ELBIT SYSTEMS LTD
Form 20-F
March 22, 2017

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

FORM 20-F

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
for the fiscal year ended December 31, 2016
Commission File No. 0-28998

ELBIT SYSTEMS LTD.
(Exact name of registrant as specified in its charter and translation of registrant's name into English)

Israel
(Jurisdiction of incorporation or organization)

Advanced Technology Center, Haifa 3100401, Israel
(Address of principal executive offices)

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(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:

Ordinary Shares, nominal value 1.0 New Israeli Shekels per share
(Title of Class)

The NASDAQ Global Select Market
(Name of each Exchange on which registered)
Securities registered or to be registered pursuant to Section 12(g) of the Act:
Not Applicable
Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:
Not Applicable

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: 42,745,816 Ordinary Shares.

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

Yes ý No o

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

Yes o No ý

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 ý No o

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

Yes ý No o

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

Large accelerated filer ý Accelerated filer o Non-accelerated filer o

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

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

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

Item 17 o Item 18 No o

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

Yes o No ý

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PART I

General Disclosure Standards

The consolidated financial statements of Elbit Systems Ltd. (Elbit Systems) included in this annual report on Form 20-F are prepared in accordance with United States generally accepted accounting principles (U.S. GAAP). Unless otherwise indicated, all financial information contained in this annual report is presented in U.S. dollars. References in this annual report to the “Company”, “we”, “our”, “us” and terms of similar meaning refer to Elbit Systems and our subsidiaries unless the context requires otherwise.
The name "ELBIT SYSTEMS," and our logo, brand, product, service and process names appearing in this document, are the trademarks of the Company or our affiliated companies. All other brand, product, service and process names appearing in this document are the trademarks of their respective holders and appear for informational purposes only. Reference to or use of any third party mark, product, service or process name herein does not imply any recommendation, approval, affiliation or sponsorship of that or any other mark, product, service or process name. Nothing contained herein shall be construed as conferring by implication, estoppel or otherwise any license or right under any patent, copyright, trademark or other intellectual property right of the Company or any of our affiliated companies.

Cautionary Statement with Respect to Forward-Looking Statements

This annual report on Form 20-F contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements relate to our current plans, estimates, strategies, goals and beliefs and as such do not relate to historical or current fact. Forward-looking statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, as amended.

Forward-looking statements contained herein generally are identified by the words “believe”, “project”, “expect”, “will likely result”, “strategy”, “plan”, “may”, “should”, “will”, “would”, “will be”, “will continue”, “will likely result” and similar express the negatives thereof. Forward-looking statements are based on management’s current expectations, estimates, projections and assumptions, are not guarantees of future performance and involve certain risks and uncertainties, the outcomes of which cannot be predicted. Therefore, actual future results, performance and trends may differ materially from these forward-looking statements due to a variety of factors, including, without limitation:

- the scope and length of customer contracts;
- governmental regulations and approvals;
- changes in governmental budgeting priorities;
- general market, political and economic conditions in the countries in which we operate or sell, including Israel and the United States among others;
- differences in anticipated and actual program performance, including the ability to perform under long-term fixed-price contracts;
- the impact on our backlog from export restrictions by the Government of Israel;
- our ability to protect our proprietary information and avoid, withstand and/or recover from cyber attacks on our systems;

- the effect of competitive products, technology and pricing;

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- our ability to attract, incentivize and retain key employees;
- changes in applicable tax rates;
- fluctuations in foreign currency exchange rates;
- inventory write-downs and possible liabilities to customers from program cancellations due to political relations between Israel and countries where our customers may be located; and
- the outcome of legal and/or regulatory proceedings.

The factors listed above are not all-inclusive, and further information about risks and other factors that may affect our future performance is contained in this annual report on Form 20-F. All forward-looking statements speak only as of the date of this annual report. We expressly disclaim any obligation to update or review any forward-looking statements, whether as a result of new information, future events or otherwise, except as may be required by applicable law.

Item 1. Identity of Directors, Senior Management and Advisers.

Information not required in annual report on Form 20-F.

Item 2. Offer Statistics and Expected Timetable.

Information not required in annual report on Form 20-F.

Item 3. Key Information.

Selected Financial Data

The following selected consolidated financial data of the Company as of and for the years ended December 31, 2012, 2013, 2014, 2015 and 2016 are derived from our audited consolidated financial statements, including our audited consolidated financial statements as of December 31, 2015 and 2016, and for each of the years ended December 31, 2014, 2015 and 2016, which appear in Item 18 in this annual report on Form 20-F. You should read the audited consolidated financial statements appearing in Item 18 together with the selected financial data set forth below. (For non-GAAP financial data see Item 5. Operating and Financial Review and Prospects – Non-GAAP Financial Data.)

	Years Ended December 31, (U.S. dollars in millions, except for per share amounts)				
	2012	2013	2014	2015	2016
Income Statement Data:					
Revenues	$2,888.6	$2,925.2	$2,958.2	$3,107.6	$3,260.2
Cost of revenues	2,072.7	2,100.3	2,133.2	2,210.5	2,300.6
Gross profit	815.9	824.9	825.0	897.1	959.6
Research and development expenses, net	233.4	220.5	228.0	243.4	255.8
Marketing and selling expenses	241.9	235.5	216.5	239.4	271.0
General and administrative expenses	137.5	129.5	139.6	145.7	151.4
Gain from changes in holdings	—	—	(6.0)	—	(17.6)
Total operating expenses	612.8	585.5	578.1	628.5	660.6
Operating income	203.1	239.4	246.9	268.6	299.0
Financial expenses, net	(26.1)	(37.3)	(47.5)	(20.2)	(23.7)
Other income, net	0.1	0.9	0.1	0.2	4.0
Income before taxes on income	177.1	203.0	199.5	248.6	279.2
Taxes on income	17.1	25.3	25.6	46.2	(45.6)
Equity in net earnings of affiliated companies and partnerships	11.2	13.0	5.5	4.5	5.2
Net income from continuing operations, net	171.2	190.7	179.4	206.9	238.8
Income (loss) from discontinued operations, net	(0.6)	0.7	—	—	—
Net income	170.6	191.4	179.4	206.9	238.8
Less: net income (loss) attributable to non-controlling interests	(2.6)	(8.0)	(8.4)	(4.4)	(1.9)
Income attributable to Elbit Systems' shareholders	$168.0	$183.4	$171.0	$202.5	$236.9
Earnings per share:					
Basic net earnings per share					
Continuing operations	$3.99	$4.34	$4.01	$4.74	$5.54
Discontinued operations	(0.01)	0.01	—	—	—
Total	$3.98	$4.35	$4.01	$4.74	$5.54
Diluted net earnings per share					
Continuing operations	$3.98	$4.33	$4.01	$4.74	$5.54
Discontinued operations	(0.01)	0.01	—	—	—
Total	$3.97	$4.34	$4.01	$4.74	$5.54

	As of December 31, (U.S. dollars in millions, except for per share amounts)				
	2012	2013	2014	2015	2016
Balance Sheet Data:					
Cash, cash equivalents, short-term bank deposits and marketable securities	$ 265	$ 265	$ 306	$ 332	$ 245
Working capital	375	561	626	645	527
Long-term deposits, marketable securities and other receivables	19	53	18	16	16
Long-term trade and unbilled receivables	230	243	213	152	190
Property, plant and equipment, net	501	481	442	450	474
Total assets	3,811	3,933	4,021	4,124	4,352
Long-term debt	174	224	221	166	—
Series A Notes, net of current maturities	409	378	294	227	171
Capital stock	249	268	272	274	274
Elbit Systems shareholders' equity	1,017	1,177	1,227	1,391	1,560
Non-controlling interests	34	17	12	8	7
Total equity	1,051	1,194	1,239	1,399	1,567
Number of outstanding ordinary shares of NIS 1 par value (in thousands)	41,882	42,587	42,685	42,730	42,746
Dividends paid per ordinary share with respect to the applicable year	$ 1.20	$ 1.20	$ 1.28	$ 1.44	$ 1.60

Risk Factors

General Risks Related to Our Business and Market

Our revenues depend on a continued level of government business. We derive most of our revenues directly or indirectly from government agencies, mainly the Israeli Ministry of Defense (IMOD), the U.S. Department of Defense (DoD) and authorities of various countries, pursuant to contracts awarded to us under defense and homeland security-related programs. The funding of these programs could be reduced or eliminated due to numerous factors, including geo-political events and macro-economic conditions that are beyond our control. Reduction or elimination of government spending under our contracts would cause a negative effect on our revenues, results of operations, cash flow and financial condition.

Certain of our contracts may be terminated for convenience of the customer. Our contracts with governments often contain provisions permitting termination for convenience of the customer. Our subcontracts with non-governmental prime contractors sometimes contain similar provisions permitting termination for the convenience of the prime contractors. In a minority of contracts with such customers, an early termination for convenience would not entitle us to reimbursement for a proportionate share of our fee or profit for work still in progress.

We depend on governmental approval of our exports. Our international sales, as well as our international procurement of skilled human resources, technology and components, depend largely on export license approvals from the governments of Israel, the U.S. and other countries. If we fail to obtain material approvals in the future, or if material approvals previously obtained are revoked or expire and are not renewed, our ability to sell our products and services to overseas customers and our ability to obtain goods and services essential to our business could be interrupted, resulting in a material adverse effect on our business, revenues, assets, liabilities and results of operations. (See Item 4. Information on the Company – Governmental Regulation.)

We are subject to procurement and anti-bribery rules and regulations. We are required to comply with government contracting rules and regulations relating to, among other things, cost accounting, anti-bribery and procurement integrity, which increase our performance and compliance costs. (See Item 4. Information on the Company – Governmental Regulation.) Failure to comply with these rules and regulations could result in the modification, termination or reduction of the value of our contracts, the assessment of penalties and fines, or suspension or debarment from government contracting or subcontracting for a period of time, all of which could negatively impact our results of operations and financial condition. We are engaged in activities in certain markets considered to be high risk from an anti-bribery compliance perspective, and investigations by government agencies in the anti-bribery area have been more prevalent.

We face other risks in our international operations. We derive a significant portion of our revenues from international sales. Changes in international, political, economic or geographic events could cause significant reductions in our revenues, which could harm our business, financial condition and results of operations. In addition to the other risks from international operations set forth elsewhere in these Risk Factors, some of the risks of doing business internationally include imposition of tariffs and other trade barriers and restrictions, political and economic instability in the countries of our customers and suppliers, changes in diplomatic and trade relationships and increasing instances of terrorism worldwide. Some of these risks may be affected by Israel's overall political situation. (See "Risks Related to Our Israeli Operations" below.)

Funding obligations to our pension plans could reduce our liquidity. Funding obligations for certain of our pension plans are impacted by the performance of the financial markets and interest rates. When interest rates are low, or if the financial markets do not provide expected returns, we may be required to make additional contributions to these pension plans. Volatility in the equity markets or actuarial changes in mortality tables can change our estimate of future pension plan contribution requirements. (See Item 18. Financial Statements – Notes 2(S) and 17.)

We face currency exchange risks. We generate a substantial amount of our revenues in currencies other than the U.S. dollar (our financial reporting currency), mainly New Israeli Shekels (NIS), Great Britain Pounds (GBP), Euros, Brazilian reals, Australian dollars and Indian rupees, and we incur a substantial amount of our expenses in currencies other than the U.S. dollar, mainly NIS. To the extent we derive our revenues or incur our expenses in currencies other than the U.S. dollar, we are subject to exchange rate fluctuations between the U.S. dollar and such other currencies. For example, we could be negatively affected by exchange rate changes during the period from the date we submit a price proposal until the date of contract award or until the date(s) of payment. Certain currency derivatives we use to hedge against exchange rate fluctuations may not fully protect against sharp exchange rate fluctuations over short time periods. In addition, our international operations expose us to the risks of price controls, restrictions on the conversion or repatriation of currencies, or even devaluations or hyperinflation in the case of currencies issued by countries with unstable economies. All of these currency-related risks could have a material adverse effect on our financial condition and financial results. (See below "Risks Related to Our Israeli Operations – Changes in the U.S. Dollar – NIS Exchange Rate" and Item 5. Operating and Financial Review and Prospects – Impact of Inflation and Exchange Rates.)

We operate in a competitive industry. The markets in which we participate are highly competitive and characterized by technological change. If we are unable to improve existing systems and products and develop new systems and technologies in order to meet evolving customer demands, our business could be adversely affected. In addition, our competitors could introduce new products with innovative capabilities, which could adversely affect our business. We compete with many large and mid-tier defense contractors on the basis of system performance, cost, overall value, delivery and reputation. Many of these competitors are larger and have greater resources than us, and therefore may be better positioned to take advantage of economies of scale and develop new technologies. Some of these competitors are also our suppliers in some programs.

Due to consolidation in our industry, we are more likely to compete with certain potential customers. As the number of companies in the defense industry has decreased in recent years, the market share of some prime contractors has increased. Some of these companies are vertically integrated with in-house capabilities similar to ours in certain areas. Thus, at times we could be seeking business from certain of these prime contractors, while at other times we could be in competition with some of them. Failure to maintain good business relations with these major contractors could negatively impact our business.

We face risks of cost overruns in fixed-price contracts. Most of our contracts are fixed-price contracts, under which we generally assume the risk that increased or unexpected costs may reduce profits or generate a loss. The risk of adverse effects on our financial performance from such increased or unexpected costs can be particularly significant under a fixed-price contracts for which we recognize profit or loss on a “percentage-of-completion” basis, and for which changes in estimated gross profit/loss are recorded on a "cumulative catch-up basis." (See Item 5. Operating and Financial Review and Prospects – General – Critical Accounting Policies and Estimates – Revenue Recognition and Item 18. Financial Statements - Note 2(T) (Significant Accounting Polities - Revenue Recognition).) The costs most likely to fluctuate under our fixed price contracts relate to internal design and engineering efforts. However, we do not believe changes in the market costs of particular commodities that may be used in the production of our products are likely to present a material risk to our costs. To the extent we underestimate the costs to be incurred in any fixed-price contract, we could experience a loss on the contract, which would have a negative effect on our results of operations, financial position and cash flow.

We face fluctuations in revenues and profit margins. Our revenues may fluctuate between periods due to changes in pricing, sales volume or project mix. Moreover, because certain of our project revenues are recognized upon achievement of performance milestones, we may experience significant fluctuations in year-to-year and quarter-to-quarter financial results. Similarly, our profit margin may vary significantly during the course of a project as a result of changes in estimated project gross profits that are recorded in results of operations on a cumulative catch-up basis pursuant to the percentage-of-completion accounting method. (See Item 5. Operating and Financial Review and Prospects – General – Critical Accounting Policies and Estimates – Revenue Recognition and Item 18. Financial Statements - Note 2(T) (Significant Accounting Polities - Revenue Recognition).) As a result, our financial results for prior periods may not provide a reliable indicator of our future results.

Our backlog of projects under contract is subject to unexpected adjustments, delays in payments and cancellations. Our backlog includes revenue we expect to record in the future from signed contracts and certain other commitments. Many projects may remain in our backlog for an extended period of time because of the size or long-term nature of the contract. In addition, from time to time, for reasons beyond our control (including economic conditions or customer needs), projects are delayed, scaled back, stopped or cancelled, or the customer delays making payments, which may adversely affect the revenue, profit and cash flow that we ultimately receive from contracts reflected in our backlog.

We may experience production delays or liability if suppliers fail to make compliant or timely deliveries. The manufacturing process for some of our products largely consists of the assembly, integration and testing of purchased components. Some components are available from a small number of suppliers, and in a few cases a single source. If a supplier stops delivery of such components, finding another source could result in added cost and manufacturing delays. Moreover, if our subcontractors fail to meet their design, delivery schedule or other obligations we could be held liable by our customers, and we may be unable to obtain full or partial recovery from our subcontractors for those liabilities. The foregoing risks could have a material adverse effect on our operating results.

We may be affected by failures of our prime contractors. We often act as a subcontractor, and a failure of our prime contractor to meet its obligations may affect our ability to receive payments under our subcontract.

Undetected problems in our products could impair our financial results and give rise to potential product liability claims. If there are defects in the design, production or testing of our or our subcontractors’ products and systems, including our products sold for public safety purposes in the homeland security area, we could face substantial repair, replacement or service costs, potential liability and damage to our reputation. In addition, we must comply with regulations and practices to prevent the use of parts and components that are considered as counterfeit or that violate third party intellectual property rights. We may not be able to obtain product liability or other insurance to fully cover such risks, and our efforts to implement appropriate design, testing and manufacturing processes for our products or systems may not be sufficient to prevent such occurrences, which could have a material adverse effect on our business, results of operations and financial condition.

Our future success depends on our ability to develop new offerings and technologies. The markets we serve are characterized by rapid changes in technologies and evolving industry standards. In addition, some of our systems and products are installed on platforms that may have a limited life or become obsolete. Unless we develop new offerings or enhance our existing offerings we may be susceptible to loss of market share resulting from the introduction of new or enhanced offerings by competitors. Accordingly, our future success will require that we:

- identify emerging technological trends;
- identify additional uses for our existing technology to address customer needs;
- develop and maintain competitive products and services;
- add innovative solutions that differentiate our offerings from those of our competitors;
- bring solutions to the market quickly at cost-effective prices;
- develop working prototypes as a condition to receiving contract awards; and
- structure our business, through joint ventures, teaming agreements and other forms of alliances, to reflect the competitive environment.

We will need to invest significant financial resources to pursue these goals, and there can be no assurance that adequate financial resources will continue to be available to us for these purposes. We may experience difficulties that delay or prevent our development, introduction and marketing of new or enhanced offerings, and such new or enhanced offerings may not achieve adequate market acceptance. Moreover, new technologies or changes in industry standards or customer requirements could render our offerings obsolete or unmarketable. Any new offerings and technologies are likely to involve costs and risks relating to design changes, the need for additional capital and new production tools, satisfaction of customer specifications, adherence to delivery schedules, specific contract requirements, supplier performance, customer performance and our ability to predict program costs. New products may lack sufficient demand or experience technological problems or production delays. Our customers frequently require demonstration of working prototypes prior to awarding contracts for new programs or require short delivery schedules which may cause us to purchase long-lead items or material in advance of receiving the contract award. Moreover, due to the design complexity of our products, we may experience delays in developing and introducing new products. Such delays could result in increased costs and development efforts, deflect resources from other projects or increase the risk that our competitors may develop competing technologies that gain market acceptance in advance of our products. If we fail in our new product development efforts, or our products or services fail to achieve market acceptance more rapidly than the products or services of our competitors, our ability to obtain new contracts could be negatively impacted. Any of the foregoing costs and risks could have a material adverse impact on our business, results of operations, financial condition and cash flows.

Our business depends on proprietary technology that may be infringed. Many of our systems and products depend on our proprietary technology for their success. Like other technology-oriented companies, we rely on a combination of patents, trade secrets, copyrights and trademarks, together with non-disclosure agreements, confidentiality provisions in sales, procurement, employment and other agreements and technical measures to establish and protect proprietary rights in our products. Our ability to successfully protect our technology may be limited because:

- intellectual property laws in certain jurisdictions may be relatively ineffective;
- detecting infringements and enforcing proprietary rights may divert management’s attention and company resources;
- contractual measures such as non-disclosure agreements and confidentiality provisions may afford only limited protection;
- our patents may expire, thus providing competitors access to the applicable technology;
- competitors may independently develop products that are substantially equivalent or superior to our products or circumvent our intellectual property rights; and
- competitors may register patents in technologies relevant to our business areas.

In addition, various parties may assert infringement claims against us. The cost of defending against infringement claims could be significant, regardless of whether the claims are valid. If we are not successful in defending such claims, we may be prevented from the use or sale of certain of our products, liable for damages and required to obtain licenses, which may not be available on reasonable terms, any of which may have a material adverse impact on our business, results of operation or financial condition.

A security breach or disruption or failure in a computer system could adversely affect us. Our operations depend on the continued and secure functioning of our computer and communications systems and the protection of information stored in computer databases maintained by us and, in certain circumstance, by third parties. Such systems and databases are subject to breach, damage, disruption or failure from, among other things, cyber attacks and other unauthorized intrusions, power losses, telecommunications failures, earthquakes, fires and other natural disasters.

We have been subject to attempted cyber attacks and face ongoing threats to our computer and communications systems and databases of unauthorized access, computer hackers, computer viruses, malicious code, cyber crime, organized cyber attacks and other security problems and system disruptions. In particular, we may be targeted by experienced computer programmers and hackers (including those sponsored by foreign governments) who may attempt to penetrate our cyber security defenses and damage or disrupt our computer and communications systems and misappropriate or compromise our intellectual property or other confidential information or that of our customers. We devote significant resources to maintain and upgrade the security of our systems and databases. However, despite our efforts to secure our systems and databases, events of this nature may still result in system failures, loss of intellectual property and interruptions in our operations, which could have a material adverse effect on our business, financial condition and results of operations.

We sometimes have risks relating to financing for our programs. A number of our major projects require us to arrange, or to provide, guarantees in connection with the customer's financing of the project. These include commitments by us as well as guarantees provided by financial institutions relating to advance payments received from customers. Customers typically have the right to drawdown against advance payment guarantees if we were to default under the applicable contract. In addition, some customers require that the payment period under the contract be extended for a number of years, sometimes beyond the period of contract performance. We may face difficulties in issuing guarantees or providing financing for our programs, including in cases where a customer encounters impaired ability to continue to comply with extended payment terms. Moreover, if we are required to provide significant financing for our programs, this could result in increased leverage on our balance sheet. (See Item 4. Information on the Company – Financing Terms.)

We are subject to buy-back obligations. A number of our international programs require us to meet "buy-back" obligations. (See Item 5. Operating and Financial Review and Prospects – Off Balance Sheet Transactions.) Should we, or the local companies we contract with, be unable to meet such obligations we may be subject to contractual penalties, and our chances of receiving further business from the applicable customers could be reduced or, in certain cases, eliminated.

We sometimes participate in risk-sharing contracts. We sometimes participate in "risk-sharing" type contracts, in which our non-recurring costs, and in some cases costs that are capitalized as pre-contract costs, are only recoverable if there is a sufficient level of sales for the applicable product, which level of sales typically is not guaranteed. If sales do not occur at the level anticipated, we may not be able to recover our non-recurring costs under the contract.

We would be adversely affected if we are unable to retain key employees. Our success depends in part on key management, scientific and technical personnel and our continuing ability to attract and retain highly qualified personnel. There is competition for the services of such personnel. The loss of the services of key personnel, and the failure to attract highly qualified personnel in the future, may have a negative impact on our business. Moreover, our competitors may hire and gain access to the expertise of our former employees.

Our effective tax rate may be subject to fluctuations. Our worldwide effective tax rate could fluctuate as a result of several factors, many of which are outside of our control, including: (i) changes in the mix of revenues and income we derive from the jurisdictions where we operate which have different statutory tax rates; (ii) amendments to tax laws and regulations, and changes in interpretations in the jurisdictions where we operate, including possible corporate tax reform in the U.S., Israel or other countries; and (iii) tax assessments, or any related tax interest or penalties that could significantly affect our income tax expense for the period in which the settlements take place. In addition, as we operate in multiple jurisdictions throughout the world, our tax returns are periodically audited or subject to review by both domestic and foreign authorities. Increases in our effective tax rates from the above factors could have a material adverse effect on our financial results and cash flows.

The Organization for Economic Cooperation and Development has recently introduced the base erosion and profit shifting (BEPS) project. The BEPS project contemplates changes to numerous international tax principles, as well as national tax incentives, and these changes, if adopted by individual countries, could adversely affect our provision for income taxes.

We may face labor relations disputes or not be able to amend collective bargaining agreements in a timely manner. We are party to collective bargaining agreements that cover a substantial number of our employees, which number could increase as a result of future acquisitions of companies. We have faced and may face future attempts to unionize additional parts of our organization. Disputes with trade unions or other labor relations difficulties, as well as failure to timely amend or extend collective bargaining agreements, could lead to worker disputes, slow-downs, strikes and other measures, which could negatively impact our results of operations.

We face acquisition and integration risks. From time to time we make equity or asset acquisitions and investments in companies and technology ventures. (See Item 4. Information on the Company – Mergers, Acquisitions and Divestitures.) Such acquisitions involve risks and uncertainties such as:

- our pre-acquisition due diligence may fail to identify material risks;
- acquisitions may result in significant additional unanticipated costs associated with price adjustments or write-downs;
- we may not integrate newly-acquired businesses and operations in an efficient and cost-effective manner;
- we may fail to achieve the strategic objectives, cost savings and other benefits expected from acquisitions;
- the technologies acquired may not prove to be those needed to be successful in our markets or may not have adequate intellectual property rights protection;
- we may assume significant liabilities that exceed the enforceability or other limitations of applicable indemnification provisions, if any, or the financial resources of any indemnifying parties, including indemnity for regulatory compliance issues, such as anti-corruption and environmental compliance, that may result in our incurring successor liability;
- we may fail to retain key employees of the acquired businesses;
- the attention of senior management may be diverted from our existing operations; and
- certain of our newly acquired operating subsidiaries in various countries could be subject to more restrictive regulations by the local authorities after our acquisition, including regulations relating to foreign ownership of, and export authorizations for, local companies.

Our acquisitions are subject to governmental approvals. Most countries require local governmental approval of acquisitions of domestic defense businesses, which approval may be denied, or subject to unfavorable conditions, if the local government determines the acquisition is not in its national interest. We may also be unable to obtain antitrust approvals for certain acquisitions as our operations expand. Failure to obtain such governmental approvals could negatively impact our future business and prospects.

Our share price may be volatile and may decline. Numerous factors, some of which are beyond our control and unrelated to our operating performance or prospects, may cause the market price of our ordinary shares to fluctuate significantly. Factors affecting market price include, but are not limited to: (i) variations in our operating results and ability to achieve our key business targets; (ii) sales or purchases of large blocks of stock; (iii) changes in securities analysts' earnings estimates or recommendations; (iv) differences between reported results and those expected by investors and securities analysts; and (v) changes in our business including announcements of new contracts by us or by our competitors. In addition, we could be subject to securities class action litigation following periods of volatility in the market price of our ordinary shares.

Other general factors and market conditions that could affect our stock price include changes in: (i) the market's perception of our business; (ii) the businesses, earnings estimates or market perceptions of our competitors or customers; (iii) the outlook for the defense and homeland security industries; (iv) general market or economic conditions unrelated to our performance; (v) the legislative or regulatory environment; (vi) government defense spending or appropriations; (vii) military or defense activities worldwide; (viii) the level of national or international hostilities; and (ix) the general geo-political environment.

Being a foreign private issuer exempts us from certain SEC requirements. As a foreign private issuer within the meaning of rules promulgated under the U.S. Securities and Exchange Act of 1934 (the Exchange Act), we are exempt from certain Exchange Act rules and requirements that apply to U.S. public companies, including: (i) the requirement to file with the SEC quarterly reports on Form 10-Q and current reports on Form 8-K; (ii) rules regulating the solicitation of proxies in connection with shareholder meetings; (iii) Regulation FD prohibiting selective disclosures of material information; and (iv) rules requiring insiders to disclose stock ownership and trading activities and establishing liability for profits realized from "short-swing" trading transactions (i.e., a purchase and sale, or sale and purchase, of the issuer's equity securities within less than six months). Therefore certain protections and information generally available to investors with respect to public companies organized in the U.S., may not be available in the same manner.

We have a major shareholder with significant influence over certain matters requiring shareholder approval. Federmann Enterprises Ltd. (FEL) owns approximately 46% of our ordinary shares, directly and indirectly. Therefore, subject to shareholder approval special majority requirements under the Companies Law and our Articles of Association, FEL may have significant influence over the outcome of certain matters requiring shareholder approval, including the election of directors who are not External Directors. Michael Federmann, who serves as the chair of our board of directors, is the controlling shareholder of the entities that own FEL, and he is also the chair of the board and the chief executive officer of FEL. Therefore, Mr. Federmann controls, directly and indirectly, the vote of ordinary shares owned by FEL. (See below - Item 6. Directors, Senior Management and Employees - Board Practices - Appointment of Directors and - External Directors and Item 10. Additional Information - Approval of Certain Transactions and - Provisions Relating to Major Shareholders).

We have risks related to our issuance of Series A Notes under an Israeli debt offering. We face various risks relating to our issuance of Series A Notes (the Notes). (See Items 5. Operating and Financial Review and Prospects - Liquidity and Capital Resources - Israeli Debt Offering.) This includes the risk that we may not be able to maintain in the future the rating level assigned to the Notes.

We have risks related to the inherent limitations of internal control systems. Despite our internal control measures, we may still be subject to financial reporting errors or even fraud, which may not be detected. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute assurance that its objectives are met. In addition, the design of a control system must reflect the fact that there are resource constraints, and the benefit of controls must be relative to their costs. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Further, controls can be circumvented by individual acts, by collusion of two or more persons or by management override of the controls. Over time, a control may be inadequate because of changes in conditions or the degree of compliance with applicable policies or procedures may deteriorate. (See Item 15. Controls and Procedures.)

Risks Related to Our Israeli Operations

Conditions in Israel may affect our operations. Political, economic and military conditions in Israel and the Middle East directly affect our operations. Since the establishment of the State of Israel, a number of armed conflicts have taken place between Israel and its Arab neighbors. An ongoing state of hostility, varying in degree and intensity has caused security and economic problems for Israel. We cannot predict whether or when such armed conflicts or other hostilities may occur or the extent to which such events may impact us. For a number of years there have been continuing hostilities between Israel and the Palestinians. This includes hostilities with the Islamic movement Hamas in the Gaza Strip, which have adversely affected the peace process and at times resulted in armed conflicts. Such hostilities have negatively influenced Israel's economy as well as impaired Israel's relationships with several other countries. Israel also faces threats from Hezbollah militants in Lebanon, from ISIS and rebel forces in Syria, and from various other countries in the Middle East region, including the government of Iran, which is believed to be developing nuclear weapons and influences extremists groups such as Hamas and Hezbollah. Moreover, some of Israel's neighboring countries have recently undergone or are undergoing significant political changes. These political, economic and military conditions in Israel could have a material adverse effect on our business, financial condition, results of operations and future growth.

Political relations could limit our ability to sell or buy internationally. We could be adversely affected by the interruption or reduction of trade between Israel and its trading partners. Some countries, companies and organizations continue to participate in a boycott of Israeli firms and others doing business with Israel, as well as with Israeli companies or with Israeli-owned companies operating in other countries. Also, over the past several years there have been calls in various countries and international organizations to reduce trade with Israel. Foreign government defense export policies towards Israel could also make it more difficult for us to obtain the export authorizations necessary for our activities. See above “General Risks Related to Our Business and Market.” There can be no assurance that restrictive laws, policies or practices directed towards Israel or Israeli businesses will not have an adverse impact on our business.

Reduction in Israeli government spending or changes in priorities for defense products may adversely affect our earnings. The Israeli government may reduce its expenditures for defense items or change its defense priorities in the coming years. In addition, the Israeli defense budget may be adversely affected if there is a reduction in U.S. foreign military assistance. See above "General Risks Related to Our Business and Market." Any of the foregoing circumstances could have an adverse effect on our operations.

Israel's economy may become unstable. From time to time Israel's economy may experience inflation or deflation, low foreign exchange reserves, fluctuations in world commodity prices, military conflicts and civil unrest. For these and other reasons, in the past the government of Israel has intervened in the economy employing fiscal and monetary policies, import duties, foreign currency restrictions, controls of wages, prices and foreign currency exchange rates and regulations regarding the lending limits of Israeli banks to companies considered to be in an affiliated group. The Israeli government has periodically changed its policies in these areas. Reoccurrence of previous destabilizing factors could make it more difficult for us to operate our business as we have in the past and could adversely affect our business.

Israeli government programs and tax benefits may be terminated or reduced in the future. We participate in programs of the Israel Innovation Authority and the Israel Investment Center, for which we receive tax and other benefits as well as funding for the development of technologies and products. (See Item 4. Information on the Company – Conditions in Israel – Israel Innovation Authority and Investment Center Funding.) If we fail to comply with the conditions applicable to these programs, we may be required to pay additional taxes and penalties or make refunds and may be denied future benefits. From time to time, the government of Israel has discussed reducing or eliminating the benefits available under these programs, and therefore these benefits may not be available in the future at their current levels or at all.

Israeli law regulates acquisition of a controlling interest in Israeli defense industries. Israeli legislation regarding the domestic defense industry requires Israeli government approval of an acquisition of a 25% or more equity interest (or a smaller percentage that constitutes a "controlling interest") in companies such as Elbit Systems. Such approval may be subject to additional conditions relating to transfers of ownership. This could limit the ability of a potential purchaser to acquire a significant interest in our shares. (See Item 4. Information on the Company – Governmental Regulation – Approval of Israeli Defense Acquisitions.)

Israel has stringent export control regulations. Israeli law regulates the export of defense products and systems and "dual use" items (items that are typically sold in the commercial market but that may also be used in the defense market). If government approvals required under these laws and regulations are not obtained, or if authorizations previously granted are not renewed or canceled, our ability to export our products from Israel could be negatively impacted, thus causing a reduction in our revenues and a potential material negative impact on our financial results. (See Item 4. Information on the Company – Governmental Regulation – Israeli Export Regulations.)

We may rely on certain Israel "home country" corporate governance practices which may not afford stockholders the same protection afforded to shareholders of U.S. companies. As a foreign private issuer for purposes of U.S. securities laws, Nasdaq rules allow us to follow certain Israeli "home country" corporate governance practices in lieu of the corresponding Nasdaq corporate governance rules. In the event we elect to adopt such home country practices, shareholders may not have the same level of rights or protections in certain matters as those of shareholders of U.S. domestic companies. (See above "General Risks Related to Our Business and Market".)

Many of our employees and some of our officers are obligated to perform military reserve duty in Israel. Generally, Israeli adult male and certain female citizens and permanent residents are obligated to perform annual military reserve duty up to a specified age. They also may be called to active duty at any time under emergency circumstances, which could have a disruptive impact on our workforce.

It may be difficult to enforce a non-Israeli judgment against us, our officers and directors. We are incorporated in Israel. Our executive officers and directors and our outside auditors are not residents of the United States, and a substantial portion of our assets and the assets of these persons are located outside the United States. Therefore, it may be difficult for an investor, or any other person or entity, to enforce against us or any of those persons in an Israeli court a U.S. court judgment based on the civil liability provisions of the U.S. federal securities laws. It may also be difficult to effect service of process on these persons in the United States. Additionally, it may be difficult for an investor, or any other person or entity, to enforce civil liabilities under U.S. federal securities laws in original actions filed in Israel. (See below – Item 4. Information on the Company – Conditions in Israel – Enforcement of Judgments.)

Item 4. Information on the Company.

Business Overview

Major Activities

We are an international high technology company engaged in a wide range of programs throughout the world. We develop and supply a broad portfolio of airborne, land and naval systems and products for defense, homeland security and commercial applications. Our systems and products are installed on new platforms, and we also perform comprehensive platform modernization programs. In addition, we provide a range of support services.

Our major activities include:

- military aircraft and helicopter systems;
- helmet mounted systems;
- commercial aviation systems and aerostructures;
- unmanned aircraft systems and unmanned surface vessels;
- electro-optic and countermeasures systems;
- land vehicle systems;
- command, control, communications, computer and intelligence (C4I) systems;
- electronic warfare and signal intelligence systems;
- cyber and intelligence systems; and
- various commercial activities.

Many of these major activities have a number of common and related elements. Therefore, certain of our subsidiaries, divisions or other operating units often jointly conduct marketing, research and development, manufacturing, performance of programs, sales and after sales support among these major activities.

Principal Market Environment

We operate primarily in the defense and homeland security arenas. There have been recent increased budgetary allocations in these areas in the U.S. and certain European countries, as well as reduced budgetary allocations in certain Latin American and other countries. The nature of military and homeland security actions in recent years, including low intensity conflicts and ongoing terrorist activities, as well as budgetary pressures to focus on leaner but more technically advanced forces, have caused a shift in the defense and homeland security priorities for many of our major customers. As a result we believe there is a continued demand in the areas of C4I systems, intelligence, surveillance and reconnaissance (ISR) systems, network centric information systems, intelligence gathering systems, border and perimeter security systems, unmanned aircraft systems (UAS), unmanned surface vessels (USVs), remote controlled systems, cyber-defense systems, space and satellite based defense capabilities and homeland security solutions. There is also a continuing demand for cost effective logistic support and training and simulation services. We believe our synergistic “one-company” approach of finding solutions that combine elements of our various activities positions us to meet evolving customer requirements in many of these areas.

We tailor and adapt our technologies, integration skills, market knowledge and operationally-proven systems to each customer’s individual requirements in both existing and new platforms. By upgrading existing platforms with advanced technologies, we provide customers with cost-effective solutions, and our customers are able to improve their technological and operational capabilities within limited budgets. We are experienced in providing “systems of systems”, which enables us to provide overall solutions in a range of areas to meet our customers’ comprehensive defense, homeland security and safety needs.

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Company History

Our predecessor Elbit Ltd. was incorporated in Israel in 1966 as Elbit Computers Ltd. Elbit Systems was formed in 1996, as part of the Elbit Ltd. corporate demerger, under which Elbit Ltd.'s defense related assets and business were spun-off to us.

Elbit Systems Ltd. is a corporation domiciled and incorporated in Israel where we operate in accordance with the provisions of the Israeli Companies Law – 1999 (the Companies Law).

Trading Symbols and Address

Our shares are traded on the Nasdaq Global Select Market (Nasdaq), under the symbol "ESLT", and on the Tel-Aviv Stock Exchange (TASE).

Our main offices are in the Advanced Technology Center, Haifa 3100401, Israel, and our main telephone number at that address is (972-77-2945315) . Our website home page is www.elbitsystems.com. We make our website content available for informational purposes only. It should not be relied upon for investment purposes, nor is it incorporated by reference in this annual report on Form 20-F.

Our principal offices in the United States are the headquarters of Elbit Systems of America, LLC at 4700 Marine Creek Parkway, Fort Worth, Texas 76179-6969, and the main telephone number at that address is 817-234-6799.

Revenues

In recent years we have achieved the highest level of defense-related revenues of any Israeli-based company. The table below shows our consolidated revenues by major areas of operations for the years ended December 31, 2014, 2015 and 2016:

	2014	2015	2016
	(U.S. dollars in millions)		
Airborne systems	$1,198	$1,226	$1,242
C4ISR systems	1,118	995	1,221
Land systems	275	559	408
Electro-optic systems	265	232	276
Other (mainly non-defense engineering and production services)	102	96	113
Total	$2,958	$3,108	$3,260

The following table provides our consolidated revenues by geographic region, expressed as a percentage of total revenues for the years ended December 31, 2014, 2015 and 2016:

	2014	2015	2016
	(U.S. dollars in millions)		
Israel	22%	20%	22%
North America	28%	27%	25%
Europe	16%	16%	20%
Asia-Pacific	18%	26%	25%

Latin America	15%	10%	6%
Others	2%	1%	2%

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Subsidiary Organizational Structure

Our beneficial ownership interest in our major subsidiaries and investees is set forth in Exhibit 8 to this annual report. Our equity and voting interests in these entities are the same as our beneficial ownership interests.

Below is a general description of our major subsidiaries, each of which is wholly-owned. We also have other smaller subsidiaries and investee companies in Israel, Europe, North America, South America and Asia-Pacific that conduct marketing, engineering manufacturing, logistic support and other activities, principally in the subsidiary's local market.

Elbit Systems of America

Elbit Systems of America, LLC (Elbit Systems of America), a Delaware limited liability company, and its subsidiaries provide products and systems solutions focusing on U.S. military, homeland security, medical instrumentation and commercial aviation customers. Elbit Systems of America and its subsidiaries have operational facilities in Fort Worth, Texas, San Antonio, Texas, Merrimack, New Hampshire, Talladega, Alabama and Boca Raton, Florida. Elbit Systems of America also has a 50% interest in a joint venture with Rockwell Collins Inc., which is engaged in the area of helmet mounted display systems for fixed-wing military and para-military aircraft.

Elbit Systems of America acts as a contractor for U.S. Foreign Military Financing (FMF) and Foreign Military Sales (FMS) programs. (See below "Governmental Regulations – Foreign Military Financing.") Each of Elbit Systems of America's major operational facilities has engineering and manufacturing capabilities. Elbit Systems of America's facilities in Alabama and Texas have significant maintenance and repair capabilities. (See below "Manufacturing" and "Customer Satisfaction and Quality Assurance.")

Elbit Systems of America, Elbit Systems and intermediate Delaware holding company subsidiaries are parties to a Special Security Agreement (SSA) with the DoD. The SSA provides the framework for controls and procedures to protect classified information, controlled unclassified information and export controlled data. The SSA allows the Elbit Systems of America companies to participate in classified U.S. government programs even though, due to their ownership by Elbit Systems, the Elbit Systems of America companies are considered to be under the control of a non-U.S. interest. Under the SSA, a Government Security Committee of Elbit Systems of America's board of directors was permanently established to supervise and monitor compliance with Elbit Systems of America's export control and national security requirements. The SSA also requires Elbit Systems of America's board of directors to include outside directors who have no other affiliation with the Company. Elbit Systems of America's board of directors also includes an officer of Elbit Systems of America and up to two inside directors, who have other affiliations with the Company. The SSA requires outside directors and officers of the Elbit Systems of America companies who are directors, and certain other senior officers, to be U.S. resident citizens and eligible for DoD personal security clearances.

Elop. Based in Rehovot, Israel, Elbit Systems Electro-Optics Elop Ltd. (Elop) designs, engineers, manufactures and supports a wide range of electro-optic systems and products mainly for defense, space and homeland security applications for customers worldwide.

ESLC. Headquartered in Netanya, Israel, Elbit Systems Land and C4I Ltd. (ESLC) is engaged in the worldwide market for land-based systems and products for military vehicles, artillery and mortar systems, C4I systems and communications systems and equipment.

Elisra. Based in Holon, Israel, Elbit Systems EW and SIGINT – Elisra Ltd. (Elisra) provides a wide range of electronic warfare (EW) systems, signal intelligence (SIGINT) systems and C4ISR technological solutions for the worldwide market.

CYBERBIT. Based in Raanana, Israel, CYBERBIT Ltd. (CYBERBIT) provides a range of solutions in the areas of intelligence monitoring and lawful interception, investigation and knowledge management, open source intelligence (OSINT), tactical SIGINT interception, cyber security and cyber training and simulation for defense, homeland security and commercial customers, including financial enterprises, national critical infrastructures, heavy industries, national cyber security organizations, military organizations, law enforcement organizations and intelligence agencies.

Merger, Acquisitions and Divestitures

Part of our growth strategy includes our continued activity in mergers and acquisitions and joint ventures with respect to businesses, assets and complementary technologies both in Israel and internationally. The Company's structure enables us to benefit from the synergy of our overall capabilities while at the same time focus on local requirements.

During 2016 and the beginning of 2017, we continued to invest resources in these activities. In addition, during this time period we continued the process of divesting non-core assets in Israel and certain other countries. See Item 18. Financial Statements - Notes 1(D) and 6(B). We continue to actively pursue acquisition and investment opportunities that meet our strategic goals and acquisition criteria in key markets.

During 2016, we participated as a potential purchaser in the tender process administered by the Israeli government for the sale of most of the assets of IMI Systems (formerly Israel Military Industries Ltd.) As of the date of this annual report, we are the sole remaining bidder in the tender. However, the tender process is currently being reviewed by the Israeli government, and there is no assurance that we will ultimately be able to complete the acquisition contemplated by the tender.

Current Business Operations

We generally operate and manage the major activities described below in an interrelated manner and on a project-oriented basis. This means that contracts are frequently performed by more than one operating subsidiary or division within the Company, on the basis of the multiple skills and available resources that may be needed or appropriate for the contract. Thus, the involvement of a particular operating subsidiary or division in the performance of a contract is not a function of management's review of such subsidiary's or division's operating results for purposes of allocation of resources within the Company.

Military Aircraft and Helicopter Systems

We supply advanced airborne systems and products to leading military aircraft manufacturers and end users designed to enhance operational capabilities and extend aircraft life cycles. Our airborne systems provide a range of solutions from a single sensor to an entire cockpit avionics suite. We integrate our systems on fixed and rotary-wing, eastern and western, new and mature aircraft. Under our aircraft and helicopter upgrade programs, we integrate advanced electronic, communication, navigation, electro-optic and EW systems. We support life cycle extension of our customers' fleets and supply logistic support services for airborne platforms, including repair and maintenance centers, spare parts, training and operation of flight schools.

Our military fixed-wing aircraft and helicopter systems and products include a broad range of avionic systems, such as integrated flight deck systems, mission management computers, displays, digital maps and digital recorders. Our portfolio also includes airborne electro-optic systems such as head-up displays, airborne intelligence gathering systems, precision guidance systems, aircraft structural components and a range of aircraft tactical, virtual, appended and embedded trainers and simulators.

The customers and end users for our military fixed-wing aircraft and helicopter programs include a wide range of air forces and other governmental defense and homeland security forces worldwide, as well as major fixed-wing aircraft and helicopter manufacturers.

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Helmet Mounted Systems

We design and supply advanced helmet mounted systems (HMS), including helmet mounted displays for fixed-wing aircraft and rotary aircraft pilots. These systems and displays include tracking and display systems for day and night flying. Our systems measure the pilot's line-of-sight, slave applicable systems to the target, identify target location and bring displays to the pilot's eye level. We supply our HMS as part of our upgrade programs and on a stand-alone basis. Through our 50% joint venture with Rockwell Collins (see above "Subsidiary Organizational Structure – Elbit Systems of America"), we are a leader in HMS for fighter aircraft.

We are engaged in a range of programs for HMS for fixed-wing aircraft and helicopters. Customers and end users for our HMS include numerous air forces and other governmental defense and homeland security forces worldwide, as well as aircraft and helicopter manufacturers.

Commercial Aviation Systems and Aerostructures

We provide a range of systems and products for the commercial and business aviation market. These systems and products include vision-based cockpit systems, other avionics systems, electrical systems and aerostructure products. Our commercial avionics systems are employed on fixed-wing aircraft and commercial helicopters. Our aerostructure products are installed on commercial aircraft.

Our portfolio of systems in the commercial aviation area includes vision-based cockpit systems, full avionic suites for commercial helicopters, air data test equipment and air data processor/sensor systems and flight instrumentation for the general avionics market, and aerostructure products such as pressurized and non-pressurized doors, composite beans and winglets. Customers for our commercial and business aviation systems and products and aerostructures products include major aircraft manufacturers and aircraft operators around the world.

UAS (Unmanned Aircraft Systems) and USVs (Unmanned Surface Vessels)

We design and supply integrated UAS for a range of applications and UAS training systems with capabilities to simulate payload performance, malfunctions and ground control station operation. We design and supply command and control ground station elements, engines, data links, stabilized electro-optic payloads and electronic intelligence (ELINT) and communications intelligence (COMINT) payloads that can be adapted for various types of UAS. Our UAS technology has also been applied to our USV activities, where we are developing USVs for a range of naval applications. We perform development, supply, lease and support services and training activities relating to UAS and USVs. Customers for our UAS and USVs include armed forces and other governmental and non-governmental organizations around the world.

Electro-Optic and Countermeasures Systems

We design and manufacture electro-optic-based solutions for space, air, land and sea applications. Our electro-optic products include laser and thermal imaging systems, head-up displays, countermeasure systems and ISR systems, including payloads for space, airborne, naval and land-based missions. Our products in this area also include ground integrated sights and homeland security solutions. We are one of the few companies in the world that has engineering capability and facilities in-house in all major areas of electro-optics. Also, in the space area, we maintain in-house Israel's national space electro-optics infrastructure.

Our portfolio of electro-optic systems and products includes forward looking infrared (FLIR) systems for night observation, laser range-finders and laser radars, stabilized payloads, electro-optic-based ISR systems and directional IR countermeasure (DIRCM) systems. We also supply panchromatic and multi-spectral cameras and telescopes for space applications. In the homeland security area our electro-optic products and systems include surveillance systems, "safe city" projects, facility perimeter security products, electronic fences, fiber optic intrusion detection systems and transportation protection systems. Our customers include armed forces of numerous governments, major defense contractors, homeland security agencies, critical infrastructure authorities and owners of VIP aircraft.

Land Vehicle Systems

We upgrade and modernize tanks, other combat vehicles and artillery platforms, both as a prime contractor and as a systems supplier to leading platform manufacturers. Our land vehicle and platform solutions cover the entire combat vehicle spectrum, from complete modernization, to system supply to maintenance depots and life cycle support services. Our systems are operational on a full range of tracked and wheeled combat vehicles including main battle tanks, medium and light tanks, light armored vehicles, armored personnel carriers, wheeled vehicles and artillery platforms. We offer a range of artillery and mortar solutions. We also develop and supply unmanned ground vehicles and robotic devices for a variety of land based missions. In addition, we supply training systems for tanks and fighting vehicles.

Our portfolio of systems and products for land vehicles includes fire control systems, electric gun and turret drive systems, laser warning and threat detection systems, manned and unmanned turrets, remote controlled weapon stations (for land and naval platforms), unmanned ground vehicles, combat vehicle C4I systems, targeting systems, artillery gun and mortar systems, mortar ammunition, driver thermal vision systems, life support systems, auxiliary power units and hydraulic systems. We are engaged in land vehicle systems programs, from comprehensive vehicle modernization programs, to stand-alone system supply to vehicle manufacturers to life cycle support programs. Customers for our land vehicle systems include armed forces and homeland security agencies, as well as major military vehicle manufacturers around the world.

C4I Systems

We provide network-centric compatible solutions for land-based C4I systems ranging from target acquisition, to battle management to communication systems. We supply our advanced land-based C4I systems as part of turn-key solutions as well as on a stand-alone basis. Our solutions cater to all types of land combatant and homeland security forces and first responders, and can be integrated into military and other types of vehicles. Providing comprehensive net-centric solutions for low intensity conflicts and counter-terror activities, our systems connect intelligence data to combat and homeland security forces via C4I networks and mobile command and control posts and support “terrain dominance”. Our integrated infantry systems provide infantry units with C4ISR, field intelligence, urban warfare and peacekeeping capabilities. We also have access to a full range of radio and military communications solutions.

Our portfolio of systems and products in the land C4I area includes Digital Army "system of systems" for net-centric operational effectiveness and connectivity throughout all land forces echelons. Our portfolio also includes battle management systems, artillery C4I systems, observation and ground reconnaissance systems, enhanced tactical computers and ruggedized personal data assistants, software design kits for mapping capabilities, ground smart display units, military IT systems and tactical battle company training systems. Our ground communications portfolio includes HF, VHF and UHF radio and communication systems and products, software defined radios, integrated radio communication systems, satellite-on-the-move solutions and tactical radio power amplifiers. Our radio and communications portfolio enables deployment of a full military network for the complete range of scenarios and terrain. In the homeland security area, we supply integrated and coastal border C4I surveillance systems, broadband communication systems, cyber protection systems, border control systems, "safe city" systems and homeland security and emergency response training and simulation systems. We perform programs under which we provide a range of C4I battle management systems, soldier mounted systems and radio and communications systems with land-based applications. Our customers include ground forces and governmental agencies worldwide.

EW and SIGINT Systems

We supply multi-spectral EW self-protection suites and systems for airborne, ground and naval platforms, including advanced electronic countermeasure (ECM) systems for radar, missiles and communication and electronic support measure (ESM) solutions, including missile warning systems, laser warning systems and radar warning receivers. We also furnish SIGINT systems, including ELINT, COMINT and direction finding systems, designed for air, ground and naval platforms and applications.

Our portfolio in the EW and SIGINT areas includes protection, intelligence and communications solutions for air, ground and naval applications. We offer EW self-protection suites, including radio frequency, radar warning receivers and laser warning systems, for all airborne platform types. We also offer IR-based missile warning systems for advanced combat aircraft as well as for other fixed-wing and rotor platforms. In addition, we provide ESM for threat identification. We also provide SIGINT systems for tactical and strategic intelligence gathering including ELINT and ECM for naval, ground and airborne applications, COMINT and communication jamming systems, counter improvised explosive devices jamming systems for ground forces and cyber protection capabilities. We also supply radar solutions, data links and video dissemination systems and search and rescue systems for pilots and rescue teams. In addition, we develop command and control systems and simulators for anti-ballistic missiles. Customers for our EW, SIGINT and COMINT systems include governmental armed forces and homeland security agencies as well as major defense contractors.

Cyber and Intelligence Systems

Our governmental and commercial cyber security systems and intelligence systems activities are led by CYBERBIT. Our cyber-security solutions enable enterprises to rapidly detect advanced cyber threats, protect critical infrastructures, automate security operations center workflows and train cyber security staff. Our solutions utilize machine learning, Big Data and continuous technology advancements. Customers include a range of commercial, financial and industrial enterprises.

Our intelligence solutions for law enforcement and national security agencies address the entire intelligence cycle including collection, processing, analysis and visualization, providing law enforcement agencies, intelligence organizations and SIGINT agencies with a full spectrum of intelligence capabilities.

Various Commercial Activities

We engage in an increasing range of technologies for commercial applications and activities. Our current commercial activities, in addition to the activities described under “Commercial Aviation Systems and Aerostructures”, "Cyber and Intelligence Systems" and elsewhere above, include, among others, medical diagnostic equipment, automotive night vision enhancement equipment, smart glasses for sports applications and super capacitor energy sources and fuel cells for transportation applications.

Property, Plant and Equipment

Facilities Owned or Leased by the Company

	Israel(1)	U.S.(2)	Other Countries(3)
Owned	2,161,000 square feet	633,854 square feet	891,000 square feet
Leased	2,281,000 square feet	671,200 square feet	453,000 square feet

(1) Includes offices, development and engineering facilities, manufacturing facilities, maintenance facilities, hangar facilities and landing strips in various locations in Israel.

(2) Includes mainly offices, development and engineering facilities, manufacturing facilities and maintenance facilities of Elbit Systems of America, primarily in Texas, New Hampshire, Florida, Alabama and Virginia. The facilities in Texas, New Hampshire and Alabama are located on owned land totaling approximately 129 acres. 318,570 square feet of the leased facilities are sublet to a third party. In addition, there is a 942,344 square foot ground lease, of which 629,910 square feet are sublet to a third party.

(3) Includes offices, design and engineering facilities and manufacturing facilities in Europe, Latin America and Asia-Pacific.

Recent Investment in Facilities. Over the last two years the average annual net investment in our facilities, including land and buildings, equipment, machinery and vehicles, amounted to approximately $112 million. We believe that our current facilities are adequate for our operations as now conducted.

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Governmental Regulation

Government Contracting Regulations. We operate under laws, regulations, administrative rules and other legal requirements governing defense and other government contracts, mainly in Israel and the United States. Some of these legal requirements carry major penalty provisions for non-compliance, including disqualification from participating in future contracts. In addition, our participation in governmental procurement processes in Israel, the United States and other countries is subject to specific regulations governing the conduct of the process of procuring defense and homeland security contracts.

Israeli Export Regulations. Israel's defense export policy regulates the sale of a number of our systems and products. Current Israeli policy encourages exports to approved customers of defense systems and products such as ours, as long as the export is consistent with Israeli government policy. Subject to certain exemptions, a license is required to initiate marketing activities. We also must receive a specific export license for defense related hardware, software and technology exported from Israel. Israeli law also regulates export of "dual use" items (items that are typically sold in the commercial market but that also may be used in the defense market). In 2016 more than 50% of our revenue was derived from exports subject to Israeli export regulations.

U.S. and Other Export Regulations. Elbit Systems of America's export of defense and dual use products, as well as military technical data and technical services to Israel and other countries is subject to applicable approvals of the U.S. government under the U.S. International Traffic in Arms Regulations (ITAR) and the U.S. Export Administration Regulations (EAR). Such approvals are typically in the form of an export license, and for defense technology or services in the form of a technical assistance agreement (TAA). Other U.S. companies wishing to export defense products or military related services and technology to our Israeli and other non-U.S. entities are also required to obtain such export licenses and TAAs. Such approvals apply to U.S. origin data required by our non-U.S. entities to perform work for U.S. programs. Licenses are also required for Israeli nationals assigned to work in defense-related technical areas at our U.S. affiliated companies. An application for an export license or a TAA requires disclosure of the intended sales of the product and the use of the technology. Pursuant to export control reform initiatives in the U.S., a greater part of Elbit Systems of America's and our U.S. suppliers' activities are becoming subject to control under the EAR. The U.S. government may deny an export authorization if it determines that a transaction is counter to U.S. policy or national security. Other governments' export regulations also affect our business from time to time, particularly with respect to end user restrictions of our suppliers' governments.

Approval of Israeli Defense Acquisitions

The Israeli Defense Entities Law (Protection of Defense Interests) establishes conditions for the approval of an acquisition or transfer of control of an entity that is determined to be an Israeli "defense entity" under the terms of the law. Designation as a "defense entity" is to occur through an order to be issued jointly by the Israeli Prime Minister, Defense Minister and Economy Minister. Although no such orders have been issued as of the date of this annual report on Form 20-F, it is assumed that Elbit Systems and most of our Israeli subsidiaries will be designated as "defense entities" under the law and that the Israeli Government will issue such an order regarding our applicable Israeli companies. Under separate regulations, Elbit Systems and our major Israeli subsidiaries have been designated as "defense entities" by the Defense Minister with respect to Israeli law governing various aspects of defense security arrangements.

Orders to be issued under the Israeli Defense Entities Law will also establish other conditions and restrictions. It is anticipated that in the case of a publicly traded company such as Elbit Systems, Israeli government approval will be required for acquisition of 25% or more of the voting securities or a smaller percentage of shares that grant "means of control." Means of control for purposes of the law include the right to control the vote at a shareholders' meeting or to appoint a director. Orders relating to defense entities are also anticipated to, among other matters: (1) impose restrictions on the ability of non-Israeli resident citizens to hold “means of control” or to be able to “substantially influence” defense entities; (2) require that senior officers of defense entities have appropriate Israeli security clearances; (3) require that a defense entity’s headquarters be in Israel; and (4) subject a defense entity’s entering into international joint ventures and transferring certain technology to the approval of the IMOD.

Approval of U.S. and Other Defense Acquisitions. Many countries in addition to Israel also require governmental approval of acquisitions of local defense companies or assets by foreign entities. Mergers and acquisitions of defense related businesses in the U.S. are subject to the Foreign Investment and National Security Act (FINSA). Under FINSA, our acquisitions of defense related businesses in the U.S. require review, and in some cases approval, by the Committee on Foreign Investment in the United States.

“Buy American” Laws. The U.S. “Buy American” laws impose price differentials or prohibitions on procurement of products purchased under U.S. government programs. The price differentials or prohibitions apply to products that are not made in the United States or that do not contain U.S. components making up at least 50% of the total cost of all components in the product. However, a Memorandum of Agreement between the United States and Israeli governments waives the Buy American laws for specified products, including most of the products currently sold in the United States by Elbit Systems and our Israeli subsidiaries.

Foreign Military Financing (FMF). Elbit Systems of America participates in United States FMF programs. These programs require countries, including Israel, receiving military aid from the United States to use the funds to purchase products containing mainly U.S. origin components. In most cases, subcontracting under FMF contracts to non-U.S. entities is not permitted. As a consequence, Elbit Systems of America generally either performs FMF contracts itself or subcontracts with U.S. suppliers. The U.S. government may authorize the IMOD to utilize a portion of the FMF budget under the United States Subcontracting Procurement (USSP) channel. In such cases, companies such as Elbit Systems or our Israeli subsidiaries, who are acting as the Israeli prime contractor to the IMOD under the NIS funded portion of an IMOD program, are authorized to negotiate and enter into a subcontract directly with a U.S. supplier. However, payment of the funds under a USSP channel subcontract is administered by the IMOD Purchasing Mission to the U.S. Elbit Systems of America also participates in U.S. Foreign Military Sales (FMS) programs.

Procurement Regulations. Solicitations for procurements by governmental purchasing agencies in Israel, the United States and other countries are governed by laws, regulations and procedures relating to procurement integrity, including avoiding conflicts of interest, corruption, human trafficking and conflict minerals in the procurement process. Such regulations also include provisions relating to information assurance and for the avoidance of counterfeit parts in the supply chain.

Anti-Bribery Regulations. We conduct operations in a number of markets that are considered high risk from an anti-bribery compliance perspective. Laws and regulations such as the Israel Penal Code, the Organization for Economic Cooperation and Development (OECD) Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, the U.S. Foreign Corrupt Practices Act, the U.K. Bribery Act and corresponding legislation in other countries, prohibit providing personal benefits or bribes to government officials in connection with the governmental procurement process. Israeli defense exporters, such as Elbit Systems, are required to maintain an anti-bribery compliance program, including specific procedures, record keeping and training.

Audit Regulations. The IMOD audits our books and records relating to its contracts with us. Our books and records and other aspects of projects related to U.S. defense contracts are subject to audit by U.S. government audit agencies. Such audits review compliance with government contracting cost accounting and other applicable standards. If discrepancies are found this could result in a downward adjustment of the applicable contract’s price. Some other customers have similar rights under specific contract provisions.

Antitrust Laws. Antitrust laws and regulations in Israel, the United States and other countries often require governmental approvals for transactions that are considered to limit competition. Such transactions may include the formation of joint venture entities, cooperative agreements for specific programs or areas, as well as mergers and acquisitions.

Civil Aviation Regulations. Several of the products sold by Company entities for commercial aviation applications are subject to flight safety and airworthiness standards of the U.S. Federal Aviation Administration (FAA) and similar civil aviation authorities in Israel, Europe and other countries.

Federal Drug Administration Regulations. Medical products designed and manufactured by Elbit Systems of America’s Medical Instruments – KMC Systems business unit are subject to U.S. Federal Drug Administration (FDA) regulations.

Environmental, Health and Safety Regulations. We are subject to a variety of environmental, health and safety laws and regulations in the jurisdictions in which we have operations. This includes regulations relating to air, water and ground contamination, hazardous waste disposal and other areas with a potential environmental or safety impact.

Buy-Back

As part of their standard contractual requirements for defense programs, several of our customers include “buy-back” or “offset” provisions. These provisions are typically obligations to make, or to facilitate third parties to make, various specified transactions in the customer’s country, such as procurement of defense and commercial products, investment in the local economy and transfer of know-how. (For further information about buy-back obligations, see Item 5. Operating and Financial Review and Prospects – Off-Balance Sheet Transactions.)

Financing Terms

Types of Financing. There are several types of financing terms applicable to our defense contracts. In some cases, we receive progress payments related to our progress in performing the contract. Sometimes we receive advances from the customer at the beginning, or during the course, of the project, and sometimes we also receive milestone payments for achievement of specific milestones. In some programs we extend credit to the customer, sometimes based on receipt of guarantees or other security. In other situations work is performed before receipt of the payment, which means that we finance all or part of the project’s costs for various periods of time. Financing arrangements may extend beyond the term of the contract’s performance. When we believe it is necessary, we seek to protect all or part of our financial exposure by letters of credit, insurance or other measures, although in some cases such measures may not be available.

Advance Payment Guarantees. In some cases where we receive advances prior to incurring contract costs or making deliveries, the customer may require guarantees against advances paid. These guarantees are issued either by financial institutions or by us. We have received substantial advances from customers under some of our contracts. In certain circumstances, such as if a contract is canceled for default and there has been an advance or progress payment, we may be required to return payments to the customer as provided in the specific guarantee. As part of the guarantees we provide to receive progress payments or advance payments, some of our customers require us to transfer to them title in inventory acquired with such payments. (See Item 5. Operating and Financial Review and Prospects – General – Long-Term Arrangements and Commitments – Bank and Other Financial Institution Guarantees.)

Performance Guarantees. A number of projects require us to provide performance guarantees in an amount equal to a percentage of the contract price. In certain cases we also provide guarantees related to the performance of buy-back obligations. Some of our contracts contain clauses that impose penalties or reduce the amount payable to us if there is a delay or failure in performing in accordance with the contract or the completion of a phase of work, including in some cases during the warranty period. These types of guarantees may remain in effect for a period of time after completion of deliveries under the contract. Such guarantees are customary in defense transactions, and we provide them in the normal course of our business. (See Item 5. Operating and Financial Review and Prospects – General – Long-Term Arrangements and Commitments – Bank and Other Financial Institution Guarantees.)

Private Finance Initiatives (PFI). Some of our projects operate under PFI financing arrangements where we provide long-term financing arrangements or facilities, with the repayment generally made based on the project’s cash flow. PFI projects can be structured in several ways. PFI projects may require us to pledge project-related equity and enter into relatively complex financial and other agreements. Such financing is usually medium or long-term and may be raised either through banks or institutional lenders and carries various financial risks and exposures. In addition, PFI projects may require us to draw upon our equity base and borrowing capacities and may significantly affect our liquidity and increase our financial leverage. In recent years we were involved in several PFI-type projects in Israel, and we expect to participate in future PFI contracts both in Israel and other countries.

Intellectual Property

Patents, Trademarks and Trade Secrets. We own hundreds of living patent families including patents and applications registered or filed in Israel, the United States, the European Patent Office and other countries. We also hold dozens of living trademark families relating to specific products. A significant part of our intellectual property assets relates to unique applications of advanced software-based technologies, development processes and production technologies. Some of these applications are protected by patents and others are considered as our trade secrets and proprietary information. We take a number of measures to safeguard our intellectual property against infringement as well as to avoid infringement of other parties' intellectual property. (For risks related to our intellectual property see Item 3. Key Information – Risk Factors – General Risks Related to Our Business and Market.)

Governmental Customers' Rights in Data. The IMOD usually retains specific rights to technologies and inventions resulting from our performance under contracts for end use by the IMOD or the IDF. This generally includes the right to disclose the information to third parties, including other defense contractors that may be our competitors. Consistent with common practice in the defense industry, approximately 25% of our revenues in 2016 was dependent on products incorporating technology that a government customer may disclose to third parties. When the IMOD funds research and development, it usually acquires rights to data and inventions. We often may retain a non-exclusive license for such inventions. The Israeli government usually is entitled to receive royalties on export sales in relation to sales resulting from government financed development. However, if only the product is purchased without development effort, we normally retain the principal rights to the technology. Sales of our products to the U.S. government and some other customers are subject to similar conditions. Subject to applicable law, regulations and contract requirements, we attempt to maintain our intellectual property rights and provide customers with the right to use the technology only for the specific project under contract.

Licensing. There are relatively few cases where we manufacture under license. Such licenses typically apply to the use of technologies that are the result of collaboration with academic institutions or where we are manufacturing another company's product in accordance with that company's specifications. In such cases, the licensor typically is entitled to royalties or other types of compensation. In some cases where we have acquired business lines we obtain a royalty free license to use the applicable technology for specified applications. Occasionally, we license parts of our intellectual property to customers as part of the requirements of a particular contract. We also sometimes license technology to other companies for specific purposes or markets, such as the right to use certain of our intellectual property relating to our training and simulation systems.

Research and Development

We invest in research and development (R&D) according to a long-term plan based on estimated market needs. Our R&D efforts focus on anticipating operational needs of our customers, achieving reduced time to market and increasing affordability. We emphasize improving existing systems and products and developing new ones using emerging or existing technologies.

Our R&D projects relate to defense, homeland security and commercial applications. We perform R&D projects to produce new systems for the IMOD and other customers. These projects give us the opportunity to develop and test emerging technologies. We develop tools for fast prototyping for both the design and development process. Fast prototyping permits the operational team members to effectively specify requirements and to automatically transfer them into software code. We also are engaged in long-term investments in science and technology infrastructure and building blocks, often in collaboration with academic bodies. We employ thousands of software, hardware and systems engineers. In addition, most of our program and business line managers have engineering backgrounds. More than 50% of our total workforce is engaged in research, development and engineering.

Our companies in Israel have collectively been awarded the Israel Defense Prize eleven times, recognizing extraordinary contributions to defense technological innovations.

Our customers, the Israel Innovation Authority in the Ministry of Economy and Industry (formerly Office of Chief Scientist) and other R&D granting authorities sometimes participate in our R&D funding. We also invest in our research and development activities. This investment is in accordance with our strategy and plan of operations. The table below shows amounts we invested in R&D activities for the years ended December 31, 2014, 2015 and 2016.

	2014	2015	2016
	(U.S. dollars in millions)		
Total Investment	$267.7	$277.8	$291.8
Less Participation*	(39.7)	(34.4)	(36.0)
Net Investment	$228.0	$243.4	$255.8

* See above – “Government Rights in Data” and see below – “Conditions in Israel – Israel Innovation Authority and Investment Center Funding.”

Manufacturing

We manufacture and assemble our systems and products at our operational facilities in Israel, the U.S., Europe, Brazil and Australia and at the facilities of certain of our subsidiaries in other countries. These facilities contain warehouses, electronic manufacturing areas, mechanical workshops, final assembly and test stations with test equipment. We also have supporting infrastructure including fully automated surface mount technology lines and clean rooms for electro-optic components, solid state components integration, environmental testing and final testing, including space simulation and thermal chambers. We also have computerized logistics systems for managing manufacturing and material supply. A number of our manufacturing activities are provided on a shared services basis by several of our in-house centers of excellence.

We also manufacture and assemble composite materials, metal parts and machinery. One of our Israeli subsidiaries has a high technology semiconductor manufacturing facility where it performs electronic integration and assembly of thermal imaging detectors and laser diodes. We also manufacture and repair test equipment.

We manufacture commercial avionics and aircraft components, as well as perform maintenance, repair and overhaul at our U.S. FAA registered facilities in the U.S., Europe and Israel. We also manufacture medical equipment at U.S. FDA registered facilities in the U.S.

Environmental Compliance

As part of overall Company policy, we are committed to environmental, health and safety standards in all aspects of our operations. This includes all regulatory requirements as well as ISO 14001 compliance. We also conduct a number of measures on an ongoing basis to promote environmentally friendly operational practices, including measures to reduce electrical, fuel and water consumption. There are no material environmental issues that affect the Company’s use of our facilities. See also "Social Sustainability" below.

Seasonality

Although revenues may sometimes increase towards the end of a fiscal year, no material portion of the Company’s business is considered to be seasonal. The timing of revenue recognition is based on several factors. (See Item 5. Operating and Financial Review and Prospects – General – Critical Accounting Policies and Estimates – Revenue Recognition.)

Purchasing and Raw Materials

We conduct purchasing activities at most of our operational facilities. A number of purchasing and related support and logistic services are performed on a shared services basis by central service providers in the Company for various Company units and entities. We generally are not dependent on single sources of supply. We manage our inventory according to project requirements. In some projects, specific major subcontractors are designated by the customer. Raw materials used by us are generally available from a range of suppliers internationally, and the prices of such materials are generally not subject to significant volatility. We monitor the on-time delivery and the quality of our contractors and encourage them to continuously improve their performance. We also require our suppliers to adhere to our Supplier Code of Conduct and to comply with a range of procurement standards, including those relating to the avoidance of counterfeit parts and conflict minerals.

Customer Satisfaction and Quality Assurance

We invest in continuous improvement of processes, with emphasis on prevention of deficiencies, to ensure customer satisfaction throughout all stages of our operations. This includes development, design, integration, manufacturing and services for software and hardware, for the range of our systems and products. Our quality teams are involved in assuring compliance with processes and administrating quality plans. These activities begin at the pre-contract stage and continue through the customer’s acceptance of the product or services.

We also use project management methods such as Kaizen and Lean and are enhancing and expanding such processes on an ongoing basis. Our processes are based on a cutting edge tool case and CAD-CAM tools. This infrastructure, together with well defined development methodology and management tools, assists us in providing high quality and on-time implementation of projects. We are in the process of implementing a "One-ERP" (enterprise resource planning) system, with a goal of consolidating uniform best practices for quality and operations across the organization.

All Israeli operational sites are certified for one or more of the following: ISO-9001, ISO-90003 for software, AS9100 (certified for revision C), AS9115 for software, ISO-14001, OHSAS 18001, FAA Part 145 and European Aviation Safety Agency (EASA) Part 145 for maintaining civil products and Part 21 G for production of civil products. Representatives of our customers generally test our products before acceptance. A number of our customers have authorized us to conduct acceptance testing of our products on their behalf.

Quality certifications applicable to defense products of Elbit Systems of America’s operating units include certifications for CMMI Level 3 of the SEI, ISO-9001, AS9100 (certified for revision C) and compliance with NATO AQAP requirements. In the area of commercial aviation Elbit Systems of America’s operating units hold EASA certification as well as a variety of FAA certifications including FAA Part 21 approval and FAA Part 145 approved repair stations. In the medical equipment area, Elbit Systems of America is certified for ISO 13485:2003, is registered with the FDA as a GMP manufacturer and is FDA compliant with Quality Systems Regulations 21 CFR Parts 820, 803 and 806.

Service and Warranty

We instruct our customers on the proper maintenance of our systems and products. In addition, we often offer training and provide equipment to assist our customers in performing their own maintenance. When required, support may be provided by a local support team or by specialists sent from our facilities. We also provide performance based logistics services.

We generally offer a one or two-year warranty for our systems and products following delivery to, or installation by, the customer. In some cases we offer longer warranty periods. We accrue for warranty obligations specifically determined for each project based on our experience and engineering estimates. These accruals are intended to cover post-delivery functionality and operating issues for which we are responsible under the applicable contract.

Marketing and Sales

We actively take the initiative in identifying the individual needs of our customers throughout the world. We then focus our research and development activities on systems designed to provide tailored solutions to those needs. We often provide demonstrations of prototypes and existing systems to potential customers.

We market our systems and products either as a prime contractor or as a subcontractor to various governments and defense and homeland security contractors worldwide. In Israel, we sell our military systems and products mainly to the IMOD, which procures all equipment for the IDF. A number of marketing related support services are provided on a central shared services basis to various units in the Company. Marketing our systems, products and services in other parts of the world is supported by subsidiaries, joint ventures and representatives.

In the U.S., generally Elbit Systems of America leads our sales and marketing activities from its facilities throughout the U.S. Elbit Systems of America operates under a Special Security Agreement that allows it and its subsidiaries to work on certain classified U.S. government programs. See above "Subsidiary Organizational Structure – Elbit Systems of America." Our subsidiaries in other countries typically lead the marketing activities in their home countries, often assisted by marketing and business development personnel based in Israel.

Over the past several years, we have entered into cooperation agreements with defense contractors, platform manufacturers and other companies in Israel, the United States, Europe, Latin America, Asia-Pacific and certain other key markets. These agreements provide for joint participation in marketing and performance of a range of projects around the world. In other situations, we actively pursue business opportunities as either a prime contractor or a subcontractor, usually together with local companies. Often we enter into cooperation agreements with other companies for such opportunities.

Competition

We operate in a competitive environment for most of our projects, systems and products. Competition is based on product and program performance, price, reputation, reliability, life cycle costs, overall value to the customer, responsiveness to customer requirements and the ability to respond to rapid changes in technology. In addition, our competitive position sometimes is affected by specific requirements in particular markets.

Continuing consolidation in the defense industry has affected competition. In addition, many major prime contractors are increasing their in-house capabilities. These factors have decreased the number but increased the relative size and resources of our competitors. We adapt to market conditions by adjusting our business strategy to changing market conditions.

Competitors in the sale of some of our products to the government of Israel include IAI and Rafael among others. From time to time we also cooperate with some of our competitors on specific projects. Outside of Israel, we compete in a number of areas with major international defense and homeland security contractors principally from the United States, Europe and Israel. Our main competitors include divisions and subsidiaries of Boeing, Lockheed Martin, Northrop Grumman, Raytheon, General Dynamics, BAE Systems, Rockwell Collins, L-3 Communications, Thales, Airbus, Leonardo, Saab, Harris, Textron, FLIR Systems, Orbital ATK, AeroVironment, Rhode and Schwartz, Rheinmetall, Kongsberg, Safran, Aselsan, Bharat Electronics, Cubic and Verint. Many of these competitors have greater financial, marketing and other resources than ours. We also compete in the worldwide defense and homeland security markets with numerous smaller companies. In addition, we compete with a range of companies in the commercial avionics market. In certain cases we also engage in strategic cooperative activities with some of our competitors.

Overall, we believe we are able to compete on the basis of our systems development and technological expertise, our systems' operationally-proven performance and our policy of offering customers overall solutions to technological, operational and financial needs.

Major Customers

Sometimes, our revenues from an individual customer account for more than 10% of our revenues in a specific year. Our only such customer during the last three years was the IMOD, which accounted for 18% in 2014, 17% in 2015 and 18% in 2016.

Ethics

We conduct our business activities and develop Company policies based on a firm commitment to ethical practices. In addition to our Code of Conduct (see Item 16.B) and compliance with applicable laws and regulations, we have an active Company-wide ethics compliance program, incorporating policies and procedures. This includes the anti-bribery area where we have a policy of zero tolerance for corruption. Our compliance program also includes ongoing training and enforcement. We also expect our supply chain to follow ethical practices. Our Code of Conduct, Anti-Bribery Compliance Policy and Supplier Code of Conduct are published on our website www.elbitsystems.com. We are active in a number of international organizations relating to ethics and compliance.

Social Sustainability

We place importance on sustainability and social responsibility to the communities in which we live and work. This is consistent with our policy of emphasizing ethical business practices. Our policy encourages the voluntary efforts of our Company entities and employees who donate their time and efforts in the support of members of our communities who are in need. In this regard, we place priority on initiatives to promote educational advancement in less developed communities, particularly in the technology sectors. We also promote numerous other community support activities, including involvement on a national level in major charitable organizations in Israel and the U.S. We place emphasis on best practices in corporate governance, ethical conduct and fair employment practices. We also pursue continuous improvement of our operations from an environmental perspective and have a policy of combating human trafficking and avoiding the use of "conflict minerals" in our supply chain. These activities support our involvement as active members in leading sustainability and ethics organizations. We periodically publish a Sustainability Report, available on our website, detailing our activities in the areas of corporate responsibility, ethics, environmental initiatives and community-related activities.

Conditions in Israel

Political, Military and Economic Risks. Our operations in Israel are subject to several potential political, military and economic risks. (See Item 3. Key Information – Risk Factors – Risks Related to Our Israeli Operations.)

Trade Agreements. 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 also is a party to the General Agreement on Tariffs and Trade, which provides for reciprocal lowering of trade barriers among its members. In addition, Israel has been granted preferences under the Generalized System of Preferences from several countries. These preferences allow Israel to export products covered by such programs either duty-free or at reduced tariffs.

Israel Innovation Authority and Investment Center Funding. The government of Israel, through the Israel Innovation Authority (IIA) in the Ministry of Economy and Industry (formerly the Office of the Chief Scientist) and the Israel Investment Center (the Investment Center), encourages research and development projects oriented towards export products and participates in the funding of such projects as well as company investments in manufacturing infrastructures. Our Israeli companies receiving IIA funding for development of products usually pay the Israeli government a royalty at various rates and such financing is typically subject to a number of conditions. (See Item 5. Operating and Financial Review and Prospects – Long-Term Arrangements and Commitments – Government Funding of Development.) Separate Israeli government consent is required to transfer to third parties technologies developed through projects in which the government participates in the funding of the development effort. The Investment Center promotes Israeli export products and increased industrialization of peripheral areas through investment in industrial infrastructure. The Investment Center either provides grants for qualified projects or provides tax benefits for qualified industrial investments by Israeli companies.

Israeli Labor Laws. Our employees in Israel are subject to Israeli labor laws. Some employees are also affected by some provisions of collective bargaining agreements between the Histadrut – General Federation of Labor in Israel and the Coordination Bureau of Economic Organizations, which includes the Industrialists' Association. These labor laws and collective bargaining provisions mainly concern the length of the work day, minimum daily wages for professional workers, insurance for work-related accidents, procedures for dismissing certain employees, determination of severance pay, employment of "manpower" employees and other conditions of employment.

Severance Pay. Under Israeli law, our Israeli companies are required to make severance payments to terminated Israeli employees, other than in some cases of termination for cause. The severance reserve is calculated based on the employee's last salary and period of employment. A portion of the severance pay and pension obligation is covered by payment of premiums to insurance companies under approved plans and to pension funds. The deposits presented in the balance sheet include profits accumulated to the balance sheet date. The amounts deposited may be withdrawn only after fulfillment of the obligations under the Israeli laws relating to severance pay. However, Elbit Systems and our Israeli subsidiaries have entered into agreements with some of our employees implementing Section 14 of the Severance Payment Law, which agreements relate to the treatment of severance pay. (See Item 18. Financial Statements – Note 2(R).)

National Insurance Institute. Israeli employees and employers are required to pay predetermined sums to the National Insurance Institute, which is similar to the U.S. Social Security Administration. These amounts also include payments for national health insurance. As of December 31, 2016, the payments to the National Insurance Institute were equal to approximately 19.5% of wages, subject to a cap if an employee's monthly wages exceed a specified amount. The employee contributes approximately 61.5%, and the employer contributes approximately 38.5%.

Enforcement of Judgments

Israeli courts may enforce U.S. and other foreign jurisdiction final executory judgments for liquidated amounts in civil matters, obtained after due process before a court of competent jurisdiction. This enforcement is made according to the private international law rules currently applicable in Israel, which recognize and enforce similar Israeli judgments, provided that:

- adequate service of process has been made and the defendant has had a reasonable opportunity to be heard;
- the judgment and its enforcement are not contrary to the law, public policy, security or sovereignty of the State of Israel;
- the judgment was not obtained by fraud and does not conflict with any other valid judgment in the same matter between the same parties;
- an action between the same parties in the same matter is not pending in any Israeli court at the time the lawsuit is instituted in the foreign court; and
- the judgment is no longer subject to a right of appeal.

Foreign judgments enforced by Israeli courts generally will be payable in Israeli currency. The usual practice in Israel in an action to recover an amount in a non-Israeli currency is for the Israeli court to provide for payment of the equivalent amount in Israeli currency at the exchange rate in effect on the judgment date. Under existing Israeli law, a foreign judgment payable in foreign currency may be paid in Israeli currency at the foreign currency's exchange rate on the payment date or in foreign currency. Until collection, an Israeli court judgment stated in Israeli currency will ordinarily be linked to the Israeli Consumer Price Index (CPI) plus interest at the annual rate (set by Israeli regulations) in effect at that time. Judgment creditors must bear the risk of unfavorable exchange rates.

Item 4A. Unresolved Staff Comments.

None.

Item 5. Operating and Financial Review and Prospects.

The following discussion and analysis should be read together with our audited consolidated financial statements and notes appearing in Item 18 below.

General

Critical Accounting Policies and Estimates

Our significant accounting policies are described in Item 18. Financial Statements – Note 2.

Our results of operations and financial condition are based on our consolidated financial statements, which are presented in conformity with United States generally accepted accounting principles (U.S. GAAP). The preparation of the consolidated financial statements requires management to select accounting policies as well as estimates and assumptions and to make judgments that involve the accounting policies described below that affect the amounts reported in the consolidated financial statements. Significant changes in assumptions and/or conditions and changes in our critical accounting policies could materially impact our operating results and financial condition.

We believe our most critical accounting policies relate to:

•Revenue Recognition.
•Business Combinations.
•Impairment of Long-Lived Assets and Goodwill.
•Useful Lives of Long-Lived Assets.
•Income Taxes.
•Stock-Based Compensation Expense.

Revenue Recognition

We generate revenues principally from fixed-price long-term contracts involving the design, development, manufacture and integration of defense electronic systems and products. In addition, to a lesser extent, we provide non-defense systems and products as well as support and services for our systems and products.

Revenues from long-term contracts are recognized primarily using the Financial Accounting Standards Board (FASB), Accounting Standards Codification (ASC) ASC 605-35 “Construction-Type and Production-Type Contracts” (ASC 605-35) according to which we recognize revenues on the percentage-of-completion basis.

The percentage-of-completion method of accounting requires management to estimate the cost and gross profit margin for each individual contract. Estimated gross profit or loss from long-term contracts may change due to changes in estimates resulting from differences between actual performance and original estimated 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. Anticipated losses on contracts are charged to earnings when determined to be probable.

In certain circumstances, sales under short-term fixed-price production type contracts or sale of products are accounted for in accordance with the SEC’s Staff Accounting Bulletin (SAB) No. 104, “Revenue Recognition in Financial Statements” (SAB 104), and recognized when all the following criteria are met: persuasive evidence of an arrangement exists, delivery has occurred, the seller’s price to the buyer is fixed or determinable, no further obligation exists and collectability is reasonably assured.

In cases where the contract involves the delivery of products and performance of services, or other obligations, we follow the guidelines specified in ASC 605-25. “Multiple-Element Arrangements”, in order to allocate the contract consideration between the identified different elements using the relative selling price method to allocate the entire arrangement consideration. The selling price of each element would be allocated by using a hierarchy of: (i) Vendor Specific Objective Evidence (VSOE); (ii) third-party evidence of the selling price for that element; or (iii) estimated selling price for individual elements of an arrangement when VSOE or third-party evidence of the selling price is unavailable.

Service revenues include contracts primarily for the provision of supplies or services other than associated with design, development or manufacturing and production activities. It may be a stand-alone service contract or a service element, which was separated from the design, development or production contract according to the criteria established in ASC 605-25. Our service contracts primarily include operation contracts, outsourcing-type arrangements, maintenance contracts, training, installation service contracts, etc. Revenue from services were less than 10% of consolidated revenues in each of the fiscal years 2014, 2015 and 2016. (For additional information see Item 18. Financial Statements - Notes 2(T) and 2(AE) (ASU 2014-09.)

Business Combinations

In accordance with ASC 805 “Business Combinations”, we allocate the purchase price of acquired companies to the tangible and intangible assets acquired and liabilities assumed, as well as to IPR&D and contingent consideration, and non-controlling interest, based on their estimated fair values. Such valuations require management to make significant estimates and assumptions, especially with respect to intangible assets. (See Item 18. Financial Statements - Note 2(E) for additional information.)

We engage third-party appraisal firms to assist management in determining the fair values of certain assets acquired and liabilities assumed. Estimating the fair value of certain assets acquired and liabilities assumed requires judgment and often involves the use of significant estimates and assumptions, mainly with respect to intangible assets. Management makes estimates of fair value based upon market participants’ assumptions believed to be reasonable. These estimates are based on historical experience and information obtained from the management of the acquired companies, and although they are deemed to be consistent with market participants’ highest and best use of the assets in the principal or most advantageous market, they are inherently uncertain. While there are a number of different methods for estimating the value of intangible assets acquired, the primary method used is the discounted cash flow approach. Some of the more significant estimates and assumptions inherent in the discounted cash flow approach include projected future cash flows, including their timing, a discount rate reflecting the risk inherent in the future cash flows and a terminal growth rate. We also estimate the expected useful lives of the intangible assets, which requires judgment and can impact our results of operations. Unanticipated events and circumstances may occur that may affect the accuracy or validity of such assumptions, estimates or actual results.

To the extent intangible assets are assigned longer useful lives, there may be less amortization expense recorded in a given period. Because we operate in industries which are extremely competitive, the value of our intangible assets and their respective useful lives are exposed to future adverse changes, which can result in an impairment charge to our results of operations.

Impairment of Long-Lived Assets and Goodwill

Our long-lived assets, including identifiable property, plant and equipment and intangible assets, are reviewed for impairment in accordance with ASC 360-10-35 “Property, Plant and Equipment Subsequent Measurement” 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 an asset to the future undiscounted cash flows expected to be generated by the asset. If an asset is determined to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair value. Fair value of non-financial assets is determined based on market participant assumptions. For each of the years ended December 31, 2014, 2015 and 2016, no material impairment of long-lived assets was identified. (See Item 18. Financial Statements - Note 2(P) for additional information.)

Goodwill represents the excess of the cost of acquired businesses over the fair values of the assets acquired net of liabilities assumed. Goodwill is not amortized, but is instead tested for impairment at least annually (or more frequently if impairment indicators arise).

We review goodwill for impairment on an annual basis and whenever events or changes in circumstances indicate the carrying value of goodwill may not be recoverable. Such events or circumstances could include significant changes in the business climate of our industry, operating performance indicators, competition or sale or disposal of a portion of a reporting unit. The assessment is performed at the reporting unit level. Our annual testing date for all reporting units is December 31.

Performing the goodwill impairment test requires judgment, including how we define reporting units and determine their fair value. We consider a component of our business to be a reporting unit if it constitutes a business for which discrete financial information is available and management regularly reviews the operating results of that component. We estimate the fair value of each reporting unit using a discounted cash flow methodology that requires significant judgment. Forecasts of future cash flows are based on our best estimate of future sales and operating costs, based primarily on existing backlog, expected future contracts, contracts with suppliers, labor agreements and general market conditions. We prepare cash flow projections for each reporting unit using a five-year forecast of cash flows and a terminal value based on the Perpetuity Growth Model. The five-year forecast and related assumptions are derived from the most recent annual financial forecast for which the planning process commenced in our fourth quarter. The discount rate applied to our forecasts of future cash flows is based on our estimated weighted average cost of capital and includes factors such as the risk-free rate of return and the return an outside investor would expect to earn based on the overall level of inherent risk. The determination of expected returns includes consideration of the beta (a measure of risk) of traded securities of comparable companies. Changes in these estimates and assumptions could materially affect the determination of fair value and/or goodwill impairment for each reporting unit.

We evaluate goodwill for impairment by comparing the estimated fair value of a reporting unit to its carrying value, including goodwill. If the carrying value exceeds the estimated fair value, we measure impairment by comparing the derived fair value of goodwill to its carrying value, and any impairment determined is recorded in the current period. For each of the three years ended December 31, 2016, no material impairment of goodwill was identified. (See Item 18. Financial Statements - Note 2(Q) for additional information.)

Useful Lives of Long-Lived Assets

Identifiable intangible assets and property, plant and equipment are amortized over their estimated useful lives. Determining the useful lives of such assets involves the use of estimates and judgments. In determining the useful lives we take into account various factors such as the expected use of the assets, effects of obsolescence, including technological developments, competition, demand and changes in business, acquisitions and other economic factors. If we experience changes and the useful lives of such assets increase or decrease, it will affect our results of operations. (See above “Impairment of Long-Lived Assets and Goodwill” for further discussion of the effects of changes in useful lives.)

Income Taxes

We record income taxes using the asset and liability approach, whereby deferred tax assets and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and of operating losses and credit carry-forwards, and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. We record a valuation allowance, if necessary, to reduce deferred tax assets to amounts that are more likely than not to be realized. We have considered future taxable income on a jurisdiction by jurisdiction basis and used prudent and feasible tax planning strategies and other available evidence in determining the need for a valuation allowance. In the event we were to determine that we would be able to realize these deferred income tax assets in the future, we would adjust the valuation allowance, which would reduce the provision for income taxes.

We establish reserves for tax-related uncertainties based on estimates of whether, and the extent to which, additional taxes will be due. These reserves are established when we believe that certain positions might be challenged despite our belief that our tax return positions are in accordance with applicable tax laws. As part of the determination of our tax liability, management exercises considerable judgment in evaluating tax positions taken by us in determining the income tax provision and establishes reserves for tax contingencies in accordance with ASC 740 "Income Taxes" guidelines. We adjust these reserves in light of changing facts and circumstances, such as the closing of a tax audit, new tax legislation or the change of an estimate based on new information. To the extent that the final tax outcome of these matters is different from the amounts recorded, such differences will affect the provision for income taxes in the period in which such determination is made. During 2014, 2015 and 2016, certain of our subsidiaries settled certain income tax matters pertaining to multiple years in Israel and Europe. Elbit Systems and certain of our Israeli subsidiaries are currently undergoing tax audits by the Israeli Tax Authority. The provision for income taxes includes the effect of reserve provisions and changes to reserves that are considered appropriate, as well as the related interest and penalties.

Management's judgment is required in determining our provision for income taxes in each of the jurisdictions in which we operate. The provision for income tax is calculated based on our assumptions as to our entitlement to various benefits under the applicable tax laws in the jurisdictions in which we operate. The entitlement to such benefits depends upon our compliance with the terms and conditions set out in these laws. Although we believe that our estimates are reasonable and that we have considered future taxable income and ongoing prudent and feasible tax strategies in estimating our tax outcome, there is no assurance that the final tax outcomes will not be different than those which are reflected in our historical income tax provisions and accruals. Such differences could have a material effect on our income tax provision, net income and cash balances in the period in which such determination is made. (See Item 18. Financial Statements - Notes 2(W) and 18.)

Stock-Based Compensation Expense

We account for equity based compensation in accordance with ASC 718 "Compensation - Stock Based Compensation" (ASC 718), which requires the measurement and recognition of compensation expense for all share-based payment awards made to our employees and directors, including employee stock options, cash-based awards linked to the share price and our Phantom Bonus Retention Plan, based on estimated fair values. (See Item 18. Financial Statements - Notes 2(Z) and 21.)

Governmental Policies

Governmental policies and regulations applicable to defense contractors, such as cost accounting and audit, export control, procurement solicitation and anti-bribery rules and regulations, could have a material impact on our operations. (See Item 3. Risk Factors – General Risks Related to Our Business and Market and Item 4. Information on the Company – Governmental Regulation.) According to Section 404 of the U.S. Sarbanes-Oxley Act of 2002, we are required to include in our annual report on Form 20-F an assessment, as of the end of the fiscal year, of the effectiveness of our internal controls over financial reporting. (See Item 15. Controls and Procedures – Management's Annual Report on Internal Control Over Financial Reporting.)

Recent Accounting Pronouncements

See Item 18. Financial Statements – Note 2(AE).

Long-Term Arrangements and Commitments

Government Funding of Development. Elbit Systems and certain Israeli subsidiaries partially finance our research and development expenditures under programs sponsored by the Israel Innovation Authority (IIA) in the Ministry of Economy and Industry (formerly the Office of the Chief Scientist) for the support of research and development activities conducted in Israel. At the time the funds are received, successful development of the funded projects is not assured. In exchange for the funds, Elbit Systems and the subsidiaries pay 2% – 5% of total sales of the products developed under these programs. The obligation to pay these royalties is contingent on actual future sales of the products. Elbit Systems and some of our subsidiaries may also be obligated to pay certain amounts to the IMOD and others on certain sales including sales resulting from the development of some of the technologies developed with such respective entity's funds. (See Item 4. Information on the Company – Conditions in Israel – Israel Innovation Authority and Investment Center Funding.)

Lease Commitments. The future minimum lease commitments of the Company under various non-cancelable operating lease agreements for property, motor vehicles and office equipment as of December 31, 2016 were as follows: $47.5 million for 2017, $35.9 million for 2018, $27.2 million for 2019, $19.4 million for 2020 and $100.6 million for 2021 and thereafter. (See below "Contractual Obligations".)

Bank Covenants. In connection with bank credits and loans, including performance guarantees issued by banks and bank guarantees in order to secure certain advances from customers, Elbit Systems and certain subsidiaries are obligated to meet certain financial covenants. (See below – "Liquidity and Capital Resources – Financial Resources".) Such covenants include requirements for shareholders' equity, current ratio, operating profit margin, tangible net worth, EBITDA, interest coverage ratio and total leverage. (See Item 18. Financial Statements – Note 20(F).) As of December 31, 2015 and 2016, the Company met all financial covenants.

Bank and Other Financial Institution Guarantees. As of December 31, 2016 and 2015, guarantees in the aggregate amount of approximately $1,219 million and $1,211 million, respectively, were issued by banks and other financial institutions on behalf of several Company entities primarily in order to secure certain advances from customers and performance bonds.

Purchase Commitments. As of December 31, 2016 and 2015, we had purchase commitments of approximately $1,313 million and $1,292 million, respectively. These purchase orders and subcontracts are typically in standard formats proposed by us. These subcontracts and purchase orders also reflect provisions from the applicable prime contract that apply to subcontractors and vendors. The terms typically included in these purchase orders and subcontracts are consistent with Uniform Commercial Code provisions in the United States for sales of goods, as well as with specific terms requested by our customers in international contracts. These terms include our right to terminate the purchase order or subcontract in the event of the vendor's or subcontractor's default, as well as our right to terminate the order or subcontract for our convenience (or if our prime contractor has so terminated the prime contract). Such purchase orders and subcontracts typically are not subject to variable price provisions.

Acquisitions During 2016

See Item 4. Information on the Company – Mergers, Acquisitions and Divestitures.

Backlog of Orders

Our backlog includes firm commitments received from customers for systems, products, services and projects that have yet to be completed. Our policy is to include orders in our backlog only when specific conditions are met. Examples of these conditions may include, among others, receipt of a letter of commitment, program funding, advances, letters of credit, guarantees and/or other commitments from customers. As a result, from time to time we could have unrecorded orders in excess of the level of backlog.

We reduce backlog when revenues for a specific contract are recognized, such as when delivery or acceptance occurs or when contract milestones or engineering progress under long-term contracts are recognized as achieved, or when revenues are recognized based on costs incurred. In the unusual event of a contract cancellation, we reduce our backlog accordingly. The method of backlog recognition used may differ depending on the particular contract. Orders in currencies other than U.S. dollars are translated periodically into U.S. dollars and recorded accordingly.

Our backlog of orders as of December 31, 2016 was $6,909 million, of which 68% was for orders outside Israel. Our backlog of orders as of December 31, 2015 was $6,564 million, of which 68% was for orders outside Israel. Approximately 69% of our backlog as of December 31, 2016 is scheduled to be performed during 2017 and 2018. The majority of the 31% balance is scheduled to be performed in 2019 and 2020. Backlog information and any comparison of backlog as of different dates may not necessarily represent an indication of future sales.

Trends

Trends in the defense and homeland security areas in which we operate have been impacted by the nature of recent conflicts and terrorism activities throughout the world, increasing the focus of defense forces on low intensity conflicts, homeland security and cyber warfare. The defense market has also been impacted by the withdrawal of most of the allied forces from Iraq and a reduction of allied forces in Afghanistan, as well as by the recent conflicts in Ukraine and Syria and various conflicts with ISIS and other terrorist organizations. There has also been a trend of many armed forces to focus more on airborne, naval and intelligence forces and less on traditional ground forces activities.

In the defense and homeland security markets, there is an increasing demand for products and systems in the areas of airborne systems, C4ISR and unmanned vehicles. Accordingly, while we continue to perform platform upgrades, in recent years more emphasis is being placed on airborne systems, C4ISR, information systems, intelligence gathering, situational awareness, precision guidance, all weather and day/night operations, border and perimeter security, UAS, other unmanned vehicles, cyber-defense systems, training and simulation, space and satellite-based defense capabilities and homeland security systems. Many governments are increasing their budgets in the homeland security and cyber-defense areas. We believe that our core technologies and abilities will enable us to take advantage of many of these emerging trends.

In recent years consolidation in the defense and homeland security industries has affected competition. This consolidation has decreased the number but increased the relative size and resources of our competitors. We adapt to evolving market conditions by adjusting our business strategy. Our business strategy also anticipates increased competition in the defense and homeland security markets due to declining budgets in certain countries such as a number of countries in Latin America. However, there have been recent indications of enhanced defense and homeland security budgets in the U.S. and in certain European countries. We believe in our ability to compete on the basis of our systems development, technological expertise, operationally-proven performance and policy of offering customers overall solutions to technological, operational and financial needs and at the same time enhancing the industrial capabilities in certain of our customers' countries.

Our future success is dependent on our ability to meet our customers' expectations and anticipate emerging customer needs. We must continue to successfully perform on existing programs, as past performance is an important selection criterion for new competitive awards. We also must anticipate customer needs so as to be able to develop working prototypes in advance of program solicitations. This requires us to anticipate future technological and operational trends in our marketplace and efficiently engage in relevant research and development efforts.

Summary of Operating Results

The following table sets forth our consolidated statements of operations for each of the three years ended December 31, 2016.

	Year ended December 31, (in thousands of U.S. dollars except per share data)					
	2016		2015		2014	
	$	%	$	%	$	%
Total revenues	$3,260,219	100.0	$3,107,581	100.0	$2,958,248	100.0
Cost of revenues	2,300,636	70.6	2,210,528	71.1	2,133,151	72.1
Gross profit	959,583	29.4	897,053	28.9	825,097	27.9
Research and development (R&D) expenses	291,749	8.9	277,837	8.9	267,691	9.0
Less – participation	(35,957)	(1.1)	(34,421)	(1.1)	(39,680)	(1.3)
R&D expenses, net	255,792	7.8	243,416	7.8	228,011	7.7
Marketing and selling expenses	271,037	8.3	239,366	7.7	216,537	7.3
General and administrative expenses	151,353	4.6	145,693	4.7	139,634	4.7
Other operating income, net	(17,575)	(0.5)	—	—	(5,951)	(0.2)
	660,607	20.3	628,475	20.2	578,231	19.5
Operating income	298,976	9.2	268,578	8.6	246,866	8.3
Financial expenses, net	(23,742)	(0.7)	(20,240)	(0.7)	(47,498)	(1.6)
Other income, net	3,967	0.1	216	—	120	—
Income before taxes on income	279,201	8.6	248,554	8.0	199,488	6.7
Taxes on income	45,617	1.4	46,235	1.5	25,624	0.9
	233,584	7.2	202,319	6.5	173,864	5.9
Equity in net earnings of affiliated companies and partnerships	5,224	0.2	4,542	0.1	5,549	0.2
Net income	$238,808	7.4	$206,861	6.6	$179,413	6.1
Less – net loss (income) attributable to non-controlling interests	(1,899)	(0.1)	(4,352)	(0.1)	(8,433)	(0.3)
Net income attributable to the Company's shareholders	$236,909	7.3	$202,509	6.5	$170,980	5.8
Diluted net earnings per share:	$5.54		$4.74		$4.01	

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2016 Compared to 2015

Revenues

Our sales are primarily to governmental entities and prime contractors under government defense and homeland security programs. Accordingly, the level of our revenues is subject to governmental budgetary constraints.

The following table sets forth our revenue distribution by areas of operation:

	Year ended December 31,			
	2016		2015	
	$ millions	%	$ millions	%
Airborne systems	1,242.3	38.1	1,225.7	39.4
C4ISR systems	1,220.9	37.4	995.2	32.0
Land systems	408.0	12.5	558.7	18.0
Electro-optic systems	276.0	8.5	231.9	7.5
Other (mainly non-defense engineering and production services)	113.0	3.5	96.1	3.1
Total	3,260.2	100.0	3,107.6	100.0

Our consolidated revenues in 2016 were the $3,260.2 million, as compared to $3,107.6 million in 2015.

The leading contributors to our revenues were the airborne systems and C4ISR systems areas of operations. The increase in the C4ISR area of operation was primarily due to an increase in sales of command and control systems and radio systems in Europe, Asia-Pacific and Israel. Revenues from land systems decreased due primarily to a decline in sales of tank fire control systems to Asia-Pacific.

The following table sets forth our distribution of revenues by geographical regions:

	Year ended December 31,			
	2016		2015	
	$ millions	%	$ millions	%
Israel	709.5	21.8	616.6	19.8
North America	825.7	25.3	838.9	27.0
Europe	640.8	19.7	497.6	16.0
Asia-Pacific	801.6	24.6	800.3	25.8
Latin America	212.8	6.5	325.4	10.5
Other	69.8	2.1	28.8	0.9
Total	3,260.2	100.0	3,107.6	100.0

The decrease in Latin America was mainly a result of lower sales of command and control systems for homeland security applications.

Cost of Revenues and Gross Profit

Cost of revenues in 2016 was $2,300.6 million (70.6% of revenues), as compared to $2,210.5 million (71.1% of revenues) in 2015.

Our major components of cost of revenues are (i) wages and related benefits costs, (ii) subcontractors and material consumed and (iii) manufacturing and other expenses (including depreciation and amortization). The amounts and percentage of those components in 2016 and 2015 were as follows:

Wages and related benefits costs in 2016 constituted 38% of cost of revenues, as compared to 39% of cost of revenues in 2015. The total cost of wages and related benefits in 2016 was approximately $874 million, as compared to $852 million in 2015.

Subcontractors and material consumed costs in 2016 constituted 47% of cost of revenues, as compared to 48% in 2015. The total amount of subcontractors and material consumed costs in 2016 was approximately $1.1 billion, similar to that in 2015.

Manufacturing and other expenses in 2016 constituted 14% of cost of revenues, as compared to 13% in 2015. The total cost of manufacturing and other expenses in 2016 was approximately $320 million, as compared to approximately $300 million in 2015.

In 2016, our cost of revenues included a decrease in inventories of approximately $60 million in work-in-progress and finished goods inventories, as compared to a decrease of approximately $30 million in work-in-progress and finished goods inventories in 2015.

Changes from 2015 to 2016 in our cost of revenues and cost of revenues components were not material. We did not identify any developing trends in cost of revenues that we believe would have a material impact on our future operations other than the continued changes in the NIS against the U.S. dollar, which could have an impact mainly on our labor costs.

Gross profit for the year ended December 31, 2016 was $959.6 million (29.4% of revenues), as compared to $897.1 million (28.9% of revenues) in the year ended December 31, 2015. The increase in the gross profit rate in 2016 was mainly due to the mix of programs sold.

Research and Development (R&D) Expenses

We continually invest in R&D in order to maintain and further advance our technologies, in accordance with our long-term plans, based on our estimate of future market needs. Our R&D costs, net of participation grants, include costs incurred for independent research and development and bid and proposal efforts and are expensed as incurred.

Gross R&D expenses in 2016 totaled $291.7 million (8.9% of revenues), as compared to $277.8 million (8.9% of revenues), in 2015.

Net R&D expenses (after deduction of third party participation) in 2016 totaled $255.8 million (7.8% of revenues), as compared to $243.4 million (7.8% of revenues) in 2015.

Marketing and Selling Expenses

We are active in developing new markets and pursue at any given time various business opportunities according to our plans.

Marketing and selling expenses in 2016 were $271.0 million (8.3% of revenues), as compared to $239.4 million (7.7% of revenues) in 2015. The increase in marketing and selling expenses in 2016 was mainly related to the mix of countries and types of marketing activities for projects in which we invested our marketing efforts.

General and Administration (G&A) Expenses

G&A expenses in 2016 were $151.4 million (4.6% of revenues), as compared to $145.7 million (4.7% of revenues) in 2015.

Other Operating Income (Net)

Other operating income, net for the year ended December 31, 2016 amounted to $17.6 million. The amount reflects net gains related to the valuation of shares in two of our Israeli subsidiaries in the energy and automotive areas due to third party investments.

Operating Income

Our operating income in 2016 was $299.0 million (9.2% of revenues), as compared to $268.6 million (8.6% of revenues) in 2015. The main reason for the improvement in the operating income was the increase in the gross profit in 2016 as compared to 2015.

Financial Expense (Net)

Net financing expenses in 2016 were $23.7 million, as compared to $20.2 million in 2015. Financial expenses in 2015 were relatively low mainly due to gains from exchange rate differences.

Other Income (Net)

Other Income, net in 2016 amounted to $4 million. This was due to a capital gain related to the sale of real estate acquired in prior years.

Taxes on Income

Our effective tax rate represents a weighted average of the tax rates to which our various entities are subject.

Taxes on income in 2016 were $45.6 million (effective tax rate of 16.3%), as compared to $46.2 million (effective tax rate of 18.6%) in 2015. The effective tax rates in 2016 and 2015 were affected by prior years adjustments of $18.6 million and $1.4 million, respectively. The adjustments in 2016 were mainly related to tax settlements. The change in the effective tax rate was also affected by the mix of the tax rates in the various jurisdictions in which the Company's entities generate taxable income. We continued to enjoy a lower effective Israeli tax rate and the benefits of an "Approved and Privileged Enterprise", which resulted in savings of $16.1 million and $20.8 million, respectively, in 2016 and 2015, significantly influencing our effective tax rates.

Company's Share in Earnings of Affiliated Entities

The entities, in which we hold 50% or less in shares or voting rights (affiliates) and are therefore not consolidated in our financial statements, operate in complementary areas to our core business activities, including electro-optics and airborne systems.

In 2016, we had income of $5.2 million from our share in earnings of affiliates, as compared to income of $4.5 million in 2015.

Net Income and Earning Per Share (EPS)

As a result of the above, net income in 2016 was $236.9 million (7.3% of revenues), as compared to net income of $202.5 million (6.5% of revenues) in 2015. The diluted EPS was $5.54 in 2016, as compared to $4.74 in 2015.

The number of shares used for computation of diluted EPS in the year ended December 31, 2016 was 42,752,000 shares, as compared to 42,733,000 shares in the year ended December 31, 2015.

2015 Compared to 2014

Revenues

The following table sets forth our revenue distribution by areas of operation:

	Year ended December 31,			
	2015		2014	
	$ millions	%	$ millions	%
Airborne systems	1,225.7	39.4	1,197.9	40.5
C4ISR systems	995.2	32.0	1,118.5	37.8
Land systems	558.7	18.0	274.9	9.3
Electro-optic systems	231.9	7.5	265.1	9.0
Other (mainly non-defense engineering and production services)	96.1	3.1	101.8	3.4
Total	3,107.6	100.0	2,958.2	100.0

Our consolidated revenues in 2015 were the $3,107.6 million, as compared to $2,958.2 million in 2014.

The leading contributors to our revenues were the airborne systems and C4ISR systems areas of operations. The increases in the land systems area of operation were primarily due to increased revenues from tank fire control systems and electro-optic night vision systems sold to Asia-Pacific. Revenues from C4ISR systems in Latin America decreased slightly, due to decline in sales of command and control systems mainly for homeland security applications.

The following table sets forth our distribution of revenues by geographical regions:

	Year ended December 31,			
	2015		2014	
	$ millions	%	$ millions	%
Israel	616.6	19.8	638.9	21.6
North America	838.9	27.0	826.8	27.9
Europe	497.6	16.0	460.9	15.6
Asia-Pacific	800.3	25.8	528.8	17.9
Latin America	325.4	10.5	454.5	15.4
Other	28.8	0.9	48.4	1.6
Total	3,107.6	100.0	2,958.2	100.0

The increase in revenues in Asia-Pacific was mainly due to increased sales of tank fire control systems and electro-optic night vision systems to this region. The decrease in Latin America was a result of lower sales of command and control systems mainly for homeland security applications.

Cost of Revenues and Gross Profit

Cost of revenues in 2015 was $2,210.5 million (71.1% of revenues), as compared to $2,133.2 million (72.1% of revenues) in 2014.

Our major components of cost of revenues are (i) wages and related benefits costs, (ii) subcontractors and material consumed and (iii) manufacturing and other expenses (including depreciation and amortization). The amounts and percentage of those components in 2015 and 2014 were as follows:

Wages and related benefits costs in 2015 constituted 39% of cost of revenues, as compared to 40% of cost of revenues in 2014. The total cost of wages and related benefits in 2015 was approximately $852 million, which was similar to those in 2014.

Subcontractors and material consumed costs in 2015 constituted 48% of cost of revenues, as compared to 52% in 2014. The total amount of subcontractors and material consumed costs in 2015 was approximately $1.1 billion, similar to that in 2014.

Manufacturing and other expenses in 2015 constituted 13% of cost of revenues, similar to that in 2014. The total cost of manufacturing expenses in 2015 was approximately $300 million, similar to that in 2014.

In 2015, our cost of revenues increased due to a decrease of approximately $30 million in our work-in-progress and finished goods inventories, as compared to a reduction in our cost of revenues in 2014 as a result of an increase of approximately $110 million in work-in-progress and finished goods inventories. Also, in 2014, a wholly-owned subsidiary in the U.S. sold certain assets related to a high speed machinery product line. As a result of the sale we recorded in cost of revenues an operating loss of approximately $5 million (see Item 18. Financial Statements - Note 1(D)).

Changes from 2014 to 2015 in our cost of revenues and cost of revenues components were not material We did not identify any developing trends in cost of revenues that we believe would have a material impact on our future operations other than the continued changes in the NIS against the U.S. dollar, which could have an impact mainly on our labor costs.

Gross profit for the year ended December 31, 2015 was $897.1 million (28.9% of revenues), as compared to $825.1 million (27.9% of revenues) in the year ended December 31, 2014. The increase in the gross profit rate in 2015 was mainly due to the mix of programs sold.

Research and Development (R&D) Expenses

Gross R&D expenses in 2015 totaled $277.8 million (8.9% of revenues), as compared to $267.7 million (9.0% of revenues), in 2014.

Net R&D expenses (after deduction of third party participation) in 2015 totaled $243.4 million (7.8% of revenues), as compared to $228.0 million (7.7% of revenues) in 2014.

Marketing and Selling Expenses

Marketing and selling expenses in 2015 were $239.4 million (7.7% of revenues), as compared to $216.5 million (7.3% of revenues) in 2014. The increase in marketing and selling expenses in 2015 was mainly related to the mix of countries and types of marketing activities for projects in which we invested our marketing efforts.

General and Administration (G&A) Expenses

G&A expenses in 2015 were $145.7 million (4.7% of revenues), as compared to $139.6 million in 2014 (4.7% of revenues). The main increase was due to the cost of the phantom bonus retention plan, which is included within G&A expenses. See Item 18. Financial Statements - Note 21(D).

Other Operating Income (Net)

Other operating income, net for the year ended December 31, 2014 amounted to $6.0 million. The amount reflects a net gain related to the revaluation of a previously held investment in the shares of an Israeli subsidiary at the acquisition date due to its accounting treatment as a business combination achieved in stages. As a result of this acquisition, the Company increased its holdings in the subsidiary from 49% to 90%.

Operating Income

Our operating income in 2015 was $268.6 million (8.6% of revenues), as compared to $246.9 million (8.3% of revenues) in 2014. The main reason for the improvement in the operating income was the increase in the gross profit between 2015 and 2014.

Financial Expense (Net)

Net financing expenses in 2015 were $20.2 million, as compared to $47.5 million in 2014. Financing expenses, net, in 2014 were comparatively high, mainly as a result of the accelerated devaluation of the NIS in the third quarter of 2014 and its effect on the Company's U.S. dollar derivative activities, as well as fluctuation of the U.S. dollar against other foreign currencies, such as the Australian dollar and the Brazilian real, during the year.

Taxes on Income

Taxes on income in 2015 were $46.2 million (effective tax rate of 18.6%), as compared to $25.6 million (effective tax rate of 12.8%) in 2014. The effective tax rates in 2015 and 2014 were affected by prior years adjustments of $1.4 million and $7.7 million, respectively, mainly related to tax settlements. The change in the effective tax rate was also affected by the mix of the tax rates in the various jurisdictions in which the Company’s entities generate taxable income. We continued to enjoy a lower effective Israeli tax rate and the benefits of an “Approved and Privileged Enterprise”, which resulted in savings of $24.9 million and $21.8 million, respectively, in 2015 and 2014, significantly influencing our effective tax rates.

Company’s Share in Earnings of Affiliated Entities

In 2015, we had income of $4.5 million from our share in earnings of affiliates, as compared to income of $5.5 million in 2014.

Net Income and Earning Per Share (EPS)

As a result of the above, net income in 2015 was $202.5 million (6.5% of revenues), as compared to net income of $171.0 million (5.8% of revenues) in 2014. The diluted EPS was $4.74 in 2015, as compared to $4.01 in 2014.

The number of shares used for computation of diluted EPS in the year ended December 31, 2015 was 42,733,000 shares, as compared to 42,677,000 shares in the year ended December 31, 2014.

Israeli Debt Offering

In June 2010, Elbit Systems completed a public offering in Israel on the TASE of NIS 1.1 billion (approximately $283 million) Series A Notes (the Series A Notes). The Series A Notes were offered and sold pursuant to a shelf prospectus filed in May 2010 with the Israeli Securities Authority and the TASE. The shelf prospectus expired in 2012. In March and May 2012, respectively, under the framework of the shelf prospectus, Elbit Systems completed both an additional public offering on the TASE and a private placement in Israel to Israeli institutional investors, of new Series A Notes, for an aggregate consideration of approximately NIS 926 million (approximately $249 million). All Series A Notes formed a single series.

We account for the outstanding principal amount of our Series A Notes as long-term liability, in accordance with ASC 470, “Debt”, with current maturities classified as short-term liabilities. Debt issuance costs are capitalized and reported as deferred financing costs, which are amortized over the life of the Series A Notes using the effective interest rate method. As of December 31, 2016, the value of the Series A Notes was $219.8 million, less $63.6 million in current maturities and a fair value adjustment of $15.8 million from cross-currency interest rate swaps.

The Series A Notes are payable in ten equal annual installments on June 30 of each of the years 2011 through 2020. The Series A Notes bear a fixed interest rate of 4.84% per annum, payable on June 30 and December 30 of each of the years through 2020 (the first interest payment was made on December 30, 2010, and the last interest payment will be made on June 30, 2020). (See Item 8. Financial Statements – Note 16.)

The Series A Notes (principal and interest) are in NIS and are not linked to any currency or index. The Series A Notes are unsecured, non-convertible and do not restrict our ability to issue additional notes of any class or distribute dividends in the future. There are no covenants on the Series A Notes.

The Series A Notes are listed for trading on the TASE. However, the Series A Notes are not registered under the U.S. Securities Act of 1933, as amended (the Securities Act), and may not be offered or sold in the United States or to U.S. Persons (as defined in Regulation "S" promulgated under the Securities Act) without registration under the Securities Act or an exemption from the registration requirements of the Securities Act.

We also entered into ten-year cross currency interest rate swap transactions in order to effectively hedge the effect of interest and exchange rate differences resulting from the NIS Series A Notes that were issued in 2010 and the additional Series A Notes that were issued in 2012. Under the cross currency interest rate swaps, we receive fixed NIS at a rate of 4.84% on NIS 2 billion and pay floating six-month USD LIBOR plus an average spread of 1.84% on $450 million, which reflects the U.S. dollar value of the Series A Notes on the specific dates the transactions were consummated. Both the debt and the swap instruments pay semi-annual interest on June 30 and December 31. The purpose of these swap transactions was to convert the NIS fixed rate Series A Notes into USD LIBOR (6 months) floating rate obligations. As a result of these agreements, we are currently paying an effective interest rate of six-month LIBOR (1.32% at December 31, 2016) plus an average of 1.84% on the principal amount, as compared to the original 4.84% fixed rate. The above transactions qualify for fair value hedge accounting. (See also Item 11. Quantitative and Qualitative Disclosures about Market Risk.)

Cash Flows

Our operating cash flow is affected by the cumulative cash flow generated from our various projects in the reported periods. Project cash flows are affected by the timing of the receipt of advances and the collection of accounts receivable from customers, as well as the timing of payments made by us in connection with the performance of the project. The receipt of payments usually relates to specific events during the project, while expenses are ongoing. As a result, our cash flow may vary from one period to another. Our policy is to invest our cash surplus mainly in interest bearing deposits, in accordance with our projected needs.

In general, subsidiaries are able to transfer cash dividends, loans or advances to Elbit Systems and among themselves, subject to corporate policy and tax considerations in their applicable jurisdiction and subject to management commitment not to distribute tax exempt earnings. Such tax considerations have not had in the past, and are not anticipated to have, a material impact on our ability to meet our obligations.

2016

Our net cash flow generated from operating activities in 2016 was approximately $208 million, resulting mainly from our net income and an increase in non-cash operating items of $104 million and an increase in trade and other payables of approximately $253 million, offset by an increase in short and long-term trade receivables of approximately $297 million and a decrease in advances received from customers of approximately $83 million.

Net cash flow used in investment activities in 2016 was approximately $118 million, which was used mainly for the purchase of property, plant and equipment in the amount of $124 million, investments in affiliated companies in the amount of $19 million and offset by proceeds from the net sale of short-term deposits and marketable securities in the amount of $12 million and sale of real estate in the amount of $16 million.

Net cash flow used for financing activities in 2016 was approximately $167 million, which was used mainly for repayment of Series A Notes in the amount of $56 million, payments of dividends in the amount of $68 million and repayment of long-term loans in the amount of $48 million.

2015

Our net cash flow generated from operating activities in 2015 was approximately $435 million, resulting mainly from our net income and an increase in non-cash operating items of $159 million, an increase in advances received from customers of approximately $71 million, a decrease in trade receivables of approximately $32 million and a decrease in inventories of approximately $40 million, offset partly by a decrease in trade payables in the amount of $74 million.

Net cash flow used in investment activities in 2015 was approximately $182 million, which was used mainly to acquire subsidiaries and business operations in the amount of approximately $165 million and to purchase property, plant and equipment in the amount of approximately $99 million, offset by net proceeds from the sale of marketable securities of $71 million.

Net cash flow used for financing activities in 2015 was approximately $154 million, which was used mainly for repayment of Series A Notes in the amount of approximately $56 million, payment of dividends to shareholders in the amount of approximately $70 million (of which $8 million was paid by a subsidiary to non-controlling interests) and net repayment of long-term loans of $2.3 million.

2014

Our net cash flow generated from operating activities in 2014 was approximately $178 million, resulting mainly from our net income and the increase in trade and other payables of approximately $82 million, offset partly by the increase in trade receivables in the amount of $67 million and the increase in inventories of approximately $113 million.

Net cash flow used in investment activities in 2014 was approximately $80 million, which was used mainly to purchase property, plant and equipment in the amount of approximately $71 million.

Net cash flow used for financing activities in 2014 was approximately $89 million, which was used mainly for repayment of Series A Notes in the amount of approximately $56 million and payment of dividends to shareholders in the amount of approximately $68 million (of which $14.5 million was paid by a subsidiary to non-controlling interests).

Financial Resources

The financial resources available to us include profits, collection of accounts receivable, advances from customers and government of Israel and other third parties' programs such as the Israel Innovation Authority and development grants. In addition, we have access to bank credit lines and financing in Israel and abroad based on our capital, assets and activities.

Elbit Systems and some subsidiaries are obligated to meet various financial covenants set forth in our respective loan and credit agreements. Such covenants include requirements for shareholders' equity, current ratio, operating profit margin, tangible net worth, EBITDA, interest coverage ratio and total leverage. As of December 31, 2015 and 2016, the Company met all financial covenants.

On December 31, 2016, we had total borrowings from banks and public institutions in the amount of $166 million in long-term loans, of which most of the loans mature in 2017, and $1,219 million in guarantees issued on our behalf by banks and other financial institutions, mainly in respect of advance payment and performance guarantees provided in the regular course of business. In addition, at December 31, 2016, we had $218 million in outstanding debt under our Series A Notes, including $56 million maturing in 2017. On December 31, 2016, we had a cash balance amounting to

$223 million. We also have the ability to raise funds on the capital market and through expansion of our credit lines. (See above “Israeli Debt Offering”.)

As of December 31, 2016, we had working capital of $527 million and a current ratio of 1.27. We believe that our working capital and cash flow from operations are sufficient to support our current requirements and financial covenants.

We believe that our current cash balances, cash generated from operations, lines of credit and financing arrangements will provide sufficient resources to meet our operational needs for at least the next fiscal year. However, our ability to borrow funds from the banking system may be impacted by the global financial and liquidity situation. See Item 3. Risk Factors – General Risk Related to Our Business and Market.

For further information on the level, maturity and terms of our borrowings, see Item 18. Financial Statements – Notes 12, 15 and 16.

We believe our cash balance, amounts available under lines of credits, cash flows from operating activities and our ability to access external capital resources should be sufficient to satisfy existing short-term and long-term commitments and plans, and also to provide adequate financial flexibility to take advantage of potential strategic business opportunities should they arise within the next year.

Pensions and Other Post-Retirement Benefits. We account for pensions and other post-employment arrangements in accordance with ASC 715 “Compensation – Retirement Benefits”. Accounting for pensions and other post-retirement benefits involves judgment about uncertain events, including estimated retirement dates, salary levels at retirement, mortality rates, rates of return on plan assets, determination of discount rates for measuring plan obligations, healthcare cost trend rates and rates of utilization of healthcare services by retirees. These assumptions are based on the environment in each country. (For our pension and other post-retirement benefit assumptions at December 31, 2016 and 2015, see Item 18. Financial Statements – Note 17.) At December 31, 2016, our employee benefit liabilities were $376 million, of which we had severance funds of $264 million set aside to satisfy potential obligations.

Material Commitments for Capital Expenditures.We believe that we have adequate sources of funds to meet our material commitments for capital expenditures for the fiscal year ending December 31, 2016 and the subsequent fiscal year (see above “Financial Resources”). Our anticipated capital expenditures (which include mainly the purchase of equipment, buildings and an enhancement to our Enterprise Resource Planning (ERP) system) as of December 31, 2016 are somewhat higher than those as of December 31, 2015, due to an anticipated increase in expenditures for buildings, ERP enhancements and certain other expenses. We plan to pay for such anticipated capital expenditures using cash from operations. (See also Item 18. Financial Statements – Consolidated Statements of Cash Flows and Note 10.)

Impact of Inflation and Exchange Rates

Functional Currency. Our reporting currency is the U.S. dollar, which is also the functional currency for most of our consolidated operations. A majority of our sales are made outside of Israel in non-Israeli currency, mainly U.S. dollars, as well as a majority of our purchases of materials and components. A significant portion of our expenses, mainly labor costs, are in NIS. Some of our subsidiaries have functional currencies in Euro, GBP, Brazilian reals, Australian dollars and other currencies. Transactions and balances originally denominated in U.S. dollars are presented in their original amounts. Transactions and balances in currencies other than the U.S. dollar are remeasured in U.S. dollars according to the principles set forth in ASC 830 “Foreign Currency Matters”. Exchange gains and losses arising from remeasurement are reflected in financial expenses, net, in the consolidated statements of income.

Market Risks and Variable Interest Rates

Market risks relating to our operations result mainly from changes in interest rates and exchange rates. We use derivative instruments to limit exposure to changes in exchange rates in certain cases. We also typically enter into forward contracts in connection with transactions where long-term contracts have been signed and that are denominated in currencies other than U.S. dollars or NIS. We also enter from time to time into forward contracts and other hedging instruments related to NIS based on market conditions.

We use financial instruments and derivatives in order to limit our exposure to risks arising from changes in exchange rates and to mitigate our exposure to effects of changes in foreign currency rates and interest rates. The use of such instruments does not expose us to additional exchange rate risks since the derivatives are held against an asset (for example, excess assets in Euros). Our policy in utilizing these financial instruments is to protect the dollar value of our cash and cash equivalent assets rather than to serve as a source of income.

In the context of our overall treasury policy specific objectives apply to the management of financial risks. These objectives are disclosed under the headings below “NIS/U.S. Dollar Exchange Rates”, “Inflation and Currency Exchange Rates” and “Foreign Currency Derivatives and Hedging”.

On December 31, 2016, our liquid assets were comprised of bank deposits and short and long-term investments. Our deposits and investments earn interest based on variable interest rates, and their value as of December 31, 2016 was therefore exposed to changes in interest rates. Should interest rates either increase or decrease, such change may affect our results of operations due to changes in the cost of the liabilities and the return on the assets that are based on variable rates.

NIS/U.S. Dollar Exchange Rates. We attempt to manage our financial activities in order to reduce material financial losses in U.S. dollars resulting from the impact of inflation and exchange rate fluctuations on our non-U.S. dollar assets and liabilities. Our income and expenses in Israeli currency are translated into U.S. dollars at the prevailing exchange rates as of the date of the transaction. Consequently, we are affected by changes in the NIS/U.S. dollar exchange rates. We entered into other derivative instruments to limit our exposure to exchange rate fluctuations, related mainly to payroll expenses incurred in NIS. (See Item 11. Quantitative and Qualitative Disclosure of Market Risks.) The amount of our exposure to the changes in the NIS/U.S. dollar exchange rate may vary from time to time. (See Item 3. Key Information – Risk Factors – Risks Relating to Our Israeli Operations.)

Inflation and Currency Exchange Rates

The U.S. dollar cost of our operations in Israel is influenced by any increase in the rate of inflation in Israel that is not fully offset by the devaluation of the NIS in relation to the U.S. dollar. Unless inflation in Israel is offset by a devaluation of the NIS, such inflation may have a negative effect on the profitability of contracts where Elbit Systems or any of our Israeli subsidiaries receives payment in U.S. dollars, NIS linked to U.S. dollars or other foreign currencies, but incurs expenses in NIS linked to the CPI. Inflation in Israel and currency fluctuations may also have a negative effect on the profitability of fixed-price contracts where we receive payments in NIS.

In the past, our profitability was negatively affected when inflation in Israel (measured by the change in the CPI from the beginning to the end of the calendar year) exceeded the devaluation of the NIS against the U.S. dollar and at the same time we experienced corresponding increases in the U.S. dollar cost of our operations in Israel. For example, in 2014, inflation decreased by approximately 0.2%, and the NIS depreciated against the U.S. dollar by approximately 12%. In 2015, the inflation rate decreased by approximately 0.2%, and the NIS depreciated against the U.S. dollar by approximately 0.3%. In 2016, the inflation rate decreased by approximately 0.2%, and the NIS strengthened against the U.S. dollar by approximately 1.5%. There can be no assurance that we will not be materially adversely affected in the future if inflation in Israel exceeds the devaluation of the NIS against the U.S. dollar or if the timing of such devaluation lags behind increases in inflation in Israel.

A devaluation of the NIS in relation to the U.S. dollar also has the effect of decreasing the dollar value of any of our assets that consist of NIS or accounts receivable denominated in NIS, unless such assets or accounts receivable are linked to the U.S. dollar. Such a devaluation also has the effect of reducing the U.S. dollar amount of any of our liabilities that are payable in NIS, unless such payables are linked to the U.S. dollar. On the other hand, any increase in the value of the NIS in relation to the U.S. dollar will have the effect of increasing the U.S. dollar value of any unlinked NIS assets as well as the U.S. dollar amount of any unlinked NIS liabilities and expenses.

Foreign Currency, Derivatives and Hedging

While our functional currency is the U.S. dollar, we also have some non-U.S. dollar or non-U.S. dollar linked exposure to currencies other than NIS. These are mainly non-U.S. dollar customer debts, payments to suppliers and subcontractors as well as obligations in other currencies, assets or undertakings. Some subcontractors are paid in local currency under prime contracts where we are paid in U.S. dollars. The exposure on these transactions has not been in amounts that are material to us. However, when we view it economically advantageous, due to anticipated uncertainty in the applicable foreign exchange rates, we seek to minimize our foreign currency exposure by entering into hedging arrangements, obtaining periodic payments upon the completion of milestones, obtaining guarantees and security from customers and sharing currency risks with subcontractors.

A significant part of our future cash flows that will be denominated in currencies other than the NIS and the U.S. dollar were covered as of December 31, 2016 by forward contracts. On December 31, 2016, we had forward contracts for the sale and purchase of Euro, GBP and various other currencies totaling approximately $207 million ($127 million in Euros, $36 million in GBP and the balance of $44 million in other currencies).

We also use forward exchange hedging contracts and options strategies in order to limit our exposure to exchange rate fluctuation associated with payroll expenses, mainly incurred in NIS. These include forward contracts with notional amount of approximately $647 million to purchase NIS maturing in 2016. (See also Item 11. Quantitative and Qualitative Disclosure of Market Risks.) As of December 31, 2016, an unrealized net loss of approximately $19 million was included in accumulated other comprehensive income. As of December 31, 2016, all of the forward contracts are expected to mature during the years 2017 – 2021.

Regarding the measures taken to reduce the foreign currency exchange rate impact on our Series A Notes see above "Liquidity and Capital Resources – Israeli Debt Offering."

The table below presents the balance of the derivative instruments held in order to limit the exposure to exchange rate fluctuations as of December 31, 2016 and is presented in millions of U.S. dollar equivalent terms:

Forward	Notional Amount*	Unrealized Gain (Loss)
Buy US$ and Sell:		
Euro	89.8	6.5
GBP	31.5	3.0
NIS	—	—
Other various currencies	19.3	0.1

Forward	Notional Amount*	Unrealized Gain (Loss)
Sell US$ and Buy:		
Euro	37.1	(1.6)
GBP	4.8	(0.7)
NIS	646.5	3.1
Other various currencies	25.1	—

* Notional amount information is based on the foreign exchange rate at year end.

Contractual Obligations

	Up to 1 year	2-3 years	4-5 years	More than 5 years
	(U.S. dollars in millions)			
1. Long-Term Debt Obligations[1]	165	—	1	—
2. Series A Notes[1]	56	112	56	—
3. Interest payment[2]	9	7	1	—
4. Operating Lease Obligations[3]	47	63	36	—
5. Purchase Obligations[3]	972	192	45	104
6. Other Long-Term Liabilities Reflected on the Company's Balance Sheet under U.S. GAAP[4]	—	—	—	—
7. Other Long-Term Liabilities[5]	—	—	—	—
Total	1,249	374	139	104

(1) The above includes derivative instruments defined as hedge accounting - see Item 18. Financial Statements - Note 2(Y).

(2) All our long-term debt borrowings and Series A Notes bear interest at variable rates, which are indexed to LIBOR (plus a fixed spread). For long-term fixed rate borrowings (mainly Series A Notes) we use variable interest rate swaps, effectively converting our long-term fixed rate borrowings to long-term variable rate borrowings indexed to LIBOR. (See also Item 18. Financial Statements - Notes 15 and 16.) To estimate the scheduled interest payments related to Series A Notes, we applied the future expected interest rates that were used for calculating the fair value of our interest rate swap at the balance sheet date. To estimate the scheduled interest payments related to our other long-term debt obligations we used the LIBOR (plus a fixed spread) interest rates that were effective at the balance sheet date. The majority of our long-term debt obligations are scheduled to be repaid within a period of two - three years.

(3) For further description of the Purchase Obligations see above "Long-Term Arrangements and Commitments – Purchase Commitments" and see Item 18. Financial Statements – Notes 20(D) and 20(G).

(4) The obligation amount does not include an amount of $376 million of pension and employee termination liabilities. See Item 18. Financial Statements – Notes 2(R) and 17. The obligation amount also does not include an amount of $47 million of tax reserve related to uncertain tax positions. See Item 18. Financial Statements – Note 18.

(5) See below "Off-Balance Sheet Transactions."

Off-Balance Sheet Transactions

Buy-Back

In connection with projects in certain countries, Elbit Systems and some of our subsidiaries have entered and may enter in the future into "buy-back" or "offset" agreements, required by a number of our customers as a condition to our obtaining orders for our products and services. These agreements are customary in our industry and are designed to facilitate economic flow back (buy-back) and/or technology transfer to businesses or government agencies in the applicable country.

These commitments may be satisfied by our placement of direct work or vendor orders for supplies and/or services, transfer of technology, investments or other forms of assistance in the applicable country. The buy-back rules and regulations, as well as the underlying contracts, may differ from one country to another. The ability to fulfill the buy-back obligations may depend, among other things, on the availability of local suppliers with sufficient capability to meet our requirements and which are competitive in cost, quality and schedule. In certain cases, our commitments may also be satisfied through transactions conducted by other parties.

We do not commit to buy-back agreements until orders for our products or services are definitive, but in some cases the orders for our products or services may become effective only after our corresponding buy-back commitments become effective. Buy-back programs generally extend at least over the relevant commercial contract period and may provide for penalties in the event we fail to perform in accordance with buy-back requirements. In some cases we provide guarantees in connection with the performance of our buy-back obligations.

Should we be unable to meet such obligations we may be subject to contractual penalties, our guarantees may be drawn upon and our chances of receiving additional business from the applicable customers could be reduced or, in certain cases, eliminated. (See Item 3. Risk Factors – General Risks Related to Our Business and Market.)

At December 31, 2016, we had outstanding buy-back obligations totaling approximately $1.1 billion that extend through 2024.

Non-GAAP Financial Data

The following non-GAAP financial data is presented to enable investors to have additional information on our business performance as well as a further basis for periodical comparisons and trends relating to our financial results. We believe such data provides useful information to investors by facilitating more meaningful comparisons of our financial results over time. Such non-GAAP information is used by our management to make strategic decisions, forecast future results and evaluate our current performance. However, investors are cautioned that, unlike financial measures prepared in accordance with GAAP, non-GAAP measures may not be comparable with the calculation of similar measures for other companies.

The non-GAAP financial data below includes reconciliation adjustments regarding non-GAAP gross profit, operating income, net income and diluted EPS. In arriving at non-GAAP presentations, companies generally factor out items such as those that have a non-recurring impact on the income statements, various non-cash items, significant effects of retroactive tax legislation and changes in accounting guidance and other items which, in management's judgment, are items that are considered to be outside the review of core operating results. In our non-GAAP presentation, we made certain adjustments as indicated in the table below.

These non-GAAP measures are not based on any comprehensive set of accounting rules or principles. We believe that non-GAAP measures have limitations in that they do not reflect all of the amounts associated with our results of operations, as determined in accordance with GAAP, and that these measures should only be used to evaluate our results of operations in conjunction with the corresponding GAAP measures. Investors should consider non-GAAP financial measures in addition to, and not as replacements for or superior to, measures of financial performance prepared in accordance with GAAP.

Reconciliation of GAAP (Audited) to
Non-GAAP (Unaudited) Supplemental Financial Data
(U.S. dollars in millions, except for per share amounts)

	Years Ended December 31,		
	2016	2015	2014
GAAP gross profit	959.6	897.1	825.1
Adjustments:			
Amortization of purchased intangible assets	31.2	29.9	21.6
Non-GAAP gross profit	990.8	927.0	846.7
Percent of revenues	30.4 %	29.8 %	28.6 %
GAAP operating income	299.0	268.6	246.9
Adjustments:			
Amortization of purchased intangible assets	41.2	48.1	43.1
Gain from change in holdings	(17.6)	—	(6.0)
Non-GAAP operating income	322.6	316.7	284.0
Percent of revenues	9.9 %	10.2 %	9.6 %
GAAP net income attributable to Elbit Systems' shareholders	236.9	202.5	171.0
Adjustments:			
Amortization of purchased intangible assets	41.2	48.1	43.1
Impairment of investment	2.5	—	—
Capital gain	(3.9)	—	—
Gain from changes in holdings	(16.4)	—	(6.0)
Related tax benefits	(6.1)	(8.2)	(6.9)
Non-GAAP net income attributable to Elbit Systems' shareholders	254.2	242.4	201.2
Percent of revenues	7.8 %	7.8 %	6.8 %
GAAP diluted net EPS	5.54	4.74	4.01
Adjustments, net	0.41	0.93	0.70
Non-GAAP diluted net EPS	5.95	5.67	4.71

Item 6. Directors, Senior Management and Employees.

Directors and Executive Officers

Board of Directors (Board)

Our directors as of March 15, 2017 are as follows:

Name	Age	Director Since
Michael Federmann (Chair)	73	2000
Rina Baum	71	2001
Yoram Ben-Zeev	72	2014
David Federmann (Vice Chair)	42	2007
Dr. Yehoshua Gleitman (External Director)	67	2010
Dov Ninveh	69	2000*
Professor Ehood (Udi) Nisan	49	2016
Dalia Rabin (External Director)	66	2010
Professor Yuli Tamir	63	2015

* was not a member of the Board from April - October 2013

The term of office of each director, other than the External Directors, expires at the annual general shareholders meeting to be held during 2017. The term of office for Yehoshua Gleitman as an External Director expires in March 2019, and the term of office for Dalia Rabin as an External Director expires in November 2019.

Michael Federmann. Michael Federmann has served as chair of the Board since 2000. Since 2002 he has served as chair and CEO of Federmann Enterprises Ltd. (FEL), a privately-owned Israeli company in which Mr. Federmann has held managerial positions since 1969. FEL, directly and through subsidiaries, holds a diversified portfolio of investments, including ownership of approximately 46% of the Company's outstanding ordinary shares. FEL also has ownership interests in Dan Hotels Ltd. (Dan Hotels), an Israeli hotel chain, in Freiberger Compound Materials GmbH (Freiberger), a German company engaged in the supply of materials for the semi-conductor industry, as well as in several financial, real estate and venture capital investments. Mr. Federmann serves as chair of the board of directors of Dan Hotels and is chair of the board of governors of the Hebrew University of Jerusalem (the Hebrew University). He serves as the president of the Israel - Germany Chamber of Industry and Commerce and is an Honorary Commander of the Order of the British Empire (CBE). Mr. Federmann holds a bachelor's degree in economics and political science from the Hebrew University, which has also awarded him an honorary doctorate in philosophy.

Rina Baum. Rina Baum is vice president for investments of FEL and since 1986 has served as a director and as general manager of Unico Investment Company Ltd. She serves as a director of Dan Hotels and Etanit Building Products Ltd. (Etanit), and holds other managerial positions with investee companies of FEL. She also serves as a director of Harel-PIA Mutual Funds Management Company Ltd. Mrs. Baum holds an L.L.B. degree in law from the Hebrew University.

Yoram Ben-Zeev. Yoram Ben-Zeev serves as a director of Kardan Ltd., an Israel-based publicly-traded company, operating mainly in the fields of real estate, property sales and rentals, leasing of vehicles as well as investments in the communication and technology sectors. Mr. Ben-Zeev also serves on the board of several non-profit organizations in Israel and is a member of the Israel Ministry of Foreign Affairs' (MFA) Nomination Committee. He served as Israel's ambassador to the Federal Republic of Germany from 2007 until 2012. Prior to that, he served for 26 years in various senior positions in the MFA, including as deputy general director, head of the North America Division and senior member of the directorate. Among other positions held during his service in the MFA, Mr. Ben-Zeev served as Israel's consul general to the West Coast in the United States, political advisor to the president of the State of Israel, special coordinator to the Middle East peace process, advisor to prime minister Ehud Barak for the Camp David Peace Conference and chair of the MFA's Steering Committee - Foreign Service Strategic and Functional Planning and of the Israel-Canada Annual Strategic Forum. Mr. Ben-Zeev has been the recipient of special awards for his diplomatic service from both the U.S. House of Representatives and the president of the Federal Republic of Germany. Mr. Ben-Zeev holds a bachelor's degree in Middle Eastern studies, political science and international relations from the Hebrew University and a master's degree in Middle Eastern studies from the Tel-Aviv University. Mr. Ben Zeev serves as the chair of the Corporate Governance and Nominating Committee of the Board and as a member of the Audit Committee, the Financial Statements Review Committee and the Compensation Committee of the Board.

David Federmann. David Federmann has served as vice chair of the Board since 2015. He has served in various management capacities in FEL since 2000. He currently serves as chair of the board of Freiberger and as a member of the boards of directors of Dan Hotels and BGN Technologies (the technology transfer company of Ben-Gurion University). David Federmann is the son of Michael Federmann, chair of the Board. Mr. Federmann holds a bachelor’s degree in mathematics and philosophy from New York University.

Dr. Yehoshua Gleitman (External Director). Dr. Yehoshua (Shuki) Gleitman has served since 2001 as the managing partner of Platinum VC, a venture capital firm. He currently serves as the chair of the board of directors of Capital Point Ltd. and and of GIBF - Guangzhou Israel Bio Tech Fund, and is a director of Teuza - A Fairchild Technology Venture Ltd. From 2000 until 2005, he was the chief executive officer and a director of SFKT Ltd. From 1997 until 1999, Dr. Gleitman was the chief executive officer of Ampal-American Israel Corporation. Prior to that he served in various senior management positions in the Israeli government and in Israeli industry, including as director general and chief scientist of the Israel Ministry of Industry and Trade, chair of the U.S.-Israel Industrial R&D Foundation, joint chair of the U.S.-Israel Science and Technology Commission, managing director of AIMS Ltd., vice president and general manager of Elop Electro-Optic Industries Ltd.’s (Elop) marine and aerial operations and head of the Laser Branch of the Israel Ministry of Defense. Dr. Gleitman serves as the honorary consul general of Singapore to Israel. Dr. Gleitman holds bachelor of science, master of science and PhD degrees in physical chemistry from the Hebrew University. Dr. Gleitman serves as the chair of the Audit Committee and the Financial Statements Review Committee of the Board and as a member of the Compensation Committee and the Corporate Governance and Nominating Committee of the Board. He is considered by the Board to have accounting and financial expertise under the Companies Law.

Dov Ninveh. Dov Ninveh has served as chief financial officer and a manager in FEL since 1994 and as general manager of Heris Aktiengesellschaft since 2012. He serves as a director of Dan Hotels and Etanit, and as a member of the board of Freiberger. Mr. Ninveh served as a director of Elop from 1996 until 2000. From 1989 to 1994, he served as deputy general manager of Etanit Building Products Ltd. Mr. Ninveh holds a bachelor of science degree in economics and management from the Israel Institute of Technology (the Technion).

Professor Ehood (Udi) Nisan. Prof. Ehood (Udi) Nisan is a professor in the School of Public Policy and Government of the Hebrew University. He serves as chair of the board of directors of Midreshet Sde Boker Banegev Ltd., an Israeli government company, is a member of the board of Bezalel Academy of Art and chair of its finance committee, and an External Director of Solgreen (Israel) Ltd. and of Rekah Pharmaceutical Industry Ltd. From 2013 to 2016, he was the chair of the board of directors of Delek, The Israel Fuel Corporation Ltd. From 2009 to 2011, Prof. Nisan was the director of the budgets department of the Israeli Ministry of Finance, and from 2007 to 2009 he served as the director of the Government Companies Authority. Prior to that he served in various executive positions in the Israeli Ministry of Finance and served as a member and chair of several government and public committees, including from 1999 until 2002 as the CEO of the Jerusalem Development Authority. Prof. Nisan holds bachelor’s and master's degrees in economics and business administration, and a PhD in economics and public policy from the Hebrew University. Prof. Nisan serves as a member of the Audit Committee and the Financial Statements Review Committee of the Board. He is considered by the Board to have accounting and financial expertise under the Companies Law.

Dalia Rabin (External Director). Dalia Rabin is the chair of the Yitzhak Rabin Center, a national institute dedicated to ensuring that the legacy of former Prime Minister and Minister of Defense Yitzhak Rabin continues to impact Israeli society through experiential educational programming, a national archive and a museum. Before that, Mrs. Rabin was a member of the Israeli Government from 1999 until 2002. She is the president of the Center for Arbitration and

Dispute Resolution and a member of the board of directors of Peilim Investment Portfolio Management Company Ltd. Mrs. Rabin was elected to the Knesset on the Center Party Ticket in 1999 and acted as chair of the Ethics Committee. She also served on the Constitution, Law and Justice Committee; the Committee for the Advancement of the Status of Women; the State Control Committee; and the Committee for the Advancement of the Status of the Child. In 2001, Mrs. Rabin was appointed Deputy Minister of Defense. She resigned in 2002 to head the Rabin Center. Prior to her election to the Knesset, Mrs. Rabin served as the legal advisor of the professional associations of the General Federation of Labor (the Histadrut). She also served for fourteen years in the Tel-Aviv District Attorney's Office in the Civil Division, specializing in labor law. Mrs. Dalia Rabin holds an L.L.B degree from Tel-Aviv University. Mrs. Rabin serves as the chair of the Compensation Committee of the Board and as a member of the Audit Committee, the Financial Statements Review Committee and the Corporate Governance and Nominating Committee.

Professor Yuli Tamir. Prof. Yuli Tamir has served since 2010 as the President of Shenkar College, a public college in Ramat-Gan, Israel. Before that, from 2006 until 2009, she served as Israel's Minister of Education. Prof. Tamir also served as the Minister of Immigration from 1999 until 2001. She was a deputy speaker of the Knesset and a member of the Finance Committee, the Education Committee and the Security and Foreign Affairs Committee. Prof. Tamir is a founding member of the Israeli peace movement "Peace Now". She served as the chair of the Association of Civil Rights in Israel and was a member of the political committee of the Women's Lobby. She was a professor at Tel-Aviv University and a scholar-in-residence at Princeton University, Harvard University, the University of Pennsylvania, the European University in Florence, the Central European University in Budapest and the Blavatnik School of Government in Oxford. Prof. Tamir is the recipient of numerous academic awards. Prof. Tamir holds a bachelor of science degree in biology and a master's degree in political science from the Hebrew University and a PhD in political philosophy from Oxford University. Prof. Tamir serves as a member of the Audit Committee and the Financial Statements Review Committee of the Board.

Executive Officers

Our executive officers, the President and CEO and the Executive Vice Presidents who report to the President and CEO) as of March 15, 2017 are as follows:

Name	Age	Position
Bezhalel Machlis	54	President and Chief Executive Officer
Elad Aharonson	43	Executive Vice President and General Manager – ISTAR Division
Jonathan Ariel	60	Executive Vice President and Chief Legal Officer
David Block Temin	61	Executive Vice President, Chief Compliance Officer and Senior Counsel
Adi Dar	45	Executive Vice President and General Manager – CYBERBIT
Joseph Gaspar	68	Executive Vice President and Chief Financial Officer
Zeev Gofer	64	Executive Vice President – Strategic and Business Development - North America
Shelly Gordon	56	Executive Vice President – Human Resources
Ran Kril	46	Executive Vice President - International Marketing and Business Development
Edgar Maimon	61	Executive Vice President and General Manager – EW and SIGINT Elisra Division
Avi Mizrachi	59	Executive Vice President - Business Development - Israel and Southeast Asia
Ilan Pacholder	62	Executive Vice President – Mergers and Acquisitions and Financing
Yuval Ramon	51	Executive Vice President and Chief Operating Officer
Gideon Sheffer	68	Executive Vice President – Strategic Planning
Yoram Shmuely	56	Executive Vice President and General Manager – Aerospace Division
Yehuda Vered	59	Executive Vice President and General Manager – Land and C4I Division
Yehoshua Yehuda	49	Executive Vice President - Chief Technology Officer

Bezhalel Machlis. Bezhalel Machlis has served as the Company’s President and CEO since 2013. From 2008 until 2012, he served as executive vice president and general manager – land and C4I division, after serving as corporate vice president and general manager – land systems and C4I since 2004. In 2003, he served as corporate vice president and general manager – ground, C4I and battlefield systems. From 2000 until 2002, he served as vice president – battlefield and information systems. Mr. Machlis joined Elbit Ltd. in 1991 and held various management positions in the battlefield and information systems area. Prior to that, he served as an artillery officer in the IDF, where he holds the rank of colonel (reserves). Mr. Machlis holds a bachelor of science degree in mechanical engineering and a bachelor of arts degree in computer science from the Technion and an MBA from Tel-Aviv University. He is a graduate of Harvard University Business School's Advanced Management Program.

Elad Aharonson. Elad Aharonson has served as Executive Vice President and General Manager - ISTAR Division since 2015. From 2011 until his current appointment, he served as executive vice president and general manager - UAS Division, after serving as vice president - UAV systems since 2009. He joined Elbit Systems in 2004 and held various senior program management positions relating to UAS. Prior to that, Mr. Aharonson served as an officer in the IDF holding command positions in the Artillery Branch and in the Ground Forces’ UAV unit. Mr. Aharonson holds an L.L.B. degree in law and a bachelor’s degree in business administration from the Hebrew University.

Jonathan Ariel. Jonathan Ariel has served as Executive Vice President and Chief Legal Officer since 2012, after serving as senior vice president and general counsel since 2008. He joined Elbit Systems in 1996 and has held several positions within the legal department, including vice president and general counsel of Elop. Prior to joining Elbit Systems, Mr. Ariel served as a legal advisor both in-house and in private law firms in Israel and the U.S. Mr. Ariel holds an L.L.B degree in law from Tel-Aviv University and is admitted to the Israeli Bar.

David Block Temin. David Block Temin has served as Executive Vice President, Chief Compliance Officer and Senior Counsel since 2012, after serving as executive vice president, chief legal officer and chief compliance officer since 2008. Prior to that he served as corporate vice president and general counsel since 2000 and as general counsel since 1996. From 1987 to 1996, he was a legal advisor to Elbit Ltd. Prior to that, Mr. Block Temin was an attorney with law firms in New York City. Mr. Block Temin received a juris doctor degree as well as a master of arts degree in international relations from Stanford University and holds a bachelor of arts degree in political science from the University of Maryland. He is admitted to the Israeli bar.

Adi Dar. Adi Dar was appointed as Executive Vice President and General Manager - CYBERBIT in 2015. From 2009 until his current appointment, he served as executive vice president and general manager - Electro-optics - Elop Division. From 2006 until 2009, he served as Elop’s vice president for business development. Prior to that he served in a number of management positions in Elbit Systems, which he joined in 2002. From 1999 until 2002, he was vice president for business development and marketing at Elron Telesoft Ltd. Mr. Dar holds a bachelor's degree in industrial engineering from the Technion and an MBA from Tel-Aviv University.

Joseph Gaspar. Joseph Gaspar was appointed as an Executive Vice President in 2008 and has served as Chief Financial Officer since 2001. He was appointed as a corporate vice president in 2000 and served as corporate vice president – strategy, technology and subsidiaries from 2000 until 2001. From 1996 until 2000, he held the position of corporate vice president, marketing and business development of Elop. Mr. Gaspar joined Elop in 1975 and held several management positions, including vice president and general manager of Elop’s optronics product division and co-manager of an Elop subsidiary in the United States. Mr. Gaspar holds a bachelor of science degree from the Technion in electronic engineering with advanced studies in digital signal processing and communication.

Zeev Gofer. Zeev Gofer has served as Executive Vice President – Strategic and Business Development – North America since 2009. From 2008 until his current appointment he was executive vice president – business development and marketing, after serving as corporate vice president – business development and marketing since 2003. He previously served as corporate vice president and as co-general manager – aircraft and helicopter upgrades and systems from 2000 until 2003. From 1999 until 2000, he was vice president – aircraft upgrades and airborne systems division, having served as division manager since 1996. He joined Elbit Ltd. in 1982 and held various management positions, including director of the aircraft upgrade division, director of a major aircraft upgrade program, director of avionics system engineering and technical manager of the Lavi aircraft avionics program. Mr. Gofer holds bachelor's and master of science degrees in electronic engineering from the Technion and a master of science of management degree from the Polytechnic University of New York.

Shelly Gordon. Shelly Gordon was appointed as Executive Vice President - Human Resources shortly after joining Elbit Systems in 2015. From 2012 until joining Elbit Systems, she headed executive education at the Interdisciplinary Center Herzilya. From 2005 until 2012, Dr. Gordon served as vice president - organizational development and talent management at Amdocs Limited and served as vice president - human resources at Elite Confectionary Ltd. from 2000 until 2005. Prior to that, she worked as an independent consultant with management teams and senior managers, leading major transformations in varied organizations and industries. Dr. Gordon received a bachelor’s degree in education and art from the Hebrew University, a bachelor’s degree in psychology from Tel-Aviv University and a doctorate in management studies from the University of Hertfordshire in the U.K.

Ran Kril. Ran Kril was appointed as Executive Vice President - International Marketing and Business Development in 2015. From 2013 until his current appointment, he served as vice president for marketing and sales in the aerospace division, after serving as the aerospace division's vice president for sales and contracts since 2007. He joined Elbit Systems in 1997 and held various senior positions in the marketing, sales and finance departments of the aerospace division. Mr. Kril holds a bachelor of science degree in economics and management from the Technion and a master of science of management degree from the Polytechnic University of New York.

Edgar Maimon. Edgar Maimon has served as Executive Vice President and General Manager – EW and SIGINT Elisra Division since 2013. From 2005 until his current appointment Mr. Maimon served as vice president of marketing and business development at Elbit Systems EW and SIGINT – Elisra Ltd. (Elisra). He joined Elisra in 2004. Prior to that Mr. Maimon served for 26 years in the IAF, where he retired with the rank of colonel. He served as the head of the IAF's C4I systems engineering department and held several additional senior positions in the IAF. Mr. Maimon holds a bachelor of science degree in electronic engineering from Ben Gurion University.

Avi Mizrachi. Avi Mizrachi was appointed Executive Vice President - Business Development - Israel and Southeast Asia in January 2017, after serving as executive vice president - business development - Southeast Asia since 2014. He joined Elbit Systems in 2013 as a senior vice president in the corporate marketing department. Prior to that, Mr. Mizrachi completed 33 years of service in the IDF, retiring with the rank of major general. From 2009 to 2012, he served as the commander of the IDF's Central Command. Prior to that he held a number of senior command positions including head of the Technology and Logistics Branch and commander of the IDF's Ground Forces. Mr. Mizrachi holds a bachelor of arts degree in computer science and business administration from Pace University in New York and is a graduate of the Harvard University Business School's Advanced Management Program.

Ilan Pacholder. Ilan Pacholder has served as Executive Vice President – Mergers and Acquisitions since 2009, in addition to his position as Executive Vice President – Financing to which he was appointed in 2008. From 2008 until 2015, he also served as executive vice president - offset. During 2007, he served as vice president and chief financial officer of Tadiran Communications Ltd. Mr. Pacholder served as corporate secretary and vice president – finance and capital markets of Elbit Systems from 2003 until 2006. From 2001 until 2003, he served as vice president – finance. Mr. Pacholder joined Elbit Ltd. in 1994 and held various senior positions in the finance department. Prior to joining Elbit Ltd. he served as the chief financial officer for Sanyo Industries in New York. Before that Mr. Pacholder worked for Bank Leumi in New York and held the position of vice president in the international and domestic lending departments. Mr. Pacholder holds a bachelor of arts degree in accounting and economics from Queens College in New York and an MBA in finance and investments from Adelphi University.

Yuval Ramon. Yuval Ramon was appointed Executive Vice President and Chief Operating Officer in 2015. From 2014 until his current appointment, he served as vice president - corporate operations. Prior to that, from 1998 - 2013, he served in a number of management positions in Elbit Systems of America, including as senior vice president of operations, site lead at the Merrimack operations and director of sales and contracts for the Fort Worth operations. He joined Elbit Systems in 1994 as a sales and contract manager. Mr. Ramon holds a bachelor of science degree in industrial engineering and economics from the Technion.

Gideon Sheffer. Gideon Sheffer has served as Executive Vice President – Strategic Planning since January 2017, after serving as executive vice president - strategic planning and business development – Israel since 2009. From 2008 until 2009 he served as executive vice president – strategic planning, after serving as corporate vice president – strategic planning since 2001. Prior to that he served as acting head of Israel's National Security Council and as national security advisor to former prime minister Ehud Barak. In 1998, he completed 32 years of service in the IDF, retiring with the rank of major general. From 1995 to 1998, he served on the general staff as head of the IDF's human resources branch. Before that, he served as deputy commander of the IAF. Mr. Sheffer held a number of command positions in the IAF after serving as a fighter aircraft and helicopter pilot. Mr. Sheffer holds a bachelor's degree in Israel studies from Bar Ilan University and is a graduate of the Harvard University Business School's Advanced Management Program.

Yoram Shmuely. Yoram Shmuely has served as Executive Vice President and General Manager – Aerospace Division since 2013, after serving as executive vice president and co-general manager of the aerospace division since 2008. Mr. Shmuely served as corporate vice president and co-general manager – airborne and helmet systems since 2003. He served as corporate vice president and general manager – helmet mounted systems from 2000 until 2003. From 1998 until 2000, he was vice president – helmet mounted systems division. From 1996 until 1998, he served as president of a U.S. subsidiary of Elbit Systems. Mr. Shmuely joined Elbit Ltd. in 1990 and served as director of Elbit Ltd.’s helmet mounted display business. He served as a fighter aircraft pilot in the IAF. Mr. Shmuely holds a bachelor of science degree in electronic engineering from the Technion.

Yehuda Vered. Yehuda (Udi) Vered has served Executive Vice President and General Manager – Land and C4I Division since 2013. From 2009 until his current appointment Mr. Vered served as executive vice president – service solutions as well as vice president – marketing for the land and C4I division. Prior to that, since 2004 he served as chief financial officer and vice president for contracts and sales of the land and C4I division. Mr. Vered joined Elbit Systems in 2003 as vice president for contracts and sales and chief financial officer – ground, C4I and battlefield systems. Before that, he served as an aircrew officer in the IAF, where he holds the rank of colonel (reserves). Mr. Vered holds a bachelor of arts degree in management and economics from Tel-Aviv University, an MBA from Ben Gurion University and is a graduate of the Harvard University Business School's Advanced Management Program.

Yehoshua Yehuda. Yehoshua (Shuki) Yehuda was appointed as Executive Vice President and Chief Technology Officer in January 2016. From 2008 until his current appointment, he served as Elisra's vice president and chief technology officer as well as general manager - radar solutions business unit. Prior to that he served in a number of management positions in Elisra, which he joined in 2000. Prior to joining Elisra, Mr. Yehuda served as an officer in the IDF, holding command positions in the Intelligence Corps. Mr. Yehuda holds a bachelor of science degree in electrical engineering from Tel-Aviv University and a master of science degree in neural computation from the Hebrew University. He is a graduate of Harvard University Business School's Advanced Management Program.

President and CEO of Elbit Systems of America

Elbit Systems of America's President and CEO reports to the board of directors of Elbit Systems of America in accordance with the provisions of the Special Security Agreement with the U.S. Department of Defense. (See Item 4. Information on the Company – U.S. Subsidiaries.) Raanan Horowitz has served as President and CEO of Elbit Systems of America since 2007. He served as executive vice president and general manager of EFW from 2001 until his current appointment. From 1991 until 2001, Mr. Horowitz held various management positions with EFW and other U.S. subsidiaries of the Company. From 1989 to 1991, he served as a senior program manager for Elbit Ltd. Mr. Horowitz serves on the executive committee of the board of governors of the Aerospace Industries Association and is a member of the executive committee of the national board of directors of the Leukemia and Lymphoma Society. Mr. Horowitz holds an MBA from the Seidman School of Business of Grand Valley State University in Allendale, Michigan. He also holds a master of science degree in electrical engineering and a bachelor of science degree in mechanical engineering from Tel-Aviv University.

Compensation of Directors and Executive Officers

Compensation Policy

Pursuant to the Companies Law, a public company such as Elbit Systems is required to adopt a compensation policy regarding the terms of office and employment of its Office Holders (as defined in the Companies Law) (generally Elbit Systems' directors and executive officers), including compensation, equity-based awards, releases from liability, indemnification and insurance, severance and all other employment benefits (Employment Terms). In accordance with the Companies Law, in 2014 our shareholders, following a favorable recommendation of the Compensation Committee of the Board and the approval of the Board as a whole, approved a compensation policy (the Compensation Policy) applicable to Employment Terms arrangements with our Office Holders. The Company contemplates proposing a new compensation policy which will be submitted for the consideration of the Compensation Committee and approval by the Board and the Company's shareholders, in accordance with the requirements of the Companies Law.

The Companies Law requires that we obtain the approval of the Compensation Committee and the Board as a whole for each Employment Terms arrangement with an Office Holder. In addition, the Companies Law requires that we also obtain the approval of our shareholders for any Employment Terms arrangement with our CEO or a director, or with any other Office Holder where the terms are not consistent with an approved compensation policy. With respect to such arrangement with our CEO or in connection with such arrangement with an Office Holder that is not consistent with an approved compensation policy, such shareholder approval requires that (a) a majority of the Applicable Shareholders (as defined below) vote to approve the arrangement and (b) Applicable Shareholders who vote against approval do not represent more than 2% of our total voting rights. For these purposes, “Applicable Shareholders” means shareholders who are not controlling shareholders and do not have a Personal Interest (as defined in the Companies' Law) in the arrangement to be approved and who participate in the voting, in person, by proxy or by written ballot (excluding abstentions).

Under certain circumstances described in the Companies Law, if the Employment Terms of an Office Holder who is not a director or a controlling shareholder that requires the approval of the shareholders as described above, are not approved by shareholders by the required minority, the Compensation Committee and the Board may nonetheless approve such arrangement.

In addition, pursuant to the Companies Law, changes determined by the Compensation Committee not to be material to the existing Employment Terms of an Office Holder who is not a director, require only the approval of the Compensation Committee.

In accordance with the requirements of the Companies' Law, at the Shareholders' Extraordinary General Meeting held on March 8, 2016, the Company's shareholders, following the recommendations of the Compensation Committee and the Board, approved, by the required majority, the Employment Terms of our CEO, Mr. Bezhalel Machlis, with effect as of April 1, 2016.

For further information see below "Board Practices - Compensation Committee", Item 10 - Additional Information - General Provisions of Israeli Law and Related Provisions of Articles of Association - Office Holders; and Item 10 - Additional Information - Approval of Certain Transactions - Approval of Employment Terms of Office Holders.

Compensation of Directors and Executive Officers

Aggregate Compensation to Directors and Executive Officers

The following table sets forth the aggregate compensation costs for all of our directors and executive officers as a group for the fiscal year ended December 31, 2016:

	Salaries, Directors' Fees Commissions and Bonuses	Pension, Retirement and Similar Benefits
	(U.S. dollars in thousands)	
All directors (consisting of 10 persons)	$485 (1)	$ —
All executive officers (consisting of 20 persons)	$23,149 (2)(3)	$ 1,702

(1) Directors Fees

In accordance with the Compensation Policy and with the Israeli Companies Regulations (Relief from Related Parties' Transactions), 5760-2000, in meetings held in October 2016, the Compensation Committee and the Board as a whole approved payment to the Company's directors, including to Michael Federmann and David Federmann (who each may be considered a direct or indirect controlling shareholder of the Company), in accordance with maximum regulatory rates payable to External Directors under Israeli law for companies similarly classified based on their shareholding equity, which is also paid to the Company's External Directors. As a result, each of the Company's directors is and will be entitled to an annual fee of NIS 111,345 (equal to approximately $29,057) and a per meeting fee of NIS 4,285 (equal to approximately $1,118), which reflect the above mentioned fee levels, linked to the Israeli consumer price index.

(2) Phantom Bonus Retention Plan

(i) In 2012, our Board approved a "Phantom" Bonus Retention Plan for Senior Officers (the Phantom Plan). The purpose of the Phantom Plan is to provide an incentive to retain applicable senior officers of Elbit Systems and certain of our subsidiaries by strengthening the alignment of the Phantom Plan recipients' financial interests with those of the Company and our shareholders. Under the Phantom Plan, phantom bonus units were granted to executive officers within the framework of three consecutive yearly tranches, each such tranche comprised of an equal number of units which entitle the recipient the right to receive the financial benefit (Unit Benefits) deriving from increases in the value of the Company's shares during the applicable periods, subject to certain restrictions. Unit Benefits are calculated separately for each tranche. The Unit Benefits accrual period for each tranche is three years from the respective grant date of the applicable bonus units.

(ii) At the end of each year during the Unit Benefits accrual period for each tranche, the Company calculates the value of each Unit Benefit for such year (the Unit Benefits Value). The Unit Benefits Value is the difference between: (i) the basic value for that year - i.e. the average closing price on the TASE of the Company's shares for the thirty (30) trading days preceding the beginning of the respective year, and (ii) the year-end value for said year - i.e. the average closing price on the TASE of the Company's shares for the thirty (30) trading days preceding the end of the relevant year.

(iii) The accrued Unit Benefits Value for each yearly tranche is the sum of the first year Unit Benefits Value, the second year Unit Benefits Value and the third year Unit Benefits value for that tranche. Because of certain conditions in the Phantom Plan, the Unit Benefits Value for a particular year of a tranche may be zero or only part of the calculated Unit Benefits Value for that year. The aggregate maximum Unit Benefits Value of a unit granted for the full three years of a tranche may not exceed 100% of the basic value determined for that tranche for its first year. Except in certain circumstances described in the Phantom Plan, the accrued Unit Benefits Value of a tranche is paid to the recipient at the end of the third year of the respective tranche.

(iv) Except as otherwise provided in the Phantom Plan, entitlement to receipt of benefits is conditioned on the recipient remaining an employee of the Company. The benefits received under the Phantom Plan are subject to tax at the regular personal income tax rates.

(v) We recorded amounts of approximately $15.1 million and $14.7 million in 2015 and 2016, respectively, as compensation costs related to grants to our executive officers under the Phantom Plan. See Item 18. Financial Statements – Note 21(D).

(3) Other Compensation

In addition to payment of monthly salary and annual bonus, our executive officers are entitled to reimbursement of travel and certain other expenses in a manner similar to other employees.
Office Holders of the Company, including our directors and executive officers, are covered by our D&O liability insurance policy and are entitled to indemnification in accordance with our Articles of Association and pursuant to an indemnification letter as approved by our shareholders. (See Item 10. "Additional Information - Exemption, Insurance and Indemnification of Directors and Officers - Exemption, Insurance and Indemnification Under the Companies Law".)

Compensation of Five Most Highly Compensated Office Holders

The following describes the compensation of our five most highly compensated Office Holders with respect to the year ended December 31, 2016. All amounts specified are in terms of cost to the Company as recorded in our financial statements. Each of the mentioned Office Holders was employed on a full-time basis in 2016.
Compensation for each of the specified executive officers is indicated in terms of the following types of compensation costs:
(1) Salary Costs. Salary Costs include gross salary and social benefits. Salary Costs also include, if and to the extent applicable to a respective Office Holders, vacation days, sick days, convalescence pay, monthly remuneration for a study fund, contributions made by the Company on behalf of the Office Holders to an insurance policy or a pension fund, contributions by the Company on behalf of the Office Holders towards work disability insurance, benefit for company car and benefit for communication costs. U.S. dollar amounts indicated for Salary Costs are based on the exchange rate of 3.832, which represents the average weighted U.S. dollar - NIS exchange rate for the date of payments for each of the months during 2016 (Average Exchange Rate).
(2) Bonus Costs. Bonus Costs represent bonuses (annual, managerial evaluation and/or special, as the case may be) to the Office Holders with respect to the year ended December 31, 2016. U.S. dollar amounts indicated for Bonus Costs

are based on the Average Exchange Rate .

(3) Phantom Bonus Costs. Phantom Bonus Costs are costs recorded with respect to the year ended December 31, 2016 related to the value of benefits under tranches of phantom bonus units granted to the Office Holders under our Phantom Bonus Retention Plan (see above "Aggregate Compensation to Directors and Officers - Table - Note (2)" and Item 18. Financial Statements - Note 21(D).) Benefits under the Phantom Plan cover tranches payable over three years.

(4) Stock Option Costs. Stock Option Costs are costs recorded with respect to the year ended December 31, 2016 related to stock options in start-up entities or similar ventures established by the Company (whether by allocation of options by the start-up entities themselves or by allocation of shares or options to purchase shares of such start-up entities which are held by the Company).
(5) Other Costs. Other Costs are one-time contributions made by the Company on behalf of the Office Holder to an insurance policy or a pension fund and/or towards employee disability insurance, as well as accrued vacation benefits, which contributions are required under Israeli law and agreed employment terms in the event the monthly salary is increased. These contributions take into account, among other factors, retroactive contributions on the basis of the actual years of employment with the Company.
The five most highly compensated Office Holders in 2016 were as follows (U.S. dollar amounts in thousands):

(1) Bezhalel Machlis - President and CEO. Compensation costs recorded for Mr. Machlis in 2016 included: $808 in Salary Costs, $800 in Bonus Costs, $1,927 in Phantom Bonus Costs and $509 in Other Costs.

(2) Joseph Gaspar - Executive Vice President and Chief Financial Officer. Compensation costs recorded for Mr. Gaspar in 2016 included: $528 in Salary Costs, $148 in Bonus Costs, $1,012 in Phantom Bonus Costs, $7 in Stock Option Costs and $148 in Other Costs.

(3) Yoram Shmuely - Executive Vice President and General Manager - Aerospace Division. Compensation costs recorded for Mr. Shmuely in 2016 included: $575 in Salary Costs, $128 in Bonus Costs, $1,012 in Phantom Bonus Costs, $2 in Stock Option Costs and $108 in Other Costs.

(4) Itzhak Dvir - Corporate Executive Lead One ERP (former Executive Vice President - Special Matters). Compensation costs recorded for Mr. Dvir in 2016 included: $484 in Salary Costs, $109 in Bonus Costs, $1,012 in Phantom Bonus Costs and $11 in Other Costs.

(5) Gideon Sheffer - Executive Vice President - Strategic Planning. Compensation costs recorded for Mr. Sheffer in 2016 included: $449 in Salary Costs, $141 in Bonus Costs, $1,012 in Phantom Bonus Costs and $9 in Other Costs.

Board Practices

Appointment of Directors

Our directors who are not External Directors are elected by the shareholders at the annual general shareholders meeting. They hold office until the next annual general shareholders meeting, which is held at least once every calendar year but not more than 15 months after the previous general shareholders meeting. Between annual general shareholders meetings our Board may appoint new directors to fill vacancies. The External Directors are elected at a general shareholders meeting as described under "External Directors" below. Our Articles of Association authorize a maximum of 17 directors, a minimum of five directors and, unless otherwise approved by our shareholders, the number of directors will be nine.

The Companies Law requires the board of directors of a public company, after considering the company's type and size and the scope and complexity of its activities, to determine the minimum number of directors on the board having "financial and accounting expertise" as defined in the Companies Law. Our Board has adopted a policy pursuant to which it will include a minimum of two directors having financial and accounting expertise as defined under the Companies Law. Currently our Board has two directors who are considered by the Board to have financial and accounting expertise: Dr. Gleitman and Prof. Nisan. In addition, the Companies Law provides that a person will not be elected and will not serve as a director in a public company if he or she does not have the required qualifications and the ability to dedicate an appropriate amount of time for the performance of his or her director position in the company, taking into consideration, among other factors, the special needs and size of the company. A general shareholders meeting of a company whose shares are publicly traded, at which the election of a director is to be considered, will not be held unless the nominee has declared to the company that he or she complies with the above-mentioned requirements, and the details of his or her applicable qualifications are provided, and in case such nominee is an "Independent Director" as defined in the Companies Law (see below), that such nominee has also declared that he or she complies with the independence criteria under the Companies Law. Each of our elected directors has declared to our Board that he or she complies with the required qualifications under the Companies Law for appointment as a member of our Board, detailing his or her applicable qualifications, and that he or she is capable of dedicating the appropriate amount of time for the performance of his or her role as a member of our Board. In addition, Mr. Ben-Zeev, Prof. Nisan and Prof. Tamir also each have declared that he or she complies with the criteria of an Independent Director under the Companies Law.

In addition to the External Directors, under the Companies Law and regulations thereunder, a director in a company such as Elbit Systems, who qualifies as an independent director under the relevant non-Israeli rules relating to independence standards, such as the Nasdaq director independence criteria, may be considered an Independent Director pursuant to the Companies Law if such director meets certain conditions listed therein, and provided such director has been designated as such by the audit committee. The Audit Committee has designated Mr. Ben-Zeev, Prof. Nisan and Prof. Tamir as Independent Directors under t