full tender offer to all of the company’s shareholders for the purchase of all of the remaining issued and outstanding shares of the company, or the class of shares, as the case may be. If: (i) the shareholders who do not accept the offer hold less than 5% of the issued share capital of the company, or of the relevant class of shares, and the majority of shareholders having no personal interest in the offer accepted it; or (ii) shareholders who do not accept the offer hold less than 2% of the issued share capital of the company; then all of the

shares that the acquirer offered to purchase will be transferred to the acquirer by operation of law. However, the shareholders may petition the court to determine the consideration for the acquisition if the consideration is less than the shares' fair value (unless the acquirer has specified in the tender offer that any shareholder tendering his shares will not be entitled to such appraisal rights). If the dissenting shareholders hold more than 5% of the issued and outstanding share capital of the company, or of the relevant class of shares, as the case may be, the acquirer may not acquire additional shares of the company from shareholders who accepted the tender offer if following such acquisition the acquirer would own over 90% of the company's issued and outstanding share capital, or of the relevant class of shares.

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

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

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

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

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

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

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

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

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

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

Disclosure of Shareholders Ownership

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

Changes in Our Capital

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

C. Material Contracts

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.

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E. Taxation

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

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

Israeli Tax Considerations

General Corporate Tax Structure

Israeli companies are generally subject to income tax on their taxable income. The regular corporate tax rate in Israel for 2017 was 24% and for 2018 and 2019 is 23%. However, the effective rate of tax payable by a company which is qualified under Israeli law as an “Industrial Company” and/or which derives income from an “approved enterprise,” “benefited enterprise,” “preferred enterprise” or “preferred technological enterprise” (as further discussed below) may be lower. See this Item 10E. “Additional Information – Taxation - Tax Benefits Under the Law for the Encouragement of Capital Investments, 5719-1959.”

Tax Benefits under the Law for the Encouragement of Industry (Taxes), 5729-1969

Pursuant to the Law for the Encouragement of Industry (Taxes), 5729-1969, or the Industry Encouragement Law, a company qualifies as an “Industrial Company” if it is a resident of Israel, was incorporated in Israel and at least 90% of its income in any tax year (exclusive of income raising from certain governmental security loans) is derived from an “Industrial Enterprise” it owns, which is located in Israel. An “Industrial Enterprise” is defined for purposes of the Industry Law as an enterprise whose principal activity in a given tax year is production.

We believe that we are currently an Industrial Company. An Industrial Company is entitled to certain tax benefits, including a deduction of the purchase price of patents or the right to use a patent or know-how used for the development or promotion of the Industrial Enterprise at the rate of 12.5% per annum, commencing the year in which such rights were first exercised.

The tax laws and regulations dealing with the adjustment of taxable income for local inflation provided that Industrial Enterprises, such as us, were eligible for special rates of depreciation deductions. These rates vary in the case of plant and equipment. With respect to equipment, the applicable rates of depreciation are determined according to the number of shifts in which the equipment is being operated and generally range from 20% to 40% on a straight-line basis, a 30% to 50% on a declining balance basis for equipment first put into operation on or after June 1, 1989 (instead of the regular rates which are applied on a straight-line basis). The applicable regulations are valid for equipment whose date of first operation was not later than December 31, 2016.

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

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

Tax Benefits under the Law for the Encouragement of Capital Investments, 5719-1959

General

One of our production facilities qualifies as a “benefited enterprise” under the Law for the Encouragement of Capital Investments, 5719-1959, as amended in 2005, or the Investment Encouragement Law, which provides certain tax benefits to investment programs of an “approved enterprise” or “benefited enterprise.” Our benefited enterprise was converted from a previously approved enterprise program pursuant to the approval of the Israel Tax Authority that we received in September 2006. As of yet, it was not necessary for us to utilize these tax benefits. In the event that we do not commence to use the tax benefits until the 2023 tax year (the “Expiration Date”), the tax benefits granted to our benefited enterprise shall expire.

The Investment Encouragement Law stipulates certain criteria which need be met with respect to investment programs carried out by an enterprise, in order for such an enterprise to be classified as a “benefited enterprise”. Israeli resident companies which own benefited enterprise are generally classified as Benefited Companies. Benefited Companies may claim tax benefits (as further discussed below) granted by the Investment Encouragement Law in its tax returns (and there is no need to obtain prior approval to qualify for such benefits). There is no requirement to file reports with the Investment Center. Audits are the responsibility of the Israeli Income Tax Authority as part of their tax audits. Companies may also approach the Israeli Tax Authority for a pre-ruling regarding their eligibility for benefits under the Investment Encouragement Law.

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

On September 20, 2006, we received a pre-ruling from the Israeli Tax Authority confirming that our most recent investment program will be deemed a “benefited enterprise” instead of its former “approved enterprise” status. Pursuant to such pre-ruling, the former approved enterprise status of that investment plan was terminated by the Investment Center. The benefited enterprise status granted to our investment program provides for a tax exemption on undistributed earnings derived from the program for two years and a reduced tax rate for five additional years (i.e., a total benefits period of seven years). However, the benefits period with respect to such program has not yet commenced, and therefore will expire on the Expiration Date, unless such period commences prior to the Expiration Date. In the event that the benefits period commences prior to the Expiration Date, such period will lapse no later than the end of the 2030 tax year.

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

Subject to certain provisions concerning income subject to the alternative benefits track with respect to a benefited enterprise (see below), any distributed dividends are deemed attributable to the entire enterprise, and the effective tax rate represents the weighted combination of the various applicable tax rates. A company may elect to attribute

dividends distributed by it only to income not subject to the alternative benefits track.

Tax Benefits

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

Dividends paid out of income derived from an approved enterprise (or out of dividends received from a company whose income is derived from an approved enterprise) are generally subject to withholding tax at the rate of 15%. Dividends paid out of income derived from a benefited enterprise (or out of dividends received from a company whose income is derived from a benefited enterprise) are generally subject to withholding tax at the rate of 20%. However, dividends paid out of income generated from our benefited enterprise are generally subject to withholding tax of 15%. The rate of 15% with respect to dividends paid from income derived from a benefited enterprise, as set forth above, is limited to dividends distributed out of income derived during the benefits period and actually paid at any time up to 12 years following the lapse of the benefits period (the “12 Years Limitation”), excluding in the event of dividends paid by foreign investor’s company, as provided below. A company which elects the alternative benefits track and pays a dividend out of income derived from its benefited enterprise during the tax exemption period will be subject to corporate tax in respect of the amount of the dividend distributed at the rate otherwise applicable to the company in the year the income was earned (the applicable tax rate is generally 25%, or lower in the case of a qualified foreign investor’s company which is at least 49% owned by non-Israeli residents) on an amount consisting of such dividend grossed up by the otherwise applicable corporate tax rate. Dividends paid to a qualifying non-resident out of the profits of a benefited enterprise which is subject to the Ireland Track (i.e., subject to 11.5% corporate tax) are generally subject to withholding tax at the rate of 4%.

The tax benefits available to a benefited enterprise relate only to taxable income attributable to that specific enterprise and are contingent upon the fulfillment of the conditions stipulated by the Encouragement Investment Law and its regulations and the terms of the pre-ruling that we received from the Israeli Tax Authority. If we fail to comply with these conditions, the tax and/or other benefits may be discontinued, in whole or in part, and we might be required to refund the amount of tax benefits, adjusted to the consumer price index (“CPI”) and interest, or other monetary penalty, as the case may be.

A company that qualifies as a foreign investor’s company is entitled to further tax benefits relating to its benefited and/or approved enterprises. Subject to certain conditions, a foreign investor company is generally a company that more than 25% of each of the rights of the company (in terms of shares, rights to profits, voting and appointment of directors), is owned, directly or indirectly, by persons who are not residents of Israel. Such a company with a foreign investment of over 25% will be eligible for an extension of the period of tax benefits for its approved and benefited enterprises (up to a total period of ten years, compared to a normal period of seven years) and further tax benefits (a reduced corporate tax rate of 10%–20%) should the foreign investment reach or exceed 49%. In addition, dividends distributed by a foreign investor’s company from income attributed to its benefited enterprise shall be subject to a rate of 15%, regardless to the date on which such dividend is distributed (i.e., the 12 Years Limitation shall not apply). No assurance can be given that we currently qualify or will qualify in the future as a foreign investor’s company.

Amendments to Investment Encouragement Law

In December 2010, the Israeli Parliament passed the Law for Economic Policy for the Years 2011 and 2012 (Amended Legislation), 5771-2011, which prescribes, among other things, amendments to the Investment Encouragement Law, effective as of January 1, 2011 (the “2011 Amendment”). The 2011 Amendment introduced new benefits for income generated by a “Preferred Company” through its Preferred Enterprise (as such terms are defined in the Investment Encouragement Law), if certain criteria are met. The new tax benefits (described below) would be

available, subject to certain conditions, to production facilities that generally derive more than 25% of their annual revenue from export, or that do not derive 75% or more of their annual revenue in a single market, or, to competitive facilities in the field of renewable energy. A “Preferred Company” is defined in the amendment as either (i) a company incorporated in Israel and not wholly-owned by governmental entities; or (ii) a partnership (a) that was registered under the Israeli Partnerships Ordinance; and (b) all of its partners are companies incorporated in Israel, which are in general not transparent for Israeli tax purposes and that not all of them are fully owned by governmental entities and such companies or partnerships own, among other conditions, Preferred Enterprises and are controlled and managed from Israel.

In accordance with the 2011 Amendment and further amendments made in 2013 and in 2017, a Preferred Company is entitled to reduced corporate tax with respect to income derived by it Preferred Enterprise (and subject to certain conditions) at the rate of 15% in 2011-2012, unless it is located in a certain development zone, in which case the rate will be 10%. Such corporate tax rate was reduced to 12.5% and 7%, respectively, in 2013, was raised to 16% and 9% (respectively) in 2014 and was reduced in 2017 to 16% and 7.5%, respectively.

Under the amendments, dividends distributed out of income which is generally attributed to a Preferred Enterprise are subject to withholding tax at the rate of 20% (or lower, under an applicable tax treaty). However, upon distribution of a dividend attributed to income generated in Israel, to an Israeli company, no withholding tax will apply.

The 2011 Amendment applies to income generated as of January 1, 2011. Under the transitional provisions of the 2011 Amendment, we may elect to irrevocably implement the 2011 Amendment to the Investment Encouragement Law while waiving benefits provided under the Investment Encouragement Law as in effect prior to the 2011 Amendment or to remain subject to the Investment Encouragement Law as in effect prior to the 2011 Amendment. We may elect to implement the 2011 Amendment by May 31 of any year, and such an election shall apply as of the tax year following the year on which the company's tax return (and the election) was filed. Electing to implement the 2011 Amendment is irreversible.

We qualify for the status of a "Preferred Company" pursuant to the 2011 Amendment. We are contemplating the implementation of the 2011 Amendment in future tax years. In 2016, we wrote-off the entire amount of our deferred tax assets based on uncertainty about our ability to realize them in the foreseeable future.

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

Taxation Under Inflationary Conditions

The Income Tax Law (Inflationary Adjustments), 5745-1985, or the Inflationary Adjustments Law, is intended to neutralize the erosion of capital investments in business and to prevent tax benefits resulting from deduction of inflationary expenses. This law applies a supplementary set of inflationary adjustments to the nominal taxable profits computed under regular historical cost principles.

The Inflationary Adjustments Law introduced a special tax adjustment for the preservation of equity based on changes in the CPI, whereby certain corporate assets are classified broadly into fixed (inflation resistant) assets and non fixed assets. In the event that the "equity summary", as defined in the Inflationary Adjustments Law, exceeds, in general, the depreciated cost of fixed assets (as defined in the Inflationary Adjustment Law), a tax deduction which takes into account the effect of the annual rate of inflation on such excess is allowed (up to a ceiling of 70% of taxable income for companies in any single year, with the unused portion carried forward on a linked basis, without limit). If the depreciated cost of such fixed assets exceeds shareholders' equity, then such excess, multiplied by the annual inflation rate, is added to taxable income. In addition, subject to certain limitations, depreciation of fixed assets and losses carried forward are adjusted for inflation on the basis of changes in the CPI.

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

On February 26, 2008, the Israeli Income Tax Law (Inflationary Adjustments) (Amendment No. 20), 5768-- 2008 was passed by the Israeli parliament. According to the amendment, the inflationary adjustments law will no longer be applicable following the 2007 tax year, excluding certain Sections as provided in the transitional provisions whose objectives are to prevent distortion of the income tax calculations.

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

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

Taxation of Israeli Resident Shareholders

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

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

Subject to certain provisions relating to the linear calculation method applicable to the determination of the capital gain tax pertaining to capital gains derived from the sale of assets, purchased prior to January 1, 2003, or prior to January 1, 2012 (with respect to sale of assets or securities not listed in a stock exchange prior to 1.1.2012), the tax rate on capital gains, including capital gain from the sale of securities listed on a stock exchange and on dividends, is generally 25% for individuals and 30% for substantial individual shareholders (that are, generally, holders of 10% or more of the shares of the company on the date of the sale of the shares or at any date during the 12 months period preceding such sale). The tax rate for capital gains generated by corporations is 23% (in 2018 and 2019). Dividends paid to an Israeli company by another Israeli company are not subject to tax, unless received out of income derived from a benefited enterprise, or an approved enterprise, or stems from income derived or accrued outside of Israel.

If the shares were sold by Israeli residents, then (i) for the period ending December 31, 2002 their sale would generally be tax exempt so long as (1) the shares were listed on a stock exchange, such as, in our case, the NASDAQ Capital Market, which is recognized by the Israeli Ministry of Finance on December 31, 2002, and (2) we qualified as an Industrial Company or Industrial Holding Company under the law for Industry Encouragement Law, at the relevant times as provided by the Income Tax Ordinance [New Version], 5721-1961, which we believe we so qualified and (ii) for the period commencing January 1, 2003, the sale of the shares would be, generally, subject to a 25% tax if sold by non-substantial individual shareholders and 30% tax if sold by a substantial individual shareholders. The tax rate for corporate shareholders for the sale of the shares is 23% (in 2018). We cannot provide any assurance that the Israeli tax authorities will agree with the determination that we qualified as an Industrial Company at the relevant times.

Taxation of Non-Israeli Resident Shareholders

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

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

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

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

Non-residents of Israel are subject to income tax on income accrued or derived from sources in Israel. Such sources of income include passive income such as dividends, royalties and interest, as well as non-passive income from services rendered in Israel. Distributions of dividends other than bonus shares or stock dividends, are subject to income tax at the rate of 25% or 30% (for individuals), or 23% (for corporations in 2018 and 2019) pursuant to Israeli domestic law as described above. However, under the Investment Encouragement Law, dividends generated by an approved enterprise or by our benefited enterprise are, generally, taxed at the rate of 15%.

Pursuant to the Convention between the State of Israel and the Government of the United States relating to relief from double taxation, the maximum tax rate on dividends paid to a holder of ordinary shares who is a Treaty U.S. Resident will be 25%. However, dividends which are not generated by an approved enterprise will generally be subject to Israeli tax at a rate of 12.5% if paid to a U.S. corporation which holds 10% of our voting power for a designated period and provided that not more than 25% of our gross income for such period consists of certain types of dividends and interest. Notwithstanding the foregoing, dividends distributed from income attributed to an approved enterprise are generally subject to a withholding tax rate of 15% for such a U.S. corporation shareholder (which meets both conditions set forth above).

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

United States Federal Income Taxation

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

- broker-dealers;
- financial institutions or financial services entities;
- certain insurance companies;
- investors liable for alternative minimum tax;

- regulated investment companies, real estate investment trusts, or grantor trusts;
- dealers or traders in securities, commodities or currencies;
- tax-exempt organizations;
- retirement plans;
- S corporations;
- pension funds;
- certain former citizens or long-term residents of the United States;
- non-resident aliens of the United States or taxpayers whose functional currency is not the U.S. dollar;
- persons who hold 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;
- direct, indirect or constructive owners of investors that actually or constructively own at least 10% of the total combined voting power of our shares or at least 10% of our shares by value; or
- investors holding ordinary shares as part of a straddle, appreciated financial position, a hedging transaction or conversion transaction.

If a partnership or an entity treated as a partnership for U.S. federal income tax purposes owns our 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 our ordinary shares and the partners in such partnership should consult their tax advisors about the U.S. federal income tax consequences of holding and disposing of ordinary shares.

This summary does not address the effect of any U.S. federal taxation (such as estate and gift tax) other than U.S. federal income taxation. In addition, this summary does not include any discussion of state, local or non-U.S. taxation.

For purposes of this summary the term “U.S. Holder” means a person that is eligible for the benefits of the Treaty and is a beneficial owner of ordinary shares who is, for U.S. federal income tax purposes:

- an individual who is a citizen or a resident of the United States;
- a corporation or other entity taxable as a corporation for United States federal income tax purposes, created or organized in or under the laws of the United States or any political subdivision thereof;
- an estate the income of which is subject to U.S. federal income taxation regardless of its source; or
- a trust if the trust has validly elected to be treated as a U.S. person for U.S. federal income tax purposes or if (1) a court within the United States is able to exercise primary supervision over the trust’s administration and (2) one or more U.S. persons have the authority to control all of the substantial decisions of the trust.

Unless otherwise indicated, it is assumed for the purposes of this discussion that the Company is not, and will not become, a “passive foreign investment company” (“PFIC”) for U.S. federal income tax purposes. See “—Passive Foreign Investment Companies” below.

Taxation of Distributions

Subject to the discussion below under the heading “—Passive Foreign Investment Companies,” the gross amount of any distributions received with respect to our ordinary shares, including the amount of any Israeli taxes withheld therefrom, will constitute dividends for U.S. federal income tax purposes when such distribution is actually or constructively received, to the extent such distribution is paid out of our current and accumulated earnings and profits, as determined for U.S. federal income tax purposes. Because we do not expect to maintain calculations of our earnings and profits under U.S. federal income tax principles, it is expected that the entire amount of any distribution will generally be reported as dividend income to you. Dividends are included in gross income at ordinary income rates, unless such dividends constitute “qualified dividend income,” as set forth in more detail below. Distributions in excess of our current and accumulated earnings and profits would be treated as a non-taxable return of capital to the extent of your adjusted tax basis in our ordinary shares and any amount in excess of your tax basis would be treated as gain from the sale of ordinary shares. See “—Sale, Exchange or Other Disposition of Ordinary Shares” below for a discussion of the taxation of capital gains. Our dividends would 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, regardless of whether the payment is in fact converted into U.S. dollars. 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 generally be treated as U.S.-source ordinary income or loss. U.S. Holders should consult their own tax advisors concerning the U.S. tax consequences of acquiring, holding and disposing of NIS.

Subject to complex limitations, some of which vary depending upon the U.S. Holder’s circumstances, any Israeli withholding tax imposed on dividends paid with respect to our ordinary shares, may 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). Israeli taxes withheld in excess of the applicable rate allowed by the Treaty (if any) will not be eligible for credit against a U.S. Holder’s federal income tax liability. The limitation on foreign income taxes eligible for credit is calculated separately with respect to specific classes of income. Dividends paid with respect to our common stock generally will be treated as foreign-source passive category income or, in the case of certain U.S. Holders, general 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. A U.S. Holder may be denied a foreign tax credit with respect to Israeli income tax withheld from dividends received on our ordinary shares if such U.S. Holder fails to satisfy certain minimum holding period requirements or to the extent such U.S. Holder’s position in ordinary shares is hedged. An election to deduct foreign taxes instead of claiming a foreign tax credit applies to all foreign taxes paid or accrued in the taxable year. The rules relating to the determination of the foreign tax credit are complex. You should consult with your own tax advisors to determine whether and to what extent you would be entitled to this credit.

Subject to certain limitations (possibly including the PFIC rules discussed below), “qualified dividend income” received by a non-corporate U.S. Holder may be subject to tax at the lower long-term capital gain rates (currently, a maximum rate of 20%). Distributions taxable as dividends paid on our ordinary shares should qualify for a reduced rate if we are a “qualified foreign corporation,” as defined in Code section 1(h)(11)(C). We will be a qualified foreign corporation if either: (i) we are entitled to benefits under the Treaty or (ii) our ordinary shares are readily tradable on an established securities market in the United States and certain other requirements are met. We believe that we are entitled to benefits under the Treaty and that our ordinary shares currently are readily tradable on an established securities market in the United States. However, no assurance can be given that our ordinary shares will remain readily tradable. The rate reduction does not apply unless certain holding period requirements are satisfied, nor does it apply to dividends received from a PFIC (see discussion below), in respect of certain risk-reduction transactions, or in certain other situations. U.S. Holders of our ordinary shares should consult their own tax advisors regarding the effect of these rules

in their particular circumstances.

Sale, Exchange or Other Disposition of Ordinary Shares

Subject to the discussion of the PFIC rules below, if you sell or otherwise dispose of our ordinary shares (other than with respect to certain non-recognition transactions), you will generally 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 your adjusted tax basis in our ordinary shares, in each case determined in U.S. dollars. Such gain or loss will generally be capital gain or loss and will be long-term capital gain or loss if you have held the ordinary shares for more than one year at the time of the sale or other disposition. Long-term capital gain realized by a non-corporate U.S. Holder is generally eligible for a preferential tax rate (currently at a maximum of 20%). In general, any gain that you recognize on the sale or other disposition of ordinary shares will be U.S.-source for purposes of the foreign tax credit limitation; losses will generally be allocated against U.S. source income. Deduction of capital losses is subject to certain limitations under the Code.

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

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

We believe that we were not a PFIC for U.S. federal income tax purposes for the 2018 taxable year. However, since PFIC status depends upon the composition of our income and assets and the market value of our assets from time to time, there can be no assurance that we will not be considered a PFIC for any future taxable year. If we were a PFIC for any taxable year during which a U.S. Holder owned ordinary shares, certain adverse consequences could apply to the U.S. Holder. Specifically, unless a U.S. Holder makes one of the elections mentioned below, gain recognized by the U.S. Holder on a sale or other disposition of ordinary shares would be allocated ratably over the U.S. Holder's holding period for the ordinary shares. The amounts allocated to the taxable year of the sale or other disposition and to any year before we became a PFIC would be taxed as ordinary income. The amount allocated to each other taxable year would be subject to tax at the highest rate in effect for individuals or corporations, as appropriate, for that taxable year, and an interest charge would be imposed on the resulting tax liability. Further, any distribution in excess of 125% of the average of the annual distributions received by the U.S. Holder on our ordinary shares during the preceding three years or the U.S. Holder's holding period, whichever is shorter, would be subject to taxation as described immediately above. Certain elections (such as a mark-to-market election or a QEF election) may be available to U.S. Holders and may result in alternative tax treatment. U.S. Holders should consult their tax advisors as to the availability and consequences of a mark-to-market election or a QEF election with respect to their ordinary shares.

In addition, if we were a PFIC for a taxable year in which we pay a dividend or the prior taxable year, the favorable dividend rates discussed above with respect to dividends paid to certain non-corporate U.S. Holders would not apply. If we were a PFIC for any taxable year in which a U.S. Holder owned our shares, the U.S. Holder would generally be required to file annual returns with the IRS on IRS Form 8621.

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 may be subject to a 3.8% Medicare contribution tax on net investment income, which includes dividends and capital gains from the sale or exchange of our ordinary shares.

Backup Withholding and Information Reporting

Payments in respect of our ordinary shares may be subject to information reporting to the IRS and to U.S. backup withholding tax at the rate (currently) of 24%. Backup withholding will not apply, however, if you (i) fall within certain exempt categories and demonstrate the fact when 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. citizens and individuals taxable as resident aliens of the United States that (i) own "specified foreign financial assets" (as defined in Section 6038D of the Code and the regulations thereunder) with an aggregate value in a taxable year in excess of certain thresholds (as determined under rules in Treasury regulations) and (ii) are required to file U.S. federal income tax returns generally will be required to file an information report with respect to those assets with their tax returns. IRS Form 8938 has been issued for that purpose. "Specified foreign financial assets" include any financial accounts maintained by foreign financial institutions, foreign stocks held directly, and interests in foreign estates, foreign pension plans or foreign deferred compensation plans. Under those rules, our ordinary shares, whether owned directly or through a financial institution, estate or pension or deferred compensation plan, would be "specified foreign financial assets." Under Treasury regulations, the reporting obligation applies to certain U.S. entities that hold, directly or indirectly, specified foreign financial assets. Penalties can apply if there is a failure to satisfy this reporting obligation. In addition, in the event a U.S. Holder that is required to file IRS Form 8938 does not file such form, the statute of limitations on the assessment and collection of U.S. federal income taxes of such U.S. Holder for the related tax year may not close until three years after the date that the required information is filed. A U.S. Holder is urged to consult the U.S. Holder's tax advisor regarding the reporting obligation.

Any U.S. Holder who acquires more than \$100,000 of our ordinary shares or holds 10% or more of our ordinary shares by vote or value may be subject to certain additional U.S. information reporting requirements.

The above description is not intended to constitute a complete analysis of all tax consequences relating to acquisition, ownership and disposition of our ordinary shares. You should consult your tax advisor concerning the tax consequences of your particular situation.

F. Dividends and Paying Agents

Not applicable.

G. Statement by Experts

Not applicable.

H. Documents on Display

We are subject to certain of the reporting requirements of the Exchange Act as applicable to "foreign private issuers" as defined in Rule 3b-4 under the Exchange Act. As a foreign private issuer, we are exempt from certain provisions of the Exchange Act. Accordingly, our proxy solicitations are not subject to the disclosure and procedural requirements of Regulation 14A under the Exchange Act, and transactions in our equity securities by our officers and directors are exempt from reporting and the "short-swing" profit recovery provisions contained in Section 16 of the Exchange Act. In addition, we are not required under the Exchange Act to file quarterly reports and financial statements. However, we file with the SEC an annual report on Form 20-F containing financial statements audited by an independent accounting firm. We also submit to the SEC reports on Form 6-K containing (among other things) press releases and

unaudited financial information. We post our annual report on Form 20-F on our website 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.

The SEC maintains an Internet website that contains reports and other information about issuers, like us, that file electronically with the SEC. The address of that website is www.sec.gov. We make our reports available on our internet website, free of charge, as soon as reasonably practicable after such material is electronically filed with the SEC.

The documents concerning our company that are referred to in this annual report may also be inspected at our offices located at 20 Ben Zion Gelis Street, Sgoola Industrial Zone, Petach Tikva 4910101, Israel.

I. Subsidiary Information

Not applicable.

ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

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

Foreign Currency Exchange Risk

Our reporting currency is the dollar. Our revenues are primarily denominated in the dollar, NIS and Euros, while our expenses are primarily denominated in NIS, dollars and Euros. As a result, the NIS value of our dollar and Euro denominated revenues are negatively impacted by the depreciation of the dollar and the Euro against the NIS. In addition, fluctuations in rates of exchange between NIS and other currencies may affect our operating results and financial condition. The average exchange rate for the NIS against the dollar was 0.1% lower in 2018 than 2017 and the average exchange rate for the NIS against the Euro was 4.5% higher in 2018 than 2017, and in total, these changes had a minor positive impact on our operating results in 2018. The average exchange rate for the NIS against the dollar was 6.3% lower in 2017 than 2016 and the average exchange rate for the NIS against the Euro was 4.4% lower in 2017 than 2016, and in total, these changes had a negative impact on our operating results in 2017. We estimate that a devaluation of 1% of the dollar against the NIS would result in a decrease of approximately \$200,000 in our operating income. As of December 31, 2018, we estimate that a devaluation of 1% of the Euro against the NIS would not have a material impact on our operating and financial results.

If we were to determine that it is in our best interests to enter into hedging transactions in the future in order to protect ourselves in part from currency fluctuations, we may not be able to do so, or such transactions, if entered into, may not materially reduce the effect of fluctuations in foreign currency exchange rates on our results of operations and may result in additional expenses.

Commodity Price Risk

Cost of raw materials is a significant component of our cost of revenues. In 2018, the cost of raw materials used in production was \$10.3 million compared to \$9.8 million in 2017. A 1% increase or decrease in the cost of raw materials used in production would increase or decrease our cost of raw materials by approximately \$317,000.

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to our short-term credit lines, short-term loans and long-term loans. For information on the interest rates of our short-term credit lines, short-term loans and long-term loans, see Item 5B. "Operating and Financial Review and Prospects - Liquidity and Capital Resources." For purposes of specific risk analysis, we use sensitivity analysis to determine the impact that market risk exposure may have on the financial expenses derived from our short-term credit lines and long-term loans. Based on our loans balance at December 31, 2018, a hypothetical increase of 1% in the interest rates would result in an increase of

approximately \$100,000 in our financial expenses. A hypothetical increase of 10% in the CPI would not have a material impact on our financial and operational expenses.

Credit Risk

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

The risk of collection associated with trade receivables is reduced by the geographical dispersion of our customer base. However, our business involves selling products to customers for whose credit we do not have insurance coverage, and we are exposed to risk with respect to our receivables from them.

ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

Not applicable.

PART II

ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

None.

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

None.

ITEM 15. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

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

Management's Annual Report on Internal Control over Financial Reporting

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

pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of our company;

provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of our company are being made only in accordance with authorizations of management and directors of our company; and

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

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

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2018. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Based on that assessment, our management concluded that as of December 31, 2018, our internal control over financial reporting is effective.

Changes in Internal Control over Financial Reporting

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

ITEM 16. [RESERVED]

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

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

ITEM 16B. CODE OF ETHICS

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

ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Independent Registered Public Accounting Firm Fees

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

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

Services Rendered.	2018	2017	2016
Audit ⁽¹⁾	\$85,000	\$82,000	\$74,500
Audit Related Fees	\$55,000	-	-
Tax ⁽²⁾	-	\$3,000	\$3,000
All other Fees ⁽³⁾	\$6,700	\$13,500	\$11,300
Total	\$146,700	\$98,500	\$85,800

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

statutory or regulatory filings.

(2) Tax fees relate to services performed regarding tax compliance.

(3) Other fees are fees for professional services other than audit or tax related fees.

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Pre-Approval Policies and Procedures

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

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

Not applicable.

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

Neither we nor any affiliated purchaser has purchased any of our securities during 2015.

ITEM 16F. CHANGES IN REGISTRANT'S CERTIFYING ACCOUNTANT

Not applicable.

ITEM 16G. CORPORATE GOVERNANCE

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

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

The requirement to maintain a majority of independent directors, as defined under the NASDAQ Stock Market Rules. Instead, we follow Israeli law and practice which requires that we appoint at least two external directors, within the meaning of the Israeli Companies Law, to our board of directors. We have the mandated three independent directors, within the meaning of the rules of the SEC and NASDAQ, on our audit committee. See Item 6C. "Directors, Senior Management and Employees - Board Practices - External and Independent Directors."

The requirements regarding the directors' nominations process. Under Israeli law and practice, our board of directors is authorized to recommend to our shareholders director nominees for election. See Item 6C. – "Directors, Senior Management and Employees - Board Practices - Election of Directors."

The requirement regarding the quorum for any meeting of shareholders. Instead, we follow Israeli law and practice which provides that, unless otherwise provided by a company's articles of association, the quorum required for a general meeting of shareholders is at least two shareholders present who hold, in the aggregate, 25% of the company's voting rights. Our articles of association provide that the quorum required for a shareholder meeting consists of at least two shareholders present in person or represented by proxy who hold or represent, in the aggregate, at least 33% of the voting rights of the issued share capital. See Item 10A. "Additional Information - Share Capital - Annual and

Extraordinary Meetings of Shareholders.”

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ITEM 16H. MINE SAFETY DISCLOSURE

Not applicable.

ITEM 17. FINANCIAL STATEMENTS

Not applicable.

ITEM 18. FINANCIAL STATEMENTS

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ITEM 19. EXHIBITS

Index to Exhibits

<u>Exhibit</u>	<u>Description</u>
1.1	Memorandum of Association of the Registrant ⁽¹⁾
<u>1.2</u>	<u>Articles of Association of the Registrant, as amended</u> ⁽²⁾
<u>3.1</u>	<u>Form of Director and Officer Indemnification Agreement</u> ⁽⁵⁾
2.1	Specimen of Share Certificate ⁽¹⁾
<u>4.1</u>	<u>Compensation Policy dated September 6, 2018.</u> ⁽³⁾
<u>4.2</u>	<u>Bank Hapoalim B.M. Agreement dated April 27, 2014: Summary of Economic Terms: Irrevocable Undertakings</u> ⁽⁴⁾
<u>4.3</u>	<u>Bank Leumi B.M. Agreement dated May 27, 2014: Summary of Economic Terms: Irrevocable Undertakings</u> ⁽⁴⁾
<u>4.4</u>	<u>English summary of terms of Waste Water Treatment Facility Building and Operation Agreement, dated July 3, 2014, by and between the Registrant and Elad Technologies (L.S.)</u> ⁽⁴⁾
<u>8.1</u>	<u>List of Subsidiaries of the Registrant</u> ⁽⁶⁾
<u>12.1</u>	<u>Certification of Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended.</u> ⁽⁶⁾
<u>12.2</u>	<u>Certification of Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1924, as amended.</u> ⁽⁶⁾
<u>13.1</u>	<u>Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u> ⁽⁶⁾
<u>13.2</u>	<u>Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u> ⁽⁶⁾
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.

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

(1) Filed as an exhibit to our registration statement on Form F-1, registration number 333- 229740, as amended, and incorporated herein by reference.

(2) Included in Exhibit 99.1 to our Report of Foreign Issuer on Form 6-K filed on September 12, 2013 and incorporated herein by reference.

(3) Included as Exhibit A to Exhibit 99.1 to our Report of Foreign Issuer on Form 6-K filed on July 26, 2018 and incorporated herein by reference.

(4) Filed as Exhibits 4.11 - 4.13 to our Annual Report on form 20-F for the year ended December 31, 2014, and incorporated herein by reference.

(5) Included as Exhibit A to Exhibit 99.1 to our Report of Foreign Issuer on Form 6-K filed on September 16, 2017 and incorporated herein by reference.

(6) Filed herewith.

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ELTEK LTD. AND ITS SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2018

IN U.S. DOLLARS

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144 Menachem Begin Road, Building A, Fax: +972-3-5622555
Tel-Aviv 6492102, Israel ey.com

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of

ELTEK LTD.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Eltek Ltd. and its subsidiaries (the Company) as of December 31, 2018 and 2017, the related consolidated statements of operations, comprehensive loss, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2018, and the related notes (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2018, in conformity with U.S. generally accepted accounting principles.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting 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.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits and the report of other auditors provide a reasonable basis for our opinion.

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

We have served as the Company's auditor since 2014.

Tel-Aviv, Israel

April 18, 2019

ELTEK LTD. AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	Note	December 31, 2018	2017
ASSETS			
CURRENT ASSETS:			
Cash and cash equivalents	2	992	887
Trade receivables (net of allowance for doubtful accounts of \$170 and \$234 at December 31, 2018 and December 31, 2017, respectively)	1h	5,682	6,963
Inventories	4	3,611	3,871
Other accounts receivable and prepaid expenses	3	1,160	1,781
<u>Total</u> current assets		11,445	13,502
LONG-TERM ASSETS:			
Severance pay fund	9	53	57
Long term prepaid expenses		39	-
<u>Total</u> long-term assets		92	57
PROPERTY AND EQUIPMENT, NET	5	6,623	8,586
<u>Total</u> assets		18,160	22,145

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

ELTEK LTD. AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

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

	Note	December 31, 2018	2017
LIABILITIES AND SHAREHOLDERS' EQUITY			
CURRENT LIABILITIES:			
Short-term credit and current maturities of long-term debt	6	6,606	7,063
Short-term credit from related party	17	2,668	1,442
Trade payables		4,108	5,451
Other accounts payable and accrued expenses	7	3,377	4,111
<u>Total</u> current liabilities		16,759	18,067
LONG-TERM LIABILITIES:			
Long-term debt, excluding current maturities	8	308	388
Accrued severance pay	9	211	231
<u>Total</u> long-term liabilities		519	619
COMMITMENTS AND CONTINGENT LIABILITIES	10		
SHAREHOLDERS' EQUITY:			
Share capital -			
Ordinary shares of NIS 3.0 par value –			
Authorized: 10,000,000 shares at December 31, 2018 and December 31, 2017; Issued and outstanding: 2,028,552 shares at December 31, 2018 and December 31, 2017		1,985	1,985
Additional paid-in capital		17,270	17,270
Foreign currency translation adjustments		2,340	2,415
Capital reserves		800	695
Accumulated deficit		(21,513)	(18,906)
<u>Total</u> shareholders' equity	11	882	3,459
<u>Total</u> liabilities and shareholders' equity		18,160	22,145

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

ELTEK LTD. AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

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

		Year ended December 31,		
	Note	2018	2017	2016
Revenues	13b	33,939	32,754	37,065
Cost of revenues		(31,342)	(31,427)	(34,248)
Gross profit		2,597	1,327	2,817
Operating expenses:				
Research and development, net		-	(41)	(117)
Selling, general and administrative		(4,669)	(4,704)	(4,699)
Operating loss		(2,072)	(3,418)	(1,999)
Financial expenses, net	14	(475)	(298)	(309)
Other income (loss), net		3	15	(259)
Loss before income taxes		(2,544)	(3,701)	(2,567)
Taxes on income	15	(63)	(74)	(1,158)
Loss		(2,607)	(3,775)	(3,725)
Less - loss attributable to non-controlling interests		-	-	101
Loss attributable to Eltek Ltd. shareholders		(2,607)	(3,775)	(3,624)
Other comprehensive income (loss):				
Foreign currency translation adjustments		(75)	600	115
Total comprehensive loss		(2,682)	(3,175)	(3,610)
Comprehensive loss attributable to non-controlling interest		-	-	(91)
Comprehensive loss attributable to Eltek Ltd. shareholders'		(2,682)	(3,175)	(3,701)
Basic and diluted loss per ordinary share attributable to Eltek Ltd. shareholders	12	(1.28)	*) (1.58)	*) (1.82)
Weighted average number of ordinary shares used to compute basic and diluted loss per ordinary share attributable to Eltek Ltd. shareholders		2,028,552	2,028,552	2,028,552

*) Respectively adjusted to reflect reverse split of shares.

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

ELTEK LTD. AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

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

			Company's shareholders				Equity	Non	
			Accumulated				attributed	controlling	
			other				to Eltek	interest	
	Ordinary	Amount	Additional	Comprehensive	Capital	Accumulated	Ltd. and		Total
	shares		paid-in	income	reserves	deficit	subsidiaries		
			capital	(loss)					
Balance as of January 1, 2016	*) 2,028,552	1,985	17,270	1,892	695	(11,507)	10,335	(91)	10,244
Comprehensive income (loss):									
Reclassification of foreign currency translation reserve upon disposal of a subsidiary	-	-	-	(276)	-	-	(276)	91	(185)
Foreign currency translation adjustments	-	-	-	199	-	-	199	-	199
Loss	-	-	-	-	-	(3,624)	(3,624)	-	(3,624)
Balance as of December 31, 2016	*) 2,028,552	1,985	17,270	1,815	695	(15,131)	6,634	-	6,634
Comprehensive income (loss):									
Foreign currency translation adjustments	-	-	-	600	-	-	600	-	600
Loss	-	-	-	-	-	(3,775)	(3,775)	-	(3,775)
Balance as of December 31, 2017	*) 2,028,552	1,985	17,270	2,415	695	(18,906)	3,459	-	3,459
Stock-based compensation	-	-	-	-	56	-	56	-	56
Transaction with controlling shareholder	-	-	-	-	49	-	49	-	49
Comprehensive loss:									
Foreign currency translation adjustments	-	-	-	(75)	-	-	(75)	-	(75)
Loss	-	-	-	-	-	(2,607)	(2,607)	-	(2,607)
Balance as of December 31, 2018	2,028,552	1,985	17,270	2,340	800	(21,513)	882	-	882

*) Respectively adjusted to reflect reverse split of shares.

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

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ELTEK LTD. AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2018	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:			
Loss	(2,607)	(3,775)	(3,725)
Adjustments required to reconcile loss to net cash flows provided by (used in) operating activities:			
Depreciation	1,649	1,722	1,856
Gain on sale of property and equipment	101	(13)	(12)
Revaluation of long term loans	29	17	1
Amortization of Intangible asset	-	348	-
Stock based compensation	56	-	-
Transaction with controlling shareholder	49	-	-
Decrease in deferred income taxes	-	-	1,083
Accrued severance pay, net	(3)	69	(150)
Decrease (increase) in trade receivables, net	790	(597)	2,145
Decrease (increase) in other accounts receivables and prepaid expenses	467	(1,249)	(97)
Increase (decrease) in inventories	(30)	471	289
Decrease in trade payables	(871)	(330)	(561)
Decrease in other accounts payables and accrued expenses	(443)	(107)	(664)
Net cash provided by (used in) operating activities	(813)	(3,444)	165
<u>Proceeds from sale of investment in previously consolidated subsidiary:</u>			
<u>The subsidiary's assets and liabilities at date of sale:</u>			
Trade receivables, net	-	-	289
Inventories	-	-	298
Prepaid and other current assets	-	-	107
property and equipment	-	-	537
Trade payables	-	-	(604)
Other accounts payables and accrued expenses	-	-	(159)
Long-term debts, including current maturities	-	-	(112)
Reclassification of foreign currency translation reserve upon disposal of a subsidiary	-	-	(276)
Non-controlling interest	-	-	191
	-	-	271
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of intangible assets	-	-	(42)
Purchase of property and equipment	(619)	(275)	(708)
Net cash used in investing activities	(619)	(275)	(750)
CASH FLOWS FROM FINANCING ACTIVITIES:			

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Short- term bank credit, net	986	2,756	1,589
Short- term shareholder loan	1,390	1,430	-
Repayment of long-term loans	(910)	(870)	(680)
Proceeds from long-term loans	378	167	235
Repayment of property and equipment payables	(317)	(239)	(671)
Net cash provided by financing activities	1,527	3,244	473

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

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ELTEK LTD. AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONT.)

U.S. dollars in thousands

	Year ended December 31,		
	2018	2017	2016
Effect of exchange rate on cash and cash equivalents	10	128	37
Increase (decrease) in cash and cash equivalents	105	(347)	196
Cash and cash equivalents at the beginning of the year	887	1,234	1,038
Cash and cash equivalents at end of the year	992	887	1,234

SUPPLEMENTAL DISCLOSURES OF CASH FLOW ACTIVITIES:

Cash paid during the year for:			
Interest	212	185	155

Non-cash activities:

Purchase of property and equipment	118	340	90
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The accompanying notes are an integral part of these consolidated financial statements.

ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:- GENERAL AND SIGNIFICANT ACCOUNTING POLICIES

a. General:

Eltek Ltd. ("the Company") was organized in Israel in 1970, and its shares have been publicly traded on the -NASDAQ Capital Market ("NASDAQ") since 1997. Eltek Ltd. and its subsidiaries (Eltek USA Inc. and Eltek Europe GmbH) are collectively referred to as "the Company".

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

The Company markets its product mainly to the medical technology, defense and aerospace, industrial, telecom and -networking equipment, as well as to contract electronic manufacturers, among other industries.

The Company is controlled by Nistec Golan Ltd ("Nistec Golan"). Nistec Golan is controlled indirectly by Mr. Yitzhak Nissan, who owns, indirectly through Nistec Holdings Ltd., all of the shares of Nistec Ltd and Nistec Golan (Nistec Holdings Ltd. and/or any of its subsidiaries are referred to as "Nistec").

The Company's business is subject to numerous risks including, but not limited to, the impact of currency exchange rates (mainly NIS/US\$), the Company's ability to implement its sales and manufacturing plans, the impact of competition from other companies, the Company's ability to receive regulatory clearance or approval to market its products, changes in regulatory environment, domestic and global economic conditions and industry conditions, and compliance with environmental laws and regulations. Due to these conditions and other financial and business -factors, the Company's liquidity position, as well as its operating performance, was negatively affected. As a result, the Company incurred net losses and suffered negative cash flows from its operating activities. As of December 31, 2018, the Company's working capital deficiency amounted to \$5.3 million and its accumulated deficit amounted to approximately \$21.4 million. The Company's liquidity position, as well as its operating performance, may be negatively affected by other financial and business factors, many of which are beyond its control.

ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:- GENERAL AND SIGNIFICANT ACCOUNTING POLICIES (CONT.)

In June 2017, due to continued losses and the Company's limited ability to obtain additional loans from the banks, the Company obtained a loan of NIS 5.0 million (approximately \$ 1.4 million) from Nistec. The terms of the loan were amended in April 2018, with retroactive effect as of June 2017.

In July 2017, the Company received a line of credit dedicated to a specific project of up to NIS 4.5 million (approximately \$1.3 million) from Bank HaPoalim, guaranteed by Nistec Ltd., for a period of up to one year. In July 2018 Bank HaPoalim extended the dedicated line of credit. In January 2019 the Company reduced the line of credit to NIS 2.25 million (approximately \$ 620).

In November 2017, the Company obtained a loan of NIS 3 million (approximately \$ 840) from Mizrahi-Tefahot Bank, guaranteed by Nistec. The bank required a repayment of this loan until April 15, 2019 and therefore, as part of the rights offering the Company's Audit Committee and Board of Directors approved that the Company will repay on April 2019 the debt owed to the bank from the proceeds of the rights offering.

In March 2018, the Company obtained another loan from Nistec of NIS 4.0 million (approximately \$ 1.1 million). In July 2018, in accordance with the Commitment Letter, the Company obtained another loan from Nistec of NIS 1.0 million (approximately \$ 275).

In April 2018, Nistec provided the Company a letter of commitment to provide the Company with additional financing in the amount of up to \$ 2.5 million, valid for one year following the date of 2017 financial statements approval (the "Commitment Letter").

In April 2018, the Company's Board of Directors approved the additional funding extended by Nistec in March 2018 and approved to receive a Commitment Letter from Nistec for providing the Company with financing, either through a bank loan guaranteed by Nistec, a loan extended directly by Nistec to the Company, or a combination thereof. In the event that Nistec will provide the Company with a loan, its terms will either be back-to-back to the terms at which Nistec obtains its financing, or, at Nistec's discretion, such loan will bear no interest, but will be linked to the Israeli Consumer Price Index.

ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:- GENERAL AND SIGNIFICANT ACCOUNTING POLICIES (CONT.)

In August 2018, the Company obtained a credit facility of NIS 7 million (approximately \$ 1,930) from a non-banking financial institution, guaranteed by Nistec.

In January 2019, Nistec provided the Company with an additional loan of NIS 2.0 million (approximately \$530), due on April 30, 2019. However, the Company exercised an option to extend the term of the loan until May 1, 2020 as approved by Company's Audit Committee that determined that such extension is required for the Company's orderly operations.

On October 2, 2018, the Company received notification from NASDAQ advising the Company that as of October 1, 2018, the Company did not maintain stockholders' equity of \$2.5 million, nor does not meet the alternatives of market value of listed securities or net income from continuing operations, and therefore is not in compliance with the stockholders' equity listing rule (the "Listing Rule"). On December 7, 2018, the Company received a notice from NASDAQ advising that the Company had been granted an extension of time to regain compliance with the shareholders' equity requirement until March 31, 2019. Therefore, the Company's Board of Directors decided to execute a right offering.

As of January 2019, the total principal amounts of the loans received by the Company from Nistec (as described above) was NIS 12 million (approximately \$ 3.3 million). In February 2019, Nistec provided the Company with a letter of commitment that in event that its loans amounted NIS 12 million (approximately \$ 3.3 million) will not be converted into ordinary shares of the Company, these loans will become due on or after May 1, 2020. Nistec also provided the Company a commitment that in the event that the rights offering will not be consummated and the Company will be expected not to be in compliance with the minimum adjusted equity covenant, Nistec will convert the debt owed to it by the Company into equity in terms to be agreed in good faith between the Company and Nistec, in order to enable the Company to meet its financial covenants. Nistec has also agreed that in the event that the guarantees that it provided to a bank and to the non-banking institution will be exercised by the bank or the non-banking financial institution, the amount due by the Company to Nistec as a result of the guarantee will be due by May 1, 2020.

In addition, during January 2019 Nistec guaranteed NIS 2.0 million (approximately US\$530) of the Company's existing debt to Bank Leumi, which is due to be repaid by April 30, 2019. During March 2019 and as part of the rights offering the Company's Audit Committee and Board of Directors approved that the Company will repay the debt owed to Bank Leumi from the proceeds of the rights offering.

In February 2019, Nistec Golan informed the Company that it was committed to exercise its subscription rights by converting approximately \$2.5 million of debt owed to it by the Company into the Company's ordinary shares. In March 2019, Nistec informed the Company that instead of converting the debt owed to it, it would participate in the rights offering by means of a cash investment in an amount of at least \$2.5 million.

As a result of the receipt of approximately \$2.5 million from the rights offering prior to March 31, 2019, the Company regained compliance with the Listing Rule and its shares continue to be listed on the NASDAQ Capital Market.

NASDAQ has advised that it will continue to monitor the Company's ongoing compliance with the shareholders' equity requirement and, if at the time of the Company next periodic report the Company does not evidence compliance, the Company may be subject to delisting.

In April 2014, the Company signed a new financial undertakings letter with one bank and in May 2014 with another bank. Under these undertakings the Company is required to maintain certain financial covenants, including: (i) adjusted shareholders' equity (excluding certain intangible and other assets) equal to the greater of \$ 4.5 million or 17% of its consolidated total assets; and (ii) a debt service ratio of 1.5. Debt service ratio is defined as the ratio of EBITDA to current maturities of long-term debt plus interest expenses. The compliance with the financial covenants is measured annually based on the Company's annual audited financial statements. As of December 31, 2018, the Company was not in compliance with these covenants.

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ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:- GENERAL AND SIGNIFICANT ACCOUNTING POLICIES (CONT.)

After the balance sheet date, one bank granted the Company a waiver from such non-compliance. The Company is required to meet these covenants in its financial statements for December 31, 2019 (to be issued no later than May 1, 2020) and the other bank granted the Company a waiver from such non-compliance and adjusted the financial covenants, to be met in the Company's financial statements for December 31, 2019 (to be issued not later than 120 days from December 31, 2019). The adjusted covenants include: (i) adjusted shareholders' equity (excluding certain intangible and other assets) of at least \$ 2.5 million; and (ii) positive EBITDA (greater than zero).

The Company believes that in the event that its business plans for the year 2019 will not be realized, it will not meet the above-mentioned financial covenants. Nistec has agreed that in the event that the guarantees that it provided to Bank Mizrahi-Tefahot and to the non-banking institution will be exercised by Bank Mizrahi-Tefahot and the non-banking financial institution, the amount due to Nistec from the Company as a result of the exercise of the guarantees will be due by May 1, 2020.

In March 2019, the Company's rights offering prospectus became effective. The subscription period ended on April 9, 2019 and the Company had a participation of 69.6% of its shareholders in the rights offering, which provided gross proceeds of \$3.4 million (before deducting expenses related to the rights offering). The Company anticipates that it will use the net proceeds received from this offering to repay a NIS 3.0 million (approximately US\$840) loan from Mizrahi Bank (guaranteed by Nistec) and a NIS 2.0 million (approximately US\$530) line of credit from Bank Leumi (for which Nistec provided a guarantee). The remainder will be used for working capital and other general corporate purposes, including the possible investment in plant and equipment.

The Company's management believes that its current business plans and the commitments from Nistec will enable the Company to continue to operate for a period of at least one year from the date of the approval of these financial statements. In the event the Company will not be successful in generating sufficient cash from its current operations, the Company may be required to obtain additional financing from external sources. There is no assurance that such financing will be obtained.

b. Sale of a wholly owned subsidiary - Kubatronik Leiterplatten GmbH:

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

ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:- GENERAL AND SIGNIFICANT ACCOUNTING POLICIES (CONT.)

On December 19, 2016, the Company sold all of its Kubatronik shares to the founder of Kubatronik. In consideration for the sale, the Company is entitled to contingent consideration equal to 20% of Kubatronik's net profit in 2017, and 10% of Kubatronik's net profit in each of 2018 and 2019. The Company and Kubatronik further agreed that until the end of 2017, they will offer a 10% discount on sales of their products to one another and pay a 10% commission on sales each party effects to consumers introduced by the other. Kubatronik continues to manage Eltek Europe GmbH. Following consummation of the transaction in 2017, Eltek recognized a loss of \$271.

c. Basis of presentation:

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States ("U.S. GAAP"), followed on a consistent basis, unless otherwise stated.

The Company sells goods through its subsidiaries that function as distributors. The consolidated financial statements include the accounts of the Company and its subsidiaries. Intercompany transactions and balances including profits from intercompany sales not yet realized outside the Company, have been eliminated upon consolidation.

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

A change in the Company's ownership interest in a subsidiary that causes a loss of control results in a deconsolidation of the subsidiary. Gain or loss is recognized upon the deconsolidation of a subsidiary, as the difference between (1) the sum of the fair value of any consideration received, the fair value of any retained non- controlling investment in the former subsidiary at the date the subsidiary is deconsolidated, and the carrying amount of any non-controlling interest in the former subsidiary (including any accumulated other comprehensive income attributable to the non-controlling interest) at the date the subsidiary is deconsolidated, and (2) the carrying amount of the former subsidiary's assets and liabilities.

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

ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:- GENERAL AND SIGNIFICANT ACCOUNTING POLICIES (CONT.)

d. Functional and reporting currency:

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

In accordance with U.S. Securities and Exchange Commission Regulation S-X, Rule 3-20, the Company has determined its reporting currency to be the U. S. dollar. The measurement process of Rule 3-20 is conceptually consistent with that of ASC 830.

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

The functional currency of the Company's foreign subsidiaries is the local currency in which each subsidiary operates. The financial statements of foreign subsidiaries are translated into the Parent's functional currency as follows:

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

e. Exchange rates and linkage bases:

1. Balances linked to the Israeli Consumer Price Index ("CPI") are recorded pursuant to contractual linkage terms of the specific assets and liabilities.
2. Details of the CPI and the representative exchange rates are as follows:

	Israeli CPI Points	Exchange rate of one US dollar NIS	Exchange rate of one Euro NIS
December 31, 2018	101.2	3.748	4.292
December 31, 2017	100.4	3.467	4.153
December 31, 2016	98.9	3.845	4.044

%

December 31, 2018	0.8	8.1	3.3
December 31, 2017	1.5	(0.1)	2.7
December 31, 2016	(0.4)	(1.5)	(4.8)

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ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:- GENERAL AND SIGNIFICANT ACCOUNTING POLICIES (CONT.)

f. Use of estimates:

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

g. Cash and cash equivalents:

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

h. Trade accounts receivable:

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

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

The activity in the allowance for doubtful accounts for the three years ended December 31, 2018 is as follows:

	Year ended December 31,		
	2018	2017	2016
Opening balance	234	160	86
Doubtful debt expenses during the year	86	147	114
Customers write-offs/collection during the year	(134)	(91)	(30)
Foreign currency translation adjustments	(16)	18	(10)
Closing balance	170	234	160

ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:- GENERAL AND SIGNIFICANT ACCOUNTING POLICIES (CONT.)

i. Inventories:

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

The Company periodically evaluates the inventory 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.

During the years ended December 31, 2018, 2017 and 2016, the Company recorded inventory write-offs in the amounts of \$ 828, \$ 673 and \$ 589, respectively. Such write-offs were included in cost of revenues.

j. Severance pay and assets held for employees' severance payments:

The Company's liability for its Israeli employees severance pay is calculated pursuant to Israel's Severance Pay Law based on the most recent salary of the employees multiplied by the number of years of employment, as of the balance sheet date (the "Shut Down Method"). Employees are entitled to one month's salary for each year of employment or a portion thereof.

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

k. Property and equipment:

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

	%
Machinery and equipment	5-33
Leasehold improvements	6-14
Motor vehicles	15
Office furniture and equipment	6-33

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

ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:- GENERAL AND SIGNIFICANT ACCOUNTING POLICIES (CONT.)

Impairment of long-lived assets:

The Company's 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. Fair value is determined through various valuation techniques including discounted cash flow models, quoted market values and third party independent appraisals, as considered necessary. During the years ended December 2018, 2017 and 2016, the Company did not record any impairment charges attributable to long-lived assets.

l. Intangible assets:

Intangible assets are amortized over their useful lives using a method of amortization that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used up, in accordance with ASC 350, "Intangibles - Goodwill and Other". The Company acquired software technology during 2014-2015, which was fully amortized during 2017.

Intangible assets are stated at cost net of accumulated amortization.

Amortization is computed by the straight-line method over the estimated useful life of 10 years.

m. Income taxes:

The Company accounts for income taxes in accordance with ASC 740, "Income Taxes." This ASC prescribes the use of the liability method whereby deferred tax assets and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company provides a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

The Company establishes reserves for uncertain tax positions based on an evaluation of whether the tax position is "more likely than not" to be sustained upon examination. The Company records interest and penalties pertaining to its uncertain tax positions in the financial statements as income tax expense.

ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:- GENERAL AND SIGNIFICANT ACCOUNTING POLICIES (CONT.)

n. Accounting for stock-based compensation:

The Company accounts for stock-based compensation in accordance with ASC 718, "Compensation-Stock Compensation".

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

The Company recognizes compensation expenses for the value of its awards, which have graded vesting, based on the accelerated attribution method over the vesting period.

In March 2016, the Financial Accounting Standards Board ("FASB") issued ASU 2016-09, Compensation - Stock Compensation (Topic 718), Improvements to Employee Share-Based Payment Accounting ("ASU 2016-09"). The Company adopted ASU 2016-09 during the first quarter of 2017, at which time it changed its accounting policy to account for forfeitures as they occur. There was no material impact of the adoption of this standard on the Company's financial statements.

During the year ended December 31, 2018, the Company recognized stock-based compensation expenses related to employee stock options in the amount of \$56 (no expenses were recorded in 2017 and 2016).

The Company estimates the fair value of stock options granted under ASC 718 using the Binomial model. The Binomial model for option pricing requires a number of assumptions, of which the most significant are the suboptimal exercise factor and expected stock price volatility. The suboptimal exercise factor is estimated using historical option exercise information. The suboptimal exercise factor is the ratio by which the stock price must increase over the exercise price before employees are expected to exercise their stock options. Expected volatility is based upon actual historical stock price movements and was calculated as of the grant dates for different periods, since the Binomial model can be used for different expected volatilities for different periods. The risk-free interest rate is based on the yield from U.S. Treasury zero-coupon bonds with an equivalent term to the contractual term of the options. The expected term of options granted is derived from the output of the option valuation model and represents the period of time that options granted are expected to be outstanding. Estimated forfeitures are based on actual historical pre-vesting forfeitures.

The following assumptions were used in the Binomial option pricing model for the year ended December 31, 2018 (no options were granted in 2017 and 2016):

	2018
Dividend yield	0%
Expected volatility	71%
Risk-free interest	2.89%
Contractual term	10 years
Forfeiture rate	0%

ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:- GENERAL AND SIGNIFICANT ACCOUNTING POLICIES (CONT.)

o. Revenue recognition:

The Company generates its revenues mainly from sales of custom made printed circuit boards ("PCBs"). The Company also generates revenues from a financed R&D project.

Revenues from the Company's contracts are recognized using the five-step model in ASC 606 - "Revenue from Contracts with Customers" ("ASC 606"). At first, the Company determines if an agreement with a customer is considered to be a contract to the extent it has a commercial substance, it is approved in writing by both parties, all rights and obligations including payment terms are identifiable, the agreement between the parties creates enforceable rights and obligations, and collectability in exchange for goods that will be transferred to the customer is considered as probable. The Company then assesses the transaction price for a contract in order to determine the consideration the Company expects to receive for satisfying the performance obligations called for in the contract.

For the Company's financed R&D project, where the Company's performance does not create an asset with an alternative use, the Company recognizes revenue over performance time because of continuous transfer of control to the customer. For these performance obligations that are satisfied over time, the Company generally recognizes revenue using an input method with revenue amounts being recognized proportionately as costs are incurred relative to the total expected costs to satisfy the performance obligation. The Company believes that costs incurred as a portion of total estimated costs is an appropriate measure of progress towards satisfaction of the performance obligation since this measure reasonably depicts the progress of the work effort and the Company has the ability to make reasonably dependable estimates of the extent of progress towards completion, contract revenues and contract costs. In addition, contracts executed include provisions that clearly specify the enforceable rights regarding services to be provided and received by the parties to the contracts, the consideration to be exchanged, the manner, and the terms of settlement, including in cases of termination for convenience. Project costs includes mainly related labor. Estimated gross profit from the project 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.

Revenues for performance obligations that are not recognized over time are recognized at the point in time when control is transferred to the customer (which is generally upon delivery) and include mainly revenues from the sales custom made printed circuit boards ("PCBs"). The Company generally does not provide a right of return to its customers. For performance obligations that are satisfied at a point in time, the Company evaluates the point in time when the customer can direct the use of, and obtain the benefits from, the products. Shipping and handling costs are not considered performance obligations and are included in cost of sales as incurred.

ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:- GENERAL AND SIGNIFICANT ACCOUNTING POLICIES (CONT.)

o. Revenue recognition (Cont.):

Unbilled accounts receivables

Unbilled accounts receivables decreased by \$390, compared to the beginning balance of \$361 as of January 1, 2018. The decrease was primarily as a result of \$984 of billings. This was offset by an increase of \$606 due to the amounts of recognized revenues in advance of contractual billing during the year. The above resulted in ending balance of deferred revenues of \$29 as of December 31, 2018.

p. Earnings per ordinary share:

Basic net earnings per share are computed based on the weighted average number of ordinary shares outstanding during each year. Diluted net earnings per share is computed based on the weighted average number of ordinary shares outstanding during each year, plus dilutive potential ordinary shares considered outstanding during the year, in accordance with ASC 260, "Earnings Per Share." Certain of the Company's outstanding stock options have been excluded from the calculation of the diluted earnings per share because such options are anti-dilutive.

q. Concentration of credit risk:

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

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

r. Research and development costs:

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

s. Commitments and contingencies:

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

ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:- GENERAL AND SIGNIFICANT ACCOUNTING POLICIES (CONT.)

t. Fair value measurements:

ASC 820, "Fair Value Measurement and Disclosure" clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. As a basis for considering such assumptions, ASC 820 establishes a three tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

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

Level 2 - Significant other observable inputs based on market data obtained from sources independent of the reporting entity.

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

As of December 31, 2018, 2017 and 2016, the Company did not have any derivative instruments, measured at fair value on a recurring or nonrecurring basis.

u. Comprehensive income (loss):

The Company accounts for comprehensive income (loss) in accordance with ASC 220, "Comprehensive Income". ASC 220 establishes standards for the reporting and display of comprehensive income and its components in a full set of general purpose financial statements. Comprehensive income generally represents all changes in shareholders' equity (deficiency) during the period except those resulting from investments by, or distributions to, shareholders.

The Company has determined that its items of comprehensive income (loss) relate to unrealized gain (loss) from foreign currency translation adjustments.

The total accumulated other comprehensive loss, net was comprised as follows:

	December 31,		
	2018	2017	2016
Foreign currency translation adjustments	(75)	600	115
Total accumulated other comprehensive loss	(75)	600	115

ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:- GENERAL AND SIGNIFICANT ACCOUNTING POLICIES (CONT.)

v. Impact of recently issued and adopted accounting standards:

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments ("ASU 2016-15"). This new standard clarifies certain aspects of the statement of cash flows and also clarifies that an entity should determine each separately identifiable source of use within the cash receipts and payments on the basis of the nature of the underlying cash flows. The Company adopted the standard effective as of January 1, 2018, and the adoption of this standard did not have an impact on the Company's consolidated financial statements

In January 2017, the FASB issued ASU No. 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business. The amendments in this update provide a more robust framework to use in determining when a set of assets and activities is a business. The amendments provide more consistency in applying the guidance, reduce the costs of application, and make the definition of a business more operable. The Company adopted the standard effective as of January 1, 2018, and the adoption of this standard did not have an impact on the Company's consolidated financial statements.

On January 1, 2018, the Company adopted ASC Topic 606 using the modified retrospective method and applied the standard to those contracts, which were not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under Topic 606, while prior period amounts are not adjusted and continue to be reported in accordance with the previous accounting under Topic 605. The adoption of this standard did not have an impact on the Company's consolidated financial statements and no cumulative-effect adjustment was recorded. The results of the Company's operations for the year ended December 31, 2018 under the previous standard are not materially different compared to the results under ASC 606. See Note 1o.

x. New accounting pronouncements not yet effective:

In February 2016, the FASB issued Accounting Standards Update No. 2016-02 (Topic 842) "Leases." Topic 842 supersedes the lease requirements in Accounting Standards Codification (ASC) Topic 840, "Leases." Under Topic 842, lessees are required to recognize assets and liabilities on the balance sheet for most leases and provide enhanced disclosures. Leases will continue to be classified as either finance or operating. This ASU is effective for annual periods beginning after December 15, 2018. The provisions of ASU 2016-02 are to be applied using a modified retrospective approach. In July 2018, the FASB issued Accounting Standards Update 2018-11, Leases (Topic 842). This update provides entities with an additional (and optional) transition method to adopt the new leases standard. Under this method, an entity initially applies the new leases standard at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. Consequently, the prior comparative period's financials will remain the same as those previously presented.

The Company has elected to apply the guidance at the beginning of the period of adoption and not restate comparative periods. In addition, the company elected the available practical expedients on adoption.

ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:- GENERAL AND SIGNIFICANT ACCOUNTING POLICIES (CONT.)

x. New accounting pronouncements not yet effective (Cont.):

The Company expects to record right-of-use leased assets and corresponding liabilities of approximately \$2,500 to \$4,000, at the beginning of first quarter 2019.

In August 2018, the FASB issued Accounting Standards Update 2018-15, Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That is a Service Contract ("ASU 2018-15"). The amendments in ASU 2018-15 provide guidance to align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). The new guidance is effective for fiscal years beginning after December 15, 2019. Early adoption is permitted. The Company is still evaluating the effect that this guidance will have on the Company's consolidated financial statements

In June 2018, the FASB issued ASU 2018-07 to expand the scope of ASC Topic 718, Compensation - Stock Compensation, to include share-based payment transactions for acquiring goods and services from nonemployees. The pronouncement is effective for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2018, with early adoption permitted. The Company is evaluating the effects of this standard on its consolidated financial statements.

In June 2016, the FASB issued Accounting Standards Update No. 2016-13 (ASU 2016-13) "Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments" which requires the measurement and recognition of expected credit losses for financial assets held at amortized cost. ASU 2016-13 replaces the existing incurred loss impairment model with an expected loss methodology, which will result in more timely recognition of credit losses. ASU 2016-13 is effective for annual reporting periods, and interim periods within those years, beginning after December 15, 2019. The Company is evaluating the effect that this guidance will have on the Company's consolidated financial statements.

y. Reclassifications:

Certain amounts in the notes to prior years financial statements have been reclassified to conform with current year presentation. The reclassification had no effect on previously reported balance sheet, net loss and cash flows.

ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- CASH AND CASH EQUIVALENTS

	December 31, 2018 2017	
Denominated in U.S. dollars	315	677
Denominated in NIS	280	33
Denominated in Euro	397	177
	992	887

NOTE 3:- OTHER ACCOUNTS RECEIVABLE AND PREPAID EXPENSES

	December 31, 2018 2017	
Prepaid expenses	292	254
Government authorities	68	35
Employees	21	18
Others	779	1,474
	1,160	1,781

NOTE 4:- INVENTORIES

	December 31, 2018 2017	
Raw materials	1,436	1,616
Work-in-progress	1,283	1,638
Finished goods	892	617
	3,611	3,871

ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 5:- PROPERTY AND EQUIPMENT, NET

	December 31,	
	2018	2017
<u>Cost:</u>		
Machinery and equipment	33,048	36,890
Leasehold improvements	8,169	9,044
Motor vehicles	68	74
Office furniture and equipment	704	260
	41,989	46,268
Accumulated depreciation:		
Machinery and equipment	(27,689)	(29,805)
Leasehold improvements	(7,089)	(7,625)
Motor vehicles	(49)	(48)
Office furniture and equipment	(539)	(204)
	(35,366)	(37,682)
Depreciated cost	6,623	8,586

Depreciation expense for the years ended December 31, 2018, 2017 and 2016 were \$1,649, and \$2,080 and \$1,856, respectively.

NOTE 6:- SHORT-TERM CREDIT AND CURRENT MATURITIES OF LONG-TERM DEBT

Banks:

	Annual interest rate at December 31,		December 31,	
	2018		2018	2017
In NIS bears interest rate of Prime+0.85% to Prime+2.7%	2.6% - 4.45 %		4,229	5,207
Short term credit from others	4.15 %		1,534	-
Long-term debt from banks in NIS bears interest of Prime rate *)	2.75 %		843	1,856
			6,606	7,063

*) The amounts of \$ 34 and \$ 911 have been classified from long term debt as of December 31, 2018 and December 31, 2017, respectively since the Company is not in compliance with its banks covenants as of those dates..

ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 7:- OTHER ACCOUNT PAYABLE AND ACCRUED EXPENSES

	December 31,	
	2018	2017
Accrued payroll including amounts due to government authorities	938	983
Provision for vacation and other employee benefits	1,315	1,584
Accrued expenses	458	600
Provision for contingent liabilities (Note 10d)	191	274
Other liabilities	475	670
	3,377	4,111

NOTE 8:- LONG-TERM DEBT, EXCLUDING CURRENT MATURITIES

Others

	Annual interest rate at		December	
	December 31, 2018	December 31, 2017	2018	2017
Linkage terms:				
U.S. dollar	5	%	503	290
NIS - Fix interest rate	5.6	%	221	398
			724	688
Less - current maturities (trade payables)			(416)	(300)
			308	388

Minimum future payments at December 31, 2018 due under the long-term (includes liabilities associated with equipment purchasing) debt are as follows:

	Long-term loan	
	2019	416
	2020	308
		724

Long-term debt includes liabilities associated with equipment purchase in the amounts of \$724 and \$688 and current maturities of long-term debt of \$416 and \$300 at December 31, 2018 and 2017, respectively. The current maturities are classified to the trade payable balance as of December 31, 2018 and 2017, respectively.

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ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

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

In April 2014, the Company signed a new financial undertakings letter with one bank and in May 2014 with another bank. Under these undertaking the Company is required to maintain certain financial covenants, including: (i) adjusted shareholders' equity (excluding certain intangible and other assets) equal to the greater of \$4.5 million or 17% of its consolidated total assets; and (ii) a debt service ratio of 1.5. Debt service ratio is defined as the ratio of EBITDA to current maturities of long-term debt plus interest expenses. The compliance with the financial covenants is measured annually based on the Company's annual audited financial statements. As of December 31, 2017 the Company was not in compliance with these covenants, however, one bank granted the Company a waiver for such non-compliance until the publication of the financial statements for December 31, 2018 and another bank granted the Company a waiver until the publication of financial statements for June 30, 2018.

As of December 31, 2018, the Company was not in compliance with those covenants; however, after the balance sheet date, one bank granted the Company a waiver from such non-compliance. The Company is requiring to meet these covenants in its financial statements for December 31, 2019 (to be issued no later than May 1, 2020). The other bank granted the Company a waiver from such non-compliance, and adjusted the financial covenants, to be met in the Company's financial statements for December 31, 2019 (to be issued not later than 120 days from December 31, 2019). The adjusted covenants include: (i) adjusted shareholders' equity (excluding certain intangible and other assets) of at least \$ 2.5 million; and (ii) Positive EBITDA (greater than zero).

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

NOTE 9:- EMPLOYEE SEVERANCE BENEFITS

Under Israeli law and labor agreements, the Company is required to make severance and pension payments to retired, dismissed or resigned employees.

The Company has an approval from the Israeli Ministry of Labor and Social welfare, pursuant to the terms of Section 14 of the Israeli Severance Pay Law, 1963, according to which the Company's current deposits in the pension fund and/or with the insurance company exempt it from any additional severance obligations to the employees for whom such depository payments were made.

The Company's employees participate in a pension plan or individual insurance policies that are purchased by them. The Company's liability for severance obligations for the employees employed for one year or more is discharged by making regular deposits with a pension fund or the insurance policies. Under Israeli law, there is no liability for severance pay in respect of employees who have not completed one year of employment. The amount deposited with the pension fund or the insurance policies is based on salary components as prescribed in the employment agreement. The custody and management of the amounts so deposited are independent of the Company and accordingly, such amounts funded and related liabilities are not reflected in the balance sheet. For non-management employees, the Company deposits 72% of its liability for severance obligations with a pension fund for such employees, and upon completion of one year of employment with the Company, it makes a one-time deposit with the pension fund for the remaining balance. The Company deposited \$723 to individual severance fund according section 14 of the Israeli severance pay law.

ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 9:- EMPLOYEE SEVERANCE BENEFITS (Cont.)

In 2011, the Company, pursuant to Section 14 of the Israeli Severance Pay Law, made a transfer of funds from a central severance fund to individual funds in the name of the employees for the unfunded liability and discharged its liability in respect of such employees' severance pay.

c. Total liability for employees' severance benefits as at December 31, 2018 amounted to \$ 211.

Expenses (income) recorded in respect of the unfunded liability for employee severance payments for the years ended December 31, 2018, 2017, and 2016 were \$(20), \$ 87 and \$ 94, respectively.

NOTE 10:- COMMITMENTS AND CONTINGENT LIABILITIES

a. Pledges:

1. The Company has pledged certain items of its equipment and the rights to any insurance claims on such items to secure its debts to banks, as well as placed floating liens on all of its remaining assets in favor of the banks.
2. The Company has also pledged machines to secure its indebtedness to certain suppliers that provided financing for such equipment.

b. Operating leases and other agreements:

1. The premises occupied by the Company are leased under three lease agreements that expire in February 2022, December 2022 and February 2024.
2. The Company's motor vehicles are leased under operating lease agreements, mainly for three-year terms.
3. Minimum future payments at December 31, 2018 due under the above agreements over the next five years and thereafter are as follows:

	Premises leases	Other agreements
First year	883	581
Second year	883	439
Third year	883	213
Fourth year	189	145
Fifth year and thereafter	14	160
	2,852	1,538

ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

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

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

Expenses recorded under these agreements for the years ended December 31, 2018, 2017 and 2016 were \$ 1,766, \$1,444 and \$ 1,447, respectively.

c. Indemnification agreement:

The Company entered into an indemnification agreement with each of its directors and officers and undertook to enter into the same agreement with future directors and officers. Such indemnification amount is limited to 25% of the Company's shareholders' equity.

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

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

d. Contingent Liabilities:

Environmental Related Matters

In connection with the change of control of the Company that resulted from Nistec's acquisition of a controlling stake in the Company, Israeli law requires it to obtain a new business permit in order to continue operating its business. The Company submitted an application for this permit and received a permit until 2099.

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

In October 2015, the Company filed an application for an emissions permit with the Ministry. In January 2016, the Company received a notice of non-compliance from the Ministry, stating that the application was incomplete and that the Company is in breach of the Clean Air Law, 5768-2008 and the Licensing of Businesses Law, 5728-1968. The Company submitted amended application and conducted discussions with the Ministry throughout 2016 and 2017. The Company received the emissions permit in July 2017.

ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

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

Employee related matters

In May 2008, a lawsuit was filed by one of the Company's former employees alleging that he had suffered personal injuries during his employment and he is seeking aggregate financial compensation of approximately \$ 71 for past damages and additional amounts for future lost income, pain and suffering as the court may determine.

Four other employees notified the Company in January 2011 and July 2013, that they allegedly suffered personal injuries during their employment with the Company. Of these four employees, one is seeking compensation of \$ 162 and the others did not state their claim amount.

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

During the period November 2015 through March 2019, four former employees filed law suits seeking additional payments in connection with their employment with the Company and subsequent termination. On August 2018 a court decision was provided for one of the labor suits and a provision was recorded accordingly. On October 2018, both the Company and this former employee appealed the Labor Court's decision. The aggregate amount claimed for the above mention labor suits is approximately \$ 900. The Company recorded a provision according to its legal advisor's opinion.

NOTE 11:- SHAREHOLDERS'
EQUITY

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

	Authorized December 31 2018 and 2017 Number of shares	Issued and outstanding December 31, 2018	2017*)
Ordinary shares of par value NIS 3.0 each	10,000,000	2,028,552	2,028,552
Ordinary shares of par value NIS 3.0 each amount in US\$		397,056	397,056

*)Respectively adjusted to reflect reverse split of shares.

ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 11:- SHAREHOLDERS' EQUITY (Cont.)

b. Stock Option Plan:

The Company's 2018 Share Incentive Plan (the "Plan") authorized the grant of options to purchase shares and restricted shares unites ("RSUs") to officers, employees, directors and consultants of the Company and its Subsidiaries. Awards granted under the Plan to participants in various jurisdictions may be subject to specific terms and conditions for such grants as may be approved by the Company's board from time to time.

Each option granted under the Plan is exercisable for a period of ten years from the date of the grant of the option or the expiration dates of the option plan. The options primarily vest gradually over four years of employment.

During July 2018 the Company granted 60,857 options to the Company's CEO to acquire 60,857 Ordinary shares under the Plan. The total fair value of the options granted was \$183 to be recognized over four years vesting period. The stock-based compensation expense related to employees' equity-based awards, recognized during 2018 was \$56.

A summary of employee option activity under the Plan as of December 31, 2018 and changes during the year ended December 31, 2018 are as follows:

	Number of options	Weighted-average exercise price	Weighted- average remaining contractual life (in months)	Aggregate intrinsic value (in thousands)
Outstanding at January 1, 2018	-	-	-	-
Granted	60,857	4.17		
Outstanding at December 31, 2018	60,857	4.17	114	-
Exercisable at December 31, 2018	-	-	-	-

The weighted-average grant-date fair value of options granted during the years ended December 31, 2018 were \$ 4.17. No options were granted in 2017 and 2016. The aggregate intrinsic value in the table above represents the total intrinsic value (the difference between the Company's closing stock price on the last trading day of the fourth quarter of fiscal 2018 and the exercise price, multiplied by the number of in-the-money options). This amount changes, based on the fair market value of the Company's stock. As of December 31, 2018, there was approximately \$ 127 of unrecognized compensation costs related to non-vested share-based compensation arrangements granted under the Company's stock option plans. This cost is expected to be recognized over a period of up to 3.5 years.

ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 11:- SHAREHOLDERS' EQUITY (Cont.)

The options outstanding as of December 31, 2018 are follows:

Number of options outstanding as of December 31, 2018	Exercise price	Weighted average remaining contractual life (In months)	Number of options exercisable as of December 31, 2018
60,857	4.17	114	-

NOTE 12:- BASIC AND DILUTED NET EARNINGS PER SHARE

	Year ended December 31,		
	2018	2017	2016
Numerator:			
Loss attributable to Eltek Ltd shareholders'	(2,607)	(3,775)	(3,624)
Denominator:			
Denominator for basic loss per share weighted-average number of shares outstanding	2,028,552	2,028,552	2,028,552
Effect of diluting securities:			
Employee stock options	-	-	-
Denominator for diluted loss per share - adjusted weighted average shares and assumed exercises	2,028,552	2,028,552	2,028,552

NOTE 13:- ENTITY WIDE DISCLOSURES

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

	Year ended December 31,		
	2018	2017	2016
Customer A - Sales of manufactured products	12.0%	14.6%	16.3%

ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 13:- ENTITY WIDE DISCLOSURES (Cont.)

b. Revenues by geographic areas:

	Year ended December 31,		
	2018	2017	2016
Israel	18,940	19,730	17,535
North America	6,973	5,219	5,811
Netherlands	3,302	2,407	2,052
Europe	1,997	2,016	8,125
India	2,239	2,362	3,100
Others	488	1,020	442
	33,939	32,754	37,065

NOTE 14:- FINANCIAL EXPENSES, NET

	Year ended December 31,		
	2018	2017	2016
Interest on long-term banks	152	54	67
Bank charges and short-term credit	232	118	64
Effect of exchange rate differences on other expenses and net loss from derivative instruments	-	-	(31)
Foreign exchange loss, net	24	75	145
Other financing expenses, net	67	51	64
	475	298	309

ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 15:- TAXES ON INCOME

a. Tax laws applicable to the Company:

Income Tax (Inflationary Adjustments) Law, 1985:

According to the law, until 2007, the results for tax purposes were adjusted for the changes in the Israeli CPI.

In February 2008, the "Knesset" (Israeli parliament) passed an amendment to the Income Tax (Inflationary Adjustments) Law, 1985, which limits the scope of the law starting 2008 and thereafter. Since 2008, the results for tax purposes are measured in nominal values, excluding certain adjustments for changes in the Israeli CPI carried out in the period up to December 31, 2007. Adjustments relating to capital gains such as for sale of property (betterment) and securities continue to apply until disposal. Since 2008, the amendment to the law includes, among others, the cancellation of the inflationary additions and deductions and the additional deduction for depreciation (in respect of depreciable assets purchased after the 2007 tax year).

The Law for the Encouragement of Capital Investments, 1959:

According to the Law, companies are entitled to various tax benefits by virtue of the "approved enterprise" and/or "beneficiary enterprise" status granted to part of their enterprises, as implied by this Law. The principal benefits by virtue of the Law are:

Tax benefits and reduced tax rates:

Following the enactment of Amendment No. 60 to the Law, subsequent to April 1, 2005, the income qualifying for tax benefits under the tax benefits track is the taxable income of a company that has met certain conditions as determined by the Law ("a beneficiary company"), and which is derived from an industrial enterprise. In respect of plant expansions executed following Amendment No. 60 to the Law, the benefit period starts at the later of the year elected and the first year the Company earns taxable income provided that 12 years have not passed since the beginning of the year of election.

The Company has production facilities in Israel qualified as "Beneficiary Enterprises" in accordance with the Law. The Company's first Beneficiary Enterprise was converted from a previously "Approved Enterprise" program pursuant to the approval of the Israel Tax Authority that the Parent received in September 2006. In the past, certain of the Company's production facilities were granted approved enterprise status pursuant to the Law; were over, the benefit periods for such approved enterprises expired in 2005. Additionally, the Company has elected 2012 as the year of election. The income generated by the "Beneficiary Enterprise" is exempt from tax over a period of two years, beginning with the year in which the Company first had taxable income. The period of tax benefit of the first Beneficiary Enterprise has not yet commenced and was expired not later than 2017. The period of tax benefit of the second beneficiary enterprise has not yet commenced and will expire not later than 2024. The benefits are contingent upon compliance with the terms of the Encouragement Law (export rate, etc.). The Company is currently in compliance with these terms.

ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 15:- TAXES ON INCOME (Cont.)

Amendment to the Law for the Encouragement of Capital Investments, 1959 (Amendment 68):

In December 2010, the "Knesset" (Israeli Parliament) passed the Law for Economic Policy for 2011 and 2012 (Amended Legislation), 2011 ("the Amendment"), which prescribes, among others, amendments in the Law for the Encouragement of Capital Investments, 1959 ("the Law"). The Amendment became effective as of January 1, 2011. According to the Amendment, the benefit tracks in the Law were modified and a flat tax rate applies to the Company's entire preferred income under its status as a privileged company with a preferred enterprise. Commencing from the 2011 tax year, the Company can elect (without possibility of reversal) to apply the Amendment in a certain tax year and from that year and thereafter, it will be subject to the amended tax rates. The tax rates under the Amendment are: 2011 and 2012 - 15% (in development area A - 10%) and in 2013 - 12.5% (in development area A - 7%).

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 from a preferred enterprise in 2014 and thereafter will be 16% (in development area A - 9%). As for changes in tax rates resulting from the enactment of Amendment 73 to the Law, see below.

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%.

Amendment to the Law for the Encouragement of Capital Investments, 1959 (Amendment 73):

In December 2016, the Economic Efficiency Law (Legislative Amendments for Applying the Economic Policy for the 2017 and 2018 Budget Years), 2016 which includes Amendment 73 to the Law for the Encouragement of Capital Investments ("the Amendment") was published. According to the Amendment, a preferred enterprise located in development area A will be subject to a tax rate of 7.5% instead of 9% effective from January 1, 2017 and thereafter (the tax rate applicable to preferred enterprises located in other areas remains at 16%).

The Company intends to implement the Amendment in future tax years. Therefore, the deferred tax balance as of December 31, 2013 was calculated based on the rate provided by the Amendment.

ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 15:- TAXES ON INCOME (Cont.)

Accelerated depreciation:

By virtue of the Law, the Company is eligible for deduction of accelerated depreciation on equipment used by the approved enterprise / beneficiary enterprise from the first year of the asset's operation.

The Law for the Encouragement of Industry (Taxation), 1969:

The Company has the status of an "industrial company", as defined by this law. According to this status and by virtue of regulations published thereunder, the Company is entitled to claim a deduction of accelerated depreciation on equipment used in industrial activities, as determined in the regulations issued under the Inflationary Law. The Company is also entitled to amortize a patent or rights to use a patent or intellectual property that are used in the enterprise's development or advancement, to deduct issuance expenses for shares listed for trading, and to file consolidated financial statements under certain conditions.

b. Tax rates applicable to the Group:

1. The Israeli regular corporate tax rate for Israeli companies was 25% in 2016, 24% in 2017 and 23% in 2018.

In December 2016, the Israeli Parliament approved the Economic Efficiency Law (Legislative Amendments for Applying the Economic Policy for the 2017 and 2018 Budget Years), 2016 which reduces the corporate income tax rate to 24% (instead of 25%) effective from January 1, 2017 and to 23% effective from January 1, 2018.

In August 2013, the Law for Changing National Priorities (Legislative Amendments for Achieving Budget Targets for 2013 and 2014), 2013 ("the Budget Law") was enacted. The Law includes, among others, provisions for the 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 foreign assets. As of the date of approval of these financial statements, these regulations have not been published.

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.

2. The tax rates of the Company's non-Israeli subsidiaries range between 29.5%-30%.

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ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 15:- TAXES ON INCOME (Cont.)

3. Tax Reform in U.S.:

On December 22, 2017, the U.S. enacted the Tax Cuts and Jobs Act (the "Act"), which among other provisions, reduced the U.S. corporate tax rate from 35% to 21%, effective January 1, 2018.

c. Tax losses and tax credits carryforwards:

As of December 31, 2018, the Company's tax loss carryforwards were approximately \$24.3 million of operating losses and \$ 9.3 million of capital. As of December, 2018 the balance of tax credits carryforward was \$992.

The Company's tax loss carryforward and tax credits carryforward do not have expiration dates.

d. Income tax assessments:

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

In Israel, the Company has received final tax assessments through the 1995 tax year. Assessments through the 2013 tax year are considered final due to statute of limitations. The Israeli tax returns of the Company may be audited by the Israeli Tax Authorities for the tax years beginning in 2014.

Eltek Europe has received final tax assessments through the 2013 tax year. The tax returns of Eltek Europe remain subject to audit for the tax years beginning in 2014. The tax returns of Eltek USA remain subject to audit for the tax years beginning in 2012.

ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 15:- TAXES ON INCOME (Cont.)

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

	Year ended December 31,		
	2018	2017	2016
Loss before income tax expense:			
Israel	(2,663)	(3,701)	(2,767)
Foreign jurisdictions	119	-	200
	(2,544)	(3,701)	(2,567)
Current tax expense:			
Israel	14	-	-
Foreign jurisdictions	49	74	73
	63	74	73
Deferred taxes:			
Israel	-	-	1,085
	-	-	1,085
Income tax expense	63	74	1,158

ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 15:- TAXES ON INCOME (Cont.)

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

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

	Year ended December 31,					
	2018		2017		2016	
Loss before income tax expense as reported in the consolidated statements of comprehensive income	(2,544)		(3,701)		(2,567)	
Statutory tax rates	23	%	24	%	25	%
Theoretical tax benefit calculated	(585)		(888)		(642)	
Changed in liability for undistributed income of subsidiaries	-		29		37	
Losses and other items for which a valuation allowance was provided	271		1,218		1,160	
Change in effective on corporate tax rate	-		(49)		(17)	
Changes in deferred tax of carryforward losses due to sale of investment in previously consolidated subsidiaries	-		-		492	
Tax benefit (expense) arising from "Preferred enterprises"	189		296		250	
Foreign tax rate differential in subsidiaries	22		44		20	
Other	166		(576)		(142)	
Total	648		962		1,800	
Income tax expense	63		74		1,158	

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ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 15:- TAXES ON INCOME (Cont.)

g. Deferred tax assets and liabilities:

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

	December 31,	
	2018	2017
Deferred tax assets:		
Net operating loss carryforwards (in Israel)	3,892	3,614
Capital loss carryforwards (in Israel)	2,137	1,170
Severance benefits	25	28
Provision for vacation	174	218
Tax credit carryforward	992	1,065
Allowance for doubtful accounts	29	37
Total gross deferred tax assets	7,249	6,132
Less valuation allowance	(6,418)	(5,256)
Net deferred tax assets	831	876
Deferred tax liabilities:		
Undistributed income of subsidiaries	(275)	(275)
Fixed assets - differences in depreciation	(556)	(601)
Total gross deferred tax liabilities	(831)	(876)

During the year ended December 31, 2016 the Company recorded a tax expense of \$1.2 million due to uncertainty about its ability to utilize these tax assets in the foreseeable future.

The Company recorded a full valuation allowance for deferred tax assets with respect to its deferred tax assets in Israel due to uncertainty about its ability to utilize such losses in the future. The ultimate realization of deferred tax assets depends on the generation of future taxable income during the periods in which those temporary differences are deductible. Management considers the scheduled reversal of deferred tax liabilities, projected taxable income, and tax-planning strategies in making this assessment. The valuation allowance for deferred tax assets as of December 31, 2018 and 2017 was \$6,418 and \$ 5,256 respectively. The net change in the total valuation allowance for each of the years ended December 31, 2018, 2017 and 2016, was an increase of \$271, \$1,218 and \$1,160, respectively.

ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 15:- TAXES ON INCOME (Cont.)

h. Accounting for uncertainty in income taxes:

For the twelve-month periods ended December 31, 2018, 2017 and 2016, the Company did not have any unrecognized tax benefits and thus, no interest and penalties related to unrecognized tax benefits were recorded. In addition, the Company does not expect that the amount of unrecognized tax benefits will change significantly within the next twelve-month months.

NOTE 16:- FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

In addition to the above, the Company's financial instruments at December 31, 2018 and 2017, consisted of cash and cash equivalents, bank deposits, trade and other accounts receivable, other current assets, short-term credit provided by financial institutions, and trade and other payables. The carrying amounts of all the aforementioned financial instruments, at face value or cost plus accrued interest, approximate fair value due to the short maturity of these instruments linked to the Israeli central bank rate.

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

NOTE 17:- RELATED PARTY BALANCES AND TRANSACTIONS

Nistec, the controlling shareholder of the Company, is also a customer of the Company. The Company sells products to Nistec, pays management fees to Nistec, purchases certain services from Nistec and shares certain expenses with Nistec, for services that it acquires jointly with Nistec. The Company's transactions with its related parties were carried out on an arm's-length basis.

a. Balances with related parties:

	December 31,	
	2018	2017
Trade accounts receivable	158	231
Trade accounts payable	170	73
Controlling shareholder loans	2,668	1,442

b. Transactions with related parties:

	Year ended December 31,		
	2018	2017	2016
Revenues	821	604	508
Purchases, general and administrative expenses	313	469	336
Interest from Loans from controlling shareholder	113	-	-

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ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 17:- RELATED PARTY BALANCES AND TRANSACTIONS (Cont.)

PCB purchases by Nistec - Nistec purchases PCBs from the Company solely to provide assembled boards to its customers and not for re-sale. The Company's quote is based on its standard price list, and may be subject to a discount of up to ten percent (10%). Should the order be for PCBs imported by the Company, the quote reflects the actual price of such PCBs, plus a mark-up of at least twenty percent (20%). Should the order be for PCBs from excess inventory of an original order, the quote will reflect the standard price of such PCBs, with a discount of up to fifty percent (50%) of the price actually paid for such PCBs in the original order (the "Excess Inventory Discount"). The Excess Inventory Discount will apply only to orders from excess inventory of the first original order of a specific PCB (i.e., should a second order of a specific PCBs generate any excess inventory, and Nistec would like to purchase such excess, the Excess Inventory Discount will not be applied to such purchase).

Soldering and assembly services - The Company may acquire soldering services and/or purchasing services from Nistec. Nistec's pricing for its soldering services will be its standard price list (the "Price List"), less a five percent (5%) discount. Nistec may charge for Purchasing Services in accordance with the actual costs of the orders, plus a fourteen and a quarter (14.25%) commission, which reflects a five percent (5%) discount, as compared to the commission charged to third parties by Nistec for similar services. Prices of services not included in the Price List will be negotiated by the parties in good faith (without participation of Mr. Nissan, the Company's controlling shareholder and CEO, or any of his relatives). Nistec standard procedures govern manufacturer warranties and restrictions regarding defective assembled products. In addition to requesting Nistec to provide the Company with a quote for soldering and assembly services, in the event that the Company requires design and/or design services for production of PCBs, it may ask Nistec to provide it with a quote for such services. Nistec may charge for design and/or design services in accordance its standard price list for such services, less a five percent (5%) discount. The Company's purchases of services under the Soldering, Assembly and Design Services Procedure may not exceed NIS 300 per annum.

Insurance expenditures - The Company may share with Nistec costs of insurance consulting and insurance premiums in the event the Company determines that a joint insurance policy with Nistec will reduce the Company's costs as compared to purchasing insurance separately. Insurance expenditures will be divided between the Company and Nistec as follows: (i) insurance consulting services costs will be divided in proportion to the insurance premiums paid by the Company and Nistec in the preceding year; (ii) the joint insurance premiums will be divided in the proportions indicated by the insurer for each of the Company and Nistec had they purchased the insurance separately. The Company will solicit updated insurance proposals at least bi-annually. The decision to enter into such a joint insurance policy with Nistec will be subject to the approval of the Audit Committee and the Board of Directors of the Company.

Employees social activities - The Company may purchase social activities for the benefit of its employees together with Nistec. The cost of such activities will be divided between the Company and Nistec in accordance with the ratio of the number of Company's employees and Nistec employees to whom the applicable activity was directed, regardless of actual participation.

ELTEK LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 17:- RELATED PARTY BALANCES AND TRANSACTIONS (Cont.)

Marketing activities - The Company may purchase services together with Nistec. Marketing costs will be divided between the Company and Nistec as follows: (i) to the extent the portion of the marketing material applicable to the Company can be quantified, costs will be divided accordingly; (ii) in the event that such costs cannot be quantified, each of Nistec and the Company will bear 50% of the marketing costs.

Managements fees - Eltek pays Nistec monthly managements fees of NIS 90 (\$25). In November 2016, the Company's Audit Committee, Compensation Committee and Board of Directors, as applicable, approved the following transactions:

The extension and amendment of the Management Agreement with Nistec Ltd. as follows:

Commencing in 2017 and each calendar year thereafter, in the event that the Company's Consolidated Financial Statements reflect that the Company has reached both sales and profit targets as set for the applicable year in the Company's Officers Bonus Plan, Nistec Ltd. will be entitled to a bonus equal to two percent (2%) of the Company's annual profit before taxes for such year, up to NIS 200 per year;

In accordance with the Company's policy approved by the Audit Committee, Mr. Nissan will receive reimbursement, against receipts, of travel expenses paid directly by him (other than food and beverage expenses) while traveling internationally on behalf of the Company provided that such reimbursement will not exceed an aggregate amount of NIS 10 per calendar quarter,

Mr. Nissan will receive reimbursement of food and beverage expenses while traveling internationally on behalf of the Company, in accordance with the Israeli Income Tax Regulations (Deduction of Certain Expenses), 1972.

During the period Mr. Nissan served as both the Company's Chief Executive Officer and Chairman of the Board of Directors, the Company will pay for the lease of a car for Mr. Nissan with a list price not to exceed NIS 250. Mr. Nissan ceased to serve as the Company CEO on June 2018.

The extension of the Directors and Officers Indemnity Agreement with Mr. Yitzhak Nissan.

These transactions were approved by the Company's shareholders in the annual general meeting, held on December 29, 2016.

Employment of Yitzhak Nissan's daughter - Mr. Yitzhak Nissan's daughter is employed by the Company as assistant to the Chief Executive Office.

Loans and guarantees from Nistec - see Note 1.

S I G N A T U R E S

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

ELTEK LTD.

By: /s/ Eli Yaffe
Name: Eli Yaffe
Title: Chief Executive Officer

By: /s/ Alon Mualem
Name: Alon Mualem
Title: Chief Financial Officer

Dated: April 18, 2019