

BOS BETTER ONLINE SOLUTIONS LTD
Form 20-F
April 14, 2014

As filed with the Securities and Exchange Commission on April 14, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 20-F

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

or

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

For the fiscal year ended December 31, 2013

or

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

For the transition period from _____ to _____

or

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

Date of event requiring this shell company report

Commission file number: 001-14184

B.O.S. BETTER ONLINE SOLUTIONS LTD.
(Exact name of Registrant as specified in its charter)

ISRAEL
(Jurisdiction of incorporation or organization)

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

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

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(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

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

| Title of each class | Name of each exchange on which registered |
|--|---|
| Ordinary shares, nominal value NIS 80.00 per share | NASDAQ Capital Market |

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

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

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

1,258,245 ordinary shares, nominal value NIS 80.00 per share, as of December 31, 2013 and 1,298,215 ordinary shares, nominal value NIS 80.00 per share, as of March 31, 2014.

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

Yes No

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

Yes No

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

Yes No

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

Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

U.S. GAAP

International Financial Reporting Standards as issued by the International Accounting Standards Board

Other

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

Item 17 Item 18

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

Yes No

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

Forward Looking Statements

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

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

Market data and forecasts used in this report have been obtained from independent industry sources that we believe to be reliable. We have not independently verified the data obtained from these sources and we cannot assure you of the accuracy or completeness of the data. Forecasts and other forward-looking information obtained from these sources are subject to the same qualifications and additional uncertainties accompanying any estimates of future market size.

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PART I

Item 1: Identity of Directors, Senior Management and Advisors

Not applicable.

Item 2: Offer Statistics and Expected Timetable

Not applicable.

Item 3: Key Information Regarding BOS

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

3A. Selected Consolidated Financial Data

The selected consolidated statement of operations data for B.O.S. Better Online Solutions Ltd. set forth below with respect to the years ended December 31, 2013, 2012 and 2011, and the selected consolidated balance sheet data as of December 31, 2013 and 2012, have been derived from our audited Consolidated Financial Statements listed in Item 18, which have been prepared in accordance with generally accepted accounting principles in the United States (“U.S. GAAP”). The selected consolidated statement of operations data set forth below with respect to the years ended December 31, 2010 and 2009, and the consolidated balance sheet data as of December 31, 2011 and 2010 and 2009, are derived from other consolidated financial statements not included herein and have been prepared in accordance with U.S. GAAP. The financial statements were audited by Kost Forer Gabbay & Kasierer, an independent registered public accounting firm and a member of Ernst & Young Global. The financial statements of BOS - Supply Chain Solutions (Lynk) Inc. (“Lynk”, formerly, Lynk, USA Inc.) and its subsidiaries for the year ended December 31, 2009 were audited by Arik Eshel, CPA & Assoc., PC an independent registered public accounting firm. The selected consolidated financial data presented below should be read in conjunction with and is qualified entirely by reference to Item 5: “Operating and Financial Review and Prospects” and the Notes to the Financial Statements included in this Annual Report on Form 20-F.

The Company has accounted for discontinued operations, in accordance with ASC 205-20, Discontinued operations of the Financial Accounting Standards Board. As such, the results of discontinued operations, including revenues, cost of revenues, operating expenses, and other income and expenses, in connection with discontinued operation in previous periods, have been reclassified in the accompanying statements of operations.

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

| | Year Ended December 31, | | | | |
|---|-------------------------|-----------|-----------|-----------|--------|
| | 2009 | 2010 | 2011 | 2012 | 2013 |
| Revenues | 25,467 | 30,187 | 33,434 | 24,503 | 25,903 |
| Cost of revenues | 19,741 | 22,668 | 26,481 | 19,050 | 20,751 |
| Inventory write offs | 2,235 | 36 | 443 | 385 | 121 |
| Gross profit | 3,491 | 7,483 | 6,510 | 5,068 | 5,031 |
| Operating expenses: | | | | | |
| Research and development, net | 360 | 372 | 403 | 125 | - |
| Sales and marketing | 5,426 | 4,068 | 4,273 | 3,058 | 2,924 |
| General and administrative | 2,004 | 1,786 | 2,252 | 1,693 | 1,523 |
| Impairment of goodwill and other intangible assets | 383 | - | 555 | - | - |
| Total operating expenses | 8,173 | 6,226 | 7,483 | 4,876 | 4,447 |
| Operating Profit (loss) | (4,682) | 1,257 | (973) | 192 | 584 |
| Financial expense, net | (606) | (961) | (2,241) | (781) | (549) |
| Other expenses, net | (409) | (120) | (172) | (147) | (22) |
| Income (loss) before tax on income | (5,697) | 176 | (3,386) | (736) | 13 |
| Tax benefit (taxes on income) | (329) | (5) | 172 | 187 | (13) |
| Income (loss) from continuing operations | (6,026) | 171 | (3,214) | (549) | - |
| Net income (loss) from discontinued operations | (3,075) | (806) | - | - | - |
| Net loss | (9,101) | (635) | (3,214) | (549) | - |
| Basic and diluted net income (loss) per share from continuing operations | \$(9.28) | \$0.28 | \$(4.56) | \$(0.49) | \$- |
| Basic and diluted net income (loss) per share from discontinued operations | \$(4.72) | \$(1.24) | \$- | \$- | \$- |
| Basic and diluted net loss per share | \$(14) | \$(0.96) | \$(4.56) | \$(0.49) | \$- |
| Weighted average number of shares used in computing basic net earnings (loss) per share | 652 | 656 | 705 | 1,118 | 1,172 |
| Weighted average number of shares used in computing diluted net earnings (loss) per share | 652 | 656 | 705 | 1,118 | 1,172 |

| Consolidated Balance Sheet Data: | As of December 31, | | | | |
|---|--------------------|--------|--------|--------|--------|
| | 2009 | 2010 | 2011 | 2012 | 2013 |
| Cash and Cash Equivalents | 564 | 703 | 411 | 354 | 1,005 |
| Working Capital (*) | 237 | 386 | (349) | (739) | (500) |
| Total Assets | 27,362 | 22,130 | 20,069 | 18,049 | 19,187 |
| Short-term banks loan and current maturities of | | | | | |
| long-term bank loans | 7,983 | 7,778 | 7,496 | 6,383 | 5,924 |
| Long-term liabilities | 4,274 | 4,073 | 2,440 | 2,017 | 1,305 |
| Share Capital | 13,225 | 13,959 | 23,065 | 23,374 | 26,178 |
| Additional paid in Capital | 57,042 | 56,805 | 51,093 | 50,891 | 48,634 |
| Shareholders' equity | 3,643 | 3,713 | 3,598 | 3,156 | 3,703 |
| (*)Working capital comprises of: | | | | | |
| Current assets | 19,682 | 14,730 | 13,682 | 12,137 | 13,679 |
| Less: current liabilities | 19,445 | 14,344 | 14,031 | 12,876 | 14,179 |
| | 237 | 386 | (349) | (739) | (500) |

3B. Capitalization and Indebtedness

Not applicable.

3C. Reasons for the Offer and Use of proceeds

Not applicable.

3D. Risk Factors

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

Risks relating to our financial results and capital structure:

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

As of December 31, 2013, we had \$793,000 in long-term debt to Dimex Systems Ltd. (includes current maturities of \$428,000) and \$1.28 million in long-term bank loans (includes current maturities of \$498,000). In addition, at December 31, 2013, we had \$5.4 million of short term bank loans drawn under a revolving credit facility. On February 6, 2014, we received a \$500,000 one year bridge loan from YA Global Master SPV Ltd. (“YA Global”), which is repayable in nine equal monthly installments commencing three months after the receipt of the loan.

We depend mainly on cash generated by continuing operating activities to make payments on our debt. We cannot assure you that we will generate sufficient cash flow from operations to make the scheduled payments on our debt. Our ability to meet our debt obligations will depend on whether we can successfully implement our business strategy, as well as on economic, financial, competitive and technical factors (See “Item 5B. Liquidity and Capital Resources” below).

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

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

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

While the Company's management believes that its cash resources are sufficient to meet its operating needs for at least the next 12 months, there can be no assurance of this. As of December 31, 2013, the Company was not in compliance with certain financial covenants in its loan documents with Bank HaPoalim, however the Company had received a waiver of compliance from Bank HaPoalim that was valid through the earlier of May 1, 2014 or the Company's filing of its 2013 financial statements. On February 2, 2014 Bank HaPoalim agreed to cancel of all the covenants for 2014 and future years for an administrative fee of approximately \$5,000.

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

As of December 31, 2013, we had an accumulated deficit of \$71 million. We ended year 2013 at breakeven ,but had net losses in each of the prior four fiscal years. Our ability to maintain and improve future levels of sales and achieve profitability depends on many factors, which include:

- delivering products in a timely manner;
- successfully implementing our business strategy;
- increased demand for existing products; and
- controlling costs.

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

We may be unable to maintain our gross profit margins.

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

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

We rely on Bank Leumi le-Israel Ltd. (“Bank Leumi”) and on Bank Ha'Poalim to provide credit facilities to our subsidiaries. As of December 31, 2013, we had \$5.4 million drawn under a Bank Leumi short term revolving credit facility. In addition, as of December 31, 2013, we had \$498,000 current maturities of long term loans and \$781,000 of long terms bank loans mainly from Bank Ha'Poalim. As of December 31, 2013, the Company was not in compliance with certain financial covenants in its loan documents with Bank HaPoalim, however the Company had received a waiver of compliance from Bank HaPoalim that was valid through the earlier of May 1, 2014 or the Company's filing of its 2013 financial statements. On February 2, 2014 Bank HaPoalim agreed to cancel of all the covenants for 2014 and future years for an administrative fee of approximately \$5,000.

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

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

The repayment of the Company's debt to Bank HaPoalim is secured by long term bank deposits in the amount of \$471,000.

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

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

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

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

Our loan agreements contain a number of conditions and limitations on the way in which we can operate our business, including limitations on our ability to raise debt, sell or acquire assets and pay dividends. These limitations may force us to pursue less than optimal business strategies or forgo business arrangements which could have been financially advantageous to our shareholders and us. Our failure to comply with the and restrictions contained in our loan agreements could lead to a default under the terms of these agreements (See “Item 5B. Liquidity and Capital Resources”).

Risks related to our business:

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

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

In order to succeed we would need to be able to:

- retain the executive officers and key technical personnel who have been involved in the development of our two operating divisions;
- attract and retain additional qualified personnel to provide technological depth; and
- attract and retain highly skilled personnel in various functions of our business.

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

We may be unable to effectively manage our growth and expansion, and as a result, our business results may be adversely affected.

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

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

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

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

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

We may expand our business through acquisitions that could result in diversion of resources and extra expenses. This could disrupt our business and adversely affect our financial condition.

In recent years, the Company has made several acquisitions, such as the acquisition of Dimex Systems' business in March 2008, and the acquisition of BOS Supply Chain Solutions (Summit) Inc. ("Summit"), a New Jersey based company, in October 2007 (Summit filed for Chapter 7 bankruptcy relief on November 23, 2010). The negotiation of acquisitions, investments or joint ventures, as well as the integration of acquired or jointly developed businesses or technologies, could divert our management's time and resources. There can be no assurance that we will be able to successfully integrate and manage future acquisitions, if they occur.

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

We have been, and may be in the future, unsuccessful in growing our RFID based business

To date, we were unable to sufficiently expand our RFID based business, and the contribution of our RFID based solutions to our revenues remains relatively small. There can be no assurance that we will be successful in expanding our RFID product offerings and RFID related revenues in the future, and this may have a material adverse effect on our growth prospects.

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

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

The balance of allowance for bad debt as of December 31, 2013 amounted to \$148,000, which was determined by our management to be sufficient. In face of a global economic slowdown or if a local or global recession reoccurs, we may be required to record additional and significant allowances for bad debts.

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

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

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

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

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

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

Our products may contain defects that may be costly to correct, delay market acceptance of our products, harm our reputation and expose us to litigation.

Despite testing by us, errors may be found in our software products. If defects are discovered, we may not be able to successfully correct them in a timely manner, or at all. Defects and failures in our products could result in a loss of, or delay in, market acceptance of our products and could damage our reputation. Although our standard license agreement with our customers contains provisions designed to limit our exposure to potential product liability claims, it is possible that these provisions may not be effective or enforceable under the laws of some jurisdictions, and we could fail to realize revenues and suffer damage to our reputation as a result of, or in defense of, a substantial claim.

Our products may infringe on the intellectual property rights of others.

Third parties may assert claims that we have violated a patent, trademark, copyright or other proprietary intellectual property right belonging to them. As is characteristic of our industry, there can be no assurance that our products do not or will not infringe the proprietary rights of third parties, that third parties will not claim infringement by us with respect to patents or other proprietary rights or that we would prevail in any such proceedings. Any infringement claims, whether or not meritorious, could result in costly litigation or arbitration and divert the attention of technical and management personnel. Any adverse outcome in litigation alleging infringement could require us to develop non-infringing technology or enter into royalty or licensing agreements. If, in such situations, we are unable to obtain licenses on acceptable terms, we may be prevented from selling products that infringe such intellectual property of a third party. An unfavorable outcome or settlement regarding one or more of these matters could have a material adverse effect on our business and operating results.

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

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

We rely on certain key suppliers.

Most of our sales rely on products of certain key suppliers, which we represent on a non-exclusive basis. 34% of our Supply Chain Solutions division purchases in the year 2013 were sourced from five key suppliers and 58% of our RFID and Mobile Solutions division purchases in the year 2013 were sourced from another five key suppliers. In the year 2012, 14% of our Supply Chain Solutions division purchases were sourced from five key suppliers and 52% of our RFID and Mobile Solutions purchases were sourced from five key suppliers.

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

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

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

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

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

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

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

Similarly, we are exposed to the risk that the NIS, after adjustment for inflation in Israel, will appreciate in relation to the U.S. dollar. In that event, the dollar-measured cost of our operations in Israel will increase and our dollar-measured results of operations will be adversely affected. In 2013 and 2012, the NIS appreciated by approximately 7.0% and 2.3% respectively, against the U.S. dollar and in 2011 the NIS devaluated by approximately 7.7% against the U.S. dollar. In 2011, 2012 and 2013, the annual inflation rate in Israel was approximately 2.17%, 1.63% and 1.82%, respectively, and therefore the U.S. dollar cost of our Israeli operations increased in 2013 and 2012 and decreased in 2011. We cannot predict whether in the future the NIS will appreciate against the U.S. dollar or vice versa. Any increase in the rate of inflation in Israel, unless the increase is offset on a timely basis by a devaluation of the NIS in relation to the U.S. dollar, will increase our labor and other costs, which will increase the U.S. dollar cost of our operations in Israel and harm our results of operations (see "Item 5A. Results of Operation - Impact of Inflation and Currency Fluctuations" below)

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

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

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Our ability to anticipate changes in technology and industry standards and successfully market new and enhanced products as well as additional applications for existing products, in each case on a timely basis, will be critical in our ability to grow and remain competitive. If we are unable, for technological or other reasons, to market products that are competitive in technology and price and responsive to customer needs, our business will be materially adversely affected.

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

We have sold and intend to continue to sell products in overseas markets, including in Europe and the Far East. A number of risks are inherent in engaging in international transactions, including:

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

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

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

A financial and economic downturn in Israel and in one or more of our overseas markets may cause revenues of our customers to decrease. This may result in reductions in sales of products and services in some markets, longer sales cycles, slower adoption of new technologies and increased price competition. In addition, weakness in the end-user market could negatively affect the cash flow of our customers who could, in turn, delay paying their obligations to us. This could increase our credit risk exposure and cause delays in our recognition of revenues on future sales to these customers.

We may be obligated to indemnify our directors and officers.

The Company has agreements with its directors and senior officers which provide, subject to Israeli law, indemnification by the Company of directors and senior officers for: (a) monetary liability imposed upon them in favor of a third party by a judgment, including a settlement or an arbitral award confirmed by the court, as a result of an act or omission of such person in its capacity as a director or officer of the Company, (b) reasonable litigation expenses, including attorney's fees, incurred by them pursuant to an investigation or a proceeding commenced against them by a competent authority if it was terminated without an indictment and without having a monetary charge imposed on them in exchange for a criminal procedure (as such terms are defined in the Israeli Companies Law 1999 – 5759 (the "Israeli Companies Law")), or that was terminated without an indictment but with a monetary charge imposed on them in exchange for a criminal procedure in a crime that does not require proof of criminal intent, or in connection with a financial sanction, as a result of an act or omission of such person in its capacity as a director or officer of the Company, (c) reasonable litigation expenses, including attorney's fees, incurred by such a director or officer or imposed on him by a court, in a proceeding brought against him by or on behalf of the Company or by a third party, or in a criminal action in which he was acquitted, or in a criminal action which does not require criminal intent in which he was convicted, in each case relating to acts or omissions of such person in its capacity as a director or officer of the Company, (d) expenses, including reasonable litigation expenses and legal fees, incurred by such a director or officer as a result of a proceeding instituted against him in relation to (A) infringements that may result in imposition of financial sanction pursuant to the provisions of Chapter H'3 under the Israeli Securities Law or (B) administrative infringements pursuant to the provisions of Chapter H'4 under the Israeli Securities Law or (C) infringements pursuant to the provisions of Chapter I'1 under the Israeli Securities Law; and (e) payments to an injured party of infringement under Section 52ND(a)(1)(a) of the Israeli Securities Law. Payment pursuant to such indemnification may materially adversely affect our financial condition.

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

Based upon our current and projected income, assets and activities, we do not believe that at this time BOS is a passive foreign investment company for U.S. federal income tax purposes, but there can be no assurance that we will not be classified as such in the future. Such classification may have grave tax consequences for U.S. shareholders. One method of avoiding such tax consequences is by making a "qualified electing fund" election for the first taxable year in which the Company is a PFIC. However, such an election is conditioned upon our furnishing U.S. shareholders annually with certain tax information. We do not presently prepare or provide such information, and such information may not be available to U.S. shareholders if we are subsequently determined to be a PFIC. You are advised to consult with your own tax advisor regarding the particular tax consequences related to the ownership and disposition of our ordinary shares under your own particular factual circumstances.

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

Our balance sheet contains a significant amount of goodwill and other amortizable intangible assets in long-term assets, totaling about \$4.3 million at December 31, 2013. We review goodwill annually for impairment, or more frequently when indications for potential impairment exist. We review other amortizable intangible assets for impairment when indicators for impairment exist. The volatility of our share price can cause significant changes to our market capitalization. If the value of our market capitalization falls below the value of our Shareholders' equity, it might indicate that impairment is required. An impairment of goodwill may be required if the carrying amount of a reporting unit exceeds its fair value.

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

There are substantial risks associated with the Standby Equity Distribution Agreements, which could contribute to the decline of our share price and have a dilutive impact on our existing shareholders.

The sale of our ordinary shares to YA Global Master SPV Ltd., or YA Global pursuant to the Standby Equity Distribution Agreements, or the SEDAs, (see "Item 5B – Liquidity and Capital Resources") will have a dilutive impact on our shareholders. The closing market price of our ordinary shares as of March 31, 2014 was \$6.56. Assuming this is the price per share used as a basis for the calculations for all draw downs under the SEDAs, we would be able to sell the full 317,460 ordinary shares to YA Global, and receive gross proceeds of approximately \$ 2,000,000. Such amount of shares would comprise 19.6% of our issued and outstanding share capital (post sale), which would dilute our current shareholders.

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

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

Risks related to our ordinary shares:

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

The market price of our ordinary shares has been and may continue to be highly volatile and subject to wide fluctuations. From January 1, 2012 through March 31, 2013, the daily closing price of our ordinary shares in NASDAQ has ranged from \$1.64 to \$8.40 per share. We believe that these fluctuations have been in response to a number of factors including the following, some of which are beyond our control:

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

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

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

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

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

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

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

There can be no assurance that the Company will continue to qualify for listing on the Nasdaq Capital Market. If the Company's ordinary shares are delisted from the Nasdaq Capital Market, trading in its ordinary shares could be conducted on the over-the-counter market. In addition, if the Company's ordinary shares were delisted from the Nasdaq Capital Market, it would be subject to the so-called penny stock rules that impose restrictive sales practice requirements on broker-dealers who sell those securities. Consequently, de-listing, if it occurred, could affect the ability of the shareholders to sell their ordinary shares in the secondary market. The restrictions applicable to shares that are de-listed, as well as the lack of liquidity for shares that are traded on an electronic bulletin board, may adversely affect the market price of such shares.

Risks related to our location in Israel:

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

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

Since its establishment in 1948, Israel has been involved in a number of armed conflicts with its Arab neighbors and a state of hostility, varying from time to time in intensity and degree, has continued into 2013. In recent years, there was an escalation in violence among Israel, Hamas, the Palestinian Authority and other groups. Also, since 2011, riots and uprisings in several countries in the Middle East and neighboring regions have led to severe political instability in several neighboring states and to a decline in the regional security situation. Such instability may affect the local and global economy, could negatively affect business conditions and, therefore, could adversely affect our operations. Syria, in particular, has been engaged in a fierce civil war and there have been threats from the Syrian government that if the conflict escalates and international forces intervene, Israel may be attacked. In addition, Iran has threatened to attack Israel and is widely believed to be developing nuclear weapons. Iran is also believed to have a strong influence among extremist groups in areas that neighbor Israel, such as Hamas in Gaza and Hezbollah in Lebanon.

To date, these matters have not had any material effect on our business and results of operations; however, the regional security situation and worldwide perceptions of it are outside our control and there can be no assurance that these matters will not negatively affect us in the future.

Furthermore, several countries, principally those in the Middle East, as well as Malaysia and Indonesia, still restrict business with Israel and Israeli companies. Restrictive laws or policies directed towards Israel or Israeli businesses may have an adverse impact on our operations, our financial results or the expansion of our business.

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

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

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

These laws may have the effect of delaying or deterring a change in control of the Company, thereby limiting the opportunity for shareholders to receive a premium for their shares and possibly affecting the price that some investors are willing to pay for the Company's securities.

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

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

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

Since we are incorporated under Israeli law, the rights and responsibilities of our shareholders are governed by our articles of association and Israeli law. These rights and responsibilities differ in some respects from the rights and responsibilities of shareholders in United States-based corporations. In particular, a shareholder of an Israeli company has a duty to act in good faith towards the company and other shareholders and to refrain from abusing its power in the company, including, among other things, in voting at the general meeting of shareholders on certain matters, such as an amendment to the company's articles of association, an increase of the company's authorized share capital, a merger and approval of related party transactions that require shareholder approval. In addition, a shareholder who knows that it possesses the power to determine the outcome of a shareholders' vote or to appoint or prevent the appointment of a director or executive officer in the company has a duty of fairness towards the company. These provisions may be interpreted to impose additional obligations and liabilities on our shareholders that are not typically imposed on shareholders of U.S. corporations.

As a foreign private issuer whose shares are listed on The Nasdaq Capital Market, we have elected to follow certain home country corporate governance practices instead of certain Nasdaq requirements.

We are a foreign private issuer as such term is defined under U.S. federal securities laws. As a foreign private issuer, we may have elected to follow certain home country corporate governance practices relating to shareholder approval of certain private placement offerings instead of certain requirements of the Marketplace Rules of The Nasdaq Capital Market, or the Nasdaq Marketplace Rules. We may in the future elect to follow Israeli corporate governance practices with regard to, among other things, the composition of our board of directors, compensation of officers, director nomination procedures and quorum requirements at shareholders' meetings. In addition, we may elect to follow Israeli corporate governance practices instead of the Nasdaq requirements to obtain shareholder approval for certain dilutive events (such as for the establishment or amendment of certain equity-based compensation plans, issuances that will result in a change of control of the company, certain transactions other than a public offering involving issuances of a 20% or more interest in the company and certain acquisitions of the stock or assets of another company). Accordingly, our shareholders may not be afforded the same protection as provided under Nasdaq's corporate governance rules. Following our home country governance practices as opposed to the requirements that would otherwise apply to a U.S. company listed on The Nasdaq Capital Market may provide less protection than is accorded to investors of domestic issuers. See "Item 16G – Corporate Governance."

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

As a foreign private issuer, we are exempt from the rules and regulations under the Exchange Act, related to the furnishing and content of proxy statements, and our officers, directors, and principal shareholders are exempt from the reporting and short-swing profit recovery provisions contained in Section 16 of the Exchange Act. In addition, we are not required under the Exchange Act to file annual, quarterly and current reports and financial statements with the Securities and Exchange Commission as frequently or as promptly as domestic companies whose securities are registered under the Exchange Act.

The regulatory and compliance costs to us under U.S. securities laws, if we are required to comply with the reporting requirements applicable to a U.S. domestic issuer, may be significantly higher than the cost we currently incur as a foreign private issuer.

As a public company in the United States, we incur significant accounting, legal and other expenses as a result of listing our ordinary shares on the Nasdaq Capital Market, and we may need to devote substantial resources to address new compliance initiatives and reporting requirements.

As a public company in the United States, we incur significant accounting, legal and other expenses as a result of listing our ordinary shares on the Nasdaq Capital Market. These include costs associated with corporate governance requirements of the SEC and the Marketplace Rules of Nasdaq, as well as requirements under Section 404 and other provisions of the Sarbanes-Oxley Act of 2002. Any future changes in the laws and regulations affecting public companies in the United States and Israel, will result in increased costs to us as we respond to such changes. These laws, rules and regulations could make it more difficult or more costly for us to obtain certain types of insurance, including director and officer liability insurance, and we may be forced to accept reduced policy limits and coverage or incur substantially higher costs to obtain the same or similar coverage. The impact of these requirements could also make it more difficult for us to attract and retain qualified persons to serve on our Board of Directors, our board committees or as executive officers.

Item 4: Information on the Company

4A. History and Development of the Company

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

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

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

We operate our business through two divisions:

- Supply Chain Solutions – conducted through our wholly owned subsidiary, Odem. Our Supply Chain Solutions business offers a wide range of electronic components to customers in the defense high technology industry and supply chain services for aviation customers that prefer to consolidate their component acquisitions through a supplier that is able to provide a comprehensive solution to their components-supply needs.

RFID and Mobile Solutions – conducted through our wholly owned subsidiary, Dimex. Our RFID and Mobile Solutions offerings form a comprehensive turn-key solution for Automatic Identification and Data Collection (AIDC), combining mobile infrastructure middleware software and a software application of manufacturers that we represent. In March 2008, Dimex and its subsidiary, Dimex Hagalil Projects (2008) Ltd. (“Dimex Hagalil 2008”), purchased the assets and activities of Dimex Systems, which was an integrator of AIDC solutions based on RFID and barcode technology. The consideration was NIS 44.6 million (approximately \$12.4 million). The consideration was comprised of cash, payable over a 24-month period and of 25,011 BOS shares (equal to approximately 4.4% of the then outstanding shares of BOS).

In the years 2009 through 2012, the Company entered into several amendments to the purchase agreement for the purchase of the assets and activities of Dimex Systems, or the Dimex Systems Asset Purchase Agreement. The amendments revised the payment schedule of the consideration payable to Dimex Systems. The remaining debt, as of December 31, 2013, amounts to \$793,000.

For further details regarding the Dimex Systems Asset Purchase Agreement, see “Item 5B. Liquidity and Capital Resources” and Notes 11 and 13 to our Consolidated Financial Statements attached to this annual report.

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

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

4B.

Business Overview

BOS's vision is to be a provider of turnkey AIDC mobility solutions and a leading distributor of electronic components for the civil aircraft industry, defense industry and high technology equipment manufacturers.

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

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

The Company's customers represent a cross-section of industry leaders, from the avionics, defense, retail, government, utilities, and livestock markets. Our Supply Chain Solutions customers include, among others, Bombardier, Elbit Systems, Rafael and Israeli Aircraft Industry and has begun expansion to international markets (e.g., India, and China). Our RFID and Mobile Solutions customers include, among others, IKEA, Blue Square, Shufersal and Teva.

In its RFID and Mobile Solutions division, the Company continues to invest in efforts to expand its product offerings.

BOS Product Offerings

RFID and Mobile Solutions

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

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

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

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

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

BOS has integrated a set of software applications for vertical segments:

- o BOS LIVESTOCK is a software application that enables livestock operations to manage, track, support and plan all day-to-day tasks.
- o BOS CarID is a turnkey solution to identify and track vehicles for a variety of transportation-related settings, such as auto vehicle testing centers, public and company parking lots, industrial factories, and automobile dealers, importers, or distributors. By using RFID tags on the vehicles, BOS CarID enables companies, government transportation agencies, and law enforcement officials in the transportation field to effectively manage, track, support and plan all day-to-day vehicle-related activities.
- o BOS STOCK is an optimized data collection solution for logistics management in stores and warehouses. The solution may be based on RFID tags or bar codes, and is intended to provide customers with greater visibility into a retailer's stock management and warehouse/logistics operations. BOS Stock enables storeroom managers to receive advanced delivery notifications and system alerts for delivery discrepancies, and gives them the ability to locate inventory in the stockroom. BOS Stock provides inventory managers with a direct communication link to the sales floor, and assists in minimizing inventory loss or theft. BOS Stock also enables sales floor representatives to instantly check on the availability of a product, offer alternatives if the product is out of stock, and provide the customer with up-to-date product information.
- o BOS Mfgr. is a production line tracking solution whereby manufacturing companies can track the progress and status of items on a production line. The solution may be based on RFID tags or bar codes, and is intended to provide greater visibility into a customer's manufacturing process, as well as traceability for critical parts. With BOS Mfgr., items entering the manufacturing plant are labeled with RFID tags or bar codes, and fixed readers that are located along the production line, record the product's progress through the production line stations. Mobile readers may also be used to collect data from the parts labeled with RFID tags or bar codes.

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

- o Integration Services, that include site surveys, business requirements analyses, system design and configuration, and implementation, testing and deployment.
- o Service lab, that lab offers maintenance and repair services to data collection equipment, as well as warehouse and on-site service plans.

In August 2012, the Company entered into a cooperation agreement with an independent software development company for the maintenance, development and support of its software solutions. The selling and marketing of the software solutions continues to be performed by our RFID and Mobile Solutions division. In 2013, 40% of our revenues were attributed to sales generated from our RFID and Mobile Solutions division.

Supply Chain Solutions

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

These services include:

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

Our Supply Chain Solutions division represents on a non-exclusive basis, among others, International Rectifier Inc., Sensata Technologies Inc., Integrated Power Designs, Inc., Positronic Global Connector Solutions, Bluegiga, Switchcraft Inc., First Sensor A.G., Microelectronics Inc., Fema Electronics Corporation, SGC Technologies Inc., and Civue Optotech Incand.

In 2013, 60% of our revenues were attributed to sales of the Supply Chain Solutions division.

Marketing, Distribution and Sales

RFID and Mobile Solutions

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

Supply Chain Solutions

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

Seasonality

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

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

Sales by major geographic areas:

| | 2013 | % | 2012 | % | 2011 | % |
|-------------------|-----------|-----|-----------|-----|-----------|-----|
| America | \$ 529 | 2 | \$ 493 | 2 | \$ 1,514 | 5 |
| Far East | 3,130 | 12 | 1,985 | 8 | 3,943 | 12 |
| Europe | 1,896 | 7 | 1,178 | 5 | 976 | 3 |
| Israel and others | 20,348 | 79 | 20,847 | 85 | 27,001 | 80 |
| Total Revenues | \$ 25,903 | 100 | \$ 24,503 | 100 | \$ 33,434 | 100 |

Sales by divisions:

| | | | | | | |
|---------------------------|----------|-----|----------|------|----------|------|
| RFID and Mobile Solutions | \$10,451 | 40 | \$8,894 | 36 | \$13,128 | 39 |
| Supply Chain Solutions | 15,496 | 60 | 15,915 | 65 | 21,332 | 64 |
| Intercompany | (44) | - | (306) | (1) | (1,026) | (3) |
| Total Revenues | \$25,903 | 100 | \$24,503 | 100 | \$33,434 | 100 |

Competition

RFID and Mobile Solutions

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

In Israel, our main competitors in the RFID and Mobile Solutions market are Soft Solutions Ltd., eWave Ltd., Dangot Computers Ltd., Danner Advanced Technologies Ltd., LogiTag Systems Ltd. and Galbital RFID Solutions Ltd.

Supply Chain Solutions

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

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

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

Strategy

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

The key elements of our strategy are as follows:

- Expand the Mobile and RFID Solutions division product offerings to our existing customer base. This will include the sale and integration of new complementary hardware and software to customers that already use our RFID solutions;
- Expand the Supply Chain Solutions division product offerings to our existing customer base and new customers. In the recent years our Supply Chain Division expanded its product offerings to telecommunication equipment for mobile operations and displays for the high tech industry.
 - Further expand sales of our Supply Chain Solutions division to our client base, in and outside of Israel;

Exchange Controls

See “Item 10D. Exchange Controls”.

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

4C. Organizational Structure

The Company’s wholly owned subsidiaries include:

In Israel:

- (1) Dimex, an Israeli corporation, representing the RFID and Mobile Solutions division;
- (2) Odem, an Israeli corporation, representing the Supply Chain Solutions division;

In the United States:

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

4D. Property, Plants and Equipment

Our offices are located in the following facilities in Israel:

| Location | Size (square meters) | End of lease period |
|-----------------------|----------------------|-------------------------------------|
| R i s h o n Lezion | 1,700 | July 2014 through – August, 2018 |
| K i b u t z Dafna | 578 | On a month-to-month basis |

Our average monthly rental fee in 2014 (up until March 31, 2014), for the year 2013 and for the year 2012 amounted to \$12,785, \$11,148 and \$9,500, respectively.

Item 4A: Unresolved Staff Comments

Not Applicable.

Item 5: Operating and Financial Review and Prospects

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

Overview

BOS is a provider of turnkey AIDC mobility solutions and a leading distributor of electronic components for the civil aircraft industry, defense industry and high technology equipment manufacturers.

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

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

Revenues

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

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

Revenues from maintenance and support services related to license are recognized ratably over the period of the support contract.

For revenues from customized solutions which offer both hardware and software, since the Company is unable to obtain reasonable dependable estimates of the total effort required for completion, the Company follows the guidance in ASC 605-35, ("ASC 605-35"), whereby the Company applies the completed contract method. Under the completed contract method, all revenue and related costs of revenue are deferred and recognized upon completion. Provisions for estimated losses on contracts in process are recognized in the period such losses are determined.

Costs and Operating Expenses

Our costs associated with a particular project may vary significantly depending on the specific requirements of the customer, the terms of the agreement, as well as on the nature of the products. As a result, our gross profits from each project may vary significantly.

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

Our selling and marketing expenses consist primarily of salaries and related costs, commissions earned by sales, marketing and operational personnel, facilities costs, trade show expenses, promotional expenses and overhead costs allocated to selling and marketing activities, as well as depreciation expenses and travel costs.

Our general and administrative expenses consist primarily of salaries and related costs earned by management and financial department, allocated overhead costs, office supplies and administrative costs, fees and expenses of our directors, information technology, depreciation, and professional service fees, including legal, insurance and audit fees.

Our operating results are significantly affected by, among other things, level of revenues. Our revenues in any quarter are substantially dependent on orders received and delivered in that quarter. As a result, our revenues and income (loss) may fluctuate substantially from quarter to quarter. The nature of certain of our expenses is mainly fixed or partially fixed and any fluctuation in revenues will generate a significant variation in gross profit and net income (loss).

Critical accounting policies

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

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

a. Inventories:

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

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

b. Impairment of Long-Lived Assets and Goodwill

Impairment of long-lived assets:

The Company's long-lived assets are reviewed for impairment in accordance with ASC 360-10, Accounting for the Impairment or Disposal of Long-Lived Asset, whenever events or changes in circumstances indicate that the carrying amount of an asset (or asset group) may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset (or asset group) to the future undiscounted cash flows expected to be generated by the assets (or asset group). If such assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the assets exceeds their fair value. During 2013, no impairment losses have been identified. The fair value of the brand name and customer list related intangibles was determined by the income approach method. Assumptions in the fair value assessment included: the impact of changes in economic conditions, revenue and cash flow forecasts for the remaining lives of the intangibles and the Company's weighted average cost of capital ("WACC").

During 2011, the Company recognized an impairment loss \$555,000 related to a brand name and customer list of which \$470,000 was attributed to the Supply Chain Solutions division and \$85,000 was attributed to the RFID and Mobile Solutions division. During 2013 and 2012, no impairment losses have been identified.

Goodwill:

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

Goodwill as of December 31, 2013 and December 31, 2012 amounted to \$4,122,000.

Testing Methodology:

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

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

The Company determined the fair value of the reporting unit using the Income Approach, which utilizes a discounted cash flow model, as it believes that this approach best approximates the reporting unit's fair value at this time. Judgments and assumptions related to revenue, operating income, future short-term and long-term growth rates, weighted average cost of capital, interest, capital expenditures, cash flows, and market conditions are inherent in developing the discounted cash flow model. The material assumptions used for the Income Approach for 2013 were five years of projected net cash flows, WACC of 15.88% and a long-term growth rate of 2%. The Company considered historical rates and current market conditions when determining the discount and growth rates to use in its analyses. If these estimates or their related assumptions change in the future, the Company may be required to record impairment charges for its goodwill.

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

Testing Results:

During 2013, 2012 and 2011 no impairment losses have been identified.

c. **Revenue recognition:**

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

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

Revenues from maintenance and support services related to license are recognized ratably over the period of the support contract.

For revenues from customized solutions which offer both hardware and software, since the Company is unable to obtain reasonable dependable estimates of the total effort required for completion, the Company follows the guidance in ASC 605-35, ("ASC 605-35"), whereby the Company applies the completed contract method. Under the completed contract method, all revenue and related costs of revenue are deferred and recognized upon completion. Provisions for estimated losses on contracts in process are recognized in the period such losses are determined.

Legal Contingencies

The Company is not a party to any legal proceedings.

5A. Operating Results

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

Comparison of 2013 and 2012

Consolidated revenues grew by 5.7% to \$25.9 million in year 2013 from \$24.5 million in year 2012.

RFID and Mobile solution revenues grew by 17.5% to \$10.5 million from \$8.9 million in year 2012. The increase in revenues in the RFID and Mobile division is attributed to an increase in sales of mobile equipment due to customers' demands for renovation of equipment and the opening of new logistic centers.

Gross profit for 2013 was \$5.0 million (gross margin of 19.4%), compared to \$5.1 million (gross margin of 20.7%) for 2012.

Operation expenses were reduced to \$4.4 million in year 2013 from \$4.9 million in year 2012. The reduction in expenses is attributed to (a) elimination of research and development expenses in year 2013 as compared to \$125,000 in year 2012, which is the result of an agreement the Company entered into in August 2012 for the maintenance, development and support to its software solutions by an outside (the selling and marketing of the software solutions continues to be performed by our RFID and Mobile Solutions division); (b) reduction in sales and marketing expenses due to a reduction in workforce; and (c) a reduction in general and administrative expenses due to a reversal of liability for royalties in connection with previous years.

As a result of the above, operating profit in 2013 amounted to \$584,000, compared to an operating profit of \$192,000 in 2012.

Financial expenses for 2013 were \$549,000, compared to \$781,000 in 2012. The decrease in financial expenses is attributed to a reduction in currency expenses and in the amount of loans.

Other expenses in 2013 and 2012, which amounted to \$22,000 and \$147,000, respectively, were mainly due to disposal of property, plant and equipment and the decrease in the value of the Company investments in Surf.

Tax expenses in 2013 amounted to \$13,000, compared to tax benefit of \$187,000 in 2012. Tax benefit in 2012 is mainly related to uncertain tax positions accounted for in accordance with ASC 740 (see Notes 21 and 14i to the Consolidated Financial Statements for the year ended December 31, 2013).

Net profit for year 2013 was 0 as compared to a net loss of \$549,000 in 2012. On a per share basis, the basic and diluted net profit per share in 2013 was \$0, compared to basic and diluted net loss per share of \$0.49 in 2012.

Comparison of 2012 and 2011

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

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

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

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

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

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

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

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

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

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

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

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

Variability of Quarterly Operating Results

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

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

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

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

Impact of Inflation and Currency Fluctuations

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

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

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

In the years ended December 31, 2013, 2012, 2011, 2010, 2009 the inflation rate in Israel, as adjusted for the depreciation or appreciation of the NIS against the U.S. dollar, was 8.8%, 3.94%, (5.49)% , 8.6 % and 4.6%, respectively. The closing representative exchange rate of the U.S. dollar at the end of each such period, as reported by the Bank of Israel, was NIS 3.471 NIS 3.733, NIS 3.821, NIS 3.549 and NIS 3.775, respectively.

Effective Corporate Tax Rate

The Israeli corporate tax rate was 24% in 2011 and 25% in 2012 and in 2013. In 2014, the corporate tax rate is 26.5%.

Grants and Participation

Under the Company's research and development agreements with the Office of the Chief Scientist ("OCS") and pursuant to applicable laws, the Company is required to pay royalties at the rate of 3.5% of sales of products developed with funds provided by the OCS, up to an amount equal to 100% of the research and development grants (dollar-linked) received from the OCS. The obligation to pay these royalties is contingent upon actual sales of the products. Royalties payable with respect to grants received under programs approved by the OCS after January 1, 1999, are subject to interest on the U.S. dollar-linked value of the total grants received at the annual rate of LIBOR applicable to U.S. dollar deposits at the time the grants are received. Since 2006, we have not participated in research and development programs supported by the OCS.

As of December 31, 2013, the Company has an outstanding off-balance sheet contingent obligation to pay royalties to the OCS, including interest, in the amount of approximately \$ 3,316, with respect to the grants. During 2012 and 2013, the developed software for which the grant was received is no longer being sold, accordingly no royalty expenses were recorded during the respective years. Additionally, the developed software for which the grant was received is no longer being sold.

Conditions in Israel

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

5B. Liquidity and Capital Resources

In the year ended December 31, 2013 the Company incurred no losses, as compared to years 2012, and 2011 in which the Company incurred losses of \$ 549,000 and \$3,214,000 respectively. In the years ended December 31, 2013 and 2012 the Company generated a positive cash flow from operating activities amounting to \$1.0 million in 2013, \$1.7 million in 2012 and a negative cash flow of \$365,000 in 2011. The Company's cash and cash equivalents increased from \$354,000 as of December 31, 2012 to \$1,005,000 as of December 31, 2013. The Company had a negative working capital of \$500,000, \$739,000 and \$349,000 as of December 31, 2013, December 31, 2012 and December 31, 2011.

As of December 31, 2013, we had \$793,000 in long-term debt to Dimex Systems Ltd. (including current maturities of \$428,000) and \$1.3 million in long-term bank loans (including current maturities of \$498,000). In addition, on December 31, 2013, we had \$5.4 million of short term bank loans drawn under a revolving credit facility.

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

The amendments to the loan agreements provided that the amount of \$ 2,523,000 of these loans was converted into the Company's ordinary shares at a reduced conversion price of \$ 6 per share, instead of the conversion rate of \$ 13 per share that was set in the original loan agreements. As a result of the conversion, the Company issued 420,491 ordinary shares.

In connection with the conversion, the term of warrants to purchase 160,996 shares that had been issued to the lenders, was extended by 2 years, until July 2014 and February 2015. Following the extension of the warrants, in accordance with ASC 815, the Company recorded \$86,000 financial expenses in its 2011 statement of operations, reflecting the incremental compensation caused directly from the extension.

In April 2013, the Company agreed with shareholders who hold 140,887 warrants to defer registration of the shares underlying the warrants issued to them. In connection with such deferral, the warrants' exercise period shall be extended by an additional one year. The shareholders have agreed to this arrangement, and it was approved by the Company's Audit Committee and Board of Directors. The extension of warrants held by Telegraph Hill Capital is subject to shareholders' approval. Given that all warrant holders are shareholders of the Company, there is no accounting impact as a result of the extension.

On January 30, 2014, the Company requested shareholders who hold 161,000 warrants to defer the registration of the shares underlying the warrants issued to them. In connection with such deferral, the warrants' exercise period shall be extended by an additional two years to July 22, 2017 and the exercise price of the warrants shall be adjusted to the weighted average price on the 20th day before the date hereof, which is \$7.43 (reflecting the weighted average closing price of the Company's shares in the 20 days ending January 30, 2014). The extension of warrants held by Telegraph Hill Capital is subject to shareholders' approval. Given that all warrant holders are shareholders of the Company, there is no accounting impact as a result of the extension.

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

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

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

There were no Bank Leumi covenants applicable for the fiscal year 2010 through 2012.

The Company's loan from Bank HaPoalim is secured by long term bank deposits in the amount of \$471,000. Bank HaPoalim's loan agreements have contained various financial covenants which required that the Company's Israeli subsidiaries maintain certain financial ratios and levels of profitability.

As of December 31, 2013, the Company was not in compliance with certain financial covenants in its loan documents with Bank HaPoalim, however the Company had received a waiver of compliance from Bank HaPoalim that was valid through the earlier of May 1, 2014 or the Company's filing of its 2013 financial statements. On February 2, 2014 Bank HaPoalim agreed to cancel of all the covenants for 2014 and future years for an administrative fee of approximately \$5,000

In June 2013, the Company entered into a Standby Equity Distribution Agreement, (the “June 2013 SEDA”), with YA Global. The June 2013 SEDA provides that, upon the terms and subject to the conditions set forth therein, YA Global is committed to purchase up to \$600,000 of the Company’s ordinary shares over a two-year commitment period. The purchase price of the ordinary shares will be at a 5% discount off the lowest daily VWAP (as defined in the agreement) of the ordinary shares during the five consecutive trading days following the date of an advance notice from us (provided such VWAP is greater than or equal to 90% of the last closing price of the ordinary shares at the time of delivery of the advance notice). From time to time, at the discretion of the Company, subject to complying with the conditions set forth in the June 2013 SEDA, the Company may present YA Global with advance notices to purchase the Company’s shares subject to limitations on price, quantity and trading volume in the Company’s stock as more fully described in the June 2013 SEDA. As of March 31, 2014, the Company has drawn \$450,000 on this equity line for which it issued an aggregate of 67,509 ordinary shares.

In February 2014, the Company had entered into a second Standby Equity Distribution Agreement, (the “February 2014 SEDA”) with YA Global. The February 2014 SEDA provides that, upon the terms and subject to the conditions set forth therein, YA Global is committed to purchase up to \$2,000,000 of the Company’s ordinary shares over a three-year commitment period. The purchase price of the ordinary shares will be at a 5% discount off the lowest daily VWAP (as defined below) of the ordinary shares during the five consecutive trading days following the date of an advance notice from us (provided such VWAP is greater than or equal to 90% of the last closing price of the ordinary shares at the time of delivery of the advance notice). From time to time, at the Company’s discretion, subject to complying with the conditions set forth in the February 2014 SEDA, the Company may present YA Global with advance notices to purchase up to \$500,000 of the Company’s shares as more fully described in the SEDA.

In February 2014, in addition to the February 2014 SEDA, the Company entered into a Note Purchase Agreement with YA Global under which YA Global has provided the Company with a one year bridge loan in the amount of \$500,000. The bridge loan is repayable in nine equal monthly installments commencing three months after the receipt of the loan.

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

Working capital requirements will vary from time-to-time and will depend on numerous factors, including but not limited to, the operating results, scope of sales and supplier and customer credit terms.

We have in-balance sheet financial instruments and off-balance sheet contingent commitments. Our in-balance sheet financial instruments consist of our assets and liabilities. Our cash is invested in U.S. dollars and NIS interest bearing deposits with banks. As of December 31, 2013, our trade receivables' and trade payables' aging days were 115 and 110 days, respectively. The fair value of our financial instruments is similar to their book value. Our off-balance sheet contingent commitments consist of: (a) royalty commitments that are directly related to our future revenues, (b) lease commitments of our premises and vehicles, (c) directors and officers' indemnities, in excess of the proceeds received from liability insurance which we obtain, and (d) legal proceedings.

The Company had negative working capital of \$500,000 as of December 31, 2013. It is the Company's opinion that current working capital is sufficient for the Company's present requirements.

Cash Flows

Net cash provided by operating activities in 2013 was \$1.0 million as compared to net cash provided by operating activities of \$1.7 million in 2012. Year 2012's positive cash flow was positively affected by the reduction of 27% in revenues in year 2012 as compared to year 2011, which reduced the Company's working capital requirements

Net cash provided by investment activities in year 2013 amounted to \$133,000 which includes proceeds from sale and lease back of real estate owned by the company in the amount of \$337,000. Net cash used in investment activity in year 2012 amounted to \$311,000 which included \$255,000 as repayment of deferred consideration related to the Dimex acquisition. Net cash used in investment activity in year 2011 amounted to \$1.0 million which included \$256,000 as repayment of deferred consideration related to Dimex acquisition, investment of \$427,000 in a bank deposit in 2011 which was part of the loan proceeds we received from Bank Ha'poalim in year 2011 and purchase of fixed assets in the amount of \$357,000, which is mainly attributed to the purchase of vehicles instead of leasing.

Net cash provided by financing activities in 2013 and 2012 amounted to \$530,000 and \$1.5 million, as compared to net cash provided by financing activities of \$1.1 million in 2011.

5C. Research and Development

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

5D. Trend Information

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

Growth of the RFID and Mobile Solutions division depend on expanding its product offering to new and existing customer base.

Growth of the Supply Chain division depends on expanding its representations list of electronic manufacturers and increasing sales to the international markets.

A material change in interest pay on our loans may have an effect on the Company's financial results and cash flow. In the event that interest rates associated with the Company's variable rate borrowings were to increase 100 basis points, the after tax impact on future cash flows would be a decrease of \$66,000, annually.

As of December 31, 2013, we had loans of \$7.5 million compared to \$8.4 million as of December 31, 2012. We plan to continue to reduce our loans through cash flow from operating activities and through raising equity.

5E. Off-Balance Sheet Arrangements

Not applicable.

5F. Tabular Disclosure of Contractual Obligations

The following table of our material contractual obligations as of December 31, 2013, summarizes the aggregate effect that these obligations are expected to have on our cash flow in the periods indicated:

| | Total | Less than 1 year | 1-3 years | 3-5 years | More than 5 years |
|--|--------------|---------------------|--------------|-----------|----------------------|
| Long-term loans (1) | \$ 1,279,000 | \$ 498,000 | \$ 781,000 | \$ - | \$ - |
| Accrued severance pay (2) | 159,000 | - | - | - | 159,000 |
| liability related to the Dimex acquisition | 793,000 | 428,000 | 365,000 | - | - |
| Operating lease - cars | 268,000 | 178,000 | 90,000 | - | - |
| Purchase obligation for service and inventory | 3,736,000 | 3,462,000 | 274,000 | - | - |
| Facilities lease | 288,000 | 113,000 | 145,000 | 30,000 | - |
| Total | \$ 6,523,000 | \$ 4,679,000 | \$ 1,655,000 | \$ 30,000 | \$ 159,000 |

(1) Does not include interest. For information on interest rate on long terms loans. See Note 10 to the Consolidated Financial Statements for the year ended December 31, 2013.

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

The above table does not include: contingent obligations to pay royalties to the Office of the Chief Scientist, since the total amount to be paid under the terms of those agreements is a function of future sales.

Item 6: Directors, Senior Management and Employees

6A. Directors and Senior Management

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

| Name | Age | Position |
|--|-----|------------------------------------|
| Mr. E d o u a r d Cukierman ¹ | 49 | Chairman of the Board of Directors |
| Mr. Yuval Viner | 51 | Chief Executive Officer |
| Mr . A v i d a n Zelicovskyl | 44 | President |
| Mr. Eyal Cohen | 45 | Chief Financial Officer |
| Mr. Ronen Zavlik (*) | 53 | Director |
| M r . L u i s Gutierrez Roy | 43 | Director |
| Mr. Yosi Lahad | 58 | Director |
| M s . O r i t N i r Schwartz (*) | 42 | External Director |
| Mr. David Golan (*) | 73 | External Director |

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

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

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

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

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

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

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

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

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

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

Mr. Yosi Lahad has joined our Board of Directors on April 13, 2014. Mr. Lahad has extensive interdisciplinary practical and academic knowledge and vast experience in restructuring processes and strategic alliances. Mr. Lahad has led as CEO/Chairman eight startup companies from early stage to growth and led several M&A events in USA, Israel and China. Mr. Lahad provides strategic and business development services for global companies in a variety of industries including communications, IT, energy, water, Home Land Security & robotics. Mr. Lahad serves as an active Chairman/ Board member of JPI Group China, a leading strategic planning firm for companies entering the Chinese market, UPO, a provider for innovative analytics of information over Internet and VPlan, a provider of automated self-service over Internet using Natural Language Processing. Yosi served as CEO in FiberZone, a provider of automated Fiber connectivity from 2009 to 2011. Yosi was CEO and active chairman of Octalica, a provider of Home Networking, from 2005 to 2007, and CEO of Avantry Networks, delivered wireless networking to global telecom and data providers from 2000 to 2004. Mr. Lahad has been a faculty member/Adjunct Professor lecturing on strategy of emerging companies and innovation at the Hertzliya Interdisciplinary Center and at Tel-Aviv University from 2005. Mr. Lahad holds BSc. engineering from the Technion, MSc. engineering from University of Texas (UTA) and MBA from Tel Aviv University.

6B.Compensation

The following table presents the total compensation paid to or accrued on behalf of all of our directors and officers as a group for the year ended December 31, 2013:

| | Salaries, Directors' fees, Service fees, Commissions and Bonus ¹ | Pension, Retirement and Similar benefits |
|--|--|---|
| All directors and officers as a group (then 9 persons) | \$ 725,800 | \$ 105,000 |

¹ Includes consulting and other fees paid to Cukierman & Co., of which Mr. Edouard Cukierman, the Company's Chairman, is (indirectly) a controlling shareholder. Also includes consulting and other fees paid to Telegraph Hill Capital Fund I, LLC, of which Mr. Gutierrez Roy, a Company's director, may be deemed to have shared voting and dispositive power. Such remuneration includes stock and options based compensation in the amount of \$211,000. Such remuneration does not include amounts expended by the Company for expenses, including business association dues and expenses reimbursed to said officers, and other fringe benefits commonly reimbursed or paid by companies in the location in which the particular executive officer of the Company is located, as the case may be.

Compensation Requirements Under Israeli Law

Compensation Policy

In December 2012, an amendment to the Israeli Companies Law, or Amendment 20, became effective, requiring companies to appoint a compensation committee. See "Compensation Committee" below for information concerning our Compensation Committee.

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

As required by the Israeli Companies Law, our Compensation Policy for Executive Officers and Directors (the “Compensation Policy”) was approved by our Board of Directors, after considering the recommendations of the compensation committee. According to the Israeli Companies Law, a compensation policy must also be approved by a majority of the company’s shareholders, provided that (i) such majority includes at least a majority of the shareholders who are not controlling shareholders and who do not have a personal interest in the matter, who are present and voting, or (ii) the non-controlling shareholders and shareholders who do not have a personal interest in the matter who were present and voted against the policy hold two percent or less of the voting power of the company (the “Compensation Majority”). Our Compensation Policy was approved by a Compensation Majority on November 7, 2013.

The Compensation Policy must be approved by the board of directors and the shareholders every three years. In the event that the compensation policy is not approved by the shareholders, the compensation committee and the board of directors may still approve the policy, if the compensation committee and the board of directors determined, based on specified reasons and following further discussion of the matter, that the Compensation Policy is in the best interests of the company.

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

Pursuant to Amendment 20, any arrangement between a company and an office holder (other than a director or the chief executive officer) as to his or her terms of office and employment must be inline with the Compensation Policy and requires the approval of the Compensation Committee and the Board of Directors. However, under certain circumstances and conditions, the Compensation Committee and the Board of Directors may approve an arrangement that deviates from the Compensation Policy, provided that such arrangement is approved by the company’s shareholders by the Compensation Majority. The Board of Directors and the Compensation Committee may, under special circumstances and for specified reasons, approve such an arrangement even if the shareholders did not approve it, following a re-discussion of the matter in which, among other things, the shareholders' objection was examined.

Directors

Pursuant to Amendment 20, any arrangement between a company and a director as to his or her terms of office and employment must be in compliance with the Compensation Policy and requires the approval of the Compensation Committee, the Board of Directors and the shareholders by a simple majority.

Under the Companies Law and regulations promulgated pursuant thereto, the compensation payable to external directors and independent directors is subject to certain further limitations.

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

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

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

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

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

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

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

Each of our current directors (including the external directors but excluding the current Chairman of the Board) was also granted options to purchase 375 ordinary shares upon commencement of his or her term as director and at an exercise price equal to the average closing prices of the shares on the Nasdaq Capital Market on the 20 trading days preceding the appointment of the director. The Options will vest and become exercisable annually over a period of three years, in three equal parts. The maximum option term is five years from grant.

If applicable, a director shall receive an additional amount of 375 options to purchase the Company’s Ordinary Shares on the third anniversary of his or her service as a director of the Company.

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

Chairman of the Board

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

Chief Executive Officer

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

Under certain circumstances and conditions, the compensation committee and the board of directors may approve an arrangement that deviates from the Compensation Policy provided it is approved by the shareholders by the Compensation Majority. In addition, under certain circumstances, a company may be exempt from receiving the shareholders' approval with respect to the terms of office and employment of a candidate for chief executive officer if such candidate meets certain independence criteria and the compensation committee has determined for specified reasons that shareholder approval would prevent the engagement, provided that the terms are in-line with the Compensation Policy. On November 7, 2013 the Company's shareholders approved the grant to the CEO of options to purchase 35,000 of the Company's Ordinary Shares as well as the CEO's bonus plan for that year.

6C. Board Practices

Directors:

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

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

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

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

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

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

External Directors:

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

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

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

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

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

External directors serve for an initial three-year term. The initial three-year term of service can be extended, at the election of a company subject to certain conditions, by two additional three-year terms, (as described below this limitation does not apply to the Company while it is listed on the Nasdaq markets). External Directors will be elected by a majority vote at a shareholders' meeting, provided that either the majority of shares voted at the meeting, including at least one-half of the shares held by non-controlling shareholders voted at the meeting, vote in favor; or the total number of shares held by non-controlling shareholders voted against does not exceed two percent of the aggregate voting rights in the company.

External Directors may be re-elected for additional terms by means of one of the following mechanisms: (i) the board of directors proposed the nominee and his appointment was approved by the shareholders in the manner required to appoint external directors for their initial term, or (ii) a shareholder holding 1% or more of the voting rights proposed the nominee, and the nominee is approved by a majority of the votes cast by the shareholders of the company, excluding the votes of controlling shareholders and those who have a personal interest in the matter as a result of their relations with the controlling shareholders, provided that, the aggregate votes cast by shareholders who are not controlling shareholders and do not have a personal interest in the matter as a result of their relations with the controlling shareholders in favor of the nominee constitute more than 2% of the voting rights in the company.

The external director who has been nominated by a shareholder must not be a linked or competing shareholder, and not have or not had, on or within the two years preceding the date of such person's appointment to serve another term as external director, any affiliation with a linked or competing shareholder. The term "linked or competing shareholder" means the shareholder(s) who nominated the external director for reappointment or a shareholder of the company holding more than 5% of the company's issued share capital or its voting rights, provided that at the time of the reappointment, such shareholder(s) of the company, the controlling shareholder of such shareholder(s) of the company, or a company under such shareholder(s) of the company's control, has a business relationship with the company or is a competitor of the company.

The term of office of external directors of Israeli companies traded on certain foreign stock exchanges, including the NASDAQ Capital Market, may be further extended, indefinitely, in increments of additional three-year terms, in each case provided that, in addition to reelection in such manner described above, (i) the audit committee and subsequently the board of directors of the Company confirm that, in light of the external director's expertise and special contribution to the work of the board of directors and its committees, the reelection for such additional period is beneficial to the Company, and (ii) prior to the approval of the reelection of the external director, the Company's shareholders have been informed of the term previously served by such nominee and of the reasons why the board of directors and audit committee recommended the extension of such nominee's term.

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

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

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

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

Fiduciary Duties of Office Holders:

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

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

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

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

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

Committees

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

Audit Committee:

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

Our Audit Committee oversees (in addition to the Board) the accounting and financial reporting processes of our company and audits of our financial statements, including the integrity of our financial statements, compliance with legal and regulatory requirements, our independent auditors' qualifications, independence, compensation and performance, and the performance of our internal audit function. Our Audit Committee is also required to find deficiencies in the business management of our company and propose to our Board of Directors ways to correct such deficiencies, determine whether certain related party actions and transactions are "material" or "extraordinary" in connection with their approval procedures, approve related-party transactions as required by Israeli law, establish whistle blower procedures (including in respect of the protections afforded to whistle blowers. Additional duties of our Audit Committee are to establish procedures to be followed in respect of non-extraordinary related party transactions with a controlling shareholder which may include, where applicable, the establishment of a competitive process for such transaction, under the supervision of the audit committee, or whomever it designates for this purpose, in accordance with criteria determined by the audit committee, to establish procedures for approving certain related party transactions with a controlling shareholder, which having been determined by the audit committee not to be extraordinary transactions, were also determined by the audit committee not to be negligible transactions, and such other duties as may be directed by our Board of Directors. The Audit Committee may consult from time to time with our independent auditors and internal auditor with respect to matters involving financial reporting and internal accounting controls.

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

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

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

Compensation Committee:

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

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

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

Israeli Securities Authority Administrative Enforcement:

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

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

6D. Employees

As of March 31, 2014, we employed 59 employees, all of them in Israel. Of these 59 employees: 9 employees are in general and administrative positions, 12 employees are in marketing and sales, 15 employees are employed as technicians and 23 employees are in operating activities. We believe that our relations with our employees are satisfactory. We have not experienced a collective labor dispute or a strike.

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

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

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

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

6E. Share Ownership

As of March 31, 2014, shares, options and warrants held by our officers and directors, then consisting of 9 persons, are as follows

| Name | Position | Shares | Options and Warrants |
|-------------------------------------|------------------------------------|--------|----------------------|
| Mr. Edouard Cukierman ¹ | Chairman of the Board of Directors | 49,354 | 16,987 |
| Mr. Avidan Zelicovsky | President | 4,339 | 35,270 |
| Mr. Yuval Viner | Chief Executive Officer | 2,838 | 42,470 |
| Mr. Eyal Cohen | Chief Financial Officer | 186 | 20,100 |
| Mr. Luis Gutierrez Roy ² | Director | 62,526 | 15,385 |
| Other directors ³ | | | 1,125 |

Share Option Plans

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

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

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

¹ Mr. Edouard Cukierman held 6,202 ordinary shares directly, 21,590 ordinary shares through a wholly owned company, E.D.I European Development and Investments Ltd. and an additional 21,562 ordinary shares through Cukierman & Co. Investment House that is indirectly controlled by Mr. Cukierman. Does not include shares as to which Mr. Cukierman may be deemed to share beneficial ownership. See "Item 7A: Major Shareholders".

² Securities are held by Telegraph Hill Capital Fund I, LLC. Mr. Gutierrez Roy may be deemed to have shared voting and dispositive power with respect to the holdings by Telegraph Hill Capital Fund I, LLC.

³ Represents less than 1% of our outstanding ordinary shares for each of such Directors and altogether.

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

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

2003 Plan

In May 2003 the Company's shareholders approved the adoption of the 2003 Israeli Stock Option Plan, pursuant to which 31,250 ordinary shares were reserved for purchase by the employees, directors, consultants and service providers of the Company and its subsidiaries. Subsequently, the shareholders approved in December 2011 increases of the shares reserved for issuance under the 2003 Plan to 275,000. In December 2012, the Company's shareholders approved a 10 year extension to the Plan, according to which the board of directors may grant options under the Plan through May 31, 2023.

The Board of Directors has resolved that no further grants shall be made under previous plans. The Company has elected to designate the 2003 Plan as providing benefits available under the "capital gains" alternative. Pursuant to the election made by the Company, capital gains derived by optionees arising from the sale of shares derived from the exercise of options granted to them under Section 102, will be subject to a flat capital gains tax rate of 25% (instead of the gains being taxed as salary income at the employee's marginal tax rate). However, as a result of this election, the Company is not allowed to claim as an expense for tax purposes the amounts credited to such employees as a benefit when the related capital gains tax is payable by them. The Company may change its election from time to time, as permitted by the Tax Ordinance. There are various conditions that must be met in order to qualify for these benefits, including registration of the options in the name of a trustee (the "Trustee") for each of the employees who is granted options. Each option, and any ordinary shares acquired upon the exercise of the option, must be held by the Trustee for a period commencing on the date of grant and ending no earlier than 24 months from the date of grant.

As of March 31, 2014, we had 135,506 options outstanding under this plan (of which 39,666 are exercisable) with the exercise prices as set forth below:

| Exercise Price | Outstanding |
|----------------|-------------|
| \$ 3.23 | 375 |
| \$ 3.40 | 375 |
| \$ 3.80 | 6,987 |
| \$ 3.88 | 90,000 |
| \$ 8.00 | 5,749 |
| \$ 33.60 | 3,750 |
| \$ 47.70 | 15,000 |
| \$ 50.40 | 13,170 |
| \$ 60.00 | 100 |
| Total | 135,506 |

Item 7: Major Shareholders and Related Party Transactions

7A. Major Shareholders

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

The following table sets forth, as of March 31, 2014, to the best of the Company's knowledge, information as to each person known to the Company to be the beneficial owner of more than five percent (5%) of the Company's outstanding ordinary shares. Except where indicated, to the best of the Company's knowledge based on information provided by the owners, the beneficial owners of the ordinary shares listed below have sole investment and voting power with respect to those shares. Applicable percentage ownership in the following table is based on 1,298,215 shares outstanding as of March 31, 2014.

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

| Name and Address | Shares Beneficially Owned | | | Percent |
|--|---------------------------|--------------------|--------------|---------|
| | Outstanding Shares | Warrant Shares (2) | Total Shares | |
| Catalyst Funds (1) 3 Daniel Frisch Street, Tel-Aviv 64731, Israel | 38,092 | 40,770 | 78,862 | 5.89 % |
| Bellite Pty Limited. (3) 7 Beresford Road, Rose Bay 2029, NSW, Australia | 116,286 | 28,847 | 145,133 | 10.94 % |
| Dimex Systems (1988) Ltd. (4) 3 Tvuot Ha'arezt Street, Tel Aviv 69546, Israel | 77,137 | 49,439 | 126,576 | 9.39 % |
| Telegraph Hill Capital Fund I, LLC (5) | 62,526 | 15,385 | 77,911 | 5.93 % |

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

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

(2) Represents shares issuable upon exercise of warrants that may be exercised within 60 days following the date of this report.

(3) Mr. Les Szekely may be deemed to have sole voting and dispositive power with respect to the shares held by Bellite Pty Limited.

(4) Ms. Gabriela Jacobs may be deemed to have sole voting and dispositive power with respect to the shares held by Dimex Systems.

(5) Mr. Luis Gutierrez Roy may be deemed to have sole voting and dispositive power with respect to the shares held by Telegraph Hill Capital Fund I, LLC.

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

| Holdings as of: | December 31, 2011 | December 31, 2012 | December 31, 2013 | March 31, 2014 |
|------------------------------------|----------------------|----------------------|----------------------|-------------------|
| Catalyst Funds (1) | 212,526 | 192,107 | 38,092 | 38,092 |
| Dimex Systems (1988) Ltd. | 106,346 | 106,346 | 77,137 | 77,137 |
| SITA | 156,996 | 113,063 | - | - |
| Bellite Pty Limited | 116,286 | 116,286 | 116,286 | 116,286 |
| Telegraph Hill Capital Fund I, LLC | 64,341 | 65,780 | 62,526 | 62,526 |

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

As of March 31, 2014, there were 61 record holders of ordinary shares, of which 9 were registered with addresses in the United States, representing approximately 69% of the outstanding ordinary shares. However, the number of record holders in the United States is not representative of the number of beneficial holders nor is it representative of where such beneficial holders are resident since many of the ordinary shares are held of record by brokers and other nominees.

7B. Related Party Transactions

Grant of Shares and Options to Mr. Cukierman

Active Chairman Agreement

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

The options vested on a quarterly basis. The exercise price of the options was \$47.70, which was equal to the weighted average of the closing prices of the Company's ordinary shares on the Nasdaq Global Market during the thirty-day period preceding the shareholders approval. Unexercised options expire after five years from their respective grant date.

In December 2011, the Company's shareholders approved a new Active Chairman Agreement with Mr. Cukierman. Pursuant to this agreement, in consideration for Mr. Cukierman's services as the Company's Active Chairman in the years 2011-2014, he shall be granted options to purchase 22,360 ordinary shares, and be paid a monthly cash payment of \$5,000, plus VAT at the prevailing rate. Payment of the cash fee shall be made each month in respect of the previous month of service. Following approval by the shareholders in December, 2011, the cash fees for 2011 were paid retroactively for the entire year. The exercise price of the options is \$3.80 and they vest and become exercisable in 16 equal quarterly installments. The first three installments vested immediately following the shareholders' approval, and the fourth installment vested on December 31, 2011. Additional installments vest at the end of each subsequent calendar quarter, provided that Mr. Cukierman shall hold his position as Chairman of the Board at the applicable vesting date. Pursuant to the agreement, if Mr. Cukierman's service to the Company is terminated by the Company for no cause then: (a) any unvested options shall be accelerated, so that they become immediately vested in full as of the date of the termination and (b) the accelerated options and any previously vested options shall be exercisable for twenty four (24) months following the termination. Except for in the events of acceleration or termination for cause, the options are exercisable for five years from the grant date.

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

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

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

On December 31, 2013, and December 31, 2012 the Company issued to Edouard Cukierman 7,787 and 5,119 ordinary shares pursuant to the revised Active Chairman Agreement, respectively.

Services Agreement with Cukierman & Co. Investment House.

In 2003, the Company's Audit Committee and Board approved the engagement of Cukierman & Co. Investment House Ltd. ("Cukierman & Co."), to provide non-exclusive investment-banking services and business development services to the Company, effective April 15, 2003 (the "Services Agreement"). Cukierman & Co. is a company indirectly controlled by Mr. Edouard Cukierman. Since June 26, 2003, he serves as Chairman of the Company's Board, and he may also be deemed to have sole voting and dispositive power with respect to shares held by Catalyst Investments and by Catalyst Private Equity Partners (Israel) II L.P.

For its services until June 2012, Cukierman & Co. was paid a monthly sum of \$10,000 plus VAT (except from February 9, 2009 until December 31, 2010, during which period Cukierman & Co. agreed to temporarily reduce such fee to \$8,500), in addition to a success fee of 4%-6% for a consummated private placements. The Services Agreement, as supplemented, provides for success fees in connection with securing M&A transactions of 3.5% of the proceeds exchanged in such a transaction and also for a success fee of 6% of the revenues actually received by the Company in respect of a sale of the Company's products to a new customer which was introduced by Cukierman & Co.

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

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

On July 15, 2013 an additional amendment to the Services Agreement was entered into, pursuant to which:

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

On December 31, 2013, and December 31, 2012 the company issued to Cukierman & Co. 20,932 and 6,501 Ordinary Shares, respectively, in accordance with the revised Services Agreement.

For payments the Company paid and accrued pursuant to the Services Agreement in 2013, see Note 17 to the Consolidated Financial Statements for the year ended December 31, 2013.

Agreements with Telegraph Hill Capital Fund I, LLC (“Telegraph Hill Capital”)

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

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

In November 2009, the Company entered into an amendment to the Advisory Agreement with THGroup LLC (management company of Telegraph Hill Capital), pursuant to which THGroup LLC shall be paid a success fee of 5% of the revenues generated to the Company from the sale of the Company products to business partners introduced by THGroup LLC. For payments the Company paid and accrued pursuant to the Advisory Agreement in 2013, see Note 17c to the Consolidated Financial Statements for the year ended December 31, 2013.

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

In December 13, 2012, the Company’s shareholders approved an additional grant to Telegraph Hill Capital of warrants to purchase 3,600 Ordinary Shares. The warrants' exercise price is equal to the weighted average of the closing prices of the Company’s Ordinary Shares on the Nasdaq Capital Market, during the twenty-day period preceding the date of the shareholders' meeting in December (i.e., \$2.39). The warrants are exercisable for 3 years from their issuance date of December 13, 2012.

On December 13, 2012 the company's shareholders approved an additional amendment to the agreement with THCAP. Pursuant to this amendment, THCAP will be paid a monthly retainer for business development services in the amount of \$3,650 per month to be paid in the Company's ordinary shares once a year.

In addition, the company's shareholders approved the payment of the Director's fees in the Company's ordinary shares.

On November 7, 2013 the Company's shareholders approved an additional amendment to the agreement with THCAP as follows:

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

On December 31, 2013 and December 31, 2012, the Company issued to THCAP 9,868 and 362 Ordinary Shares, respectively as retainer payment for business development services.

On December 31, 2013 and December 31, 2012, the Company issued 1,219 and 1,077 Ordinary Shares respectively to THCAP as director fees.

Indemnity Undertakings by the Company to its Directors and Officers

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

7C. Interests of Experts and Counsel

Not applicable.

Item 8: Financial Information

8A. Consolidated Statements and Other Financial Information

Consolidated Financial Statements

See “Item 18. Financial Statements”.

Sales Outside of Israel

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

| Year | Export revenues | % of all revenues |
|------|-----------------|-------------------|
| 2013 | 5,555,000 | 21 % |
| 2012 | \$ 3,656,000 | 15 % |
| 2011 | \$ 6,433,000 | 19 % |

Legal Proceedings

None

Dividend Policy

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

8B. Significant Changes

Not applicable.

Item 9: The Offer and Listing

9A. Offer and Listing Details

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

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

| Period | High (\$) | Low (\$) |
|-------------------------------------|-----------|----------|
| Annual Information | | |
| 2009 Annual | 13.20 | 4.40 |
| 2010 Annual | 13.20 | 3.08 |
| 2011 Annual | 14.08 | 2.72 |
| 2012 Annual | 8.19 | 1.64 |
| 2013 Annual | 8.40 | 2.63 |
| Quarterly Information (2012) | | |
| First Quarter | 4.76 | 2.84 |
| Second Quarter | 4.2 | 2.56 |
| Third Quarter | 3.6 | 1.64 |
| Fourth Quarter | 8.19 | 1.64 |
| Quarterly Information (2013) | | |
| First Quarter | 6.08 | 2.66 |
| Second Quarter | 4.73 | 2.63 |
| Third Quarter | 4.20 | 2.77 |
| Fourth Quarter | 8.40 | 3.64 |
| October | 4.67 | 3.64 |
| November | 4.89 | 3.65 |
| December | 8.40 | 6.67 |
| Monthly Information (2014) | | |
| January | 7.88 | 6.80 |
| February | 6.94 | 6.56 |
| March | 7.00 | 6.27 |

9B. Plan of Distribution

Not applicable.

9C. Markets

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

9D. Selling Shareholders

Not applicable.

9E. Dilution

Not applicable.

9F. Expenses of Issue

Not applicable.

Item 10: Additional Information

10A. Share Capital

Not applicable.

10B. Memorandum and Articles of Association

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

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

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

1. Objects of the Company:

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

2. Provisions related to the directors of the Company:

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

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

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

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

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

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

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

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

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

(b) Voting Rights

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

(c) Election of Directors.

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

(d) Redemption

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

(e) Capital Calls by the Company

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

(f) Discrimination

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

4. Modification of Rights of Holders of Stock:

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

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

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

5. Annual General Meetings and Extraordinary General Meetings:

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

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

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

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

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

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

6. Limitations on the rights to own securities:

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

7. Change of Control:

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

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

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

8. Disclosing Share Ownership:

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

10C. Material Contracts

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

10D. Exchange Controls

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

10E. Taxation

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

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

ISRAELI TAX CONSIDERATIONS

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

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

Tax Consequences Regarding Disposition of Our Ordinary Shares

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

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

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

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

Israeli Companies are subject to the Corporate Tax rate of 26.5% on capital gains derived from the sale of listed shares.

U.S.-Israel Tax Treaty

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

Taxes Applicable to Dividends distributed

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

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

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

General Corporate Tax Structure in Israel

Israeli companies are generally subject to corporate tax at the rate of 25% for the 2012 and 2013 tax years, and of 26.5% for the 2014 tax year.

Special Provisions Relating to Taxation under Inflationary Conditions

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

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

Foreign Exchange Regulations

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

UNITED STATES FEDERAL INCOME TAX CONSIDERATIONS

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

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

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

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

This discussion is based on current provisions of the Internal Revenue Code of 1986, as amended (the “Code”), current and proposed Treasury Regulations promulgated under the Code and administrative and judicial interpretations of the

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

This summary of material United States Federal income tax considerations is for general information only and is not tax advice. Each holder of our ordinary shares is advised to consult with its tax advisor with respect to the specific U.S. federal, state, local and foreign income tax consequences to it of purchasing, holding or disposing of our ordinary shares.

U.S. Holders of Ordinary Shares

Taxation of distributions on ordinary shares

Subject to the discussion below under “Tax consequences if we are a passive foreign investment company,” a distribution paid by us with respect to our ordinary shares, including the amount of any non- U.S. taxes withheld, to a U.S. holder will be treated as dividend income to the extent that the distribution does not exceed our current and accumulated earnings and profits, as determined for U.S. federal income tax purposes. Dividends that are received with respect to ordinary shares by U.S. holders that are individuals, estates or trusts generally will be taxed at the rate applicable to long-term capital gains (currently a maximum rate of 20% for the taxable years beginning after December 31, 2012), provided that such dividends meet the requirements of “qualified dividend income.” For this purpose, qualified dividend income generally includes dividends paid by a non-U.S. corporation if certain holding period and other requirements are met and either (a) the stock of the non-U.S. corporation with respect to which the dividends are paid is “readily tradable” on an established securities market in the U.S. (e.g., the NASDAQ Global Market) or (b) the non-U.S. corporation is eligible for benefits of a comprehensive income tax treaty with the U.S. which includes an information exchange program and is determined to be satisfactory by the U.S. Secretary of the Treasury. The United States Internal Revenue Service (“IRS”) has determined that the U.S.-Israel income tax treaty is satisfactory for this purpose. Dividends that fail to meet such requirements, and dividends received by corporate U.S. holders, are taxed at ordinary income rates. No dividend received by a U.S. holder will be a qualified dividend (1) if the U.S. holder held the ordinary share with respect to which the dividend was paid for less than 61 days during the 121-day period beginning on the date that is 60 days before the ex-dividend date with respect to such dividend, excluding for this purpose, under the rules of Code section 246(c), any period during which the U.S. holder has an option to sell, is under a contractual obligation to sell, has made and not closed a short sale of, is the grantor of a deep-in-the-money or otherwise nonqualified option to buy, or has otherwise diminished its risk of loss by holding other positions with respect to, such ordinary share (or substantially identical securities); or (2) to the extent that the U.S. holder is under an obligation (pursuant to a short sale or otherwise) to make related payments with respect to positions in property substantially similar or related to the ordinary share with respect to which the dividend is paid. If we were to be a “passive foreign investment company” (as such term is defined in the Code) for any taxable year, dividends paid on our ordinary shares in such year or in the following taxable year would not be qualified dividends. See discussion below regarding our PFIC status at “Tax Consequences If We Are A Passive Foreign Investment Company.” In addition, a non-corporate U.S. holder will be able to take a qualified dividend into account in determining its deductible investment interest (which is generally limited to its net investment income) only if it elects to do so; in such case the dividend will be taxed at ordinary income rates.

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

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

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

Taxation of the disposition of ordinary shares

Subject to the discussion below under “Tax Consequences if We Are a Passive Foreign Investment Company” upon the sale, exchange or other disposition of our ordinary shares, a U.S. holder will recognize capital gain or loss in an amount equal to the difference between the amount realized on the disposition and the U.S. holder’s tax basis in the ordinary shares. The gain or loss recognized on the disposition of the ordinary shares will be long-term capital gain or loss if the U.S. holder held the ordinary shares for more than one year at the time of the disposition. Long-term capital gains of certain non-corporate shareholders are currently taxable at a maximum rate of 20% for taxable years beginning after December 31, 2012. Gain or loss recognized by a U.S. holder on a sale, exchange or other disposition of ordinary shares generally will be treated as U.S. source income or loss for U.S. foreign tax credit purposes.

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

Medicare Tax

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

Tax consequences if we are a passive foreign investment company

For U.S. federal income tax purposes, we will be a passive foreign investment company, or PFIC, if either (1) 75% or more of our gross income in a taxable year is passive income, or (2) 50% or more of the value (determined on the basis of a quarterly average) of our assets in a taxable year produce or are held for the production of passive income. If we own (directly or indirectly) at least 25% by value of the stock of another corporation, we will be treated for purposes of the foregoing tests as owning our proportionate share of that other corporation’s assets and as directly earning our proportionate share of that other corporation’s income. If we are a PFIC, a U.S. holder must determine under which of three alternative taxing regimes it wishes to be taxed:

- The “QEF” regime applies if the U.S. holder elects to treat us as a “qualified electing fund” (“QEF”) for the first taxable year in which the U.S. holder owns our ordinary shares or in which we are a PFIC, whichever is later, and if we comply with certain reporting requirements. A U.S. holder may not make a QEF election with respect to warrants. If the QEF regime applies, then, for each taxable year that we are a PFIC, such U.S. holder will include in its gross income a proportionate share of our ordinary earnings (which is taxed as ordinary income) and net capital gain (which is taxed as long-term capital gain), subject to a separate election to defer payment of taxes, which deferral is subject to an interest charge. These amounts would be included in income by an electing U.S. holder, whether or not such amounts are actually distributed to the U.S. holder. A U.S. holder’s basis in our ordinary shares for which a QEF election has been made would be increased to reflect the amount of any taxed but undistributed income. Generally, a QEF election allows an electing U.S. holder to treat any gain realized on the disposition of his ordinary shares as capital gain.

Once made, the QEF election applies to all subsequent taxable years of the U.S. holder in which it holds our ordinary shares and for which we are a PFIC and can be revoked only with the consent of the IRS.

If a QEF election is made after the first taxable year in which a U.S. holder holds our ordinary shares and we are a PFIC, then special rules would apply.

- A second regime, the “mark-to-market” regime, may be elected so long as our ordinary shares are “marketable stock” (e.g., “regulatory traded” on the NASDAQ Global Market). Under current law, a mark-to-market election cannot be made with respect to warrants. Pursuant to this regime, in any taxable year that we are a PFIC, an electing U.S. holder’s ordinary shares are marked-to-market each taxable year and the U.S. holder recognizes as ordinary income or loss an amount equal to the difference as of the close of the taxable year between the fair market value of our ordinary shares and the U.S. holder’s adjusted tax basis in our ordinary shares. Losses are allowed only to the extent of net mark-to-market gain previously included by the U.S. holder under the election for prior taxable years. An electing U.S. holder’s adjusted basis in our ordinary shares is increased by income recognized under the mark-to-market election and decreased by the deductions allowed under the election.

Under the mark-to-market election, in a taxable year that we are a PFIC, gain on the sale of our ordinary shares is treated as ordinary income, and loss on the sale of our ordinary shares, to the extent the amount of loss does not exceed the net mark-to-market gain previously included, is treated as ordinary loss. The mark-to-market election applies to the taxable year for which the election is made and all later taxable years, unless the ordinary shares cease to be marketable stock or the IRS consents to the revocation of the election.

If the mark-to-market election is made after the first taxable year in which a U.S. holder holds our ordinary shares and we are a PFIC, then special rules would apply.

- A U.S. holder making neither the QEF election nor the mark-to-market election is subject to the “excess distribution” regime. Under this regime, “excess distributions” are subject to special tax rules. An excess distribution is either (1) a distribution with respect to our ordinary shares that is greater than 125% of the average distributions received by the U.S. holder from us over the shorter of either the preceding three taxable years or such U.S. holder’s holding period for our ordinary shares prior to the distribution year or (2) gain from the disposition of our ordinary shares.

Excess distributions must be allocated ratably to each day that a U.S. holder has held our ordinary shares. A U.S. holder must include amounts allocated to the current taxable year and any taxable year prior to the first taxable year in which we were a PFIC, in its gross income as ordinary income for that year. All amounts allocated to other taxable years of the U.S. holder would be taxed at the highest tax rate for each such year applicable to ordinary income and the U.S. holder also would be liable for interest on the deferred tax liability for each such year calculated as if such liability had been due with respect to each such year. The portions of gains and distributions that are not characterized as “excess distributions” are subject to tax in the current taxable year as ordinary income under the normal tax rules of the Code.

A U.S. person who inherits shares in a foreign corporation that was a PFIC in the hands of the decedent, is generally denied the otherwise available step-up in the tax basis of such shares to fair market value at the date of death. Instead, such U.S. holder’s basis would generally be equal to the lesser of the decedent’s basis or the fair market value of the ordinary shares on the date of death. Furthermore, if we are a PFIC, each U.S. holder will generally be required to file an annual report with the IRS.

Based on an analysis of our assets and income, we believe that we were not a PFIC for our taxable year ended December 31, 2013. We currently expect that we will not be a PFIC in 2014. However, PFIC status is determined as of the end of the taxable year and is dependent on a number of factors, including the relative value of our passive assets and our non-passive assets, our market capitalization and the amount and type of our gross income. There can be no assurance that we will not become a PFIC for the current taxable year ending December 31, 2014 or in a future taxable year.

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

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

Information reporting and backup withholding

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

Non-U.S. Holders of Ordinary Shares

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

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

10F. Dividends and Paying Agents

Not applicable.

10G. Statement by Experts

Not applicable.

10H. Documents on Display

The documents concerning the Company that are referred to in the form may be inspected at the Company's office in Israel.

10I. Subsidiary Information

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

Item 11: Quantitative and Qualitative Disclosure about Market Risk

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

Foreign Currency Exchange Rate Risk

We are exposed to currency transaction risks because some of our expenses are incurred in a different currency from the currency in which our revenues are received. Our most significant currency exposures are to the NIS. In periods when the U.S. dollar is significantly devaluated against the NIS, our reported results of operations may be adversely affected. The Company enters into foreign currency contracts, with financial institutions to reduce the risk of exchange rate fluctuations. Such contracts are not designated as hedging instruments. From time to time, the Company recognizes derivative instruments as either assets or liabilities on the balance sheet at fair value.

As of December 31, 2013, the notional principal of foreign exchange contracts to purchase U.S. dollars with foreign currencies was \$1,313,000, to purchase NIS with foreign currencies was \$310,000 and to purchase Euros for foreign currencies was ^660,000, respectively. The Company recorded the fair value of a derivative asset in the amount of \$17,000 in other accounts receivable and prepaid expenses.

Although from time to time we enter into foreign currency contracts to reduce currency transaction risk, these transactions will not eliminate translation risk or all currency risk.

Credit Risk Management

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

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

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

The table below presents the account receivables balance by geographical market as of December 31, 2013 and December 31, 2012:

| | December 31 | |
|-------------------|--------------|--------------|
| | 2013 | 2012 |
| Americas | \$ 138,000 | \$ 26,000 |
| Europe | 341,000 | 334,000 |
| Far East | 1,242,000 | 113,000 |
| Israel and others | 6,416,000 | 7,534,000 |
| | \$ 8,137,000 | \$ 8,007,000 |

Interest Rate Risk

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

A material change in interest pay on our loans may have an effect on the Company's financial results and cash flow. In the event that interest rates associated with the Company's variable rate borrowings were to increase 100 basis points, the after tax impact on future cash flows would be a decrease of \$67,000.

Bank Risk

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

Item 12: Description of Securities Other than Equity Securities

Not applicable.

PART II

Item 13: Defaults, Dividend Arrearages and Delinquencies

Not applicable.

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

Not applicable.

Item 15: Controls and Procedures

(a) Disclosure controls and procedures.

The Company's principal executive officer and its principal financial officer evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report at the reasonable level of assurance (see paragraph (e) below). Based on that evaluation, such principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report.

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

Our management, under the supervision of our Chief Executive Officer and Chief Financial Officer, is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) and Rule 15d-15(f) of the Exchange Act. Our internal control system was designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation and fair presentation of our consolidated financial statements for external purposes in accordance with generally accepted accounting principles. Our Chief Executive Officer and Chief Financial Officer assessed the effectiveness of our internal control over financial reporting as of December 31, 2013. In making this assessment, they used the criteria established in Internal Control–Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, our Chief Executive Officer and Chief Financial Officer have concluded that, as of December 31, 2013, our internal control over financial reporting is effective based on those criteria. Notwithstanding the foregoing, all internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective may not prevent or detect misstatements and can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

(c) Attestation report of the registered public accounting firm.

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

(d) Change in Internal Control over Financial Reporting.

There were no changes in the Company's internal controls over financial reporting that occurred during the fiscal year ended December 31, 2013, that have materially affected or are reasonably likely to materially affect these controls.

(e) Other.

The Company believes that a control system, no matter how well designed and operated, can not provide absolute assurance that the objectives of the control system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, with the Company have been determined. Therefore, a control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Our disclosure controls and procedures are designed to provide such reasonable assurances of achieving our desired control objectives, and our Chief Executive Officer and Chief Financial Officer have concluded, as of December 31, 2013, that our disclosure controls and procedures were effective in achieving that level of reasonable assurance.

Item 16: [Reserved]

Item 16A: Audit Committee Financial Expert

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

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

Item 16B: Code of Ethics

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

Item 16C: Principal Accountant Fees and Services

The Company's principal accountants for the years 2012 and 2013 were Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global.

The table below summarizes the audit and other fees paid and accrued by the Company and its consolidated subsidiaries to Kost Forer Gabbay & Kasierer during each of 2012 and 2013:

| | Year Ended December 31, 2013 | | Year Ended December 31, 2012 | | |
|--------------------|---------------------------------|------------|---------------------------------|------------|---|
| | Amount | Percentage | Amount | Percentage | |
| Audit Fees (1) | 54,000 | 78 | % \$77,000 | 85 | % |
| Tax Fees (2) | 4,000 | 6 | % \$14,000 | 15 | % |
| All other Fees (3) | 9,000 | 18 | % | | |
| Total | 69,000 | 100 | % \$91,000 | 100 | % |

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

(2) Tax fees are fees for professional services rendered by our auditors for tax compliance, tax planning and tax advice on actual or contemplated transactions

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

Audit Committee's pre-approval policies and procedures:

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

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

Not applicable.

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

The Company (or anyone acting on its behalf) did not purchase any of the Company's securities in 2013.

Item 16F: Change in Registrant's Certifying Accountant

Not applicable.

Item 16G: Corporate Governance

The Company's shares are listed on the NASDAQ Capital Market. Under NASDAQ Marketplace Rule 5615(a)(3) or Rule 5615(a)(3), foreign private issuers, such as our company, are permitted to follow certain home country corporate governance practices in lieu of the requirements of Listing Rule 5600 Series with the exception of those rules which are required to be followed pursuant to the provisions of Listing Rule 5615(a)(3).

We have elected to follow Israeli law and practice instead of the following NASDAQ rule:

- The requirement to obtain shareholder approval for the approval of certain private placements. Under Israeli law and practice, shareholder approval is not required for a private placement in a public Company, whose shares are traded only outside of Israel.

Item 16H: Mine Safety Disclosures

Not applicable.

PART III

Item 17: Financial Statements

Not applicable.

Item 18: Financial Statements

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

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| Consolidated Statements of Cash Flows | F-8 – F-9 |
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Item 19: Exhibits

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

- 1.1 Memorandum of Association, as amended (incorporated by reference to the Company's Annual Report on Form 20-F filed on April 30, 2013).
- 1.2 Articles of Association, as amended (incorporated by reference to the Company's Annual Report on Form 20-F filed on April 30, 2013).
- 4.1 Form of Indemnification Agreement between the Company and its officers and directors, as amended (incorporated by reference to Annex A of the Company's Proxy Statement on Form 6-K, filed on November 9, 2011).
- 4.2 Services Agreement, dated as of April 15, 2003, between Cukierman & Co. Investment House Ltd., Dimex Solutions Ltd. and the Company (incorporated by reference to the Company's Annual Report on Form 20-F filed on June 17, 2004).
- 4.3 M&A Addendum to the Services Agreement, as of August 22, 2004, by and among Cukierman & Co. Investment House Ltd., Dimex Solutions Ltd. and the Company (incorporated by reference to the Company's Annual Report on Form 20-F filed on June 27, 2005).
- 4.4 Business Development Addendum to the Services Agreement, as of May 24, 2010, by and among Cukierman & Co. Investment House Ltd., BOS-Dimex Ltd., and the Company. (incorporated by reference to the Company's Annual Report on Form 20-F filed on June 30, 2010).

- 4.5 Amendment to the Services Agreement, dated as of January 13, 2013, by and among Cukierman & Co. Investment House Ltd., and the Company (incorporated by reference to the Company's Annual Report on Form 20-F filed on April 30, 2013).
- 4.6* Amendment to the Services Agreement, dated as of July 15, 2013, by and among Cukierman & Co. Investment House Ltd., and the Company.
- 4.7 The Company's Israeli 2003 Share Option Plan (incorporated by reference to the Company's Registration Statement on Form S-8 No. 333-11696 filed on November 24, 2003).
- 4.8 Asset Purchase Agreement as of January 29, 2008 by and between Dimex Systems (1988) Ltd., Dimex Hagalil Ltd., and the Company (incorporated by reference to the Company's Annual Report on Form 20-F filed on June 30, 2008).
- 4.9 Amendment No. 1 to Asset Purchase Agreement by and among the Company, Dimex Systems (1988) Ltd. and Dimex Hagalil Ltd., dated March 23, 2009 (incorporated by reference to the Company's Amendment No. 2 to Registration Statement on Form F-3 No. 333-152020 filed on April 1, 2009).
- 4.10 Amendment No. 2 to Asset Purchase Agreement by and among the Company, Dimex Systems (1988) Ltd. and Dimex Hagalil Ltd., dated February 3, 2010 and Warrant dated as of February 3, 2010 issued by the Company to Dimex Systems (1988) Ltd. (incorporated by reference to the Company's Annual Report on Form 20-F filed on June 30, 2010).
- 4.11 Amendment No. 3 to the Asset Purchase Agreement as of December 31, 2012 by and among the Company, Dimex Systems (1988) Ltd. and Dimex Hagalil Ltd. (incorporated by reference to the Company's Annual Report on Form 20-F filed on April 30, 2013).
- 4.12 Loan Agreement by and between the Company and Dimex Systems (1988) Ltd., dated February 3, 2010; Registration Rights Agreement dated as of the February 3, 2010 by and between the Company and Dimex Systems (1988) Ltd.; Warrant dated as of February 3, 2010 issued by the Company to Dimex Systems (1988) Ltd. (incorporated by reference to the Company's Annual Report on Form 20-F filed on June 30, 2010).
- 4.13 Agreement by and between the Company and Dimex Systems dated November 9, 2011; Amendments to Warrants issued by the Company to Dimex Systems. (incorporated by reference to the Company's Annual Report on Form 20-F filed on April 30, 2012).
- 4.14 Form of 2009 Loan Agreement and Registration Rights Agreement by and among certain lenders and the Company. Form of Warrant issued by the Company to certain lenders. (incorporated by reference to the Company's Annual Report on Form 20-F filed on June 30, 2010).

- 4.15 Form of Agreement by and among certain lenders and the Company (Conversion Amendments); Form of Amendment to Warrant issued by the Company to certain lenders. (incorporated by reference to the Company's Annual Report on Form 20-F filed on April 30, 2012).
- 4.16 Bank Leumi Le-Israel Ltd. Agreements: Summary of Economic Terms; Form of Request to Allocate a Credit in Israeli Currency (unlinked); Form of Request to Allocate a Credit Framework in Debtor Account (unlinked); Form of Subordination Letters of BOS-Dimex Ltd. and of BOS-Odem Ltd.; and B.O.S Better Online Solutions Ltd. Subordination Letter. (incorporated by reference to the Company's Annual Report on Form 20-F filed on April 30, 2012).
- 4.17 Bank Hapoalim Ltd. Agreements: Summary of Economic Terms; Irrevocable Undertakings by BOS-Dimex Ltd., BOS-Odem Ltd. and the Company. (incorporated by reference to the Company's Annual Report on Form 20-F filed on April 30, 2012).
- 4.18 Share Purchase Agreement dated as of October 4, 2010 between the Company and Telegraph Hill Capital Fund I, LLC (incorporated by reference to the Company's Annual Report on Form 20-F filed on June 30, 2011).
- 4.19 Advisory Agreement dated September 1, 2009, by and between the Company and Telegraph Hill Group LLC (incorporated by reference to the Company's Annual Report on Form 20-F filed on April 30, 2013).
- 4.20 Amendment Number 1 to Advisory Agreement dated November 16, 2009, by and between the Company and Telegraph Hill Group LLC (incorporated by reference to the Company's Annual Report on Form 20-F filed on April 30, 2013).
- 4.21 Amendment Number 2 to Advisory Agreement dated February 8, 2013, by and between the Company and Telegraph Hill Group LLC; Warrant issued by the Company to Telegraph Hill Capital Fund I, LLC (incorporated by reference to the Company's Annual Report on Form 20-F filed on April 30, 2013).
- 4.22* Amendment Number 3 to Advisory Agreement dated November 7, 2013, by and between the Company and Telegraph Hill Group LLC.
- 4.23 Standby Equity Distribution Agreement with YA Global dated June 18, 2013 (incorporated by reference to the Company's report on Form 6-K, filed on June 19, 2013).
- 4.24 Standby Equity Distribution Agreement with YA Global, dated February 3, 2014; Note Purchase Agreement with YA Global, dated February 3, 2014. (incorporated by reference to the Company's report on Form 6-K, filed on June 6, 2014).

6* Statement of Computation of Earnings Per Share.

8.1 List of subsidiaries (incorporated by reference to Item 4C of this Annual Report on Form 20-F).

11* Code of Ethics.

12.1* Certification by Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934.

12.2* Certification by Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934.

13.1* Certification by Chief Executive Officer and Chief Financial Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934.

23.1* Consent of Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global.

101* The following financial information from the Company's Annual Report on Form 20-F for the year ended December 31, 2013, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Statements of Operations for the years ended December 31, 2013, 2012 and 2011; (ii) Consolidated Balance Sheets at December 31, 2013 and 2012; (iii) Consolidated Statements of Changes in Shareholders' Equity for the years ended December 31, 2013, 2012 and 2011; (iv) Consolidated Statements of Cash Flows for the years ended December 31, 2013, 2012 and 2011; and (v) Notes to Consolidated Financial Statements, tagged as blocks of text.

* Filed herewith.

Signatures

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

B.O.S. Better Online Solutions Ltd.

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

Date: April 14, 2014

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B.O.S. BETTER ONLINE SOLUTIONS LTD.
AND SUBSIDIARIES
CONSOLIDATED FINANCIAL STATEMENTS
AS OF DECEMBER 31, 2013
IN U.S. DOLLARS
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Kost Forer Gabbay &
Kasierer Tel: +972-3-6232525
3 Aminadav St. Fax: +972-3-5622555
Tel-Aviv 6706703, ey.com
Israel

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of

B.O.S. BETTER ONLINE SOLUTIONS LTD.

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

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

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

Tel-Aviv, Israel
April 14, 2014

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

B.O.S. BETTER ONLINE SOLUTIONS LTD.

AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

| | December 31, | |
|---|------------------|------------------|
| | 2013 | 2012 |
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 1,005 | \$ 354 |
| Trade receivables (net of allowance for doubtful accounts of \$ 148 and \$ 127 at December 31, 2013 and 2012, respectively) | 8,137 | 8,007 |
| Other accounts receivable and prepaid expenses | 819 | 616 |
| Inventories | 3,718 | 3,160 |
| Total current assets | 13,679 | 12,137 |
| LONG-TERM ASSETS: | | |
| Severance pay fund | 26 | 21 |
| Restricted bank deposits | 486 | 438 |
| Other assets | 9 | 11 |
| Total long-term assets | 521 | 470 |
| PROPERTY, PLANT AND EQUIPMENT, NET | 689 | 963 |
| OTHER INTANGIBLE ASSETS, NET | 176 | 357 |
| GOODWILL | 4,122 | 4,122 |
| | \$ 19,187 | \$ 18,049 |

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

B.O.S. BETTER ONLINE SOLUTIONS LTD.

AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

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

| | December 31, | |
|--|------------------|------------------|
| | 2013 | 2012 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Short-term bank loans | \$ 5,426 | \$ 5,959 |
| Current maturities of long term loans | 498 | 424 |
| Trade payables | 6,232 | 4,915 |
| Employees and payroll accruals | 433 | 408 |
| Deferred revenues | 639 | 467 |
| Current maturities of liability related to the Dimex acquisition | 428 | 136 |
| Accrued expenses and other liabilities | 523 | 567 |
| Total current liabilities | 14,179 | 12,876 |
| LONG-TERM LIABILITIES: | | |
| Long-term bank loans, net of current maturities | 781 | 1,188 |
| Accrued severance pay | 159 | 119 |
| Liability related to the Dimex acquisition, net of current maturities | 365 | 710 |
| Total long-term liabilities | 1,305 | 2,017 |
| COMMITMENTS AND CONTINGENT LIABILITIES | | |
| SHAREHOLDERS' EQUITY: | | |
| Share capital: | | |
| Ordinary shares of NIS 80.00 nominal value: | | |
| Authorized; 2,500,000 shares at December 31, 2013 and 2012; Issued and outstanding: 1,258,245 and 1,132,685 shares at December 31, 2013 and 2012, respectively | | |
| | 26,178 | 23,374 |
| Additional paid-in capital | 48,634 | 50,891 |
| Accumulated other comprehensive loss | (243) | (243) |
| Accumulated deficit | (70,866) | (70,866) |
| Total shareholders' equity | 3,703 | 3,156 |
| Total liabilities and shareholders' equity | \$ 19,187 | \$ 18,049 |

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

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B.O.S. BETTER ONLINE SOLUTIONS LTD.

AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

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

| | Year ended December 31, | | |
|---------------------------------------|-------------------------|-----------|------------|
| | 2013 | 2012 | 2011 |
| Revenues | \$25,903 | \$24,503 | \$33,434 |
| Cost of revenues | 20,751 | 19,050 | 26,481 |
| Inventory write offs | 121 | 385 | 443 |
| Gross profit | 5,031 | 5,068 | 6,510 |
| Operating costs and expenses: | | | |
| Research and development | - | 125 | 403 |
| Sales and marketing | 2,924 | 3,058 | 4,273 |
| General and administrative | 1,523 | 1,693 | 2,252 |
| Impairment of other intangible assets | - | - | 555 |
| Total operating costs and expenses | 4,447 | 4,876 | 7,483 |
| Operating Profit (loss) | 584 | 192 | (973) |
| Financial expenses, net | (549) | (781) | (2,241) |
| Other expenses, net | (22) | (147) | (172) |
| Profit (loss) before taxes on income | 13 | (736) | (3,386) |
| Taxes benefit (tax on income) | (13) | 187 | 172 |
| Net profit (loss) | \$- | \$(549) | \$(3,214) |
| Basic and diluted net loss per share | \$- | \$(0.49) | \$(4.56) |

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

B.O.S. BETTER ONLINE SOLUTIONS LTD.

AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

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

| | Year ended December 31, | | |
|---|-------------------------|----------|------------|
| | 2013 | 2012 | 2011 |
| Net profit (loss) | \$- | \$(549) | \$(3,214) |
| Other comprehensive loss: | | | |
| Change in foreign currency translation adjustment | - | - | (295) |
| | - | - | (295) |
| Comprehensive profit (loss) | \$- | \$(549) | \$(3,509) |

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

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B.O.S. BETTER ONLINE SOLUTIONS LTD.

AND ITS SUBSIDIARIES

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. dollars in thousands, except share data

| | Ordinary shares | Share capital and additional paid-in capital | Accumulated other comprehensive income (loss) | Accumulated deficit | Total shareholders' equity |
|---|--------------------|--|--|------------------------|----------------------------------|
| Balance at January 1, 2011 | 688,129 | \$70,764 | \$ 52 | \$ (67,103) | \$ 3,713 |
| Issuance of Ordinary shares for options exercised | 8,361 | - | - | - | - |
| Issuance of Ordinary shares related to an inducement of a convertible note | 420,491 | 3,139 | - | - | 3,139 |
| Extension of warrants related to convertible note | - | 86 | - | - | 86 |
| Share-based compensation expense | - | 169 | - | - | 169 |
| Other comprehensive loss | - | - | (295) | - | (295) |
| Net loss | - | - | - | (3,214) | (3,214) |
| Total comprehensive loss | - | - | - | - | - |
| Balance at December 31, 2011 | 1,116,981 | 74,158 | (243) | (70,317) | 3,598 |
| Issuance of Ordinary shares for options exercised | 1,254 | - | - | - | - |
| Issuance of Ordinary shares | - | - | - | - | - |
| Share-based compensation expense | 14,450 | 107 | - | - | 107 |
| Net loss | - | - | - | (549) | (549) |
| Balance at December 31, 2012 | 1,132,685 | 74,265 | (243) | (70,866) | 3,156 |
| Issuance of Ordinary shares for options and warrants exercised | 34,420 | 95 | - | - | 95 |
| Issuance of Ordinary shares related to SEDA, net of issuance costs (see note 13b) | 51,334 | 241 | - | - | 241 |
| Share-based compensation expense | 39,806 | 211 | - | - | 211 |
| Net profit (loss) | - | - | - | - | - |
| Balance at December 31, 2013 | 1,258,245 | \$74,812 | \$ (243) | \$ (70,866) | \$ 3,703 |

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

B.O.S. BETTER ONLINE SOLUTIONS LTD.

AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

| | Year ended December 31, | | |
|--|-------------------------|---------------|-----------------|
| | 2013 | 2012 | 2011 |
| Cash flows from operating activities: | | | |
| Net profit (loss) | \$- | \$(549) | \$(3,214) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | | |
| Depreciation and amortization | 352 | 363 | 656 |
| Inventory write off | 121 | 385 | 443 |
| Impairment of other intangible assets | - | - | 555 |
| Capital loss from sale and disposal of property, plant and equipment | 11 | 79 | - |
| Currency fluctuation of long term deposits | (34) | (11) | - |
| Impairment of available for sale securities | - | - | 156 |
| Impairment of investment in other company | - | 68 | 39 |
| Severance pay, net | 35 | (24) | 5 |
| Share-based compensation expenses related to employees, directors and service providers | 211 | 107 | 169 |
| Amortization of discount on convertible note | - | 22 | 202 |
| Accrued interest and currency differences on liability related to Dimex acquisition | 24 | 32 | 230 |
| Conversion expenses of convertible note | - | - | 760 |
| Revaluation of fair value related to extension of warrants as part of an inducement of a convertible note | - | - | 86 |
| Increase (decrease) in trade receivables, net | (130) | 500 | (1,045) |
| Change in income tax accruals | (9) | (187) | (199) |
| Increase (decrease) in other accounts receivable and other assets | (201) | 140 | 363 |
| Decrease (increase) in inventories | (679) | 475 | 506 |
| Increase (decrease) in trade payables | 1,317 | 750 | (46) |
| Increase (decrease) in employees and payroll accruals, deferred revenues, accrued expenses and other liabilities | 30 | (441) | (31) |
| Net cash provided by (used in) operating activities | 1,048 | 1,709 | (365) |
| Cash flows from investing activities: | | | |
| Purchase of property, plant and equipment | (113) | (82) | (357) |
| Proceeds from sale and lease back of property, plant and equipment | 337 | 26 | - |
| Change in long term bank deposits | (14) | - | (427) |
| Repayment of deferred consideration related to the Dimex acquisition | (77) | (255) | (256) |
| Net cash provided by (used in) investing activities | 133 | (311) | (1,040) |
| Cash flows from financing activities: | | | |

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| | | | |
|---|---------|---------|-------|
| Proceeds from issuance of shares, net | 336 | - | - |
| Repayment of (proceeds from) short and long-term bank loans | (866) | (1,455) | 1,113 |
| Net cash used in (provided by) financing activities | (530) | (1,455) | 1,113 |
| Increase (decrease) in cash and cash equivalents | 651 | (57) | (292) |
| Cash and cash equivalents at the beginning of the year | 354 | 411 | 703 |
| Cash and cash equivalents at the end of the year | \$1,005 | \$354 | \$411 |

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

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B.O.S. BETTER ONLINE SOLUTIONS LTD.

AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

| | 2013 | Year ended December 31, 2012 | 2011 |
|---|--------|---------------------------------|----------|
| Supplemental disclosure of cash flow activities: | | | |
| (i) Net cash paid during the year for: | | | |
| Interest | \$ 418 | \$ 502 | \$ 572 |
| (ii) Non-cash activities: | | | |
| Conversion of convertible note into share capital | \$ - | \$ - | \$ 2,523 |

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:- GENERAL

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

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

- b. The Company has two operating segments: the RFID and Mobile Solutions segment, and the Supply Chain Solutions segment (see Note 16).

The Company's wholly-owned subsidiaries include:

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

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

- a. Use of estimates:

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

- b. Financial statements in U.S. dollars:

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

c. Principles of consolidation:

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

d. Cash equivalents:

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

e. Inventories:

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

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

f. Property, plant and equipment:

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

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

g. Impairment of long-lived assets:

The Company's long-lived assets are reviewed for impairment in accordance with ASC 360-10, Accounting for the Impairment or Disposal of Long-Lived Asset, whenever events or changes in circumstances indicate that the carrying amount of an asset (or asset group) may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset (or asset group) to the future undiscounted cash flows expected to be generated by the assets (or asset group). If such assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the assets exceeds their fair value. During 2013 no impairment losses have been identified. The fair value of the brand name and customer list related intangibles was determined by the income approach method. Assumptions in the fair value assessment included: the impact of changes in economic conditions, revenue and cash flow forecasts for the remaining lives of the intangibles and the Company's weighted average cost of capital ("WACC").

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

During 2013 and 2012, no impairment losses have been identified.

h. Goodwill:

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

Testing Methodology:

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

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

The Company determined the fair value of the reporting unit using the Income Approach, which utilizes a discounted cash flow model, as it believes that this approach best approximates the reporting unit's fair value at this time. Judgments and assumptions related to revenue, operating income, future short-term and long-term growth rates, weighted average cost of capital, interest, capital expenditures, cash flows, and market conditions are inherent in developing the discounted cash flow model. The material assumptions used for the Income Approach for 2013 were five years of projected net cash flows, WACC of 15.88% and a long-term growth rate of 2%. The Company considered historical rates and current market conditions when determining the discount and growth rates to use in its analyses. If these estimates or their related assumptions change in the future, the Company may be required to record impairment charges for its goodwill.

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

Testing Results:

During 2013, 2012 and 2011 no impairment losses have been identified.

i. Research and development costs:

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

j. Severance pay:

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

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

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

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

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

Severance expenses for 2013, 2012 and 2011 amounted to \$ 244, \$ 117 and \$ 242, respectively.

k. Revenue recognition:

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

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

Revenues from maintenance and support services related to license are recognized ratably over the period of the support contract.

For revenues from customized solutions which offer both hardware and software, since the Company is unable to obtain reasonable dependable estimates of the total effort required for completion, the Company follows the guidance in ASC 605-35, ("ASC 605-35"), whereby the Company applies the completed contract method. Under the completed contract method, all revenue and related costs of revenue are deferred and recognized upon completion. Provisions for estimated losses on contracts in process are recognized in the period such losses are determined.

l. Income taxes:

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company implements a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with ASC 740. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is- more- likely- than- not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. During the years ended December 31, 2013 and 2012, the Company recorded tax income of \$ 31 and \$195, respectively due to a decrease of uncertain tax position for closed tax years.

m. Concentrations of credit risk:

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

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

n. Derivative financial instruments:

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

As of December 31, 2013, the notional principal of foreign exchange contracts to purchase U.S. dollars with foreign currencies was \$1,313, to purchase NIS with foreign currencies was \$310 and to purchase Euros for foreign currencies was €660, respectively. The Company recorded the fair value of a derivative asset in the amount of \$17 in other accounts receivable and prepaid expenses.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

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

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

The total number of ordinary shares related to outstanding options and warrants that was excluded from the calculations of diluted net earnings (loss) per share, since they would have an anti-dilutive effect, was 331,300, 255,228 and 381,153 for the years ended December 31, 2013, 2012 and 2011, respectively.

p. Accounting for share-based compensation:

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

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

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

The Company estimates the fair value of stock options granted using the Black-Scholes option pricing model. The option-pricing model requires a number of assumptions, of which the most significant are expected stock price volatility and the expected option term. Expected volatility was calculated based upon actual historical stock price movements over the most recent periods ending on the date of grant, equal to the expected option terms. The expected option term represents the period that the Company's stock options are expected to be outstanding and was determined based on the Simplified method permitted by SAB 107 and extended by SAB 110 as the average of the vesting period and the contractual term. The Company currently uses the simplified method as adequate historical experience is not available to provide a reasonable estimate.

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

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company adopted SAB 110 effective January 1, 2008 and will continue to apply the simplified method until enough historical experience is available to provide a reasonable estimate of the expected term for stock option grants. The risk-free interest rate is based on the yield from U.S. Treasury zero-coupon bonds with an equivalent term. The Company has historically not paid dividends and has no foreseeable plans to pay dividends.

The fair value for options granted in 2013 and 2012 was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

| | 2013 | Year ended December 31, 2012 | 2011 |
|----------------------|-----------|------------------------------------|-------|
| Risk-free interest | 0.93% | 1.34% | 1.17% |
| Dividend yields | 0% | 0% | 0% |
| Volatility | 89% | 83% | 96% |
| | | | 3.83 |
| Expected option term | 3.5 years | 3 years | years |
| Forfeiture rate | 0% | 0% | 24% |

During 2013, 2012 and 2011, the Company recognized stock-based compensation expense related to employee and director stock options as follows:

| | 2013 | Year ended December 31, 2012 | 2011 |
|--|-------|------------------------------------|--------|
| Selling and marketing | \$ - | \$ - | \$ 8 |
| General and administrative | 23 | 23 | 161 |
| Total stock-based compensation expense | \$ 23 | \$ 23 | \$ 169 |

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

q. Fair value of financial instruments:

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

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

of long-term loans approximate their fair value.

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2013 are comprised of foreign currency forward contracts.

Assets measured at fair value on a non-recurring basis as of December 31, 2013 are intangible assets and goodwill.

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

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

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

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

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

r. New and recent accounting pronouncements:

In July 2013, the Financial Accounting Standards Board ("FASB") issued a new accounting standard that will require the presentation of certain unrecognized tax benefits as reductions to deferred tax assets rather than as liabilities in the Consolidated Balance Sheets when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The Company will be required to adopt this new standard on a prospective basis in the first quarter of fiscal 2015; however, early adoption is permitted as is a retrospective application. The Company is currently evaluating the timing, transition method and impact of this new standard on its Consolidated Financial Statements.

NOTE 3:- OTHER ACCOUNTS RECEIVABLE AND PREPAID EXPENSES

| | December 31, | |
|------------------------|--------------|--------|
| | 2013 | 2012 |
| Government authorities | \$ 133 | \$ 78 |
| Advances to suppliers | 320 | 258 |
| Prepaid expenses | 276 | 163 |
| Other | 90 | 117 |
| | \$ 819 | \$ 616 |

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

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

NOTE 4:- FAIR VALUE MEASUREMENTS

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

The Company's financial liabilities and assets measured at fair value on a recurring basis, consisted of derivatives which were classified within Level 2 and amounted to a \$ 17 and a \$ (5) liability as of December 31, 2013 and 2012, respectively.

NOTE 5:- INVENTORIES

| | December 31, | |
|----------------|--------------|----------|
| | 2013 | 2012 |
| Raw materials | \$ 167 | \$ 163 |
| Finished goods | 3,551 | 2,997 |
| | \$ 3,718 | \$ 3,160 |

NOTE 6:- PROPERTY, PLANT AND EQUIPMENT

| | December 31, | |
|--|--------------|--------|
| | 2013 | 2012 |
| Cost: | | |
| Computers and software | \$ 740 | \$ 728 |
| Office furniture and equipment | 689 | 706 |
| Leasehold improvements and real estate (1) | 297 | 648 |
| Motor Vehicles | 397 | 347 |
| | 2,123 | 2,429 |
| Computers and software | 705 | 674 |
| Office furniture and equipment | 352 | 343 |
| Leasehold improvements and real estate (1) | 187 | 299 |
| Motor Vehicles Depreciated cost | 190 | 150 |
| | 1,434 | 1,466 |
| Depreciated cost | \$ 689 | \$ 963 |

Depreciation expenses amounted to \$ 171, \$ 180 and \$ 280 for the years ended December 31, 2013, 2012 and 2011, respectively.

(1) On May 6, 2013 the Company sold real estate it owned and leased it back for a five year period and an option to extend the lease period by an additional 5 years. The consideration amounted to \$ 337. The Capital gain generated from the sale in the amount of \$ 143 was capitalized and is depreciated for the duration of the lease agreement.

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 7:- OTHER INTANGIBLE ASSETS, NET

| | December 31, 2013 | Weighted average amortization period | December 31, 2012 | Weighted average amortization period |
|----------------------------------|----------------------|---|----------------------|---|
| Cost: | | | | |
| Brand name | 670 | 4.1 | 670 | 4.1 |
| Customer list | 2,450 | 2.5 | 2,450 | 2.5 |
| | 3,120 | | 3,120 | |
| Accumulated amortization: | | | | |
| Brand name | 539 | | 475 | |
| Customer list | 2,405 | | 2,288 | |
| | 2,944 | | 2,763 | |
| Amortized cost | \$ 176 | | \$ 357 | |

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

Amortization expenses amounted to \$ 181, \$ 183 and \$ 931 for the years ended December 31, 2013, 2012 and 2011, respectively. The remaining unamortized cost as of December 31, 2013 will be fully amortized in the year ended December 31, 2014.

NOTE 8:- SHORT-TERM BANK LOANS AND CURRENT MATURITIES

| | Loan currency | Weighted interest rate as of December 31, 2013 % | December 31, | |
|--------------------|------------------|---|--------------|--------|
| | | | 2013 | 2012 |
| Short term loans | NIS | 5.88 | \$ 1,226 | \$ 929 |
| | USD | 4.8 | 4,200 | 4,937 |
| | Euro | - | - | 93 |
| | | | 5,426 | 5,959 |
| Current maturities | NIS | 3.88 | 498 | 424 |

\$ 5,924

\$ 6,383

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

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

NOTE 8:- SHORT-TERM BANK LOANS AND CURRENT MATURITIES (Cont.)

All of the Company's short term loans were extended by Bank Leumi. The repayment of the Company's bank loans to Bank Leumi is secured by a first priority floating charge on all of the Company's assets, and by a first priority fixed charge on all of the Company's issued and unpaid share capital, its goodwill and its shares of its Israeli subsidiaries. The loan terms restrict substantial asset sales, cash dividends, and certain inter-company and shareholders payments. In addition, the Company and its Israeli subsidiaries entered into a series of inter-company guarantees in favor of the bank. There were no Bank Leumi covenants related to short term loans applicable for the fiscal years 2013 and 2012.

NOTE 9:- ACCRUED EXPENSES AND OTHER LIABILITIES

| | December 31, | |
|------------------------------------|--------------|--------|
| | 2013 | 2012 |
| Government authorities | \$ 149 | \$ 300 |
| Professional services | 100 | 120 |
| Tax accruals | 77 | 86 |
| Deferred Capital Gain (see Note 6) | 117 | - |
| Other | 80 | 61 |
| | \$ 523 | \$ 567 |

NOTE 10:- LONG-TERM BANK LOANS, NET OF CURRENT MATURITIES

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

| Loan currency | Weighted interest rate as of December 31, 2013 % | December 31, | |
|---------------------------|---|--------------|----------|
| | | 2013 | 2012 |
| NIS | 3.88 (Prime minus 0.5 up to Prime plus 1.5) | \$ 1,279 | \$ 1,612 |
| Less - current maturities | | 498 | 424 |

| | |
|--------|----------|
| \$ 781 | \$ 1,188 |
|--------|----------|

Bank HaPoalim loan amounted to \$ 1,202 and \$ 1,521 as of December 31, 2013 and 2012, respectively.

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 10:- LONG-TERM BANK LOANS, NET OF CURRENT MATURITIES (Cont.)

The repayment of the Company's loan to Bank HaPoalim is not secured, except by long term bank deposits in the amount of \$ 471. As of December 31, 2013, Bank HaPoalim's loan agreements contained various financial covenants, which required that the Company's Israeli subsidiaries maintain certain financial ratios and level of profitability.

As of December 31, 2013, the Company was not in compliance with certain financial covenants, however was still covered by the waiver received by Bank HaPoalim valid through the earlier of May 1, 2014 or the Company's filing of its 2013 financial statements. On February 2, 2014 Bank HaPoalim agreed to cancel of all the covenants for 2014 and future years, for an administrative fee of approximately \$5.

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

| | |
|---------------------------|---------|
| 2014 (Current maturities) | \$498 |
| 2015 | 431 |
| 2016 | 350 |
| | \$1,279 |

NOTE 11:- LIABILITY RELATED TO THE DIMEX ACQUISITION

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

| Loan currency | Nominal interest rate as of December 31, 2013 % | December 31, | |
|---------------------------|--|--------------|--------|
| | | 2013 | 2012 |
| NIS (1) | 4.0 | \$ 586 | \$ 527 |
| NIS (2) | 4.0 | 207 | 319 |
| | | 793 | 846 |
| Less - current maturities | 4.0 | 428 | 136 |
| | | \$ 365 | \$ 710 |

- (1) Will be paid in 24 equal monthly payments commencing January, 2014 (see note 13b).

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

NOTE 11:- LIABILITY RELATED TO THE DIMEX ACQUISITION (Cont.)

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

NOTE 12:- COMMITMENTS AND CONTINGENT LIABILITIES

a. Commitments:

1. Royalty commitments:

a) Under the Company's research and development agreements with the Office of the Chief Scientist ("OCS") and pursuant to applicable laws, the Company is required to pay royalties at the rate of 3.5% of sales of products developed with funds provided by the OCS, up to an amount equal to 100% of the research and development grants (dollar-linked) received from the OCS. The obligation to pay these royalties is contingent upon actual sales of the products. Royalties payable with respect to grants received under programs approved by the OCS after January 1, 1999, are subject to interest on the U.S. dollar-linked value of the total grants received at the annual rate of LIBOR applicable to U.S. dollar deposits at the time the grants are received. No grants were received during the years 2012 and 2013.

As of December 31, 2013, the Company has an outstanding contingent obligation to pay royalties to the OCS, including interest, in the amount of approximately \$ 3,316, with respect to the grants, which is an off-balance sheet contingent commitment. During 2012 and 2013, the developed software for which the grant was received is no longer being sold, accordingly no royalty expenses were recorded during the respective years.

2. The facilities of the Company are rented under operating lease agreements that expire on various dates ending in 2018. Minimum future rental payments are:.

| | |
|------|-------|
| 2014 | \$113 |
| 2015 | 81 |
| 2016 | 34 |
| 2017 | 30 |
| 2018 | 30 |
| | \$288 |

The Company's motor vehicles are leased under various cancelable operating lease agreements. The lease agreements for the motor vehicles expire on various dates ending in 2016.

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NOTE 12:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

Lease expenses for the facilities occupied by the Company and the Company's motor vehicles in 2013, 2012 and 2011 amounted to \$ 405, \$ 420 and \$ 551, respectively.

3. Litigation:

On November 2008, Blockshtil Ltd. filed a claim in the Petach-Tikva Magistrate Court alleging breach of contract by the Company and seeking damages in the amount of NIS 149 (approximately \$43). During 2012, the Company has served a statement of defense and the case has been heard. On June 13, 2013 the court dismissed the claim and ordered Blockshtil to pay the Company for legal expenses.

NOTE 13:- SHAREHOLDERS' EQUITY

a. Private placements:

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

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

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

The balance of the convertible loan in the amount of \$ 501 as of December 21, 2011 was (the "Deferred Loan" or the "2011 restructuring") remains outstanding, and bears a reduced interest rate of 4%. The Deferred Loan is no longer be convertible. The Deferred Loan will be repaid in 24 equal monthly installments commencing January 10, 2014 (instead of in two payments - in July 2012 and February 2013, according to the original convertible note agreement). The balance of the deferred loan as of December 31, 2013 is \$586 (see note 11).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 13:- SHAREHOLDERS' EQUITY (Cont.)

2. In April 2013, the Company requested shareholders who hold 140,887 warrants to defer registration of the shares underlying the warrants issued to them. In connection with such deferral, the warrants' exercise period shall be extended by an additional one year. The shareholders have agreed to this arrangement, and it was approved by the Company's Audit Committee and Board of Directors. The extension of warrants held by Telegraph Hill Capital is subject to shareholders' approval. Given that all warrant holders are shareholders of the Company, there is no accounting impact as a result of the extension.

3. On December 31, 2012 the Company issued:

i. 6,501 shares to Cukierman & Co. Investment House Ltd. ("Cukierman & Co"), in consideration for non-exclusive investment-banking services and business development services to the Company (see note 17a)

ii. 5,119 shares to Edouard Cukierman pursuant to his Active Chairman Agreement (see note 17b).

iii. 362 and 1,077 shares to Telegraph Hill Capital Fund I, LLC ("THCAP") pursuant to a service agreement (see note 17c) and as a directors fee, respectively.

iv. 1,391 shares to a director as a director fees.

4. During year ended December 31, 2013 the Company issued:

i. 20,932 shares to Cukierman & Co, in consideration for non-exclusive investment-banking services and business development services to the Company (see note 17a)

ii. 7,787 shares to Edouard Cukierman pursuant to his Active Chairman Agreement (see note 17b).

iii. 9,868 shares and 1,219 shares to THCAP pursuant to a service agreement (see note 17c) and as a directors fee, respectively.

5. On June 18, 2013, the Company entered into a Standby Equity Distribution Agreement, or SEDA, with YA Global for the sale of up to \$600,000 for its ordinary shares to YA. The Company may effect the sale, at its sole discretion, during two-year period beginning on the date on which the Securities and Exchange Commission first declares effective a registration statement registering the resale the Company ordinary shares by YA Global.

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NOTE 13:- SHAREHOLDERS' EQUITY (Cont.)

For each ordinary share purchased under the SEDA, YA Global will pay 95% of the lowest daily VWAP (as defined below) of the ordinary shares during the five consecutive trading days following the date of an advance notice from the Company (provided such VWAP is greater than or equal to 90% of the last closing price of the ordinary shares at the time of delivery of the advance notice). Once presented with an advance notice, YA Global is required to purchase the number of shares specified in the advance notice. Each such notice may be for an amount of ordinary shares not to exceed the greater of (1) \$25,000 and (2) the average of the Daily Value Traded for the five trading days prior to the advance notice, where Daily Value Traded is the product obtained by multiplying the daily trading volume for such day by the VWAP for such day. Notwithstanding the foregoing, the notice shall not exceed \$150,000. "VWAP" defined as of any date, to be the daily dollar volume-weighted average price for such security as reported by Bloomberg, LP.

The Company has paid to YA Global a commitment fee of 7,500 ordinary shares to YA Global. The Company may terminate the SEDA at any time upon prior notice to YA Global, as long as there are no advance notices outstanding and we have paid to YA Global all amounts then due.

During the month of December 2013, the Company issued to YA 43,834 ordinary shares for a total of \$300 to YA Global.

b. Warrants to shareholders

The Company's outstanding warrants to shareholders as of December 31, 2013 are as follows:

| Outstanding and exercisable warrants | Weighted average exercise price of outstanding warrants | Weighted average Remaining contractual life (years) |
|---|--|--|
| 161,000 | \$ 11 | 1.58 |

c. Stock option plans:

In December 2012, the Company's shareholders approved a 10-year extension to the 2003 Israeli Stock Option Plan ("the Plan"), until May 31, 2023. Under the plan 275,000 ordinary shares were reserved for purchase by the employees and directors of the Company and its subsidiaries. Any option which is canceled or forfeited before expiration will become available for future grants.

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NOTE 13:- SHAREHOLDERS' EQUITY (Cont.)

As of December 31, 2013 an aggregate of 71,582 options are available for future grants under the Plan. Each option granted under the Plan expires between 2-10 years from the date of the grant. The options vest gradually over a period of up to four years.

A summary of the Company's employee and director stock option activity and related information for the year ended December 31, 2013, is as follows:

| | Number of options | Weighted-average exercise price | Weighted-average remaining contractual term (in years) | Aggregate intrinsic value |
|----------------------------------|-------------------|---------------------------------|--|---------------------------|
| Outstanding at January 1, 2013 | 93,512 | \$ 23.45 | \$ 2.74 | \$ 78 |
| Changes during the year: | | | | |
| Granted | 90,000 | \$ 3.87 | | |
| Exercised | (30,574) | \$ 2.81 | | |
| Forfeited or cancelled | (8,212) | \$ 37.52 | | |
| Outstanding at December 31, 2013 | 144,726 | \$ 14.80 | \$ 3.80 | \$ 378 |
| Vested and expected to vest | 47,614 | \$ 37.09 | \$ 1.93 | \$ 1 |
| Exercisable at December 31, 2013 | 47,614 | \$ 37.09 | \$ 1.93 | \$ 1 |

The weighted-average grant-date fair value of options granted during the year ended December 31, 2013 was \$ 4.18 (No options were granted during 2012). The weighted-average grant-date fair value of unvested options as of December 31, 2013 was \$3.89 The aggregate intrinsic value in the table above represents the total intrinsic value (the difference between the fair market value of the Company's ordinary shares on December 31, 2013 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on December 31, 2013.

Total intrinsic value of options exercised for the years ended December 31, 2013, 2012 and 2011 was \$ 91, \$ 5 and \$ 33, respectively. As of December 31, 2013, there was \$ 231 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the Company's Plan. That cost is expected to be recognized through 2016.

During 2013, a sum of \$ 86 was received from the exercise of options. No cash was received from exercise of options in the years ended December 31, 2012 and 2011.

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NOTE 13:- SHAREHOLDERS' EQUITY (Cont.)

Options granted to employees and directors that are outstanding as of December 31, 2013 broken into ranges of exercise prices, are as follows:

| Exercise Price | Options outstanding as of December 31, 2013 | Weighted average remaining contractual life (years) | Options exercisable as of December 31, 2013 | Weighted average Remaining contractual life of options exercisable (years) |
|----------------|---|---|---|--|
| \$ 3.40 | 375 | 2.97 | 250 | 2.97 |
| \$ 3.80 | 6,987 | 2.97 | - | - |
| \$ 3.87 | 90,000 | 4.85 | - | - |
| \$ 8.00 | 5,749 | 2.25 | 5,749 | 2.25 |
| \$ 9.91 | 375 | 0.14 | 375 | 0.14 |
| \$ 20.00 | 8,660 | 0.00 | 8,660 | 0.00 |
| \$ 33.60 | 3,750 | 4.24 | 3,750 | 4.24 |
| \$ 47.70 | 15,000 | 1.25 | 15,000 | 1.25 |
| \$ 50.40 | 13,430 | 3.25 | 13,430 | 3.24 |
| \$ 60.00 | 400 | 0.63 | 400 | 0.63 |
| | 144,726 | 3.80 | 47,614 | 1.93 |

d. Warrants issued to service providers and debt providers:

The Company accounts for warrants issued to service providers and debt providers in accordance with the provisions of ASC 505-50, "Equity-Based Payments to Non-Employees". The fair value for these warrants was estimated at the date of grant using the Black-Scholes option pricing model.

In December 2012, the company granted 3,600 warrants to purchase Ordinary shares to THCAP. The warrants exercise price is \$2.39 and will be exercisable for 3 years starting December 13, 2012. No warrants were granted in 2013 to service and debt providers.

The Company's outstanding warrants to service and debt holders as of December 31, 2013 are as follows:

| Exercise price | Warrants* outstanding | Weighted average remaining |
|----------------|-----------------------|----------------------------|
|----------------|-----------------------|----------------------------|

Contractual
life (years)

| | | |
|----------|--------|------|
| \$ 10.00 | 5,000 | 2.59 |
| \$ 16.00 | 17,274 | 1.09 |
| \$ 20.00 | 3,300 | 0.00 |
| | 25,574 | 1.24 |

*

All warrants are exercisable as of December 31, 2013

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NOTE 14:- TAXES ON INCOME

a. Change in corporate tax rate:

The Israeli corporate tax rate was 24% in 2011 and 25% in 2012 and 2013. The tax rate for years 2014 and onward will be 26.5%

b. Loss carry forward:

The Company and its Israeli subsidiaries have accumulated losses for Israeli income tax purposes as of December 31, 2013, in the amount of approximately \$ 33,089. These losses may be carried forward and offset against taxable income in the future for an indefinite period. In addition, the Company and its Israeli subsidiaries have accumulated capital losses in the amount of approximately \$23,094 which may be carried forward under certain limitations.

c. Deferred income taxes:

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

| | December 31, | |
|---|--------------|----------|
| | 2013 | 2012 |
| Assets in respect of: | | |
| Allowances and provisions | \$ 112 | \$ 313 |
| Intangible assets | 227 | 142 |
| Net operating loss carry forward (1) | 8,272 | 8,116 |
| | 8,611 | 8,571 |
| Valuation allowance (2) | (8,611) | (8,571) |
| | - | - |
| Liabilities in respect of intangible assets | - | - |
| Net deferred tax Liability | \$ - | \$ - |

(1) See Note 14b.

(2) In 2013 and 2012, the Company has provided valuation allowances on deferred tax assets that results from tax loss carry forward and other reserves and allowances due to its history of operating losses and current uncertainty about the ability to realize these deferred tax assets in the future. Net change in valuation allowance during 2013 amounts to an increase of \$40.

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NOTE 14:-

TAXES ON INCOME (Cont.)

d. Taxes on income (tax benefit) is comprised as follows:

| | Year ended December 31, | | |
|-------------|-------------------------|-----------|-----------|
| | 2013 | 2012 | 2011 |
| Current | \$ 13 | \$ (187) | \$ (172) |
| Prior years | - | - | - |
| | \$ 13 | \$ (187) | \$ (172) |
| Domestic | 7 | (195) | (172) |
| Foreign | 6 | 8 | - |
| | \$ 13 | \$ (187) | \$ (172) |

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

| | Year ended December 31, | | |
|----------|-------------------------|-----------|-------------|
| | 2013 | 2012 | 2011 |
| Domestic | \$ (41) | \$ (766) | \$ (3,429) |
| Foreign | 54 | 30 | 43 |
| | \$ 13 | \$ (736) | \$ (3,386) |

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

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

g. Tax assessments:

BOS Odem and BOS Dimex have final assessments through 2008. BOS has final assessments through 2007.

Tax assessments for Ruby-Tech Inc., a U.S. subsidiary, through 2009 have all been assessed as final.

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

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NOTE 14:- TAXES ON INCOME (Cont.)

The Company and its subsidiaries file income tax returns in Israel and in the United States. BOS Dimex and BOS Odem may be subject to auditing by the Israel tax authorities for fiscal years 2009 and thereafter. BOS may be subject to auditing by the Israel tax authorities for fiscal years 2008 and thereafter. Ruby-Tech Inc., a U.S. subsidiary, may be subject to auditing by the U.S. Internal Revenue Service for fiscal years 2010 and thereafter.

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

i. Uncertain tax positions:

| | December 31, | |
|---|--------------|--------|
| | 2013 | 2012 |
| Uncertain tax positions, beginning of year | \$ 31 | \$ 172 |
| Decreases in tax positions for prior years | - | (172) |
| Increases in tax positions for current year | - | 31 |
| Uncertain tax positions, end of year | \$ 31 | \$ 31 |

The Company records accrued interest for balances related to unrecognized tax benefits and penalties in taxes on income. During the years ended December 31, 2013 and 2012, the Company recognized approximately \$ - and \$ (54), respectively, in interest and penalties. The Company had no accruals for the payment of interest and penalties at December 31, 2013 and 2012, respectively.

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NOTE 15:- SUPPLEMENTARY INFORMATION TO STATEMENTS OF OPERATIONS

| a. | Financial expenses, net: | | |
|---|--------------------------|-----------|-------------|
| | Year ended December 31, | | |
| | 2013 | 2012 | 2011 |
| Financial income: | | | |
| Interest on bank deposits | \$ 2 | \$ 5 | \$ 3 |
| foreign currency transaction | 16 | - | - |
| | 18 | 5 | 3 |
| Financial expenses: | | | |
| In respect of bank loans, bank fees, convertible note and liability related to Dimex acquisition | (542) | (681) | (1,251) |
| Inducement and related cost | - | - | (760) |
| Revaluation of fair value related to extension of warrants as part of an Inducement of a convertible note | - | - | (86) |
| Change in fair value of forward contracts | (25) | (34) | (44) |
| Other (mainly foreign currency transaction losses) | - | (71) | (103) |
| | (567) | (786) | (2,244) |
| | \$ (549) | \$ (781) | \$ (2,241) |

b. Net earnings (loss) per share:

| | | | |
|---|-------|------------|-------------|
| 1. Numerator: | | | |
| Numerator for basic and diluted net Earnings (loss) per share: | | | |
| Income (loss) | \$ - | \$ (549) | \$ (3,214) |
| Net loss available to ordinary shareholders | \$ - | \$ (549) | \$ (3,214) |
| 2. Denominator (in thousands): | | | |
| Basic weighted average ordinary shares outstanding (in thousands) | 1,172 | 1,118 | 705 |
| Diluted weighted average ordinary shares outstanding (in thousands) | 1,172 | 1,118 | 705 |
| Basic and diluted net earnings (loss) per share | \$ - | \$ (0.49) | \$ (4.56) |

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NOTE 16:- SEGMENTS AND GEOGRAPHICAL INFORMATION

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

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

a. Revenues, gross profit and assets for the operating segments for the years 2013, 2012 and 2011 were as follows:

| | RFID and Mobile Solutions | Supply Chain Solutions | Not Allocated/ Intercompany | Consolidated |
|---------------------------|---------------------------------|------------------------------|-----------------------------------|--------------|
| 2013 | | | | |
| Revenues | \$ 10,451 | \$ 15,496 | \$ (44) | \$ 25,903 |
| Gross profit | \$ 2,882 | \$ 2,149 | \$ - | \$ 5,031 |
| Assets related to segment | \$ 10,476 | \$ 8,711 | \$ - | \$ 19,187 |
| 2012 | | | | |
| Revenues | \$ 8,894 | \$ 15,915 | \$ (306) | \$ 24,503 |
| Gross profit | \$ 2,345 | \$ 2,723 | \$ - | \$ 5,068 |
| Assets related to segment | \$ 8,558 | \$ 9,491 | \$ - | \$ 18,049 |
| 2011 | | | | |
| Revenues | \$ 13,128 | \$ 21,332 | \$ (1,026) | \$ 33,434 |
| Gross profit | \$ 3,105 | \$ 3,405 | \$ - | \$ 6,510 |
| Assets related to segment | \$ 10,132 | \$ 9,869 | \$ 68 | \$ 20,069 |

b. The following presents total revenues and long-lived assets for the years 2013, 2012 and 2011 based on the location of customers:

| | Year ended December 31, | | | | | |
|----------|-------------------------|-------------------------|-------------------|-------------------------|-------------------|-------------------------|
| | 2013 | | 2012 | | 2011 | |
| | Total revenues | Long-lived assets *) | Total revenues | Long-lived assets *) | Total revenues | Long-lived assets *) |
| America | \$ 529 | \$ - | \$ 493 | \$ - | \$ 1,514 | \$ - |
| Far East | 3,130 | - | 1,985 | - | 3,943 | - |
| Europe | 1,896 | - | 1,178 | - | 976 | - |

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| | | | | | | |
|-------------------|-----------|--------|-----------|--------|-----------|----------|
| Israel and others | 20,348 | 689 | 20,847 | 963 | 27,001 | 1,166 |
| | \$ 25,903 | \$ 689 | \$ 24,503 | \$ 963 | \$ 33,434 | \$ 1,166 |

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

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NOTE 16:- SEGMENTS AND GEOGRAPHICAL INFORMATION (Cont.)

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

| | 2013 | | Year ended December 31, 2012 | | 2011 | |
|-----------------------------------|------|---|------------------------------------|---|------|---|
| Customer A (Supply Chain Segment) | 13 | % | 15 | % | 10 | % |

NOTE 17:- RELATED PARTIES

a. Service Agreement with Cukierman & Co.:

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

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

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

On July 15, 2013 an additional amendment to the Service Agreement was signed by which all payments to Cukierman & Co. will be made on a quarterly basis.

During the year 2013 the company issued 20,932 ordinary shares to Cukierman & Co as per the revised Service Agreement.

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NOTE 17:- RELATED PARTIES (Cont.)

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

| | 2013 | Year ended December 31, 2012 | 2011 |
|--------------|-------|------------------------------------|--------|
| Retainer fee | \$ 76 | \$ 98 | \$ 120 |
| Total | \$ 76 | \$ 98 | \$ 120 |

b. Active Chairman Agreement with Edouard Cukierman:

In March 2011, the Company's Audit Committee and Board of Directors approved an Active Chairman Agreement with Mr. Cukierman for services during the years 2011 through 2014. The agreement was approved by the Company's shareholders on December 20, 2011. Pursuant to this agreement Mr. Cukierman was to be granted options to purchase 22,360 ordinary shares, and was to be paid a monthly cash payment of \$ 5,000 plus VAT at the prevailing rate.

The exercise price of the options is \$ 3.80 and they vest and become exercisable in 16 equal quarterly installments. The first three installments vested immediately following the shareholders' approval, and the fourth installment vested on December 31, 2011. Additional installments vest at the end of each subsequent calendar quarter, provided that Mr. Cukierman maintains his position as Chairman of the Board at the applicable vesting date.

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

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NOTE 17:- RELATED PARTIES (Cont.)

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

On December 13, 2012 an Amendment to the agreement was approved stating that commencing July 1, 2012 the payment for the Chairman services will be paid in ordinary shares of the Company instead of in cash. Payment shall be made once a year, at the end of each calendar year. The price per share used for the share consideration calculation will be equal to the weighted average closing price of the ordinary shares on the applicable stock market on the 20 trading days ending on December 31 of the applicable year.

On December 31, 2013 and December 31, 2012 the Company issued Edouard Cukierman 7,787 and 5,119 ordinary shares, respectively, pursuant to the revised Agreement.

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

| | 2013 | Year ended December 31, 2012 | 2011 |
|------------------------------------|-------|------------------------------------|--------|
| Chairman fees | \$ 60 | \$ 60 | \$ 60 |
| Stock option compensation expenses | 10 | 10 | 43 |
| Total | \$ 70 | \$ 70 | \$ 103 |

c. Agreements with THCAP:

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

On October 5, 2010 the Company entered into a definitive private placement agreement with THCAP pursuant to which the Company issued to THCAP 24,091 Ordinary Shares at a price per share of \$ 12.44, or approximately \$ 300 in total. Additionally, Mr. Luis Gutierrez Roy, managing partner of THCAP, was appointed to the Company's Board of Directors.

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NOTE 17:- RELATED PARTIES (Cont.)

On December 13, 2012, the Company's shareholders approved an additional grant of 3,600 warrants to THCAP. The warrants were issued at an exercise price of \$ 2.39, and are exercisable for 3 years from the date of grant of December 13, 2012.

On December 13, 2012 the Company's shareholders approved an additional amendment to the Advisory Agreement with THCAP, pursuant to which, THCAP will be paid a monthly retainer for business development services in the amount of \$3.7 per month to be paid in the Company's ordinary shares once a year, using a price per share as stipulated in the revised Agreement.

In addition, the Company's shareholders approved those payments to THCAP on behalf of Mr. Gutierrez Roy's services as a Director be made in the Company's ordinary shares, on a quarterly basis.

On December 31, 2013 and December 31, 2012, the Company issued 9,868 and 362 ordinary shares to THCAP respectively, as consideration for the retainer for business development services.

On December 31, 2013 and December 31, 2012, the Company issued 1,219 and 1,077 ordinary shares to THCAP, respectively, as consideration for director fees.

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

| | 2013 | Year ended December 31, 2012 | 2011 |
|--------------------------------------|--------------|------------------------------------|--------------|
| Retainer fees | \$ 44 | \$ 2 | \$ - |
| Directors fee | 7 | 11 | 10 |
| Stock warrants compensation expenses | - | 6 | 1 |
| Total | \$ 51 | \$ 19 | \$ 11 |

NOTE 18:- SUBSEQUENT EVENTS

a. On February 3, 2014, the Company entered into a Standby Equity Distribution Agreement, or SEDA, with YA Global for issuance of ordinary shares in an amount up to \$2,000. The Company may draw on the SEDA at its sole discretion during a three-year period beginning March 4, 2014.

For each ordinary share purchased under the SEDA, YA Global will pay 95% of the lowest daily VWAP (defined as, of any date, the daily dollar volume-weighted average price for such security as reported by Bloomberg, LP) of the ordinary shares during the five consecutive trading days following the date of an advance notice from the Company.

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NOTE 18:- SUBSEQUENT EVENTS

- b. On February 3, 2014, the Company entered into a Note Purchase Agreement with YA Global (the "NPA") under which YA Global has provided the Company with a one year bridge loan in the amount of \$ 500. The bridge loan bears a 10% annual interest and is repayable in nine equal monthly installments commencing three months after the receipt of the loan.
- c. On January 30, 2014, the Company requested shareholders who hold 161,000 warrants to defer the registration of the shares underlying the warrants issued to them. In connection with such deferral, the warrants' exercise period shall be extended by an additional two years to July 22, 2017 and the exercise price of the warrants shall be adjusted to the weighted average price on the 20th day before the date hereof, which is \$ 7.43 (reflecting the weighted average closing price of the Company's shares in the 20 days ending January 30, 2014). The extension of warrants held by Telegraph Hill Capital is subject to shareholders' approval.

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