

ELTEK LTD  
Form 20-F  
June 27, 2007

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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, 2006

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

OR

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

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

Commission file number 0-28884

**ELTEK LTD.**

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

**Israel**

(Jurisdiction of incorporation or organization)

**4 Drezner Street, Sgoola Industrial Zone, P.O. Box 159, Petach Tikva 49101, Israel**

(Address of principal executive offices)

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

Commission file number 0-28884

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Ordinary Shares, NIS 0.6 Par Value

NASDAQ Capital Market

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

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

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

**5,624,011 Ordinary Shares, par value NIS 0.6 per share (as of December 31, 2006)**

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

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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 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.

Large Accelerated filer  Accelerated filer  Non-accelerated filer

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 Annual Report on Form 20-F is incorporated by reference into our Form S-8 Registration Statements File Nos. 333-12012, 333-123559 and 333-130611.

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**INTRODUCTION**

Eltek Ltd., incorporated in 1970 under the laws of the State of Israel, develops, manufactures, markets and sells printed circuit boards, or PCBs, including high density interconnect, or HDI, multi-layered and flex-rigid boards for the medical technology, defense and aerospace, industrial equipment and telecommunications industries. Our principal customers include manufacturers of medical, defense, aerospace, industrial, telecom and networking equipment, as well as contract electronic manufacturers. Our ordinary shares are listed on the NASDAQ Capital Market (symbol: ELTK). Our European manufacturing and marketing subsidiary named Kubatronik Leiterplatten GmbH, or Kubatronik, is located in Geislingen, Germany and is our only active subsidiary. As used in this annual report, the terms we, us and our mean Eltek Ltd. and its subsidiaries, unless otherwise indicated.

Our consolidated financial statements appearing in this annual report are prepared in New Israeli Shekels, or NIS, and in accordance with generally accepted accounting principles in Israel, or Israeli GAAP, which vary in certain significant respects from generally accepted accounting principles in the United States, or U.S. GAAP, as described in Note 29 to the consolidated financial statements. All references in this annual report to dollars or \$ are to U.S. dollars and all references in this annual report to NIS are to New Israeli Shekels. Amounts stated in dollars in this report, except where the context otherwise indicates, have been translated from NIS at a specified rate solely for convenience and should not be construed as representations that the NIS amount actually represents such dollar amount or could be converted into dollars at the rate indicated. The translations of NIS amounts into dollars appearing throughout this annual report have been made at the representative rate of exchange on December 31, 2006 of NIS 4.225 = \$1.00, as published by the Bank of Israel. See Item 3.A. Key Information Selected Financial Data Exchange Rate Information .

Effective as of January 1, 2007, our consolidated financial statements are being prepared in accordance with U.S. GAAP and our reporting currency has been changed from NIS to U.S. dollars, while our functional currency will remain NIS. We believe that presenting our consolidated financial statements in U.S. dollars in the future will provide more meaningful and relevant financial information to our shareholders as the majority of our shareholders (in terms of both the number of shareholders and numbers of shares they hold) are U.S. persons.

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

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

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**PART I**

**ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS**

Not applicable.

**ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE**

Not applicable.

**ITEM 3. KEY INFORMATION**

**A. SELECTED FINANCIAL DATA**

The following table presents selected consolidated financial data as of the dates and for each of the periods indicated. You should read the selected consolidated financial data set forth below together with Item 5. Operating and Financial Review and Prospects as well as our consolidated financial statements and notes thereto appearing elsewhere in this annual report.

The selected consolidated financial data as of December 31, 2005 and 2006 and for each of the three years ended December 31, 2004, 2005 and 2006 have been derived from our audited consolidated financial statements and notes thereto included elsewhere in this annual report. The selected consolidated financial data as of December 31, 2002, 2003 and 2004 and for each of the two years ended December 31, 2002 and 2003 have been derived from our audited consolidated financial statements and notes thereto which are not included in this annual report.

Our consolidated financial statements included in this annual report have been audited by the firm of Somekh Chaikin, an independent registered public accounting firm in Israel, a member firm of KPMG International, whose report appears elsewhere herein. Our consolidated financial statements have been prepared in accordance with Israeli GAAP, which vary in certain significant respects from U.S. GAAP, as described in Note 29 to the consolidated financial statements.

For the convenience of the reader, the reported consolidated NIS figures as at and for the year ended December 31, 2006 have been presented in U.S. dollars (unaudited) translated at the representative rate of exchange on December 31, 2006 of NIS 4.225 = \$1.00, as published by the Bank of Israel. The U.S. dollars amounts so presented should not be construed as representing amounts receivable, payable or incurred in U.S. dollars or convertible into U.S. dollars.

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## STATEMENT OF CONSOLIDATED OPERATIONS DATA:

	Convenience Translation into Dollars					
	Year Ended December 31,					
	2002 <sup>(1)</sup>	2003 <sup>(1)</sup>	2004 <sup>(2)</sup>	2005 <sup>(2)</sup>	2006 <sup>(2)</sup>	2006
	(In thousands, except per share data)					
<b>Israeli GAAP:</b>						
Revenues	NIS 108,035	NIS 108,303	NIS 125,002	NIS 144,429	NIS 173,944	\$ 41,171
Cost of revenues	(106,458)	(102,643)	(109,998)	(115,733)	(136,526)	(32,313)
Gross profit	1,577	5,660	15,004	28,696	37,418	8,858
Research and development income (expenses), net	(116)	18	--	(646)	(687)	(163)
Selling, general and administrative expenses	(15,152)	(14,996)	(18,265)	(19,862)	(24,308)	(5,754)
Amortization of goodwill	(292)	(584)	(593)	(593)	--	--
Operating income (loss)	(13,983)	(9,902)	(3,854)	7,595	12,423	2,941
Financial expenses, net	(1,443)	(2,989)	(2,948)	(2,656)	(2,396)	(568)
Income (loss) before other income (expenses), net	(15,426)	(12,891)	(6,802)	4,939	10,027	2,373
Other income (expenses), net	290	(20)	52	103	24	6
Income (loss) before tax benefit (expenses) and minority interest	(15,136)	(12,911)	(6,750)	5,042	10,051	2,379
Tax benefit (expenses)	(380)	(194)	713	--	(703)	(166)
Income (loss) after tax benefit (expenses) before minority interest	(15,516)	(13,105)	(6,037)	5,042	9,348	2,213
Minority interests	(198)	118	182	218	266	63
Net income (loss)	NIS (15,714)	NIS (12,987)	NIS (5,855)	NIS 5,260	NIS 9,614	\$ 2,276
Basic net earnings (loss) per share	NIS (3.22)*	NIS (2.66)*	NIS (1.07)*	NIS 0.94*	NIS 1.71	\$ 0.41
Diluted net earnings (loss) per share	NIS (3.22)*	NIS (2.66)*	NIS (1.07)*	NIS 0.81*	NIS 1.39	\$ 0.33
Weighted average shares used to compute basic net earnings (loss) per share	4,886	4,886	5,492	5,575	5,617	5,617
Weighted average shares used to compute diluted net earnings (loss) per share	4,886	4,886	5,492	6,785	6,954	6,954
<b>U.S. GAAP:</b>						
Net income (loss)	NIS (15,422)	NIS (12,403)	NIS (5,376)	NIS 5,913	NIS 6,944	\$ 1,644

							Convenience Translation into Dollars					
Basic net earnings (loss) per share	NIS	(3.16)	NIS	(2.54)	NIS	(0.98)	NIS	1.06	NIS	1.24	\$	0.29
Diluted net earnings (loss) per share	NIS	(3.16)	NIS	(2.54)	NIS	(0.98)	NIS	0.90	NIS	1.00	\$	0.24
Weighted average shares used to compute basic net earnings (loss) per share		4,886		4,886		5,492		5,575		5,617		5,617
Weighted average shares used to compute diluted net earnings (loss) per share		4,886		4,886		5,492		6,785		6,954		6,954

\* Restated, see Note 2S to consolidated financial statements.

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#### CONSOLIDATED BALANCE SHEETS DATA:

	As at December 31,						Convenience Translation into Dollars					
	2002 <sup>(1)</sup>	2003 <sup>(1)</sup>	2004 <sup>(2)</sup>	2005 <sup>(2)</sup>	2006 <sup>(2)</sup>	2006						
	(In thousands)											
<b>Israeli GAAP:</b>												
Working capital (deficit)	NIS	(4,521)	NIS	(10,059)	NIS	(10,786)	NIS	(4,440)	NIS	7,750	\$	1,834
Total assets		105,831		88,624		80,441		86,612		97,777		23,142
Long-term liabilities excluding current maturities		21,725		14,632		7,735		7,881		13,306		3,150
Shareholders' equity		30,919		19,397		14,991		21,713		31,945		7,560
<b>US GAAP:</b>												
Total assets	NIS	106,123	NIS	89,540	NIS	82,039	NIS	88,673	NIS	102,449	\$	24,248
Shareholders' equity		31,211		20,273		16,475		23,720		31,326		7,414

(1) Adjusted amount. The nominal historical amount adjusted in accordance with the provisions of Opinions 23, 34, 36 and 37 of the Institute of Certified Public Accountants in Israel.

(2) Reported amount. Amount as at the transition date (December 31, 2003) with the addition of amounts in nominal values that were added after the transition date and less amounts eliminated after the transition date.

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#### STATEMENT OF CONSOLIDATED OPERATIONS DATA:

**Exchange Rate Information**

The following tables sets forth, for the periods and dates indicated, certain information regarding the Bank of Israel representative rate of exchange for dollars, expressed in NIS per one dollar.

<b>Period</b>	<b>Average (1)</b>	<b>High</b>	<b>Low</b>	<b>Period End</b>
Year ended December 31, 2002	4.736	4.994	4.437	4.737
Year ended December 31, 2003	4.512	4.924	4.283	4.379
Year ended December 31, 2004	4.483	4.634	4.308	4.308
Year ended December 31, 2005	4.503	4.741	4.299	4.603
Year ended December 31, 2006	4.453	4.725	4.176	4.225

(1) Calculated based on the average of the representative exchange rates on the last business day of each month during the relevant period.

<b>Period</b>	<b>High</b>	<b>Low</b>
December 2006	4.234	4.176
January 2007	4.260	4.187
February 2007	4.254	4.183
March 2007	4.222	4.155
April 2007	4.135	4.014
May 2007	4.065	3.932

At June 25, 2007, the representative rate of exchange was NIS 4.251 = \$1.00, as published by the Bank of Israel.

**B. CAPITALIZATION AND INDEBTEDNESS**

Not applicable.

**C. REASONS FOR THE OFFER AND USE OF PROCEEDS**

Not applicable.

**D. RISK FACTORS**

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

**Risks Relating to Our Business and Market**

*We have had a history of operating losses and we may not be able to sustain profitable operations.*

Prior to attaining operating profits in 2005, we incurred operating losses in each of the years in the three-year period ended December 31, 2004, and we may not be able to continue to sustain profitable operations in the future. Even if we continue to maintain profitability, we cannot assure that future net income will offset our cumulative losses. To the extent that we incur operating losses in the future, we may not have sufficient working capital to fund our operations. If we do not generate sufficient cash from operations, we will be required to obtain additional



financing or reduce our level of expenditure. Such financing may not be available in the future, or, if available, may not be on terms favorable to us.

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

Our principal customers include manufacturers of medical, defense, aerospace, industrial, telecom and networking equipment, as well as contract electronic manufacturers. These industry segments, as well as the electronics industry as a whole, are subject to rapid technological changes and products obsolescence. Discontinuance or modification of products containing printed circuit boards, or PCBs, manufactured by us could have a material adverse effect on us. In addition, the electronics industry, particularly the medical equipment industries and the defense and aerospace industries, which accounted for approximately 33% and 24%, respectively, of our sales in the year ended December 31, 2006, is subject to sharp economic cycles. Increased or excess production capacity by our competitors in the PCB industry and recessionary pressure in major electronics industry segments may result in intensified price competition and reduced margins. As a result, our financial condition and results of operations may be adversely affected. A weakness in the Israeli and international electronic markets may adversely affect our operating results and financial condition in the future.

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

The global PCB industry is highly fragmented and intensely competitive. It is characterized by rapidly changing technology, frequent new product introductions and rapidly changing customer requirements. We compete principally in the market for complex, flex-rigid and rigid multi-layer PCBs. In the Israeli market we mainly compete with PCB Technologies Ltd. and Melta Ltd., as well as with major international PCB exporters, mainly from the United States, Europe and Asia. In the European market we mainly compete with Ruwel Werke GmbH (Germany), Advanced Circuit Boards NV (Belgium), Dyconex (Switzerland) and certain other German companies. In the United States market we mainly compete with TTM Technologies Inc., Merix Corp. and DDI Corp. Many of these competitors have significantly greater financial and marketing resources than us. Our current competition in the rigid PCB segment is mainly from PCB manufacturers in the Far-East (mainly in China), which have substantially lower production costs than us. Continued competitive pressures could cause us to lose market share.

***Our operating results fluctuate significantly.***

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

- the size and timing of significant orders and their fulfillment;
- demand for the products produced by our customers;
- competition with our products;
- plant utilization;
- changes in currency fluctuation of the NIS against the U.S. dollar and the Euro;
- yields in the manufacturing process;
- timing of expenditures based on projections of future sales;
- availability of raw materials;
- timing to repair or replace any malfunctioning manufacturing equipment;
- the length of our sales cycles;
- changes in our strategy;

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the number of working days in the quarter; and

changes in seasonal trends and general domestic and international economic and political conditions.

Due to the foregoing factors, quarterly revenues and operating results are difficult to forecast, and it is likely that our future operating results will be adversely affected by these or other factors.

Quarterly sales and operating results are also difficult to forecast because quarterly sales and results are dependent, almost exclusively, on the volume and timing of orders during the quarter and our customers generally operate with a short delivery cycle and expect delivery of a significant portion of our production within twenty working days. The delivery of such orders is subject to the number of available working days during the quarter, which can fluctuate significantly from quarter to quarter due to holidays and vacations. Certain prototype and pre-production runs require even shorter turn-around times stemming from customers' product launches and design changes. In addition, there might be sudden increases, decreases or cancellations of orders for which there are commitments, which further characterize the electronics industry and the companies that operate in it. The industry practice is to make such changes without forfeiture, except for the time and materials expended on the order.

Our business involves highly complex manufacturing processes that are subject to periodic failure. Process failures have occurred in the past and have resulted in delays in product shipments. There is no assurance that process failures will not occur in the future. Further, our expenses are, in significant part, relatively fixed in the short-term. If revenue levels fall below expectations, our net income is likely to be disproportionately adversely affected because a proportionately smaller amount of the expenses varies with our revenues. We may not be able to be profitable on a quarterly or annual basis in the future. An ongoing pattern of cancellations, reductions in orders and delays could have a material adverse effect on our results of operations. Due to all of the foregoing, we cannot predict revenues for any future quarter with any significant degree of accuracy. Accordingly, we believe that period-to-period comparisons of our operating results are not necessarily meaningful and should not be relied upon as indications of future performance. We may not be able to continue to generate increased revenues in the future.

***We may encounter difficulty in realizing the potential financial or strategic benefits of future business acquisitions and investments.***

We believe that the acquisition of and the investment in new subsidiaries could assist us in reaching our goals of focusing on the high end flex-rigid and specialty PCB market, and in expanding our exports mainly into Europe and the United States. Any acquisition or investment would present risks commonly encountered in the acquisition of or investment in other businesses. The following are examples of such risks, one or more of which may apply to any such acquisition or investment:

difficulty in combining the technology, operations or work force of the acquired business;

adverse effects on our reported operating results due to the amortization or write-down of intangible assets associated with acquisitions;

diversion of management attention from running our existing business; and

increased expenses, including compensation expenses resulting from newly-hired employees.

***Our results may be adversely affected by product liability claims.***

The sale and support of our products may entail the risk of product liability claims, which are likely to be substantial in light of the use of our products in business-critical applications. In the past we were involved in a costly litigation relating to allegedly defective products. If such suits are brought against us in the future, our business, results of operations and financial condition may be adversely affected.

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

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

***We depend on our key customers and the loss of one or more of our key customers would result in a loss of a significant amount of our revenues.***

In the years ended December 31, 2005 and December 31, 2006, our top ten customers accounted for 63% and 60% of our revenues, respectively, and one customer accounted for approximately 31% and 25% of our total revenues, respectively. The principal product of our largest customer is at the end of its lifecycle and revenues from such customer decreased to 17% of our total revenues in the three months ended March 31, 2007. In June 2007, such customer notified us to cease production of the PCB for its principal product. The customer may not continue to purchase products from us in the future, or if it continues to purchase products from us, the volume of purchases would likely be significantly lower than previous volumes. We expect that a significant portion of our future revenues will continue to be dependent on a small number of customers. If we are unable to retain our key customers or if we are unable to attract sufficient new business to compensate for the loss of any of our key customers, our results of operations and financial condition would be adversely affected.

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

We currently obtain our key raw materials from a select number of suppliers. We do not have long-term supply contracts with our suppliers and our principal suppliers may not continue to supply raw materials to us at current levels or at all. Any delays in delivery of or shortages in these raw materials could interrupt and delay manufacturing of our products and may result in the cancellation of orders for our products. In addition, these suppliers could discontinue the manufacture or supply of these raw materials at any time. During the year ended December 31, 2006, one supplier accounted for 21% of our total consolidated materials and non-manufactured products purchase costs. We may not be able to identify and integrate alternative sources of supply in a timely fashion. Any transition to alternate suppliers may result in delays in production and shipment and increased expenses and may limit our ability to deliver products to our customers. Furthermore, if we are unable to identify an alternative source of supply, we may have to modify our products or a large portion of our production process to use a substitute raw material, which may cause delays in production and shipments, increased design and manufacturing costs and increased prices for our products.

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

Our working capital requirements and cash flow provided by our operating and financing activities are likely to vary greatly from quarter to quarter, depending on the following factors:

- the timing of orders and deliveries;
- the purchase of new equipment;
- the build-up of inventories;

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- the payment terms offered to our customers;
  - the payment terms offered by our suppliers; and
  - approval of the current or additional lines of credit and long-term loans from our banks.

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As of December 31, 2006, we had revolving lines of credit aggregating NIS 13.9 million (\$3.3 million) with our banks, of which NIS 8.5 million (\$2 million) was utilized as of such date. As of December 31, 2006, we also had NIS 14.2 million (\$3.4 million) of long-term loans. These credit facilities may not remain available to us in the future. Furthermore, under certain circumstances our banks may require us to accelerate the repayment of our credit facilities. All of our assets are pledged as security for our liabilities to our banks, whose consents are required for any future pledge of such assets.

Financial covenants in respect of our credit facilities and long-term debt with one of our banks require us to maintain the higher of shareholders' equity, excluding intangible assets, of NIS 24.0 million or 23% of our total assets (on a non consolidated basis). With another bank, the financial covenants require us to maintain the higher of tangible shareholders' equity of NIS 15.0 million or 15% of our consolidated total assets, and the higher of tangible shareholders' equity of NIS 14.0 million or 14% of our total assets (on a non consolidated basis). For these purposes, shareholders' equity includes the outstanding convertible note and excludes prepaid expenses (except insurance). As of December 31, 2006, we were in compliance with such covenants. We may not be able to maintain compliance with such covenants in the future.

To the extent that the funds generated from our operations and from our existing capital resources are insufficient to fund our operating and financial requirements, we may be required to raise additional funds through public or private financing or other sources. Such additional financing may not be available to us or, if available, may not be obtained on terms favorable to us. Any equity financing may cause dilution to our then current shareholders. If additional funds are raised through the issuance of equity securities, the percentage ownership of then current shareholders will be diluted. We do not have any committed sources of additional financing, and additional financing, if necessary, may not be available on commercially reasonable terms, if at all. If adequate funds are not available on terms acceptable to us, we may be required to delay, scale back or eliminate certain aspects of our operations, and our business, financial condition and results of operations would be materially adversely affected.

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

During 2005 and 2006, the significant increase in oil and energy costs and commodity prices (such as copper, gold and glass fibers) put pressure on our suppliers to increase their prices for most of our principal raw materials, and we expect these conditions to continue through 2007. During 2005 and 2006, price negotiations with our suppliers resulted in lower price increases than requested by our suppliers, however we may not continue to be successful in such negotiations in the future. We have also faced pressure to raise our prices for our products to compensate for these price increases and maintain our operating margins, and although we have managed to date to maintain our sales volume with moderate price increases, we may not be able to do so in the future. Future price changes in raw materials may materially affect our future profitability.

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

We are based in Israel and Germany and generate a large percentage of our sales in Europe. Our sales in Europe in the years ended December 31, 2004, 2005 and 2006 accounted for 38.4%, 50.6% and 46.0% of our consolidated revenues, respectively, of which 13.0%, 12.9% and 11.7% was generated in Germany, respectively. We intend to pursue market share in the United States, including the U.S. military, however contracts with U.S. military agencies are subject to certain regulatory restrictions and approvals, which we may not be able to comply with or obtain. We may not be able to maintain or increase international market demand for our products. To the extent that we cannot do so, our business, operating results and financial condition may be adversely affected.

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

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

*If we are found to be in violation of environmental laws, we could be liable for damages and costs of remedial actions or our production may be subject to stop orders, which may affect our business, operating results and financial condition.*

We use certain materials in our manufacturing processes that are classified as hazardous substances. Proper waste disposal and environmental regulations are major considerations for PCB manufacturers because metals and chemicals classified as hazardous substances are used in the manufacturing process. Since May 2003, our environmental management system has been ISO 14001 certified. This certification was based on successful implementation of environmental management requirements and includes ongoing monitoring of our processes, raw materials and products. The certification is subject to periodic compliance audits conducted by the Israeli Institute of Standards. If, in the future, we are found to be in violation of environmental laws, we could be liable for damages and costs of remedial actions and could also be subject to revocation of permits necessary to conduct our business or any part thereof. Any such revocation could require us to cease production, which could have a material adverse effect on our financial condition and results of operations. We are also subject to laws relating to the storage, use and disposal of hazardous materials, as well as air quality regulations. Environmental laws could become more stringent over time, imposing greater compliance costs and increasing risks and penalties associated with a violation. For example, environmental regulations enacted in Israel in September 2000 provide that a company that is found to have discharged water containing contaminants will be liable for quadruple the amount normally charged for its water consumption. Moreover, according to the same regulations, manufacturing plants were required to reduce the quantity of the wastewater discharged by them by 90% within four years. To be exempted from such legislation, a plant would have to show the Israeli Ministry of the Environment that a partial or complete decrease in the quantity of wastewater is not feasible. Since 1996 we have undertaken various actions to reduce the use of water in our manufacturing facilities. We believe that we have materially complied with the September 2000 regulations, but such compliance may not be sufficient in the future.

*Compliance with corporate governance regulations could increase the cost of our operations.*

As a result of changing laws, regulations and standards relating to accounting, corporate governance and public disclosure, the costs of being a public company in general have increased in recent years. The Sarbanes-Oxley Act of 2002 requires changes in some of our corporate governance and securities disclosure or compliance practices. We expect that the on-going implementation of these regulations will further increase our legal compliance costs and will make some activities more time consuming. We are presently evaluating and monitoring regulatory developments and cannot estimate the magnitude of additional costs we may incur as a result of such developments. In connection with our future implementation of Section 404 of the Sarbanes-Oxley Act of 2002, which governs internal controls and procedures for financial reporting, we will need to spend significant management time and financial resources to comply with the applicable requirements. This and other proposed legislation may increase the fees of our professional advisors and our insurance premiums.

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## **Risk Factors Related to Our Ordinary Shares**

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

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

- quarterly variations in our operating results;
- operating results that vary from the expectations of securities analysts and investors;
- changes in expectations as to our future financial performance, including financial estimates by securities analysts and investors;
- announcements of technological innovations or new products by us or our competitors;
- announcements by us or our competitors of significant contracts, acquisitions, strategic partnerships, joint ventures or capital commitments;
- changes in the status of our intellectual property rights;
- announcements by third parties of significant claims or proceedings against us;

announcements by governmental or regulatory authorities of significant investigations or proceedings against us;

additions or departures of key personnel;

changes in our cost structure due to factors beyond our control, such as new laws or regulations relating to environmental matters and employment;

future sales of our ordinary shares;

general stock market price and volume fluctuations; and

further devaluation of the dollar against the NIS.

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

***We do not expect to distribute dividends.***

We have never declared or paid any cash dividends on our ordinary shares. We currently intend to retain our current and any future earnings to finance operations and expand our business and, therefore, do not expect to pay any dividends in the foreseeable future. According to the Israeli Companies Law, a company may distribute dividends out of its profits (within the meaning of the Israeli Companies Law), provided that there is no reasonable concern that such dividend distribution will prevent the company from paying all its current and foreseeable obligations, as they become due. The declaration of dividends is subject to the discretion of our Board of Directors and would depend on various factors, including our operating results, financial condition, future prospects and any other factors deemed relevant by our Board of Directors.

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You should not rely on an investment in our company if you require dividend income from your investment. The success of your investment will likely depend entirely upon any future appreciation of the market price of our ordinary shares, which is uncertain and unpredictable. There is no guarantee that our ordinary shares will appreciate in value or even maintain the price at which you purchased your ordinary shares.

**Risks Relating to Our Operations in Israel**

***Conducting business in Israel entails special risks.***

We are incorporated under the laws of the State of Israel, and our executive offices and research and development facilities are located in Israel. Although most of our sales are made to customers outside Israel, we are directly influenced by the political, economic and military conditions affecting Israel. Any major hostilities involving Israel, a full or partial mobilization of the reserve forces of the Israeli army, the interruption or curtailment of trade between Israel and its present trading partners, or a significant downturn in the economic or financial condition of Israel could have a material adverse effect on our business, financial condition and results of operations.

Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors, and a state of hostility, varying from time to time in intensity and degree, has led to security and economic problems for Israel. Although Israel has entered into various agreements with Egypt, Jordan and the Palestinian Authority, there has been an increase in unrest and terrorist activity in Israel, which began in September 2000 and which has continued with varying levels of severity through 2006. The future effect of this deterioration and violence on the Israeli economy and our operations is unclear. The election of representatives of the Hamas movement to a majority of seats in the Palestinian Legislative Council in January 2006 resulted in an escalation in violence among Israel, the Palestinian Authority and other groups. In July 2006, extensive hostilities began along Israel's northern border with Lebanon between Israel and Hezbollah forces and to a lesser extent in the Gaza Strip, which involved rocket attacks on populated areas in the northern parts of Israel. On August 14, 2006, a cease-fire between Hezbollah and Israel took effect. This situation has had an adverse effect on Israel's economy, primarily in the geographical areas directly harmed by this conflict. Any future armed conflict, political instability or violence in the region may have a negative effect on our business condition, harm our results of operations and adversely affect our share price. No predictions can be made as to whether or when a final resolution of the area's problems will be achieved or the nature thereof and to what extent the situation will impact Israel's economic

development or our operations.

Furthermore, there are a number of countries, primarily in the Middle East, as well as Malaysia and Indonesia, that restrict business with Israel or Israeli companies, and we are precluded from marketing our products to these countries. 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.

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

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

***Our results of operations may be harmed by currency fluctuations.***

We record our revenues and expenses in NIS. Our revenues are generally denominated in foreign currencies, primarily the U.S. dollar and Euro, while our expenses are primarily denominated in NIS, U.S. dollars, Euros, dollar-linked NIS and Euro-linked NIS. As a result, fluctuations in rates of exchange between NIS and non-NIS currencies may affect our operating results and financial condition. The NIS value of our U.S. dollar and Euro revenues decline if the NIS devaluates against the dollar and Euro. In addition, our expenses other than those paid in Israeli currency that are not-linked to other currencies are influenced by the devaluation of the NIS in relation to the U.S. dollar and the Euro. The NIS value of our U.S. dollar and Euro expenses increase if the NIS devaluates against the dollar and the Euro and other currencies other than NIS. In 2006, the U.S. dollar devaluated against the NIS by 8.2%.

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From time to time in the past we have engaged in hedging transactions in order to partially protect ourselves from currency fluctuation and inflation risks and may use hedging instruments from time to time in the future. If we were to determine that it is in our best interests to enter into any other hedging transactions in the future, we may not be able to do so or such transactions, if entered into, may not materially reduce the effect of fluctuations in foreign currency exchange rates on our results of operations.

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

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

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

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

Provisions of Israeli corporate and tax laws may have the effect of delaying, preventing or making more difficult a merger with, or other acquisition of, us. This could cause our ordinary shares to trade at prices below the price for which third parties might be willing to pay to gain control of us. Third parties who are otherwise willing to pay a premium over prevailing market prices to gain control of us may be unable or unwilling to do so because of these provisions of Israeli law.

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

We are incorporated under Israeli law. The rights and responsibilities of holders of our ordinary shares are governed by our memorandum of association, articles of association and by Israeli law. These rights and responsibilities differ in some respects from the rights and responsibilities of shareholders in typical U.S. corporations. In particular, each shareholder of an Israeli company has a duty to act in good faith in exercising his or her rights and fulfilling his or her obligations toward the company and other shareholders and to refrain from abusing his

power in the company, including, among other things, in voting at the general meeting of shareholders on certain matters. Israeli law provides that these duties are applicable in shareholder votes on, among other things, amendments to a company's articles of association, increases in a company's authorized share capital, mergers and interested party transactions requiring shareholder approval. In addition, a controlling shareholder of an Israeli company, or a shareholder who knows that he or she possesses the power to determine the outcome of a shareholder vote or who has the power to appoint or prevent the appointment of a director or officer in the company, has a duty of fairness toward the company. However, Israeli law currently does not define the substance of this duty of fairness. Because Israeli corporate law has undergone extensive revision in recent years, there is relatively little case law available to assist in understanding the implications of these provisions that govern shareholder behavior.

*As a foreign private issuer whose shares are listed on The NASDAQ Capital Market, we may follow certain home country corporate governance practices instead of certain NASDAQ requirements.*

As a foreign private issuer whose shares are listed on The NASDAQ Capital Market, we are permitted to follow certain home country corporate governance practices instead of certain requirements of the NASDAQ Marketplace Rules. A foreign private issuer that elects to follow a home country practice instead of such requirements, must submit to NASDAQ in advance a written statement from an independent counsel in such issuer's home country certifying that the issuer's practices are not prohibited by the home country's laws. In addition, a foreign private issuer must disclose in its annual reports filed with the Securities and Exchange Commission each such requirement that it does not follow and describe the home country practice followed by the issuer instead of any such requirement. As a foreign private issuer listed on The NASDAQ Capital Market, we may follow home country practice with regard to, among other things, composition of the board of directors, director nomination procedure, compensation of officers, and quorum at shareholders' meetings. In addition, we may follow our home country law, instead of the NASDAQ Marketplace Rules, which require that we obtain shareholder approval for certain dilutive events, such as for the establishment or amendment of certain equity based compensation plans, an issuance that will result in a change of control of the company, certain transactions other than a public offering involving issuances of a 20% or more interest in the company and certain acquisitions of the stock or assets of another company.

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## **ITEM 4. INFORMATION ON THE COMPANY**

### **A. HISTORY AND DEVELOPMENT OF THE COMPANY**

We were incorporated under the laws of the State of Israel on January 1, 1970. We are a public limited liability company under the Israeli Companies Law 5759-1999 and operate under this law and associated legislation. Our registered offices and principal place of business are located at 4 Drezner Street, Sgoola Industrial Zone, Petach Tikva 49101, Israel, and our telephone number is 972-3-939-5025. Our address on the Internet is [www.eltekglobal.com](http://www.eltekglobal.com). The information on our website is not incorporated by reference into this annual report.

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

We design and develop innovative manufacturing solutions pursuant to complex interconnect requirements of original equipment manufacturers, and provide our customers with a wide range of custom designed PCBs, including complex rigid, double-sided and multi-layer PCBs as well as flexible circuitry (flex and flex-rigid boards) made of several types of high-performance base material. To complement our quick-turnaround, prototype, pre-production and low to medium volume production capability and provide our customers with single source service, we also act as an agent for the importation of PCBs from the Far East when customers require high volume production runs.

In July 2000, we adopted a plan to create the capacity and capability to offer our customers the new state-of-the-art PCB technology known as high density interconnect, or HDI. This technology enables manufacturers to produce PCBs with line width and spaces as narrow as 4-5 mils and hole diameters of 10 to 12 mils (1 mil=0.001 inch). We began to supply PCBs utilizing the HDI technology to select customers in August 2000 and since such time, have focused our efforts on HDI PCBs. In 2006, we continued to focus on the sale of flex-rigid HDI PCBs and PCBs made with high performance base materials. Such products accounted for approximately \$28.8 million or 70% of our total sales in the year ended December 31, 2006 as compared to approximately \$22.7 million or 72% of our total sales in the year ended December 31, 2005.

In June 2002, we acquired 76% of Kubatronik, a privately held German PCB manufacturer, for approximately Euro 2.6 million. The remaining 24% of Kubatronik is held by Mr. Alois Kubat, its founder and General Manager at that time. Kubatronik specializes in



manufacturing short run and prototype boards, including multi-layer, flex-rigid and HDI boards. Its customers include companies engaged in the production of industrial, defense, aerospace, telecom, networking, computer and data storage equipment, as well as contract electronic manufacturers. This acquisition facilitated our entry into the German market, while complementing our other relationships throughout the rest of Europe.

In November 2006, we entered into a license agreement with Stablcor, Inc., under which we were granted the first license to use the STABLCOR® technology, an advanced thermal management solution for PCB fabrication, outside the United States. The STABLCOR technology enables PCB manufacturers, such as our company, to produce smaller electronic products while eliminating the thermal, mechanical and reliability concerns that currently challenge the semiconductor industry. We intend to work with the STABLCOR technology to design and develop new and unique solutions for our high end customers and believe that this license will expand our opportunities in the high-end PCB market. We expect to introduce a PCB product using the STABLCOR technology in the third quarter of 2007.

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Since 2004 and through March 31, 2007, we have invested \$7.4 million in facilities expansion, restructuring our infrastructures and purchasing equipment.

## **B. BUSINESS OVERVIEW**

### **Industry Overview**

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

*Rigid PCBs.* Rigid PCBs are the core product of the industry and can be found in virtually every electronics device. The layer count of these products generally ranges from two to thirty-two layers.

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

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

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

### **Manufacturing and Engineering Processes**

In the PCB industry, significant investments in equipment are necessary to maintain technological competitiveness. During the five years ended December 31, 2006, we invested approximately \$6.3 million for these purposes (not including the acquisition of Kubatronik).

*Manufacturing Capabilities.* We have the capability to manufacture PCBs with layer counts in excess of 30 layers, blind and buried vias and designs using materials as thin as 0.001 inches. We established our HDI advanced capabilities after a two-year period of research and development, followed by a significant investment in HDI production capacity. In August 2000, we began to supply HDI products to selected customers. We are able to produce short runs of five to thirty PCBs within three to five working days, and a few hundred units within ten working days and are capable of producing such number of boards within five working days when production line scheduling permits. In the year ended December 31, 2006, approximately 27% of our manufactured products were ordered for delivery in less than 20 working days, of which approximately 6% were ordered for delivery within six to ten working days and approximately 7% in five or less working days.

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

*Advanced Finishing Capabilities for Dense Packaging Designs.* We provide a wide assortment of alternative surface finishes, including hot air solder leveling, electroless gold over nickel, tin immersion, silver immersion and Entek, which is produced by Enthone-Omi Inc., for the attachment of components to PCBs.

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

*Quality and Environment Standards.* Our quality management system has been ISO 9001:2000 certified since July 2002 (and prior to such date, was ISO 9002 certified from January 1995). This certification is based on successful implementation of quality assurance requirements and includes ongoing monitoring of our business and periodic compliance audits conducted by the Israeli Institute of Standards. We have obtained United States Department of Defense Qualified Product List approval (MIL-PRF-55110F and MIL-P-50884D) for our products. Since 1976, our Glass Epoxy (FR4) Boards have been UL 94V-0 certified by Underwriters Laboratories Inc. (a standards organization that offers product safety testing and certification of product safety). Our environmental management system has been ISO 14001:2004 certified since 2005 (and prior to such date was ISO 14001 certified from 2003). We are currently in the process of OHSAS 18001 certification for occupation health and safety management systems, a standard of the Occupational Safety and Health Administration of the U.S. Department of Labor, which we expect to complete during 2007.

## **Sales, Customers and Marketing**

*Sales.* In the years ended December 31, 2004, December 31, 2005 and December 31, 2006, the primary industries for which we produced PCBs were medical equipment (23%, 37% and 35% of production, respectively), defense and aerospace equipment (35%, 26% and 25% of production, respectively), telecom and networking equipment (18%, 5% and 7% of production, respectively) and industrial equipment (16%, 11% and 11% of production, respectively) as well as for contract electronic manufacturers (3%, 12% and 16% of production, respectively).

*Customers.* During the year ended December 31, 2006, we provided PCBs to approximately 180 customers in Israel and approximately 280 customers outside of Israel (including Kubatronik's customers). Our customers outside of Israel are located primarily in Germany, Scandinavia, France (where our principal customer is located), the United States and the Netherlands. Sales to non-Israeli customers increased from \$13.3 million (45.7% of revenues) in the year ended December 31, 2004 to \$18.1 million (57.7% of revenues) in the year ended December 31, 2005 to \$22.3 million (54.2% of revenues) in the year ended December 31, 2006.

In the years ended December 31, 2004, 2005 and 2006, our ten largest customers accounted for 46%, 63% and 60% of our revenues in the years ended December 31, 2004, 2005 and 2006, respectively, and one customer accounted for 12.3%, 30.6% and 25.2% of our total revenues, respectively. The principal product of our largest customer is at the end of its lifecycle and revenues from such customer decreased to 17% of our total revenues in the three months ended March 31, 2007. In June 2007, such customer notified us to cease production of the PCB for its principal product, which will be succeeded by a new internally developed product. The customer may not continue to purchase products from us in the future, or if it continues to purchase products from us, the volume of purchases would likely be significantly lower than previous volumes. We expect that a significant portion of our future revenues will continue to be dependent on a small number of customers.

*Marketing.* We market and sell our products primarily through our direct sales personnel, sales agents and agreements with PCB trading and manufacturing companies. Our sales personnel currently consist of 18 persons (12 in Israel, one in the United States and five persons employed by our German subsidiary, Kubatronik). In Europe we market and sell our products through a full-time self-employed marketing and sales manager and also have sales agents in Sweden, Germany, Switzerland, France, Belgium and Spain. In the Netherlands, the United Kingdom and Italy we have PCB trading and manufacturing companies acting as distributors of our products. In the United States we market and sell our products through a full-time self-employed marketing and sales manager, who is supported by six representatives, as well as through a PCB manufacturing company. In India we have marketed our products since 2001 through a local sales agent. We maintain technical support services for our customers world-wide. We also maintain customer service support centers that handle all logistical matters relating to delivery and maintenance arrangements and receive and handle complaints relating to delivered products.

Our strategy is to focus on the high end of the PCB market, mainly in flex-rigid PCBs, in which margins are significantly better. We also initiated a program to upgrade our processes by implementing high-quality standards, employee training and special training activities for clients. We are continuing to expand our export marketing efforts in Europe, as well as in the United States. Marketing efforts include the distribution of promotional items, seminars for engineers, technical information supplied to business publications and participation in trade shows and industry conferences.

### **Materials and Supplies**

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

Our suppliers decreased their prices in 2002, 2003 and 2004 for the principal raw materials we use in the manufacture of PCBs. During 2005 and 2006, the significant increase in oil and energy costs and commodity prices (such as copper, gold and glass fibers) put pressure on our suppliers to increase their prices for most of our principal raw materials, and we expect these conditions to continue through 2007. During 2005 and 2006, price negotiations with our suppliers resulted in lower price increases than requested by our suppliers, however we may not continue to be successful in such negotiations in the future. We have also faced pressure to raise our prices for our products to compensate for these price increases and although we have managed to date to maintain our sales prices with moderate price increases, however we may not be able to do so in the future. Although to date our profitability has not been significantly affected by such price changes, future price changes in raw materials may materially affect our future profitability.

### **Competition**

The global PCB industry is highly fragmented and intensely competitive, trends that we believe will continue. It is characterized by rapidly changing technology, frequent new product introductions and rapidly changing customer requirements. We compete principally in the market for complex, flex-rigid multi-layer PCBs. In the Israeli market we mainly compete with PCB Technologies Ltd. and Melta Ltd., as well as with major PCB exporters, mainly from the United States, Europe and Asia. In the European market we mainly compete with Ruwel Werke GmbH (Germany), Advanced Circuit Boards NV (Belgium) and Dyconex (Switzerland) and certain other German companies. In the United States market we mainly compete with TTM Technologies Inc., Merix Corp. and DDI Corp. Many of these competitors have significantly greater financial, technical and marketing resources than us. Although capital requirements are a significant barrier to entry for manufacturing complex PCBs, the basic interconnect technology is generally not protected by patents or copyrights. Our current competition in the rigid PCB segment is mainly from PCB manufacturers in the Far-East (mainly in China), which have substantially lower production costs than us. Continued competitive pressures could cause us to lose market share.

### **Environmental Matters**

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

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PCB manufacturing requires the use of metals and chemicals classified as hazardous substances. Water used in the manufacturing process must be treated to remove metal particles and other contaminants before it can be discharged into the local sewer systems. Environmental regulations enacted in Israel in September 2000 provide that a company, which is found discharging water containing contaminants, will be liable to pay quadruple the amount normally charged for its water consumption. We operate and maintain effluent water treatment systems and use approved testing procedures at our manufacturing facilities. There is no assurance, however, that violations will not occur in the future. We are also subject to environmental laws and regulations relating to the storage, use and disposal of chemicals, solid waste and other hazardous materials, as well as air quality regulations. Environmental laws and regulations could become more stringent over time, and the costs of compliance with more stringent laws could be substantial. According to the September 2000 regulations, manufacturing plants are required to reduce the quantity of the wastewater discharged by them by 90% within four years. To be exempted from such legislation, an owner of a plant would have to show the Israeli Ministry of the Environment that a partial or complete decrease in the quantity of wastewater is not feasible. Since 1996, we have undertaken various actions to reduce the use of water in our manufacturing facilities. We believe that we have materially complied with the September 2000 regulations, but no assurance can be given that such compliance will be sufficient in the future.

## Intellectual Property Rights

Our success depends in part on our proprietary techniques and manufacturing expertise, particularly in the area of complex multi-layer and flex-rigid PCBs. Like many companies in the PCB industry, we do not hold any patents and rely principally on trade secret protection of our intellectual property. However, we have applied for two patents in Israel in the field of opto-electronic circuits. We believe that, because of the rapid pace of technological change in the electronics industry, the legal protections for our products are less significant factors in our success than the knowledge, ability and experience of our employees, the frequency of product enhancements and the timeliness and quality of support services that we provide. We are devoting resources to the research and development of new manufacturing technology that we believe will allow us to enhance our product offerings.

## C. ORGANIZATIONAL STRUCTURE

In June 1999, we established Eltek Europe Ltd., a wholly-owned subsidiary organized in the United Kingdom, to manage our marketing activities in Europe. Since July 31, 2002, Eltek Europe Ltd. is inactive and the marketing activities in Europe are currently managed from Israel and Germany.

In May 2002, we established En-Eltek Netherlands 2002 B.V., a wholly-owned subsidiary organized in the Netherlands, in connection with our acquisition of a 76% interest in Kubatronik. We currently intend to transfer our entire holdings in Kubatronik from En-Eltek Netherlands 2002 B.V. to our company. Kubatronik is a PCB manufacturer that specializes in short run and prototype boards, including multi-layer, flex-rigid and HDI boards. Its customers include companies engaged in the production of industrial equipment, defense and aerospace equipment, telecom and networking equipment, and computer and data storage equipment as well as contract electronic manufacturers. Mr. Alois Kubat, Kubatronik's founder, holds the remaining 24% interest in Kubatronik. Mr. Kubat has the right to require us to purchase, and we have the right to require him (or his permitted transferee) to sell to us, his remaining interest in Kubatronik. See Item 5B. Operating and Financial Review and Prospects – Liquidity and Capital Resources.

## D. PROPERTY, PLANTS AND EQUIPMENT

### Leased Facilities

Our executive offices, as well as our design, production, storage and shipping facilities, aggregating approximately 90,000 square feet, are located in an industrial building in the Sgoola Industrial Zone of Petach Tikva, Israel. The lease for such facilities expires in February 2017 and we have an option to extend the lease for an additional five year term upon six months prior notice. In the year ended December 31, 2006, we paid NIS 2.1 million (\$500,000) in rent for these premises.

Kubatronik's executive offices as well as its design, production, storage and shipping facilities, aggregating approximately 15,000 square feet, are located in an industrial building in Geislingen, Germany. The lease for their facilities expires in June 30, 2008. A lease for an adjoining 8,000 square feet parking area expires on December 31, 2010. In the year ended December 31, 2006, Kubatronik paid an aggregate of NIS 422,000 (\$100,000) in rent for these premises.

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### Leased Equipment

We lease manufacturing equipment under two operating lease agreements, pursuant to which as of December 31, 2006 we are obligated to pay a total amount of NIS 2.3 million (\$544,000), through March 2010. Our monthly lease expense under these two agreements is approximately NIS 60,000 (\$14,250), linked to the U.S. dollar.

From September 2005 until May 2006, we leased additional manufacturing equipment under an operating lease agreement. Our monthly lease expense under this agreement was approximately NIS 48,000 (\$10,000), linked to the Swiss Franc. In May 2006, we purchased this equipment and the agreement terminated.

Kubatronik leases manufacturing equipment under two operating lease agreements, which as of December 31, 2006 require us to pay a total of Euro 41,000 (\$68,000) through April 2009. Our monthly lease expense under these two agreements is approximately Euro 3,155 (\$4,170).

## Investment in Equipment and Infrastructure

In 2004, we invested approximately NIS 1.5 million in capital expenditures. Almost all of our capital expenditures in 2004 were related to the purchase of production and manufacturing equipment in the amount of NIS 1.1 million and leasehold improvements in the amount of NIS 306,000.

In 2005, we invested approximately NIS 12.6 million (\$2.7 million) in capital expenditures. Of such amount, NIS 12 million (\$2.6 million) was used to purchase production and manufacturing equipment and NIS 365,000 was used for leasehold improvements.

In 2006, we invested approximately NIS 12.7 million (\$3.0 million) in capital expenditures. Of such amount, approximately NIS 10.7 million (\$ 2.5 million) was used to purchase production and manufacturing equipment and NIS 1.8 million (\$ 0.4 million) was used for leasehold improvements.

In 2007, we intend to invest approximately NIS 19 million (\$ 4.5 million) in capital expenditures, including approximately \$ 2.9 million in manufacturing equipment and approximately \$ 1.6 million in leasehold improvements for the expansion of our production facilities.

### ITEM 4A. UNRESOLVED STAFF COMMENTS

Not applicable.

### ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

#### A. OPERATING RESULTS

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

#### Overview

We were incorporated under the laws of the State of Israel in 1970. Kubatronik, our European manufacturing and marketing subsidiary located in Geislingen Germany, is our only active subsidiary.

We develop, manufacture, market and sells PCBs (printed circuit boards), including high density interconnect (HDI) multi-layered and flex-rigid boards for the telecommunications, defense and aerospace and medical technology industries. Our principal customers include manufacturers of medical equipment, defense and aerospace equipment, industrial equipment, and telecom and networking equipment, as well as contract electronic manufacturers.

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Our consolidated financial statements appearing in this annual report are prepared in NIS and in accordance with Israeli GAAP, which vary in certain significant respects from U.S. GAAP, as described in Note 29 to the consolidated financial statements.

Effective as of January 1, 2007, our consolidated financial statements are being prepared in accordance with U.S. GAAP and our reporting currency has been changed from NIS to U.S. dollars, while our functional currency will remain NIS. We believe that presenting our consolidated financial statements in U.S. dollars in the future will deliver more meaningful and relevant financial information to our shareholders as the majority of our shareholders (in terms of both the number of shareholders and numbers of shares they hold) are U.S. persons. The financial statements for all years (or periods) presented will be translated into U.S. dollars using the current rate method. Under that method, the income statement and cash flow statement items for each year (or period) will be translated into U.S. dollars using the exchange rates in effect at the date of the transactions and assets and liabilities will be translated using the exchange rate at the end of each year (or period), except for equity

accounts which will be translated using the rates in effect at the date of the transactions. All resulting exchange differences that do not affect our earnings will be reported in the accumulated other comprehensive income as a separate component of shareholders' equity.

### **Critical Accounting Policies**

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

The significant accounting policies described in Note 2 of our consolidated financial statements, which we believe to be most important to fully understand and evaluate our financial condition and results of operation under generally accepted accounting principles in Israel, are discussed below.

#### ***Revenue Recognition***

We recognize revenues when products are shipped and the customer takes ownership and assumes risk of loss, collection of the relevant receivable is probable, persuasive evidence of an arrangement exists and the sale price is fixable or determinable. Commission income is accounted for on the accrual basis.

#### ***Inventories***

Inventories are recorded at the lower of cost or market value. The cost of raw materials is determined on a moving average basis. The cost of work-in process and completed products is determined on direct production costs, plus allocated indirect expenses, all of which are determined on an average basis. If actual market conditions are less favorable than those projected by us or if there is no future demand for part or all of our inventories, we will need to write-off the affected inventories. This could result in an increase of our operating expenses.

#### ***Property and Equipment***

Assets are recorded at cost. Depreciation on property and equipment is calculated on the straight-line method over the estimated useful lives of the assets. The cost of maintenance and repairs is charged to expenses as incurred. The cost of significant renewals and improvements is added to the carrying amount of the respective asset.

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#### ***Impairment in Value of Assets***

Since January 1, 2003, we have applied the Israel Accounting Standards Board, or IASB, Accounting Standard No. 15, *Impairment in Value of Assets*, to ensure that our assets in the consolidated balance sheet are not stated at an amount exceeding their recoverable value, which is the higher of the net sales price and the usage value, which is the present value of the estimated future cash flows expected to be derived from the use and realization of the asset. This standard, which is based on International Accounting Standard No. 36, applies to all of our assets in the consolidated balance sheet, except for tax assets and monetary assets. Likewise this Standard prescribes the presentation and disclosure principles for assets that have declined in value. When the carrying value of an asset in the consolidated balance sheet exceeds its recoverable amount, we recognize an impairment loss equal to the difference between the book value of the asset and its recoverable value. A loss recognized in this manner will be reversed only if changes have occurred in the estimates used in determining the recoverable value of the asset, from the date on which the last impairment loss was recognized. As of December 31, 2006, no impairment losses have been identified. Under Israeli GAAP, in accordance with Accounting Standard No. 15, certain procedures must be applied in order to ensure that our property and equipment in our consolidated balance sheet are not presented at an amount which is in excess of our recoverable value, which is the higher of the net selling price or the present value of the estimated future cash flows expected to be derived from use and disposal of our property and equipment. If in the future the carrying value of our property and equipment do not meet the requirements of Standard No. 15, we may be required to accelerate the depreciation or write-off part of our property and equipment. This could result in an increase of our operating expenses. For the impact under the U.S. GAAP, see Note 29 to the consolidated financial statements.

#### ***Goodwill***

Our goodwill as of December 31, 2006 is the cost of our investment in Kubatronik over the unamortized fair value of the assets acquired and liabilities assumed, determined as of the acquisition date. Until January 1, 2006, we applied Israeli Accounting Standard No. 20 *Amortization of Goodwill*, according to which goodwill was systematically amortized over the period of its useful life (ten years). Amortization of identified

goodwill was NIS 593,000 for each of the years ended December 31, 2005 and 2004.

As of January 1, 2006, we implement the provisions of Israeli Accounting Standard No. 20 (Revised), *The Accounting Treatment of Goodwill and Intangible Assets with indefinite useful lives when Purchasing an Investee Company*, according to which goodwill is not systematically amortized. Instead, we examine whether there has been an impairment in the value of the goodwill and intangible assets deriving from the acquisition of a subsidiary, once a year or more frequently if events or changes in circumstances indicate that there may have been an impairment in the value of the assets. The financial statements for periods prior to the implementation of the revised Standard were not restated. We obtained an appraisal from an independent appraiser to evaluate our investment in Kubatronik as of December 31, 2006 and their conclusion was that no impairment was required to be recorded as of such date.

## Recent Accounting Pronouncements

### *Recent Accounting Pronouncements in Israel*

In July 2006, the IASB published Accounting Standard No. 29, *Adoption of International Financial Reporting Standards*, or Standard No. 29. Standard No. 29 provides that entities subject to the Israeli Securities Law, 1968 that are required to report according to the regulations of such law, are to prepare their financial statements for periods beginning as from January 2008 according to International Financial Reporting Standards, or IFRS. Standard No. 29 permits early adoption as of financial statements published after July 31, 2006. Standard No. 29 does not apply to entities subject to Israeli Securities Regulations (Periodic and Immediate Reports of a Foreign Entity) - 2000, the financial statements of which are not prepared in accordance with Israeli GAAP. Furthermore, Standard No. 29 provides that entities that are not subject to the Israeli Securities Law, 1968 and not required to report according to the regulations of such law, are also permitted to prepare their financial statements according to IFRS as of financial statements published after July 31, 2006. The initial implementation of IFRS will be effected along with the implementation of IFRS 1, the initial implementation of IFRS, for purposes of the transition. In accordance with Standard No. 29, we are required to include in our annual financial statements for the year ended December 31, 2007, balance sheet data as at December 31, 2007 and statement of operations data for the year then ended that have been prepared according to the recognition, measurement and presentation principles of IFRS.

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In August 2006, the Israeli Accounting Standards Board, or IASB, published Accounting Standard No. 26, *Inventory*, or Standard No. 26. Standard No. 26 provides guidelines for determining the cost of inventory and its subsequent recognition as an expenses as well as for determining impairment in value of inventory written down to net realizable value. Standard No. 26 also provides guidelines regarding cost formulas used to allocate costs to various types of inventory. Standard No. 26 applies to financial statements for periods beginning on January 1, 2007 or thereafter.

In September 2006, the IASB published Accounting Standard No. 27, *Fixed Assets*, or Standard No. 27. Standard No. 27 prescribes rules for the presentation, measurement and derecognition of fixed assets and for the disclosure required in respect of the foregoing. Standard No. 27 provides that upon the initial recognition of a fixed asset, the entity shall include in the cost of the item all the costs it will incur in respect of a liability to dismantle and remove the item and to restore the site on which it was located. Furthermore, Standard No. 27 provides that a group of similar fixed asset items shall be measured at cost net of accumulated depreciation, and less impairment losses or, alternatively, at its revalued amount less accumulated depreciation, whereas an increase in the value of the asset to above its initial cost as a result of the revaluation will be directly included in the shareholders' equity under a revaluation reserve. Any part of a fixed asset item with a cost that is significant in relation to the total cost of the item shall be depreciated separately, including the costs of significant periodic examinations. Standard No. 27 also provides that a fixed asset that was purchased in consideration for another non-monetary item in a transaction having a commercial substance shall be measured at fair value. Standard No. 27 is effective for periods beginning on January 1, 2007. An entity that on January 1, 2007 chooses for the first time to use the revaluation method for measuring fixed assets shall on this date recognize a revaluation reserve in the amount of the difference between the revalued amount of the asset on that date and its cost on the books. Furthermore, an entity that in the past, upon the initial recognition of a fixed asset, had not included in its cost the initial estimate of costs for dismantling and removing the asset and for restoring the site on which it is located will measure these costs as follows: (a) the liabilities to dismantle and remove the fixed asset and to restore the site on which it was located as at January 1, 2007 should be measured in accordance with generally accepted accounting principles; (b) the amount that would have been included in the cost of the relevant asset on the date on which the liability was initially incurred by capitalizing the amount of the liability mentioned in item (a) above to the date on which the liability was initially incurred; and (c) the accumulated depreciation on the capitalized amount under item (b) above as at January 1, 2007 should be measured on the basis of the useful life of the asset as of that date. The difference between the amount to be charged to the asset in accordance with items (b) and (c) above and the amount of the liability in accordance with item (a) above are to be included in retained earnings. Other than the foregoing, Standard No. 27 will be adopted on a retroactive basis.

In December 2006, the IASB published Accounting Standard No. 23, *The Accounting Treatment of Transactions Between an Entity and its Controlling Shareholder*, or Standard No. 23. Standard No. 23 replaces the main provisions of the Israeli Securities Regulations (Financial

Statement Presentation of Transactions between a Company and its Controlling Shareholder) that were amended in February 2007. Standard No. 23 provides that assets (other than an intangible asset with no active market) and liabilities included in a transaction between the entity and its controlling shareholder shall be measured on the date of the transaction at fair value and that the difference between the fair value and the consideration from the transaction shall be included in shareholders' equity. A debit difference is a dividend and accordingly reduces the retained earnings. A credit difference is an investment of the shareholder and therefore must be presented under a separate item of shareholders' equity titled "capital reserve from transaction between an entity and its controlling shareholder." Standard No. 23 applies to transactions between an entity and its controlling shareholder that are executed after January 1, 2007 and to a loan that was granted to a controlling shareholder or that was received from it before the date Standard No. 23 came into effect as of the date of come into effect.

In March 2007 the Israel Accounting Standards Board published Accounting Standard No. 30, *Intangible Asset*, or Standard No. 30. Standard No. 30 explains the accounting treatment of intangible assets and defines how to measure the book value of these assets, as well as the disclosures that are required. Standard No. 30 has been initially implemented retroactively, except as described below. With regards to business combinations, Standard No. 30 is implemented with respect to business combinations that took place on January 1, 2007 or thereafter, whereas in respect of a research and development project acquired in a business combination that took place before January 1, 2007 and which meets the definition of an intangible asset on the date of acquisition, and was recorded as an expense on the date of acquisition, the entity shall recognize the research and development project in process as an asset on January 1, 2007 and make an allocation of taxes. A research and development asset shall be recognized in the amount of its value on the date of acquisition less the amortization that would have accumulated from the date of acquisition until December 31, 2006 on the basis of the useful life of the asset, and less any accrued impairment losses. The amount of the adjustment shall be included in the balance of retained earnings as at January 1, 2007. Implementation of Standard No. 30 is not anticipated to have a material effect on our results of operation and financial position.

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As of January 1, 2007, our consolidated financial statements will be prepared in accordance with U.S. GAAP. See Note 31 to the consolidated financial statements.

#### ***Recent Accounting Pronouncements in the United States***

In July 2006, the Financial Accounting Standards Board, or FASB, issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109*, or FIN 48. FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 utilizes a two-step approach for evaluating tax positions. Recognition (step one) occurs when an enterprise concludes that a tax position, based solely on its technical merits, is more-likely-than-not to be sustained upon examination. Measurement (step two) is only addressed if step one has been satisfied (when the position is more-likely-than-not to be sustained). Under step two, the tax benefit is measured as the largest amount of benefit, determined on a cumulative probability basis that is more-likely-than-not to be realized upon ultimate settlement. FIN 48 applies to all tax positions related to income taxes subject to the FASB Statement of Financial Accounting Standard, or SFAS, or SFAS, No. 109, *Accounting for income taxes*. This includes tax positions considered to be routine as well as those with a high degree of uncertainty. FIN 48 has expanded disclosure requirements, which include a tabular roll forward of the beginning and ending aggregate unrecognized tax benefits as well as specific detail related to tax uncertainties for which it is reasonably possible the amount of unrecognized tax benefit will significantly increase or decrease within twelve months. These disclosures are required at each annual reporting period unless a significant change occurs in an interim period. FIN 48 is effective for fiscal years beginning after December 15, 2006. The cumulative effect of applying FIN 48 will be reported as an adjustment to the opening balance of retained earnings. We do not expect the implementation of FIN 48 to have a material impact on our consolidated results of operations and financial position.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, or SFAS No. 157. SFAS No. 157 provides a single definition of fair value, a framework for measuring fair value, and expanded disclosures concerning fair value. Previously, different definitions of fair value were contained in various accounting pronouncements creating inconsistencies in measurement and disclosures. SFAS No. 157 applies under those previously issued pronouncements that prescribe fair value as the relevant measure of value, except SFAS No. 123(R) and related interpretations. SFAS No. 157 does not apply to accounting standards that require or permit measurement similar to fair value but are not intended to measure fair value. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. We do not expect the implementation of SFAS No. 157 to have a material impact on our consolidated results of operations and financial position.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, or SFAS No. 159. SFAS No. 159 provides companies with an option to report selected financial assets and liabilities at fair value. Generally accepted accounting principles have required different measurement attributes for different assets and liabilities that can create artificial volatility in earnings. The Standard's objective is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. SFAS No. 159 is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. We do not expect the implementation of SFAS No. 159 to have a material impact on our consolidated results of operations and financial position.



**Differences between Israeli Accounting Standards and U.S. Accounting Standards**

Our consolidated financial statements appearing in this annual report are prepared in NIS in accordance Israeli GAAP, which vary in certain significant respects from U.S. GAAP, as described in Note 29 to the consolidated financial statements. The differences between Israeli GAAP and U.S. GAAP that have a material effect on net income (loss) and total shareholders' equity are also described in Note 29 to the consolidated financial statements.

The following table sets forth a comparison of our net income (loss) and total shareholders' equity in accordance with Israeli GAAP and U.S. GAAP as of the dates and for the periods indicated:

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	As of and for the years ended December 31,		
	2004	2005	2006
	<i>(NIS in thousands)</i>		
Net income (loss) in accordance with:			
Israeli GAAP	(5,855)	5,260	9,614
U.S. GAAP	(5,376)	5,913	6,944
Total shareholders' equity in accordance with:			
Israeli GAAP	14,991	21,713	31,945
U.S. GAAP	16,475	23,720	31,326

**Results of Operations**

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

	Year Ended December 31,		
	2004	2005	2006
Revenues	100.0%	100.0%	100.0%
Cost of revenues	(88.0)	(80.1)	(78.5)
Gross profit	12.0	19.9	21.5
Research and development expenses, net	--	(0.4)	(0.4)
Selling, general and administrative expenses	(14.6)	(13.8)	(14.0)
Amortization of goodwill	(0.5)	(0.4)	--
Operating income (loss)	(3.1)	5.3	7.1
Financial expenses, net	(2.3)	(1.8)	(1.4)
Other income (expenses), net	*	*	*
Income (loss) before tax benefit (expenses) and minority interest	(5.4)	3.4	5.7
Tax benefit (expenses)	0.6	--	(0.4)
Income (loss) after tax benefit (expenses) before minority interest	(4.8)	3.5	5.3

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	Year Ended December 31,		
	2006	2005	2004
Minority interest	0.1	0.1	0.2
Net income (loss)	(4.7)	3.6	5.5

\* Less than 0.1%

**Year Ended December 31, 2006 Compared with Year Ended December 31, 2005**

**Revenues.** Revenues increased by 20.4 % to NIS 173.9 million (\$41.2 million) in the year ended December 31, 2006 from NIS 144.4 million in the year ended December 31, 2005. This increase in revenues is primarily attributable to the increase in sales of our flex-rigid boards, which are higher priced than our rigid PCBs, and the increased number of PCBs sold in 2006. The increase was offset in part by the devaluation of the U.S. dollar against the NIS by 8.2% in 2006.

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**Cost of Revenues.** Cost of revenues increased by 18.0 % to NIS 136.5 million (\$32.3million) in the year ended December 31, 2006 from NIS 115.7 million in the year ended December 31, 2005. This increase in cost of revenues is primarily due to increased revenues and the increase in payroll and related benefits. Cost of revenues as a percentage of revenues decreased to 78.5 % in the year ended December 31, 2006 from 80.1% in the year ended December 31, 2005. This decrease in cost of revenues as a percentage of revenues is primarily attributable to the increase in our sales volume, while our costs increased at a lower rate due to fixed costs being absorbed over a greater volume of sales. The continued increase in energy and commodity prices may result in our costs increasing at a higher level than anticipated. In addition, if the devaluation of the dollar against the NIS continues in 2007, the dollar value of NIS denominated expenses (primarily salaries and other domestic expenses) will increase and as a result, our expenses as a percentage of revenue will increase.

**Gross Profit.** Gross profit increased by 30.4 % to NIS 37.4 million (\$8.9 million) in the year ended December 31, 2006 from NIS 28.7 million in the year ended December 31, 2005. This increase in gross profit is primarily due to increased revenues. Gross profit as a percentage of revenues increased to 21.5 % in the year ended December 31, 2006 from 19.9% in the year ended December 31, 2005. This increase in gross profit as a percentage of revenues is primarily attributable to the increase in our sales volume, while our costs increased at a lower rate due to fixed costs being absorbed over a greater volume of sales. The continued increase in energy and commodity prices may result in our costs increasing at a higher level than anticipated. In addition, if the devaluation of the dollar against the NIS continues in 2007, the dollar value of NIS denominated expenses (primarily salaries and other domestic expenses) will increase, and as a result our gross margin as a percentage of revenue will decrease.

**Research and Development Expenses, Net.** We generally do not engage in significant research and developments efforts. In 2005 and 2006, we incurred NIS 1,115,000 and NIS 1,453,000 (\$343,000), respectively, in research and development expenses in connection with our membership in OptiPac, a consortium within the framework of the MAGNET program of the Office of the Chief Scientist of the Ministry of Industry and Trade of the State of Israel, or the OCS. Of such total expenses in 2005 and 2006, NIS 469,000 and NIS 766,000 (\$180,000), respectively, were reimbursed to us by the OCS in accordance with the terms of the OptiPac consortium.

**Selling, General and Administrative Expenses.** Selling, general and administrative expenses increased by 22.4 % to NIS 24.3 million (\$5.8 million) in the year ended December 31, 2006 from NIS 19.9 million in the year ended December 31, 2005. This increase in selling, general and administrative expenses is primarily attributable to the associated growth in payroll and employee benefits expenses, commissions to sales representatives, export and delivery expenses, travel expenses of marketing personnel and costs of professional services resulting from our increased revenues. We expect that our selling, general and administrative expenses will increase in 2007 as we intend to increase the number of our sales personnel, as well as due to an anticipated increase in commissions to sales representatives and increased export and delivery expenses as a result of the anticipated increase in our export revenues.

**Amortization of Goodwill.** We recorded amortization of goodwill of NIS 593,000 in the year ended December 31, 2005. Goodwill represents the goodwill that arose from our acquisition of Kubatronik. As of January 1, 2006, we apply Israeli Accounting Standard No. 20 *The Accounting Treatment of Goodwill and Intangible Asset when Purchasing an Investee*, according to which no amortization is recorded and instead, an examination of impairment in value is performed once a year or more frequent if events or changes in circumstances indicate that there may be an impairment in the value of goodwill.

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*Operating income.* As a result of the foregoing, our operating income was NIS 12.4 million (\$2.9 million) in the year ended December 31, 2006 compared to NIS 7.6 million in the year ended December 31, 2005.

*Financial Expenses, Net.* Financial expenses, net decreased to NIS 2.4 million (\$568,000) in the year ended December 31, 2006 from NIS 2.7 million in the year ended December 31, 2005. These financial expenses were primarily attributable to interest paid on short-term debt and long-term debt as well as exchange rate expenses net. This decrease in financial expenses is attributable to a reduction in our short-term debt, reduced interest rates, gain on currency hedging transactions and differences in foreign currency exchange rates.

*Other Income, Net.* We had other income, net of NIS 24,000 (\$6,000) in the year ended December 31, 2006 and NIS 103,000 in the year ended December 31, 2005. Other income, net in the years ended December 31, 2006 and 2005 was attributable to the gain we recorded on the disposal of fixed assets.

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*Tax Expenses.* We did not record any tax expenses in the years ended December 31, 2005 and 2006 in respect of our profits in Israel, as we utilized our tax loss carryforwards to offset such profits. Despite our accumulated profits in Israel during the three years ended December 31, 2006, we did not record a deferred tax asset in 2006 with respect to our profits generated in Israel due to uncertainty about our ability to utilize such tax asset in the foreseeable future. Such uncertainty is primarily due to the devaluation of the U.S. dollar against the NIS, our dependency on one major customer whose product is at the end of its lifecycle, the uncertainty of our being able to attract sufficient business to compensate for the loss of such a major customer, the fluctuations of the PCB industry and our history of losses. We recorded a tax expense of NIS 703,000 (\$166,000) in the year ended December 31, 2006, relating to the establishment of a valuation allowance on the deferred tax asset in respect of the loss carryforward of Kubatronik.

*Minority Interest.* Minority share in subsidiary's net results reflects the minority's interest of NIS 266,000 (\$63,000) in Kubatronik's net loss in the year ended December 31, 2006, as compared to the minority's interest of NIS 218,000 in its net loss in the year ended December 31, 2005.

### **Year Ended December 31, 2005 Compared with Year Ended December 31, 2004**

*Revenues.* Revenues increased by 15.5% to NIS 144.4 million in the year ended December 31, 2005 from NIS 125 million in the year ended December 31, 2004. This increase in revenues was primarily attributable to the increase in sales of our flex-rigid boards, which have a higher price per PCB than our rigid PCBs, and the increased number of our PCBs sold in 2005.

*Cost of Revenues.* Cost of revenues increased by 5.2 % to NIS 115.7 million in the year ended December 31, 2005 from NIS 110.0 million in the year ended December 31, 2004. This increase in cost of revenues is due to an increase in the volume of sales. Cost of revenues as a percentage of revenues decreased to 80.1% in the year ended December 31, 2005 from 88% in the year ended December 31, 2004. This decrease in cost of revenues as a percentage of revenues is primarily attributable to the increase in sales volume while costs increased at a lower pace due to fixed costs being absorbed over a greater volume of sales.

*Gross Profit.* Gross profit increased by 91.3 % to NIS 28.7 million in the year ended December 31, 2005 from NIS 15.0 million in the year ended December 31, 2004. This increase in gross profit as a percentage of revenues is primarily attributable to the increase in sales of flex-rigid boards, which yield higher gross margins.

*Research and Development Expenses, Net.* We generally do not engage in significant research and developments efforts. In 2005, we incurred NIS 1,115,000 in research and development expenses in connection with our membership in OptiPac, a consortium within the framework of the MAGNET program of the Office of the Chief Scientist of the Ministry of Industry and Trade of the State of Israel, or the OCS. Of such total expenses, NIS 469,000 were reimbursed to us by the OCS in accordance with the terms of the OptiPac consortium. We did not record research and development income or expense in 2004.

*Selling, General and Administrative Expenses.* Selling, general and administrative expenses increased by 8.7 % to NIS 19.9 million in the year ended December 31, 2005 from NIS 18.3 million in the year ended December 31, 2004. This increase in selling, general and administrative expenses is primarily attributable to the associated growth in payroll and employee benefits expenses, commissions to sales representatives, travel expenses of marketing personnel and costs of professional services resulting from our increased revenues.

*Amortization of Goodwill.* We recorded amortization of goodwill of NIS 593,000 (\$129,000) in the year ended December 31, 2005 and NIS 593,000 in the year ended December 31, 2004. Goodwill represents the goodwill that arose from our acquisition of Kubatronik.

*Operating income (loss).* As a result of the foregoing, our operating income was NIS 7.6 million in the year ended December 31, 2005 compared to an operating loss of NIS 3.9 million in the year ended December 31, 2004.

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*Financial Expenses, Net.* Financial expenses, net decreased to NIS 2.7 million in the year ended December 31, 2005 from NIS 2.9 million in the year ended December 31, 2004. These financial expenses were primarily attributable to interest on short-term debt and long-term debt as well as exchange rate expenses net. The decrease in financial expenses in 2005 is attributable to a reduction in our long-term debt and differences in foreign currency exchange rates.

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*Other Income (Expenses), Net.* We had other income, net of NIS 103,000 in the year ended December 31, 2005 as compared to other income, net of NIS 52,000 in the year ended December 31, 2004. Other income, net in the years ended December 31, 2004 and 2005 was attributable to the gain we recorded on the disposal of fixed assets, which in 2004 was partially offset by certain legal expenses that were not in the ordinary course of business.

*Tax Benefit (Expenses).* We did not record a tax expense in the years ended December 31, 2004 and 2005 in respect of our profits in Israel, as we utilized our tax loss carryforward to offset such profits in Israel. We recorded a tax benefit of NIS 713,000 in the year ended December 31, 2004 from a deferred tax asset due to the loss carryforward of Kubatronik.

*Minority Interest.* Minority share in subsidiary's net results reflects the minority's interest of NIS 218,000 in Kubatronik's net loss in the year ended December 31, 2005, as compared to the minority's interest of NIS 182,000 in its net loss in the year ended December 31, 2004.

### Quarterly Results of Operations

The following table sets forth certain unaudited quarterly financial information in accordance with Israeli GAAP expressed in NIS and as a percentage of revenues for each of the eight fiscal quarters ended December 31, 2006. The data has been prepared on a basis consistent with our audited consolidated financial statements included elsewhere in this annual report and includes all adjustments, consisting only of normal recurring accruals, that we consider necessary for a fair presentation. The operating results for any quarter are not necessarily indicative of results for any future periods.

	Quarter Ended							
	2005				2006			
	Mar. 31	Jun. 30	Sep. 30	Dec. 31	Mar. 31	Jun. 30	Sep. 30	Dec. 31
	(NIS in thousands) (Unaudited)							
<b>Israeli GAAP:</b>								
Revenues	34,395	33,842	36,622	39,570	43,365	43,080	44,087	43,412
Cost of revenues	(28,083)	(27,746)	(28,921)	(30,983)	(33,957)	(34,714)	(34,923)	(32,932)
Gross profit	6,312	6,096	7,701	8,587	9,408	8,366	9,164	10,480
Research and development income, net	(191)	(160)	(134)	(161)	(157)	(151)	(186)	(193)
Selling, general and administrative expenses	(4,519)	(4,686)	(5,212)	(5,445)	(5,599)	(5,721)	(6,406)	(6,582)
Amortization of goodwill	(152)	(148)	(147)	(146)	-	-	-	-
Operating income	1,450	1,102	2,208	2,835	3,652	2,494	2,572	3,705
Financial expenses, net	(614)	(766)	(648)	(628)	(759)	(501)	(529)	(607)
Other income (expenses), net	(11)	(13)	58	69	(10)	41	-	(7)
Income before tax expenses and minority interest	825	323	1,618	2,276	2,883	2,034	2,043	3,091
Tax expenses	-	-	-	-	-	-	-	(703)
	825	323	1,618	2,276	2,883	2,034	2,043	2,388

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Quarter Ended

Income after tax expenses before minority interest								
Minority Interest	14	138	42	24	(22)	(14)	23	279
Net income	839	461	1,660	2,300	2,861	2,020	2,066	2,667

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Quarter Ended

	2005				2006			
	Mar. 31	Jun. 30	Sep. 30	Dec. 31	Mar. 31	Jun. 30	Sep. 30	Dec. 31
(As a percentage of total revenues) (Unaudited)								
<b>Israeli GAAP:</b>								
Revenues	100%	100%	100%	100%	100%	100%	100%	100%
Cost of revenues	(81.7)	(82.0)	(79.0)	(78.3)	(78.2)	(80.6)	(79.2)	(75.9)
Gross profit	18.3	18.0	21.0	21.7	21.7	19.4	20.8	24.1
Research and development income, net	(0.6)	(0.5)	(0.4)	(0.4)	(0.4)	(0.4)	(0.4)	(0.4)
Selling, general and administrative expenses	(13.1)	(13.8)	(14.2)	(13.7)	(12.9)	(13.2)	(14.6)	(15.2)
Amortization of goodwill	(0.4)	(0.4)	(0.4)	(0.4)	-	-	-	-
Operating income	4.2	3.3	6.0	7.2	8.4	5.8	5.8	8.5
Financial expenses, net	(1.8)	(2.3)	(1.8)	(1.6)	(1.8)	(1.2)	(1.2)	(1.4)
Other income (expenses), net	*	*	0.2	0.2	*	0.1	*	*
Income before tax expenses and minority interest	2.4	1.0	4.4	5.8	6.6	4.7	4.6	7.1
Tax expenses	-	-	-	-	-	-	-	(1.6)
Income after tax expenses	2.4	1.0	4.4	5.8	6.6	4.7	4.6	5.5
Minority Interest	*	0.4	0.1	*	*	-	0.1	0.6
Net income	2.4	1.4	4.5	5.8	6.6	4.7	4.7	6.1

\* Less than 0.1%

**Conditions in Israel**

We are incorporated under the laws of the State of Israel, and our executive offices and research and development facilities are located in Israel. Although most of our sales are made to customers outside Israel, we are directly influenced by the political, economic and military conditions affecting Israel. Any major hostilities involving Israel, a full or partial mobilization of the reserve forces of the Israeli army, the interruption or curtailment of trade between Israel and its present trading partners, or a significant downturn in the economic or financial condition of Israel could have a material adverse effect on our business, financial condition and results of operations.

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Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors, and a state of hostility, varying from time to time in intensity and degree, has led to security and economic problems for Israel. Although Israel has entered into various agreements with Egypt, Jordan and the Palestinian Authority, there has been an increase in unrest and terrorist activity in Israel, which began in September 2000 and which has continued with varying levels of severity through 2006. The future effect of this deterioration and violence on the Israeli economy and our operations is unclear. The election of representatives of the Hamas movement to a majority of seats in the Palestinian Legislative Council in January 2006 resulted in an escalation in violence among Israel, the Palestinian Authority and other groups. In July 2006, extensive hostilities began along Israel's northern border with Lebanon between Israel and Hezbollah forces and to a lesser extent in the Gaza Strip, which involved rocket attacks on populated areas in the northern parts of Israel. On August 14, 2006, a cease-fire between Hezbollah and Israel took effect. This situation has had an adverse effect on Israel's economy, primarily in the geographical areas directly harmed by this conflict. Any future armed conflict, political instability or violence in the region may have a negative effect on our business condition, harm our results of operations and adversely affect our share price. No predictions can be made as to whether or when a final resolution of the area's problems will be achieved or the nature thereof and to what extent the situation will impact Israel's economic development or our operations.

Furthermore, there are a number of countries that restrict business with Israel and with Israeli companies. Restrictive laws or policies of those countries directed towards Israel or Israeli businesses had, and may in the future continue to have, an adverse impact on our operations, our financial results or the expansion of our business. No predictions can be made as to whether or when a final resolution of the area's problems will be achieved or the nature thereof and to what extent the situation will impact Israel's economic development or our operations.

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In addition, many of our employees and some of our directors and officers in Israel are obligated to perform annual reserve duty in the Israeli Defense Forces and may be called for active duty under emergency circumstances at any time. If a military conflict or war arises, these individuals could be required to serve in the military for extended periods of time. Our operations could be disrupted by the absence for a significant period of one or more of our executive officers or key employees or a significant number of other employees due to military service. Any disruption in our operations could adversely affect our business. To date, no executive officer or key employee has been recruited for military service for any significant time period. Any further deterioration of the hostilities between Israel and the Palestinian Authority into a full-scale conflict might require more significant military reserve service by some of our employees, which may have a material adverse effect on our business.

### **Economic Conditions**

In past years Israel has been going through a period of recession in economic activity, resulting in low growth rates and growing unemployment. Although economic activity in Israel has improved recently, our operations could be adversely affected if the economic conditions in Israel begin to deteriorate again.

### **Trade Relations**

Israel is a member of the United Nations, the International Monetary Fund, the International Bank for Reconstruction and Development and the International Finance Corporation. Israel is a member of the World Trade Organization and is a signatory to the General Agreement on Tariffs and Trade. In addition, Israel has been granted preferences under the Generalized System of Preferences from the United States, Australia, Canada and Japan. These preferences allow Israel to export the products covered by such programs either duty-free or at reduced tariffs.

Israel and the European Union Community, known now as the European Union, concluded a Free Trade Agreement in July 1975 that confers some advantages with respect to Israeli exports to most European countries and obligates Israel to lower its tariffs with respect to imports from these countries over a number of years. In 1985, Israel and the United States entered into an agreement to establish a Free Trade Area. The Free Trade Area has eliminated all tariff and some non-tariff barriers on most trade between the two countries. On January 1, 1993, an agreement between Israel and the European Free Trade Association, known as the EFTA, established a free-trade zone between Israel and the EFTA nations. In November 1995, Israel entered into a new agreement with the European Union, which includes a redefinition of rules of origin and other improvements, such as allowing Israel to become a member of the Research and Technology programs of the European Union. In recent years, Israel has established commercial and trade relations with a number of other nations, including Russia, China, India, Turkey and other nations in Eastern Europe and Asia.

### **Effective Corporate Tax Rate**

Israeli companies are generally subject to income tax on their taxable income. The applicable rate for 2006 was 31%, which was reduced to 29% in 2007 and will be further reduced to 27% in 2008, 26% in 2009 and 25% in 2010 and thereafter.

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However, certain of our production facilities have been granted the status of an approved enterprise under the Law for the Encouragement of Capital Investments, 1959, as amended. Subject to certain time limitations, income derived from such approved enterprise will be subject to corporate tax of up to 25%. The base year is 2005, however due to our tax loss carryforwards, there was no tax payment in Israel for the year ended December 31, 2006. For additional information see Item 10E. Additional Information Taxation Tax Benefits Under the Law for the Encouragement of Capital Investments, 1959 and Note 24 to our consolidated financial statements.

As of December 31, 2006, we had approximately NIS 41.7 million (\$9.9 million) in tax loss carryforwards in Israel, which can be offset against future income in Israel without time limitation. In Israel, we have received final tax assessments through the 1995 tax year and the tax assessments we received for the 1996-2001 tax years are considered final due to the statute of limitations. Our principal foreign subsidiary, Kubatronik has received final tax assessments through the 2003 tax year. We can not be reasonably assured as to our ability to utilize the tax asset attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and our loss carry-forwards in the foreseeable future. Therefore we have recorded a full valuation allowance on the deferred tax asset in respect of these differences and loss carry-forwards.

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### Impact of Currency Fluctuations and of Inflation

For many years prior to 1986, the Israeli economy was characterized by high rates of inflation and devaluation of the Israeli currency against the dollar and other currencies. However, since the institution of the Israeli Economic Program in 1985, inflation, while continuing, has been significantly reduced and the rate of devaluation has substantially diminished. Because governmental policies in Israel linked exchange rates to a weighted basket of foreign currencies of Israel's major trading partners, the exchange rate between the NIS and the dollar remained relatively stable during reported periods.

The following table sets forth, for the periods indicated, (i) devaluation of the NIS against the most important currencies for our business, the U.S. dollar and the Euro, and (ii) inflation as reflected in changes in the Israeli consumer price index.

	Year Ended December 31,				
	2002	2003	2004	2005	2006
U.S. dollar	7.3%	(7.6)%	(1.6)%	6.9%	8.2%
Euro	27.2%	11.3%	6.2%	(7.3)%	2.1%
Israeli consumer price index	6.5%	(1.9)%	1.2%	2.4%	(0.2)%

We record our revenues and expenses in NIS. Our revenues are generally denominated in foreign currencies, primarily the U.S. dollar and Euro, while our expenses are primarily denominated in NIS, U.S. dollars, Euros, dollar-linked NIS and Euro-linked NIS. As a result, fluctuations in rates of exchange between NIS and non-NIS currencies may affect our operating results and financial condition. The NIS value of our U.S. dollar and Euro revenues decline if the NIS devaluates against the dollar and Euro. In addition, our expenses other than those paid in Israeli currency that are not-linked to other currencies are influenced by the devaluation of the NIS in relation to the U.S. dollar and the Euro. The NIS value of our U.S. dollar and Euro expenses increase if the NIS devaluates against the dollar and the Euro and other currencies other than NIS. In 2006, the U.S. dollar devaluated against the NIS by 8.2%.

We have engaged external consultants to assist us to manage our foreign exchange risk. From time to time in the past we have engaged in hedging transactions in order to partially protect ourselves from currency fluctuation and inflation risks and may use hedging instruments from time to time in the future.

### B. LIQUIDITY AND CAPITAL RESOURCES

Historically, we have financed our operations through cash generated by operations, shareholder loans, funds generated by our initial public offering in 1997 (approximately \$5.8 million), long-term and short-term bank loans and borrowings under available credit facilities, and a convertible note issued to our major shareholder.

Our principal commitments consist of obligations outstanding under bank loans and credit facilities, suppliers' credit and operating leases.

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We spent approximately NIS 12.7 million (\$3.0 million) for capital expenditures in the year ended December 31, 2006 and NIS 12.6 million in the year ended December 31, 2005. In the years ended December 31, 2006 and 2005, our capital expenditures mainly related to our investments in production and manufacturing equipment, and leasehold improvements. We expect to invest approximately NIS 19 million (\$ 4.5 million) in capital expenditures and capital leases in 2007 mainly for the expansion of our production facilities.

In June 2002, we acquired 76% of Kubatronik for approximately Euro 2.6 million. The remaining 24% of Kubatronik is held by Mr. Alois Kubat. Pursuant to the agreement under which we acquired our interest in Kubatronik (as amended), following the termination of Mr. Kubat's employment with Kubatronik and prior to December 31, 2007, Mr. Kubat has the right to require us to purchase, and we have the right to require him (or his permitted transferee) to sell to us, his remaining interest in Kubatronik. The price for Mr. Kubat's remaining holdings in Kubatronik will not be less than Euro 552,000 (\$ 727,000) and will not exceed Euro 920,000 (\$ 1.2 million), subject to certain price adjustments set forth in the agreement (including, among other things, an accrual of annual interest at the rate of LIBOR + 1% from May 2005). Mr. Kubat retired in October 2003. Under Israeli GAAP, our right to purchase the remaining 24% of Kubatronik has no accounting consequences. Under U.S. GAAP, such an arrangement gives rise to a derivative instrument which should be marked to market every reporting period, in accordance with SFAS 150, *Accounting for Certain Financial Instruments with characteristics of both Liabilities and Equity* (see Note 29 of our financial statements, *Effect of Significant Differences Between Generally Accepted Principles in Israel and the United States*).

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In May 2007, Mr. Josef Maiman elected to convert a convertible note held of record by Merhav for an aggregate 985,796 ordinary shares. As a result, Mr. Maiman's beneficial ownership interest increased to 1,585,540 ordinary shares, representing approximately 24% of our then outstanding shares, of which 985,796 are held of record by Merhav and 599,744 are held of record by Integral.

### Cash Flows

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

	Year ended December 31,			Convenience Translation into U.S. Dollars
	2005	2006	2006	
	(in thousands)			
Net provided by operating activities	NIS 14,276	NIS 11,619	\$ 2,750	
Net cash used in investing activities	12,464	9,605	2,274	
Net cash provided by (used in) financing activities	1,328	(707)	(169)	
Adjustments from translation of financial statements of foreign entity	(156)	11	5	
Net increase in cash and cash equivalents	2,984	1,318	312	
Cash and cash equivalents at beginning of period	4,274	7,258	1,718	
Cash and cash equivalents at end of period	7,258	8,576	2,030	

Net cash provided by operating activities was NIS 11.6 million (\$ 2.8 million) for the year ended December 31, 2006. This amount was primarily attributable to net income of NIS 9.6 million (\$2.3 million), fixed asset depreciation of NIS 10.4 million (\$2.5 million), a decrease in other receivables and prepaid expenses of NIS 1.0 million (\$0.2) and cancellation of deferred taxes of NIS 0.7 million (\$ 0.2). This amount was partially offset by an increase in trade receivables of NIS 9.5 million (\$2.3 million) and accrued interest and inflationary and exchange rate impact on long-term debts of NIS 0.7 million (\$0.2). Net cash provided by operating activities was NIS 14.3 million for the year ended December 31, 2005. This amount was primarily attributable to net income of NIS 5.3 million, fixed asset depreciation of NIS 10.9 million, an increase in trade payables of NIS 0.9 million, a decrease in trade receivables of NIS 0.8 million and amortization of goodwill of NIS 0.6 million. This amount was partially offset by an increase in inventories of NIS 2.5 million, an increase in other receivables and prepaid expenses of NIS 1.3 million and a decrease in employee severance benefits, net of NIS 0.8 million.



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Net cash used in investing activities was NIS 9.6 million (\$2.3 million) for the year ended December 31, 2006 and NIS 12.5 million for the year ended December 31, 2005. Net cash used in investing activities for the year ended December 31, 2005 and 2006 was primarily for the purchase of fixed assets for our production lines.

Net cash used in financing activities was NIS 0.7 million (\$170,000) for the year ended December 31, 2006, which was primarily attributable to new loans of NIS 11.2 million (\$2.6 million) from our banks and cash from the exercise of employee stock options of NIS 0.4 million (\$104,000), which was partly offset by the repayment of NIS 10.8 million (\$2.6 million) in long-term and short-term credit from our banks and the repayment of NIS 1.5 million (\$359,000) of credit from fixed assets payables. Net cash provided by financing activities was NIS 1.3 million for the year ended December 31, 2005, which was primarily attributable to new loans of NIS 8.3 million from our banks and cash from the exercise of employee stock options of NIS 2.1 million, which was partly offset by a decrease NIS 9.1 million in long-term and short-term credit from our banks.

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As of December 31, 2006, we had NIS 8.6 million (\$2.0 million) in cash and cash equivalents and a working capital of NIS 7.8 million (\$1.8 million), as compared to NIS 7.3 million in cash and cash equivalents and a working capital deficit of NIS 4.4 million at December 31, 2005.

As of December 31, 2006, the following revolving lines of credit and long-term loans were outstanding.

a revolving line of credit of approximately NIS 1.5 million (\$347,000) with Bank Hapoalim B.M. Of such amount, NIS 465,000 (\$110,000) is linked to the U.S. dollar and NIS 1.0 million (\$237,000) is not linked.

long-term loans from Bank Hapoalim B.M. aggregating NIS 6.1 million (\$1.5 million). Of such amount, NIS 0.9 million (\$222,000) is linked to the Israeli consumer price index, NIS 222,000 (\$53,000) is linked to the U.S. dollar and NIS 5.0 million (\$1.2 million) is not linked.

a revolving line of credit of approximately NIS 7 million (\$1.7 million) with Israel Discount Bank Ltd, which is not linked.

long-term loans from Israel Discount Bank Ltd. in the aggregate amount of NIS 7.8 million (\$1.8 million). Of such amount, NIS 0.8 million (\$192,000) is linked to the Israeli consumer price index, NIS 1.3 million (\$309,000) is linked to the U.S. dollar and NIS 5.7 million (\$1.3 million) is not linked.

long-term loans from Bank Leumi LelIsrael Ltd. in the aggregate amount of NIS 166,000(\$39,000). Of such amount, NIS 148,000 (\$35,000) is linked to the Israeli consumer price index and NIS 18,000 (\$4,000) is linked to the U.S. dollar.

Our credit lines bear annual interest ranging from 6.95% to 7.1% for non-linked credit and 7.38% for credit which was linked to the dollar. Our long-term loans bear annual interest ranging from 5.3% to 6.7% for long-term loans which were linked to the Israeli consumer price index, 6.88% to 7.53% for long-term loans which were linked to the dollar and 5% to 8.4% for non-linked long-term loans.

In 2003, we negotiated a financing plan with our banks and controlling shareholder, pursuant to which the banks agreed to extend the payment of our outstanding debt and our major shareholder contributed \$500,000 to our company in consideration of a convertible note. In July 2003, as part of this financing plan, we signed a factoring agreement with U Bank Ltd. (formerly Investec Bank (Israel) Ltd.), or U Bank, for a \$1.0 million factoring facility, in consideration for the assignment to U Bank of an equal amount of our accounts receivable. In December 2006, we replaced the factoring arrangement by a NIS 2.8 million line of credit from Israel Discount Bank Ltd. and a long-term loan of NIS 1.7 million from Bank Hapoalim B.M. Also see Item 7.B., Major Shareholders and Related Party Transactions Related Party Transactions.

The borrowings from our banks are secured by specific liens on certain assets, by a first priority floating charge on the rest of our assets and by a fixed lien on goodwill (intangible assets) and insurance rights (rights to proceeds on insured assets in the event of damage). In addition, the agreements with our banks prohibit us from selling or otherwise transferring any assets except in the ordinary course of business or from placing a lien on our assets without the banks' consent. Financial covenants in respect of our credit facilities and long-term debt with one of our banks require us to maintain the higher of shareholders' equity, excluding intangible assets, of NIS 24.0 million or 23% of our total assets (on a non-consolidated basis). With another bank, the financial covenants require us to maintain the higher of tangible shareholders' equity of NIS 15.0 million or 15% of our consolidated total assets, and the higher of tangible shareholders' equity of NIS 14.0 million or 14% of our total assets (on a non-consolidated basis). For these purposes, shareholders' equity includes the outstanding convertible note and excludes prepaid expenses (except insurance). As of December 31, 2006, we were in compliance with such covenants.

We expect to finance our 2007 budget from operational cash flow, revolving bank credit lines and long-term bank loans, and supplier financing. We believe that the availability of our revolving lines of credit, long-term bank loans and cash flow from operations will provide us with sufficient working capital to fund our operational and capital requirements through December 31, 2007.

#### **C. RESEARCH AND DEVELOPMENT, PATENTS AND LICENSES**

We generally do not engage in significant research and development.

In 2005, we were granted membership in OptiPac, a consortium within the framework of the MAGNET program of the Office of the Chief Scientist. OptiPac was created specifically to develop generic optical packaging technologies for the microelectronics sector, technologies that are critically important to the communications industry. Under the terms of the consortium, each member of the consortium will be provided with an advance for its research and development costs for a specific research and development project assigned to it by the consortium. The Office of the Chief Scientist reimburses 66% of such approved research and development expenses. These reimbursements are contingent upon our submitting periodic reports prepared in accordance with the requirements of the Office of the Chief Scientist. We are not required to pay the Office of the Chief Scientist royalties with respect to this grant. In 2005 and 2006, we incurred NIS 1,115,000 and NIS 1,453,000 (\$344,000), respectively, in research and development expenses in connection with our membership in OptiPac, a consortium within the framework of the MAGNET program of the Office of the Chief Scientist of the Ministry of Industry and Trade of the State of Israel, or the OCS. Of such total expenses in 2005 and 2006, NIS 469,000 and NIS 766,000 (\$181,000), respectively, were reimbursed to us by the OCS in accordance with the terms of the OptiPac consortium.

#### **D. TREND INFORMATION**

Since the third quarter of 2004, we have experienced growth in our revenues, primarily as a result of the implementation of our new strategy to focus our marketing efforts in the high end of the PCB market, mainly in the flex-rigid PCB market. In addition, we are developing new business relationships with customers from abroad.

In the years ended December 31, 2005 and December 31, 2006, one customer accounted for approximately 31% and 25% of our total revenues, respectively. The principal product of our largest customer is at the end of its lifecycle and revenues from such customer decreased to 17% of our total revenues in the three months ended March 31, 2007. In June 2007, such customer notified us to cease production of the PCB for its principal product, which will be succeeded by a new internally developed product. The customer may not continue to purchase products from us in the future, or if it continues to purchase products from us, the volume of purchases would likely be significantly lower than previous volumes. We cannot assure you that we will be able to attract sufficient new business to compensate for the loss of our largest customer.

Our backlog at December 31, 2006 was approximately \$5.9 million compared to a backlog of approximately \$4.9 million at December 31, 2005. We include in our backlog all purchase orders scheduled for delivery within the next 12 months, although the majority of the backlog typically is scheduled for delivery within 45 days. For a variety of reasons, including the timing of orders, delivery intervals, customer and product mix and the possibility of customer changes in delivery schedules, backlog as of any particular date may not be a reliable measure of sales for any succeeding period. Cancellation charges generally vary depending upon the time of cancellation and, therefore, substantially all of our backlog may be subject to cancellation without penalty.

#### **E. OFF-BALANCE SHEET ARRANGEMENTS**

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

#### **F. TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS**

The following table summarizes our minimum contractual obligations as of December 31, 2006.

Contractual Obligations	Payments due by period NIS (in thousands)				
	Total	less than 1 year	1-3 years	3-5 years	more than 5 years
Short-term bank credit (1)	8,465	8,465	-	-	-
Long-term debt obligations (2)	14,199	3,266	8,526	2,407	-
Long-term debt related to fixed assets financing transactions (3)	3,392	1,363	2,029	-	-
Operating lease and other contractual obligations	31,766	5,391	8,133	5,229	13,013
Purchase obligations	9,180	9,180	-	-	-
Convertible note (3)	1,844	1,844	-	-	-
Other long-term liabilities reflected on the company's balance sheet under Israeli GAAP	344	-	-	-	344
Total	69,190	29,509	18,688	7,636	13,357

(1) Our credit lines bear annual interest ranging from 6.95% to 7.1% for non-linked credit and 7.38% for credit which was linked to the dollar.

(2) Our long-term loans bear annual interest ranging from 5.3% to 6.7% for long-term loans which were linked to the Israeli consumer price index, 6.88% to 7.53% for long-term loans which were linked to the dollar and 5% to 8.4% for non-linked long-term loans.

(3) Our long-term debt related to fixed assets financing transactions bear annual interest ranging from 4%-5.88% for such long-debt which was linked to the dollar and 6.35% linked to the Israeli consumer price index.

(4) In May 2007, the principal amount of the convertible note was converted in ordinary shares and we repaid the accrued interest on the principal amount. See Item 7B. Major Shareholders and Related Party Transactions Related Party Transactions.

## ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

### A. DIRECTORS AND SENIOR MANAGEMENT

Set forth below are the name, age, principal position and a biographical description of each of our directors and executive officers December 31, 2006:

<u>Name</u>	<u>Age</u>	<u>Position</u>
Nissim Gilam(1)(2)	68	Chairman of the Board of Directors
Arieh Reichart	52	President and Chief Executive Officer
Amnon Shemer	47	Vice President, Finance and Chief Financial Officer
Dan Eshed	56	Senior Vice President, Subsidiaries
Eli Dvora	50	Vice President, Operations
Moshe Leibovich	49	Vice President, Marketing and Sales
Roberto Tulman	48	Vice President, Technologies and Chief Technology Officer
Shlomo Danino	44	Vice President, Engineering and Quality Assurance
Vardit Dekel	42	Vice President, Human Resources
David Banitt(1)(3)(4)	55	Independent Director
Jack Bigio	41	Director
Josef Maiman	61	Director
Ophira Rosolio-Aharonson(1)(3)	57	Outside Director
Eliyaho Tov(1)(2)(3)(4)	63	Outside Director
Joseph Yerushalmi	60	Director

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- (1) Member of the Executive Committee
  - (2) Member of the Compensation Committee
  - (3) Member of the Audit Committee
  - (4) Member of the Stock Option Committee

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Mr. Joseph Yerushalmi, a Class I director, will serve as a director until our 2009 general annual meeting of shareholders. Messrs. David Banitt and Jack Bigio, Class II directors, will serve as directors until our 2007 annual general meeting of shareholders. Messrs. Josef A. Maiman and Nissim Gilam, Class III directors, will serve as directors until our 2008 general annual meeting of shareholders. Mr. Eliyaho Tov and Ms. Ophira Rosolio-Aharonson will serve as outside directors pursuant to the provisions of the Israeli Companies Law for a three-year term until our 2009 annual general meeting of shareholders, following which the service of Mr. Tov as an outside director may not be extended and service of Ms. Rosolio-Aharonson as an outside director may be renewed for one additional three-year term.

**Nissim Gilam** has served as chairman of our board of directors since December 1, 1998, he has served as a director since January 1996 and previously held office as a director and our chief executive officer during the period January 1990 through March 1991. Since April 2002, Mr. Gilam has been self-employed. Mr. Gilam is also a member of the board of directors of Israel Steel Corporation, Eliyaho Insurance Company and Prisma Capital Markets. From September 1993 until March 2002, Mr. Gilam served as managing director of Ney Agencies Ltd., an Israeli company engaged as a sales agent of raw materials and machinery sold by trading companies. From September 1987 through September 1993, Mr. Gilam served as vice president-finance of Merhav M.N.F. Ltd., an Israeli company that constructs turnkey projects in, among other fields, refineries, energy and agriculture.

**Arieh Reichart** joined us in September 1984 as our chief financial officer and assumed the position of president and chief executive officer in May 1991. Mr. Reichart holds a B.A. degree in Economics and M.B.A. degree from Bar-Ilan University.

**Annon Shemer** joined us in February 2004 as vice president-finance and chief financial officer. From January 2003 until November 2003, Mr. Shemer was managing director of Mea Control Transfer Ltd., a company that provides investment banking services. From June 1995 until August 2002, Mr. Shemer was vice president of finance for Mentergy Ltd., a publicly-traded company that provides e-learning solutions and satellite communications services. Mr. Shemer holds a B.A. degree in Economics and Business Administration and M.A. degree in Economics, both from Bar-Ilan University.

**Dan Eshed** joined us in April 1987 as a production manager. During his employment with our company, Mr. Eshed has served as operation manager, senior vice president technology and infrastructure and was appointed senior vice president subsidiaries in February 2005. Mr. Eshed holds a B.Sc. degree in Management and Industrial Engineering from Ben Gurion University.

**Eli Dvora** joined us in 1993 after our merger with TPC Ltd. and served as our comptroller until August 1997. From September 1997 until February 1998, Mr. Dvora was self-employed. In March 1998, Mr. Dvora rejoined our company and in August 1999, was appointed as our vice president operations. Mr. Dvora holds a B.A. degree in Economics and M.B.A. degree, both from Bar Ilan University.

**Moshe Leibovich** joined us in November 2003 as vice president marketing and sales. From February 1996 until November 2003, Mr. Leibovich served as marketing and sales manager of Ophir Optronics Ltd., an Israeli company engaged in infra red optical components and subassemblies. Prior to joining Ophir Optronics Ltd. and from January 1994, Mr. Leibovich served as technical marketing and sales manager of A.I. Gil Import Ltd., an Israeli company engaged as the representative of Eveready Battery Company, Inc. in Israel.

**Roberto Tulman** joined us in August 2005 as vice president, technologies and chief technology officer. During the 22 years prior to joining our company, Mr. Tulman served in the electronic research department of the Israel Defense Forces, where he held various research and development and management positions, and managed the printed circuits division during his last eight years of service. Mr. Tulman holds a B.Sc. degree (Cum Laude) in Chemistry, M.Sc degree in Chemistry (Electrochemistry) and MBA degree, all from Tel-Aviv University.

**Shlomo Danino** joined us in August 1985. During his employment with our company, Mr. Danino has served as product engineering manager, and was appointed as vice president, engineering and quality assurance in February 1999. Mr. Danino holds a B.Sc. degree in mechanics from Ort Technology College in Israel and a B.Sc. degree in general business from Champlain College, in Burlington, Vermont.

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**Vardit Dekel** joined us in August 2005 as vice president, human resources. From May 2001 until July 2005, Ms. Dekel served as Human Resources manager of Chefa Ltd., an Israeli group engaged in food services for airlines, business and industry companies. During the 12 years prior to joining Chefa Ltd., Ms. Dekel served at Israel Elwyn's Residential Center for people with special needs, where she served in several management positions, including human resources and training manager and as its manager. Ms. Dekel holds a B.A degree in special education and MA degree in organizational sociology and organizational counseling, both from The Hebrew University of Jerusalem.

**David Banitt**, an independent director, has served as a director since March 1997. Since January 2006, Mr. Banitt has served as chief executive officer of YDesign Ltd., a company involved in the development of consumer products. Mr. Banitt is a member of the board of directors of Tidex Systems Ltd. From July 2005 until January 2006, Mr. Banitt was self-employed, providing consulting services in marketing, primarily in the PCB market. From August 2001 until July 2005, Mr. Banitt served as chief executive officer and member of the board of directors of Nano-OR Ltd., an Israeli start-up company engaged in the development of electro-optics systems. Prior to joining Nano-OR Technology Ltd. and from January 2001, Mr. Banitt was self-employed. From September 1997 until January 2001, Mr. Banitt served as President and member of the board of directors of Exsight Electro Optical Systems Ltd., an Israeli start-up company engaged in the development of electro-optics systems for the printed circuit boards industry. From 1993 until 1997, Mr. Banitt served as general manager of Nitzanim Initiative Center. From 1985 until 1992, Mr. Banitt served as Vice President of Marketing of Optrotech Ltd., an Israeli company that provided optical inspection systems to the PCB industry. Mr. Banitt holds a B.Sc. degree in Electronics Engineering from Tel Aviv University.

**Jack Bigio** has served as a director since May 2000. From May 2002 until October 2006, Mr. Bigio served as the president and chief executive officer of Ampal American Israel Corporation. Mr. Bigio serves as a member of the board of directors of Ampal and several companies within the Ampal group. From July 1995 until April 2002, Mr. Bigio served as vice president – operations and finance of Merhav M.N.F. Ltd., an Israeli company that constructs turnkey projects in, among other fields, refineries, energy and agriculture. Prior thereto, Mr. Bigio served as an economist and executive assistant to the president of Merhav M.N.F. Ltd. for five years. Mr. Bigio holds a B.A. degree in Economics and Business Administration and M.B.A. degree, both from The Hebrew University of Jerusalem.

**Josef Maiman** has served as a director since July 1988. Mr. Maiman has served as president of Merhav M.N.F. Ltd. since August 1972. Mr. Maiman has served as the chairman of the board of directors of Israel 10 Channel Ltd. since January 2002 and since April 2002, as the chairman of the board of directors of Ampal American Israel Corporation, a public holding company listed on The NASDAQ National Market, and since October 2006 he also serves as the CEO of Ampal. Mr. Maiman holds a B.A. degree in Economics from University of Texas and M.A. degree in Economics from Cornell University.

**Ophira Rosolio-Aharonson** was appointed as an outside director in December 2006. Ms. Rosolio-Aharonson serves as an executive director of several private and publicly traded companies, a strategic business consultant to high-technology companies and an advisor to venture capital firms in Israel and the United States. From 2000 to 2006, Ms. Rosolio-Aharonson served as an active executive director and audit committee member of Scitex Ltd. (NASDAQ:SCIX), and as a director and chair of the audit committee of Cimatron Ltd. (NASDAQ:CIMT). Ms. Rosolio-Aharonson is a co-founder of Seagull Tech Inc. and KeyScan Inc. From 1992 through 1999, Ms. Rosolio-Aharonson served as the chief executive officer of Terra Computers, Inc. in the United States. From 1980 to 1989, Ms. Rosolio-Aharonson served as a senior executive, holding managerial positions, at Clal Ltd., an Israeli company publicly traded on the Tel Aviv Stock Exchange, including director, chief executive officer, chief operations officer and vice president of sales and marketing of Clal Ltd.'s subsidiaries. Ms. Rosolio-Aharonson holds a B.Sc. degree in applied mathematics and physics, and has completed courses required for a M.Sc. degree in bio-medical engineering, both from the Technion – Israel Institute of Technology, Haifa and is a graduate of the executive business and management program of Tel Aviv University.

**Eliyaho Tov** was appointed as an outside director in December 2003. Since November 1999, Mr. Tov has been a freelance consultant as an economic advisor and management advisor. Mr. Tov serves as a director of several other companies. From 1973 until September 1999, Mr. Tov served as a senior economist of The Israel Corporation Ltd. and during such period served as a director of several companies within The Israel Corporation Ltd. group. Mr. Tov holds a B.A. degree in economics and political science and M.A. degree in business management, both from The Hebrew University of Jerusalem. Mr. Eliyaho Tov qualifies as an audit committee financial expert, as defined by rules of the Securities and Exchange Commission.

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**Joseph Yerushalmi** has served as a director since December 2003. Since January 1996, Mr. Yerushalmi has served as a senior vice president in charge of the projects of Merhav M.N.F Ltd. Mr. Yerushalmi serves as a member of the board of directors of Ampal Israel Corporation Ltd. From 1992 to 1996, Mr. Yerushalmi served as vice president, projects development at Israel Chemicals Ltd., Israel's largest chemical concern. Between 1989 and 1992, Mr. Yerushalmi was a visiting professor at the University of Pittsburgh. In 1980, Mr. Yerushalmi founded PAMA ( Energy Resources Development ) Ltd. in Israel with the goal of commercial utilization of Israel oil shale reserves and he served

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as its General Manager until 1989. From 1977 to 1980, Mr. Yerushalmi was Technical Manager of the Coal Gasification Program of the Electric Power Research Institute (EPRI) in Palo Alto, California. Between 1969 and 1977, Mr. Yerushalmi was professor of Chemical Engineering at the City College of New York where he pioneered in research the field of alternative energy. Mr. Yerushalmi holds a Ph.D. in Chemical Engineering from the City University of New York.

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

### B. COMPENSATION

The following table sets forth all compensation we paid with respect to all of our directors and executive officers as a group for the year ended December 31, 2006.

	<u>Salaries, fees, commissions and bonuses</u>	<u>Pension, retirement and similar benefits</u>
All directors and executive officers as a group (consisting of 16 persons)	\$ 1,390,000	\$ 30,000

During the year ended December 31, 2006, we paid each of our outside and independent directors an annual fee of NIS 16,200 (\$3,840) and a per meeting attendance fee of NIS 1,020 (\$241). During such period we paid Nissim Gilam, chairman of our board of directors, a management fee of \$5,000 per month and reimbursed him for various expenses that he incurred in connection with his service as chairman of the board of directors in an annual amount of NIS 20,880 (\$4,942). We also provide Mr. Gilam with a company car and pay all expenses in connection therewith.

As of December 31, 2006, our directors and executive officers as a group, consisting of 14 persons, held options to purchase an aggregate of 119,500 ordinary shares. Of such options, options to purchase 20,000 ordinary shares have an exercise price of \$1.14, and vest over a three-year period (of which, options to purchase 13,332 ordinary shares had vested at December 31 2006) and will expire in November 2009 and options to purchase 99,500 ordinary shares have an exercise price of NIS 21 (\$ 4.97 ), were fully vested upon grant and will expire in December 2007. The options were granted under our 2000 Stock Option Plan and 2005 Stock Option Plan. See Share Ownership Stock Option Plans.

The compensation of our chief executive officer and all other executive officers is recommended to our Board of Directors for determination by a majority of the independent directors.

### C. BOARD PRACTICES

#### Introduction

According to the Israeli Companies Law and our Articles of Association, the management of our business is vested in our board of directors. The board of directors may exercise all powers and may take all actions that are not specifically granted to our shareholders. Our executive officers are responsible for our day-to-day management. The executive officers have individual responsibilities established by our chief executive officer and board of directors.

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#### Election of Directors

Our Articles of Association provide for a board of directors consisting of no less than three and no more than nine members or such other number as may be determined from time to time at a general meeting of shareholders, and the number of directors must be odd. Our Board of Directors is currently composed of seven directors.

Pursuant to our articles of association, our board of directors is divided into three classes (other than outside directors). Generally, at each annual meeting of shareholders one of such classes of directors is elected for a term of three years by a vote of the holders of a majority of the voting power represented and voting at such meeting. All the members of our board of directors (except the outside directors as detailed below) may be reelected upon completion of their term of office. Directors (other than outside directors) may be removed earlier from office by a

resolution passed at a general meeting of our shareholders, provided that shareholders holding in the aggregate no less than forty-percent of our outstanding share capital vote in favor of such resolution. Our board of directors may temporarily fill vacancies in the board or add to their body until the next annual meeting of shareholders, provided that the total number of directors will not exceed the maximum number permitted under our articles of association.

The board of directors of an Israeli public company is required to determine a minimum number of directors with accounting and financial expertise, as defined by regulations promulgated under the Israeli Companies Law. Our board of directors determined, accordingly, that at least one director must have accounting and financial expertise. Our Board of Directors has further determined that Mr. Eliyaho Tov has the requisite accounting and financial expertise.

We do not follow the requirements of the NASDAQ Marketplace Rules with regard to the nomination process of directors, and instead, we follow Israeli law and practice, in accordance with which director nominees are recommended by our board of directors to our shareholders for election. See below in this Item 6C. Directors, Senior Management and Employees Board Practices NASDAQ Marketplace Rules and Home Country Practices.

### Outside and Independent Directors

*Outside Directors.* Under the Israeli Companies Law, Israeli companies whose shares have been offered to the public are required to appoint at least two outside directors. The Israeli Companies Law provides that a person may not be appointed as an outside director if the person, or the person's relative, partner, employer or an entity under that person's control, has or had during the two years preceding the date of appointment any affiliation with the company, or any entity controlling, controlled by or under common control with the company. The term relative means a spouse, sibling, parent, grandparent, child or child of spouse or spouse of any of the above. The term affiliation includes an employment relationship, a business or professional relationship maintained on a regular basis, control and service as an office holder excluding service as an outside director of a company that is offering its shares to the public for the first time.

In addition, no person may serve as an outside director if the person's position or other activities create, or may create, a conflict of interest with the person's responsibilities as director or may otherwise interfere with the person's ability to serve as director. If, at the time an outside director is appointed all members of the board of directors are of the same gender, then that outside director must be of the other gender. A director of one company may not be appointed as an outside director of another company if a director of the other company is acting as an outside director of the first company at such time.

As of 2006, at least one of the outside directors elected must have accounting and financial expertise and any other outside director must have accounting and financial expertise or professional qualification, as such terms are defined by regulations promulgated under the Israeli Companies Law. Our outside director, Mr. Eliyaho Tov, has accounting and financial expertise and our other outside director, Ms. Ophira Rosolio-Aharonson, has professional qualification, as such terms are defined by regulations promulgated under the Israeli Companies Law.

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Outside directors are elected by shareholders. The shareholders voting in favor of their election must include at least one-third of the shares of the non-controlling shareholders of the company who voted on the matter. This minority approval requirement need not be met if the total shareholdings of those non-controlling shareholders who vote against their election represent 1% or less of all of the voting rights in the company. Outside directors serve for a three-year term, which may be renewed for only one additional three-year term. Outside directors can be removed from office only by the same special percentage of shareholders as can elect them, or by a court, and then only if the outside directors cease to meet the statutory qualifications with respect to their appointment or if they violate their duty of loyalty to the company.

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

Mr. Eliyaho Tov and Ms. Ophira Rosolio-Aharonson serve as our outside directors under the Israeli Companies Law until our 2009 annual general meeting of shareholders, following which the service of Mr. Tov as an outside director may not be extended and service of Ms. Rosolio-Aharonson as an outside director may be renewed for one additional three-year term.

*Independent Directors.* In general, NASDAQ Marketplace Rules require that the board of directors of a NASDAQ-listed company have a majority of independent directors and its audit committee must have at least three members and be comprised only of independent directors, each of whom satisfies the respective independence requirements of NASDAQ and the Securities and Exchange Commission. However, on June 9, 2005, we provided NASDAQ with a notice of non-compliance with respect to (among other things) the requirement to maintain a majority of independent directors, as defined under NASDAQ Marketplace Rules. Instead, we follow Israeli law and practice which requires that we appoint

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at least two outside directors, within the meaning of the Israeli Companies Law, to our board of directors. (See below in this Item 6C. Directors, Senior Management and Employees Board Practices NASDAQ Marketplace Rules and Home Country Practices. ) In addition, in accordance with the rules of the Securities and Exchange Commission and NASDAQ, we have the mandated three independent directors, as defined by the rules of the Securities and Exchange Commission and NASDAQ, on our audit committee.

Our Board of Directors has determined that each of Messrs. Banitt and Tov and Ms. Rosolio-Aharonson qualifies as an independent director under the requirements of the Securities and Exchange Commission and NASDAQ.

### **Committees of the Board of Directors**

#### *Executive Committee*

Our Board of Directors established an executive committee, which is responsible for monitoring the implementation of the plan to improve our profitability that was adopted by our management, and recommending to our board of directors future strategies for our company and monitoring their implementation. Messrs. Gilam, Banitt and Tov and Ms. Rosolio-Aharonson are the current members of our executive committee. Our executive committee meets approximately once a month with our Chief Executive Officer.

#### *Audit Committee*

Under the Israeli Companies Law, the board of directors of any public company must establish an audit committee. The audit committee must consist of at least three directors and must include all of the outside directors. The audit committee may not include the chairman of the board of directors, any director employed by the company or providing services to the company on an ongoing basis, or a controlling shareholder or any of the controlling shareholder's relatives.

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

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Our audit committee assists our Board of Directors in overseeing the accounting and financial reporting processes of our company and audits of our financial statements, including the integrity of our financial statements, compliance with legal and regulatory requirements, our independent registered public accountants' qualifications and independence, the performance of our internal audit function and independent registered public accountants, finding any defects in the business management of our company and proposing to the Board of Directors ways to correct such defects, approving related-party transactions as required by Israeli law, 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.

Our audit committee consists of three members of our Board of Directors who satisfy the respective independence requirements of the Securities and Exchange Commission, NASDAQ and Israeli Law for audit committee members. Our audit committee is currently composed of Messrs. Banitt and Tov and Ms. Rosolio-Aharonson. The audit committee meets at least once each quarter.

#### *Compensation Committee*

Our board of directors established a compensation committee, which is responsible for the administration of our: (i) 1996 Stock Option Plan; and (ii) 2000 Stock Option Plan (see Item 6.E., Directors, Senior Management and Employees Share Ownership Stock Option Plans ). Messrs. Tov and Gilam are the current members of our compensation committee. Under the Israeli Companies Law, subject to certain conditions, the board of directors may delegate to a board committee its authority to grant options. The grant of options to our office holders (within the meaning of the Israeli Companies Law) requires the approval of our audit committee and board of directors, and if the office holder is a director, also by our shareholders.

#### *Stock Option Committee*

Our Board of Directors established a Stock Option Committee, the initial purpose of which is to administer, where permitted under applicable law, our 2005 Stock Option Plan (see Item 6.E., Directors, Senior Management and Employees Share Ownership Stock Option Plans ). Messrs. Tov and Banitt are the current members of our Stock Option Committee. Our Stock Option Committee meets on an as required



basis.

### **Internal Audit**

The Israeli Companies Law also requires the board of directors of a public company to appoint an internal auditor nominated by the audit committee. The internal auditor must meet certain statutory requirements of independence. The role of the internal auditor is to examine, among other things, the compliance of the company's conduct with applicable law and orderly business practice. Mr. Daniel Shapira, Certified Public Accountant (Israel), serves as our internal auditor.

### **Directors Service Contracts**

We do not have any service contracts with our directors, except for the compensation we pay to Mr. Nissim Gilam in connection with his services as Chairman of our Board of Directors. We pay Mr. Gilam a management fee of \$5,000 per month, reimburse him for various expenses that he incurs in connection with his service as Chairman of the Board of Directors in an annual amount up to NIS 18,000 (approximately \$ 4,260 ), and provide him with a company car and pay all expenses in connection therewith. Mr. Gilam may receive this compensation directly or through his personal company, Nissim Gilam Ltd.

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

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### **Approval of Related Party Transactions Under Israeli Law**

The Israeli Companies Law codifies the fiduciary duties that office holders, including directors and executive officers, owe to a company. An office holder is defined in the Israeli Companies Law as a director, general manager, chief business manager, deputy general manager, vice general manager, or any person filling any of these positions in a company even if he or she holds a different title, and also includes any other manager directly subordinate to the general manager. An office holder's fiduciary duties consist of a duty of care and a duty of loyalty. An office holder must 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 information regarding the business feasibility of an action brought for his or her approval or performed by him or her by virtue of his or her position and all other important information pertaining to these actions.

The duty of loyalty requires that an office holder act in good faith and for the benefit of the company, including the duty to: avoid any conflict of interest between the office holder's position in the company and any other position he holds or his personal affairs; avoid any competition with the company's business; avoid exploiting any business opportunity of the company in order to obtain benefit for the office holder or any other person; and disclose to the company any information or documents relating to the company's affairs which the office holder received by virtue of his or her position as an office holder.

Under the Israeli Companies Law, transactions of a company with an office holder and transactions of a company with another entity in which an office holder has a personal interest and which are not extraordinary transactions, must be approved by the board of directors or as otherwise provided for in a company's articles of association. An extraordinary transaction 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. Extraordinary transactions with an office holder that is not a director and transactions that involve the grant of an exemption, insurance, indemnification or an undertaking to indemnify an office holder that is not a director must be approved by the audit committee and the board of directors. Extraordinary transactions with a director and transactions involving the conclusion of a contract by a company with a director as to the terms of his office, including the grant of an exemption, insurance, indemnification or an undertaking to indemnify, or the conclusion of a contract by a company with a director as to the terms of his employment in other positions, must be approved by the audit committee, board of directors and shareholders. If the office holder is a controlling shareholder or a relative of a controlling shareholder, any extraordinary transaction, compensation, exemption, indemnification and insurance of the office holder must be approved by our audit committee, board of directors and shareholders, supported by the vote of at least one-third of the shares of the non-controlling shareholders voting on the matter, or provided that the total number of shares held by non-controlling shareholders that voted against the proposal did not exceed one percent of all of the voting rights in the company.

The Israeli Companies Law requires that an office holder and a controlling shareholder disclose promptly, and no later than by the first board meeting at which such transaction is considered, any personal interest that he or she may have and all related material information and documents, in connection with any existing or proposed transaction of the company. Personal interest includes any personal interest of the person's relative, or any corporation in which the person or any relative of such person is an interested party. The disclosure requirement does not apply where the office holder or controlling shareholder's personal interest is created only by the personal interest of a relative in a transaction

that is not an extraordinary transaction.

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

Under the Companies Regulations (Relief from Related Party Transactions), 5760-2000, promulgated under the Israeli Companies Law, and amended in January 2002 and in March 2006, certain transactions between a company and its controlling shareholder(s) do not require shareholder approval. In addition, under such regulations, directors' compensation and employment arrangements do not require the approval of the shareholders if both the audit committee and the board of directors agree that such arrangements only benefit the company or if the directors' compensation does not exceed the maximum amount of compensation for outside directors determined by applicable regulations. Under very limited circumstances, employment and compensation arrangements for an office holder that is a controlling shareholder of the company or his relative do not require the approval of shareholders. The foregoing relief will not apply if one or more shareholders holding at least 1% of the issued and outstanding share capital of the company or of the company's voting rights, objects to the grant of such relief, provided that such objection is submitted to the company in writing not later than fourteen days from the date of the filing of a report regarding the adoption of such resolution by the company. If such objection is duly and timely submitted, then the transaction or compensation arrangement will require shareholders' approval as detailed above.

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Board of directors and shareholder approval is also required in the event a company issues its securities in a private placement of securities that will cause a person to become a controlling shareholder, or in the event a private placement in which 20% or more of the company's outstanding share capital prior to the placement are offered, the payment for which (in whole or in part) is not in cash or not under market terms, and that issuance will (i) increase the relative holdings of a shareholder that holds 5% or more of the company's outstanding share capital, or (ii) cause any person to become a holder of more than 5% of the company's outstanding share capital.

Notwithstanding all of the above, if any of the enumerated transactions requiring special approvals is adverse to the company's interest, such approval would not be effective.

## **Exculpation, Indemnification and Insurance of Directors and Officers**

### *Exculpation of Office Holders*

The Israeli Companies Law provides that an Israeli company cannot exculpate an office holder from liability with respect to a breach of his or her duty of loyalty. If permitted by its articles of association, a company may exculpate in advance an office holder from his or her liability to the company, in whole or in part, with respect to a breach of his or her duty of care. However, a company may not exculpate in advance a director from his or her liability to the company with respect to a breach of his duty of care in the event of distributions. Our articles of association allow us to exculpate any office holder from his or her liability to us for breach of duty of care, to the maximum extent permitted by law, before or after the occurrence giving rise to such liability.

### *Insurance of Office Holders*

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

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

### *Indemnification of Office Holders*

The Israeli Companies Law provides that a company may, if permitted by its articles of association, indemnify an office holder for liabilities or expenses imposed on him or her, or incurred by him or her concerning acts or omissions performed by the office holder in such

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

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

Our articles of association provide that we may undertake to indemnify in advance an office holder, in accordance with the conditions set under applicable law, against any liabilities he or she may incur in such capacity, provided that such undertaking is limited with respect to categories of events that can be expected as determined by our board of directors when authorizing such undertaking, and with respect to such amounts determined by our board of directors as reasonable in the circumstances. Furthermore, under our articles of association, we may indemnify any past or present office holder, in accordance with the conditions set under any law, with respect to any past occurrence, whether or not we are obligated under any agreement to indemnify such office holder in respect of such occurrence.

#### *Limitations on Exculpation, Insurance and Indemnification*

The Israeli Companies Law provides that neither a provision of the articles of association permitting the company to enter into a contract to insure the liability of an office holder, nor a provision in the articles of association or a resolution of the board of directors permitting the indemnification of an office holder, nor a provision in the articles of association exempting an office holder from duty to the company shall be valid, where such insurance, indemnification or exemption relates to any of the following: (i) a breach by the office holder of his duty of loyalty, except with respect to insurance coverage or indemnification if the office holder acted in good faith and had reasonable grounds to assume that the act would not prejudice the company; (ii) a breach by the office holder of his duty of care if such breach was committed intentionally or recklessly, unless the breach was committed only negligently; (iii) any act or omission committed with intent to derive an unlawful personal gain; and (iv) any fine or forfeiture imposed on the office holder.

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

We have agreed to indemnify our office holders to the fullest extent permitted by law. We currently maintain directors and officers liability insurance with a per claim and aggregate coverage limit of \$10 million. Under our current directors and officers liability insurance policy, losses will be paid in accordance with the following order of priority: first, on behalf of officers and directors, for all loss that they will be obligated to pay as a result of a claim made against them; thereafter, on our behalf, for all loss that an officer or director will be obligated to pay as a result of a claim made against them, to the extent that we are required or permitted by law to indemnify our officers and directors; and thereafter, on our behalf, for all loss that we will be obligated to pay as a result of a securities claim made against us.

#### **NASDAQ Marketplace Rules and Home Country Practices**

Under NASDAQ Marketplace Rule 4350, or Rule 4350, foreign private issuers, such as our company, are permitted to follow certain home country corporate governance practices instead of certain provisions of Rule 4350, without the need to seek individual exemptions from NASDAQ. A foreign private issuer that elects to follow a home country practice instead of any of such provisions of Rule 4350, must submit to NASDAQ, in advance, a written statement from an independent counsel in such issuer's home country certifying that the issuer's practices are not prohibited by the home country's laws. On June 9, 2005, we provided NASDAQ with a notice of non-compliance with Rule 4350. We do not comply with the following requirements of Rule 4350, and instead follow Israeli law and practice in respect of such requirements:

the requirement to maintain a majority of independent directors, as defined under the NASDAQ Marketplace Rules. Instead, we follow Israeli law and practice which requires that we appoint at least two outside directors, within the meaning of the Israeli Companies Law, to our Board of Directors. In addition, we have the mandated three independent directors, within the meaning of the rules of the Securities and Exchange Commission and NASDAQ, on our audit committee. See above in this Item 6C.

Directors, Senior Management and Employees Board Practices Outside and Independent Directors.

the requirements regarding the directors nominations process. Under Israeli law and practice our board of directors and shareholders holding at least 1% of a company's voting rights are authorized to recommend to our shareholders director nominees for election. See above in this Item 6C. Directors, Senior Management and Employees Board Practices Election of Directors.

the requirement regarding the quorum for any meeting of the holders of common stock. Instead, we follow Israeli law and practice which provides that, unless otherwise provided by a company's articles of association, the quorum required for a general meeting of shareholders is at least two shareholders present who hold, in the aggregate, 25% of the company's voting rights. Our articles of association provide that the quorum required for an ordinary meeting of shareholders consists of at least two shareholders present in person or represented by proxy who hold or represent, in the aggregate, at least 40% of the voting rights of the issued share capital. See Item 10A. Additional Information Share Capital Annual and Extraordinary Meetings of Shareholders.

#### **D. EMPLOYEES**

As of December 31, 2006, we employed 310 full-time employees in Israel, of which 184 were employed in manufacturing services, 35 in process and product engineering, 42 in quality assurance and control, 12 in sales and marketing and 37 in finance, accounting, information service and administration.

As of December 31, 2005, we employed 273 full-time employees in Israel, of which 157 were employed in manufacturing services, 36 in process and product engineering, 30 in quality assurance and control, 13 in sales and marketing and 37 in finance, accounting, information service and administration.

As of December 31, 2004, we employed 261 full-time employees in Israel, of which 150 were employed in manufacturing services, 34 in process and product engineering, 30 in quality assurance and control, 12 in sales and marketing and 35 in finance, accounting, information service and administration.

In addition, as of December 31, 2006, Kubatronik, our subsidiary in Germany, employed 40 full-time employees and 7 part-time employees, compared to 37 full-time employees and 9 part-time employees at December 31, 2005 and 32 full-time employees and 9 part-time employees at December 31, 2004.

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

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

Pursuant to Israeli law, we are legally required to pay severance benefits upon certain circumstances, including the retirement or death of an employee or the termination of employment of an employee without due cause. Some of our employees are covered by life and pension insurance policies providing customary benefits to employees, including retirement and severance benefits. Most of our employees are covered by pension funds providing similar benefits. We contribute between 12.0% and 14% of base salaries to such plans and employees contribute between 5.0% to 6.5% of base salaries. We also contribute 7.5% of base salaries to certain professional advancement funds for managers,

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engineers and others and such employees contribute 2.5% of base salaries. Our contribution and employee contributions are not limited; however, a company's contribution above certain specified maximum amounts are taxable income to the employee. Israeli employers and employees are required to pay predetermined sums to the National Insurance Institute, which is similar to the United States Social Security Administration. Subject to minimum thresholds, the employer contribution to the National Insurance Institute is at the rate of 5.29% of the salary and the employee contribution to the National Insurance Institute is at the rate of 8.1% of the salary (of which 4.1% relates to payments for national health insurance), both of which are limited to a maximum salary of NIS 35,760 (approximately \$8,500). In the year ended December 31, 2006, our aggregate payments as an employer to the National Insurance Institute amounted to approximately 5.3% of salaries.

### E. SHARE OWNERSHIP

#### Beneficial Ownership of Executive Officers and Directors

The following table sets forth certain information as of June 25, 2007 regarding the beneficial ownership by each of our directors and executive officers:

Name	Number of Ordinary Shares Beneficially Owned (1)	Percentage of Ownership (2)
Nissim Gilam	30,000(3)	*
Arieh Reichart	115,515(4)	1.7 %
Amnon Shemer	10,666(5)	*
Dan Eshed	-	-
Eli Dvora	23,500(3)	*
Moshe Leibovich	10,666(5)	*
Roberto Tulman	5,000(3)	*
Shlomo Danino	-	-
Vardit Dekel	3,000(3)	*
David Banitt	-	-
Jack Bigio	-	-
Josef Maiman	1,585,540(6)	24.0 %
Ophira Rosolio-Aharonson	-	-
Eliyaho Tov	-	-
Joseph Yerushalmi	-	-

\* Less than 1%

- (1) Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and generally includes voting or investment power with respect to securities. Ordinary shares relating to options or convertible notes currently exercisable or exercisable within 60 days of the date of this table are deemed outstanding for computing the percentage of the person holding such securities but are not deemed outstanding for computing the percentage of any other person. Except as indicated by footnote, and subject to community property laws where applicable, the persons named in the table above have sole voting and investment power with respect to all shares shown as beneficially owned by them.
- (2) The percentages shown are based on 6,609,807 ordinary shares issued and outstanding as of June 25, 2007.
- (3) Subject to currently exercisable options granted under our 2005 Stock Option Plan, having an exercise price of NIS 21 (\$ 4.97) per share, which options expire in December 2007.

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- (4) Includes 30,000 ordinary shares subject to currently exercisable options granted under our 2005 Stock Option Plan, having an exercise price of NIS 21 (\$ 4.97) per share, which options expire in December 2007.

- (5) Of such shares, 6,666 ordinary shares are subject to currently exercisable options granted under our 2000 Stock Option Plan, having an exercise price of \$1.14 per share, which options expire in November 2009 and 4,000 ordinary shares are subject to currently exercisable options granted under our 2005 Stock Option Plan, having an exercise price of NIS 21 (\$ 4.97) per share, which options expire in December 2007.
- (6) Includes 985,796 ordinary shares held of record by Merhav M.N.F. Ltd., an Israeli private company controlled by Mr. Maiman. Also includes 571,993 ordinary shares held of record by Integral International Inc., a Panama corporation, and 27,751 ordinary shares held of record by Integral International Inc.'s wholly owned subsidiary, A. Sariel Ltd, an Israeli corporation. Mr. Maiman, a director, is the controlling shareholder of Integral International Inc. and its wholly owned subsidiary, A. Sariel Ltd. Mr. Maiman may be deemed to be the beneficial owner of the aggregate 1,585,540 ordinary shares held directly by Merhav M.N.F. Ltd., Integral International Inc. and A. Sariel Ltd.

### Major Shareholders Voting Rights

Our major shareholders do not have different voting rights.

### Stock Option Plans

#### *2000 Stock Option Plan*

Our 2000 Stock Option Plan, or the 2000 Plan, authorizes the grant of options to purchase up to 750,000 ordinary shares. Employees, officers, directors and consultants of our company and its subsidiaries are eligible to participate in the 2000 Plan. Awards under the 2000 Plan may be granted in the forms of incentive stock options as provided in Section 422 of the U.S. Internal Revenue Code of 1986, as amended, non-qualified stock options, options granted pursuant to Section 102 of the Israeli Income Tax Ordinance (New Version), 1961, or the Israeli Tax Ordinance, and options granted pursuant to Section 3.9 of the Israeli Tax Ordinance. The 2000 Plan has a term of ten years and will terminate on July 31, 2010. No award of options may be made after such date.

The compensation committee administers the 2000 Plan. Subject to the provisions of the 2000 Plan and applicable law, the compensation committee has the authority, in its sole discretion, to:

propose to grant awards under the 2000 Plan and recommend to the board of directors the persons to whom such awards be granted;

determine the form, terms and conditions of the written stock option agreement evidencing the option, including the type of option and the number of shares to which it pertains, the option price, the option period and its vesting schedule, and exercisability of the option in special cases (such as death, retirement, disability and change of control);

prescribe the form and provisions of the notice of exercise and payment of the option;

nominate a trustee for options issued under Section 102 of the Israeli Tax Ordinance;

adjust any or all of the number and type of shares that thereafter may be made the subject of options, the number and type of shares subject to outstanding options, and the grant or exercise price with respect to any option, or, if deemed appropriate, make provision for a cash payment to the holder of any outstanding option in order to prevent dilution or enlargement of the benefits or potential benefits intended to be made available under the 2000 Plan in the event of any dividend or other distribution, recapitalization, stock split, reverse stock split, reorganization, merger, consolidation, split-up, spin-off, combination, repurchase, or exchange of shares or other securities;

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interpret the provisions of the 2000 Plan; and

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prescribe, amend, and rescind rules and regulations relating to the 2000 Plan or any award thereunder as it may deem necessary or advisable.

Neither the board of directors nor the compensation committee may, without the consent of the optionee, alter or in any way impair the rights of an optionee under any award previously granted. Neither the termination of the 2000 Plan nor the change of control of our company (except to the extent provided in the 2000 Plan) will affect any option previously granted.

The option price per share may not be less than 100% of the fair market value of such share on the date of the grant. However, in the case of an award of an incentive stock option made to a 10% owner, the option price per share may not be less than 110% of the fair market value (as such term is defined in the 2000 Plan) of such share on the date of the award. Generally the options vest ratably over a three-year period. An option may not be exercisable after the expiration of five years from the date of its award. No option may be exercised after the expiration of its term.

Options are not assignable or transferable by the optionee, other than by will or the laws of descent and distribution, and may be exercised during the lifetime of the optionee only by the optionee or his or her guardian or legal representative. However, during the optionee's lifetime, the optionee may, with the consent of the compensation committee, transfer without consideration all or any portion of his options to members of the optionee's immediate family (as defined in the 2000 Plan), a trust established for the exclusive benefit of members of the optionee's immediate family, or a limited liability company in which all members are members of the optionee's immediate family.

As of December 31, 2006, options for the purchase of 138,400 ordinary shares had been granted under the 2000 Plan (excluding options that expired without being exercised), of which, options to purchase 118,400 ordinary shares having an exercise price of \$4.375 per share and options to purchase 20,000 ordinary shares having an exercise price of \$1.14 per share. During the year ended December 31, 2006, options to purchase 7,600 ordinary shares were exercised. Options to purchase 13,333 ordinary shares are currently exercisable under the 2000 Plan. Of the options granted under the 2000 Plan (excluding options that expired without being exercised), options to purchase 59,500 ordinary shares were granted to our executive officers and the chairman of our board of directors, of which options to purchase 13,333 ordinary shares are currently exercisable and options to purchase 39,500 ordinary shares have been exercised. Since December 2004, we have not granted options under the 2000 Plan and we do not intend to grant any additional options under the 2000 Plan in the future.

### **2005 Stock Option Plan**

Our 2005 Stock Option Plan, or the 2005 Plan, was adopted at our 2005 annual general meeting.

In August 2000, our company granted options under the 2000 Plan to certain of our employees, officers and the Chairman of our Board of Directors. The exercise price of such *options* was \$4.375, which, except for limited periods of time, exceeded the market price of our ordinary shares and the majority of the grantees did not exercise these options prior to their expiration on July 31, 2005. In order to maintain the interest of such individuals in our company in a manner that would defer the optionees' tax liability (if any) to the date that the options are exercised and so that the underlying shares issued upon exercise of the options will not be subject to a minimum lock-up period prior to the disposition thereof, as provided under new Section 102(c) of the Israeli Income Tax Ordinance that came into effect on January 1, 2003, we adopted the 2005 Plan, which is designed to reflect the provisions of such new Section 102(c). Under the 2005 Plan we have granted options to those optionees who did not exercise their August 2000 options prior to the expiration, to the extent not exercised, and a few additional employees.

Under the 2005 Plan, up to an aggregate of 284,500 ordinary shares may be issued to our Israeli directors, officers and employees. Options granted under the 2005 Plan may only be awarded in accordance with Section 102 (c) of the Israeli Income Tax Ordinance. The 2005 Plan has a term of two years commencing on December 11, 2005. No option grant may be made under the 2005 Plan after December 31, 2005.

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The 2005 Plan is currently administered by our Board of Directors. However, where permitted under applicable law, the 2005 Plan may be administered by a stock option committee appointed by the board of directors. Subject to the provisions of the 2005 Plan, the board of directors has the authority, in its sole discretion, among other things, to grant options under the 2005 Plan and to determine their terms, to interpret the provisions of the 2005 Plan and, subject to the requirements of applicable law, to prescribe, amend, and rescind rules and regulations relating to the 2005 Plan or any options granted thereunder.

The exercise price per share of options granted under the 2005 Plan is NIS 21. All options granted under the 2005 Plan are fully vested upon their award. The period for which an option is granted under the 2005 Plan is two years. No option may be exercised after the expiration of its term.

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Options are not assignable or transferable by the optionee, other than by will or the laws of descent, and may be exercised during the lifetime of the optionee only by the optionee or his or her guardian or legal representative. However, during the optionee's lifetime, the optionee may, with the consent of the board of directors, transfer without consideration all or any portion of his options to (i) one or more members of the optionee's immediate family (as defined in the 2005 Plan), (ii) a trust established for the exclusive benefit of one or more members of the optionee's immediate family, or (iii) a limited liability company in which all members are members of the optionee's immediate family.

As of December 31, 2006, options for the purchase of 284,500 ordinary shares had been granted under the 2005 Plan, all of which were fully vested upon grant and expire in December 2007. During the year ended December 31, 2006, options to purchase 13,900 ordinary shares were exercised and options to purchase 3,200 ordinary shares were forfeited without being exercised. No additional options may be granted in the future under the 2005 Plan. Of the options granted under the 2005 Plan, options to purchase 99,500 ordinary shares were granted to our executive officers and the chairman of our board of directors.

### ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

#### A. MAJOR SHAREHOLDERS

The following table sets forth certain information as of June 25, 2007 regarding the beneficial ownership by all shareholders known to us to own beneficially 5% or more of our ordinary shares:

Name	Number of Ordinary Shares Beneficially Owned (1)	Percentage of Ownership (2)
Josef Maiman	1,585,540(3)	24.0%
Merhav M.N.F. Ltd.	985,796	14.9%
Integral International Inc.	599,744(4)	9.1%

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

(2) The percentages shown are based on 6,609,807 ordinary shares issued and outstanding as of June 25, 2007.

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(3) Includes 985,796 held of record by Merhav M.N.F. Ltd., an Israeli private company controlled by Mr. Maiman. Also includes 571,993 ordinary shares held of record by Integral International Inc., a Panama corporation, and 27,751 ordinary shares held of record by Integral International Inc.'s wholly owned subsidiary, A. Sariel Ltd. Mr. Maiman, a director, is the controlling shareholder of Integral International Inc. and its wholly owned subsidiary, A. Sariel Ltd. Mr. Maiman may be deemed to be the beneficial owner of the aggregate 599,744 ordinary shares held directly by Integral International Inc. and A. Sariel Ltd.

(4) Includes 571,993 ordinary shares held of record by Integral International Inc., a Panama corporation, and 27,751 ordinary shares held of record by Integral International Inc.'s wholly owned subsidiary, A. Sariel Ltd. Mr. Maiman, a director, is the controlling shareholder of Integral International Inc. and its wholly owned subsidiary, A. Sariel Ltd. Mr. Maiman may be deemed to be the beneficial owner of the aggregate 1,585,540 ordinary shares held directly by Merhav M.N.F. Ltd., Integral International Inc. and A. Sariel Ltd.



### Significant Changes in the Ownership of Major Shareholders

As of December 31, 2004, Mr. Josef Maiman beneficially held 2,015,956 ordinary shares, representing approximately 36.7% of our then outstanding ordinary shares. Of such shares, 341,500 ordinary shares, representing approximately 6.2% of our then outstanding shares, were held of record by Mr. Maiman, 606,060 ordinary shares, representing approximately 11.0% of our then outstanding shares, were held of record by Merhav M.N.F. Ltd., or Merhav, an Israeli private company controlled by Mr. Maiman (excluding ordinary shares that were issuable upon exercise of a convertible note then held by Merhav) and 1,068,396 ordinary shares, representing approximately 19.5% of our then outstanding shares, were held of record by Integral International Inc., or Integral, a Panama corporation controlled by Mr. Maiman.

During the period of March 24, 2005 through April 6, 2005, Mr. Josef Maiman sold 1,416,212 ordinary shares that were beneficially held by him, of which 606,060 ordinary shares were held of record by Merhav, 468,652 ordinary shares were held of record by Integral and 341,500 were held directly by Mr. Maiman. As a result, Mr. Maiman's beneficial ownership interest decreased to approximately 10.7% of our then outstanding shares (excluding ordinary shares that were issuable upon exercise of a convertible note then held by Merhav).

As of December 31, 2005 and 2006, Mr. Josef Maiman beneficially held 599,744 ordinary shares, which were held of record by Integral, representing approximately 10.7% of our outstanding shares at such times (excluding ordinary shares that were issuable upon exercise of a convertible note then held by Merhav).

In May 2007, Mr. Josef Maiman elected to convert a convertible note held of record by Merhav for an aggregate 985,796 ordinary shares. As a result, Mr. Maiman's beneficial ownership interest increased to 1,585,540 ordinary shares, representing approximately 24.0% of our then outstanding shares, of which 985,796 are held of record by Merhav and 599,744 are held of record by Integral.

### Major Shareholders Voting Rights

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

### Record Holders

Based on a review of the information provided to us by our transfer agent, as of June 26, 2007, there were 21 holders of record of our ordinary shares, of which 12 record holders holding approximately 75% of our ordinary shares had registered addresses in the United States. These numbers are not representative of the number of beneficial holders of our shares nor are they representative of where such beneficial holders reside, since many of these ordinary shares were held of record by brokers or other nominees (including one U.S. nominee company, CEDE & Co., which held approximately 74.68% of our outstanding ordinary shares as of such date).

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## B. RELATED PARTY TRANSACTIONS

In 2003, we negotiated a new financing plan with our banks and controlling shareholder. As part of this financing plan, we issued a convertible note in the principal amount of \$500,000 to Merhav M.N.F. Ltd., or Merhav, an Israeli private company controlled by our controlling shareholder, Mr. Josef A. Maiman. In January 2004, pursuant to the terms of the note, Merhav converted \$200,000 of the amounts due and payable under the note into 606,060 ordinary shares of our company, and we issued a replacement convertible note to Merhav for the amount that remained outstanding under the original note at such date, in the principal amount of \$325,312.5. The note became due on May 15, 2007. The note bore interest at the rate of 10% per year, compounded on a quarterly basis. Under the terms of the note, Merhav had the right, at any time, to convert the note into ordinary shares of our company at a price of \$0.33 per ordinary share. We had the right, at our sole discretion, to repay the accrued interest or convert the accrued interest into ordinary shares at the foregoing price. On May 15, 2007, Mr. Maiman elected to convert the entire note into 985,796 ordinary shares. Upon the conversion of the note, we elected to repay the accrued interest on the principal amount of the convertible note to Merhav in the amount of \$128,000. During 2006, we recorded interest and exchange rate expenses of NIS 24,000 (\$5,680) on the convertible note.

## C. INTERESTS OF EXPERTS AND COUNSEL

Not applicable.

**ITEM 8. FINANCIAL INFORMATION**

**A. CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION**

See the consolidated financial statements, including the notes thereto, and the exhibits listed in Item 17 hereof and incorporated herein by this reference.

**Legal Proceedings**

In June 2002, an action was initiated by a former employee, citing an alleged breach of an agreement for the payment of royalties in exchange for the use of his invention. The plaintiff is seeking damages of NIS 1.0 million. We have denied all liability under this claim and asserted that no agreement was entered into between the parties, no compensation was agreed upon and that the amount of the claim is baseless. In April 2005, the court referred the parties to mediation proceedings. In 2006, we reached an agreement with the plaintiff according to which the claim has been cancelled.

Since the end of 2004, we have received a number of correspondence from one of our customers alleging that we have caused the customer to suffer damages between \$120,000 to \$500,000 due to our supplying allegedly defective PCBs. We do not agree with the customer's allegations and do not believe that we are responsible for such damages. To our knowledge, no lawsuit has been filed against us by the customer to date. o.k.

From time to time, claims arising in the ordinary course of our business are brought against us. In the opinion of management, no currently existing claims will have a material adverse effect on our financial position, liquidity or results of operations.

**Dividend Distributions Policy**

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

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

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**B. SIGNIFICANT CHANGES**

None.

**ITEM 9. THE OFFER AND LISTING**

**A. OFFER AND LISTING DETAILS**

*Annual Stock Information*

The following table sets forth, for each of the years indicated, the range of high ask and low bid prices of our ordinary shares on the NASDAQ Capital Market:

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Year	High	Low
2002	\$ 1.91	\$ 0.28
2003	\$ 1.84	\$ 0.31
2004	\$ 2.84	\$ 0.82
2005	\$ 6.40	\$ 1.21
2006	\$ 5.35	\$ 2.87

*Quarterly Stock Information*

The following table sets forth, for each of the full financial quarters in the two most recent full financial years and any subsequent period, the range of high ask and low bid prices of our ordinary shares on the NASDAQ Capital Market:

	High	Low
<b>2005</b>		
First Quarter	\$ 6.40	\$ 1.21
Second Quarter	\$ 4.50	\$ 1.62
Third Quarter	\$ 4.43	\$ 1.68
Fourth Quarter	\$ 4.75	\$ 3.61
<b>2006</b>		
First Quarter	\$ 5.35	\$ 3.79
Second Quarter	\$ 5.05	\$ 3.70
Third Quarter	\$ 4.25	\$ 2.87
Fourth Quarter	\$ 4.66	\$ 3.55
<b>2007</b>		
First Quarter	\$ 4.55	\$ 3.70

*Monthly Stock Information*

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

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	High	Low
<b>Month</b>		
December 2006	\$ 4.66	\$ 3.67
January 2007	\$ 4.30	\$ 3.88
February 2007	\$ 4.50	\$ 3.95
March 2007	\$ 4.55	\$ 3.70
April 2007	\$ 4.64	\$ 4.10
May 2007	\$ 4.70	\$ 4.29

**B. PLAN OF DISTRIBUTION**

Not applicable.

**C. MARKETS**

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

**D. SELLING SHAREHOLDERS**

Not applicable.

**E. DILUTION**

Not applicable.

**F. EXPENSE OF THE ISSUE**

Not applicable.

**ITEM 10. ADDITIONAL INFORMATION**

**A. SHARE CAPITAL**

Not applicable.

**B. MEMORANDUM AND ARTICLES OF ASSOCIATION**

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

**Purposes and Objects of the Company**

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

**The Powers of the Directors**

Under the provisions of the Israel Companies Law and our articles of association, a director cannot participate in a meeting nor vote on a proposal, arrangement or contract in which he or she is materially interested. In addition, our directors cannot vote compensation to themselves or any members of their body without the approval of our audit committee and our shareholders at a general meeting. The requirements for approval of certain transactions are set forth above in Item 6C. Directors, Senior Management and Employees Board Practices Approval of Related Party Transactions Under Israeli Law.

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

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

### **Rights Attached to Shares**

Our authorized share capital consists of NIS 30,000,000 divided into 50,000,000 ordinary shares of a nominal value of NIS 0.6 each. All outstanding ordinary shares are validly issued, fully paid and non-assessable. The rights attached to the ordinary shares are as follows:

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

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

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

Pursuant to our articles of association, our board of directors is divided into three classes (other than outside directors). Generally, at each annual meeting of shareholders one of such classes of directors is elected for a term of three years by a vote of the holders of a majority of the voting power represented and voting at such meeting. For information regarding the election of our outside directors, see Item 6C. Directors, Senior Management and Employees Board Practices Election of Directors.

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

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

**Limitations on any existing or prospective major shareholder.** See Item 6C. Directors and Senior Management Board Practices Approval of Related Party Transactions Under Israeli Law.

### **Changing Rights Attached to Shares**

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

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### **Annual and Extraordinary Meetings of Shareholders**

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

The quorum required for an ordinary meeting of shareholders consists of at least two shareholders present in person or represented by proxy who hold or represent, in the aggregate, at least 40% of the voting rights of the issued share capital. A meeting adjourned for lack of a quorum is adjourned by three business days, at the same time and place, or any time and place as the board of directors unanimously designate in a notice to the shareholders. The requisite quorum at an adjourned general meeting will be: (i) if the original meeting was convened upon requisition by shareholders pursuant to the Israeli Companies Law the number of shareholders holding the minimum number of voting shares necessary to make such requisition, present in person or by proxy; and (ii) in any other case one or more shareholders, present in person or by proxy, holding at least one share. We do not follow the requirements of the NASDAQ Marketplace Rules regarding the quorum for any meeting of the holders of common stock. See Item 6C. Directors, Senior Management and Employees Board Practices NASDAQ Marketplace Rules and Home Country Practices.

### **Limitations on the Rights to Own Securities in Our Company**

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

### **Provisions Restricting Change in Control of Our Company**

*Tender Offer.* A person wishing to acquire shares, or any class of shares, of a publicly traded Israeli company and who would as a result hold over 90% of the company's issued and outstanding share capital, or a class of shares, is required by the Israeli Companies Law to make a tender offer to all of the company's shareholders for the purchase of all of the remaining issued and outstanding shares of the company, or the class of shares, as the case may be. If the shareholders who do not respond to the offer hold less than 5% of the issued share capital of the company, or of the relevant class of shares, all of the shares that the acquirer offered to purchase will be transferred to the acquirer by operation of law. However, the shareholders may petition the court to determine the consideration for the acquisition if the consideration is less than the shares' fair value. If the dissenting shareholders hold more than 5% of the issued and outstanding share capital of the company, or of the relevant class of shares, as the case may be, the acquirer may not acquire additional shares of the company from shareholders who accepted the tender offer if following such acquisition the acquirer would own over 90% of the company's issued and outstanding share capital, or of the relevant class of shares.

The Israeli Companies Law provides that an acquisition of shares of a public company be made by means of a tender offer if as a result of the acquisition the purchaser would become the holder of a control block. Under the Israeli Companies Law shares conferring 25% or more of the voting rights in the company constitute a control block. The requirement for a tender offer does not apply if there is already another holder of a control block. 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 acquirer would hold more than 45% of the voting rights in the company, unless there is another person holding more than 45% of the voting rights in the company. These requirements do not apply if:

the acquisition was made in a private placement the object of which was to confer to the acquirer a control block where there is no holder of a control block, or to confer to the acquirer more than 45% of the voting rights in the company where there is no holder of more than 45% of the voting rights in the company, and the private placement received the general meeting's approval; or

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the acquisition was from the holder of a "control block" and resulted in the acquirer becoming the holder of a "control block"; or

the acquisition was from a shareholder holding more than 45% of the voting rights in the company and resulted in the acquirer becoming a holder of more than 45% of the voting rights in the company.

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

Under the Israeli Companies Law, if the approval of a general meeting of the shareholders is required, merger transactions may be approved by holders of a simple majority of the shares present and voting, in person or by proxy or by written ballot, at the general meeting convened to approve the transaction. If one of the merging companies, or a shareholder that holds 25% or more of the means of control of one of the merging companies, or a substantial shareholder, holds shares of the other merging company, then a dissenting vote of holders of the

majority of the shares of the other merging company present and voting, excluding shares held by the merging company or a substantial shareholder thereof, or by anyone acting on behalf of either of them, their relatives and corporations controlled thereby, is sufficient to reject the merger transaction. Means of control are defined as any of the following: (i) the right to vote at a general meeting of a company and (ii) the right to appoint a director of a company. If the transaction would have been approved but for the exclusion of the votes as previously indicated, a court may still approve the merger upon the request of holders of at least 25% of the voting rights of the company. The court will not approve a merger unless it is convinced that the merger is fair and reasonable, taking into account the values of the merging companies and the consideration offered to the shareholders. 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 the merged company. In addition, a merger may not be completed unless at least 50 days have passed from the date that a proposal for approval of the merger was filed with the Israeli Registrar of Companies and 30 days from the date that shareholder approval of both merging companies was obtained.

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

the merger does not require the alteration of the memorandum or articles of association of the acquiring company;

the acquiring company would not issue more than 20% of the voting rights thereof to the shareholders of the target company in the course of the merger and no person will become, as a result of the merger, a controlling shareholder of the acquiring company, on a fully diluted basis;

neither the target company, nor any shareholder that holds 25% of the means of control of the target company is a shareholder of the acquiring company; and

there is no person that holds 25% or more of the means of control in both companies.

#### **Disclosure of Shareholders Ownership**

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

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#### **Changes in Our Capital**

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

#### **C. MATERIAL CONTRACTS**

None.

#### **D. EXCHANGE CONTROLS**

Israeli law and regulations do not impose any material foreign exchange restrictions on non-Israeli holders of our ordinary shares.

Non-residents of Israel who purchase our ordinary shares will be able to convert dividends, if any, thereon, and any amounts payable upon our dissolution, liquidation or winding up, as well as the proceeds of any sale in Israel of our ordinary shares to an Israeli resident, into freely repatriable dollars, at the exchange rate prevailing at the time of conversion, provided that the Israeli income tax has been withheld (or paid) with respect to such amounts or an exemption has been obtained.

#### **E. TAXATION**

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

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

## ISRAELI TAX CONSIDERATIONS

### General Corporate Tax Structure

Israeli companies are subject to Corporate Tax on their worldwide income. The applicable rate for 2006 was 31%. The rate was reduced to 29% in 2007 and will be further reduced to 27% in 2008, 26% in 2009 and 25% in 2010 and thereafter. However, the effective rate of tax payable by a company which is qualified under Israeli law as an Industrial Company and/or which derives income from an approved enterprise or a benefited enterprise (as further discussed below) may be considerably lower. See this Item 10E. Additional Information Taxation Tax Benefits Under the Law for the Encouragement of Capital Investments, 1959.

As of December 31, 2006, we had approximately NIS 41.7 million (\$9.9 million) in tax loss carryforwards in Israel, which can be offset against future income in Israel without time limitation. In Israel, we have received final tax assessments through the 1995 tax year and the tax assessments we received for the 1996-2001 tax years are considered final due to the statute of limitations. Our principal foreign subsidiary, Kubatronik, has received final tax assessments through the 2003 tax year. Despite our accumulated profits in Israel during the three years ended December 31, 2006, we did not record a deferred tax asset in 2006 with respect to our profits generated in Israel due to uncertainty about our ability to utilize such tax asset in the foreseeable future. Such uncertainty is primarily due to the devaluation of the U.S. dollar against the NIS, our dependency on one major customer whose product is at the end of its lifecycle, the uncertainty of our being able to attract sufficient business to compensate for the loss of such a major customer, the fluctuations of the PCB industry and our history of losses. We recorded a tax expense of NIS 703,000 (\$166,000) in the year ended December 31, 2006, relating to the establishment of a valuation allowance on the deferred tax asset in respect of the loss carryforward of Kubatronik.

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### Tax Benefits Under the Law for the Encouragement of Industry (Taxes) 1969

Pursuant to the Law for the Encouragement of Industry (Taxes), 1969, or the Industry Law, a company qualifies as an Industrial Company if it is resident in Israel and at least 90% of its income in any tax year, determined in Israeli currency (exclusive of income from defense loans, capital gains, interest and dividends) is derived from an Industrial Enterprise it owns. An Industrial Enterprise is defined for purposes of the Industry Law as an enterprise whose majority activity in a given tax year is industrial production.

We believe that we are currently an Industrial Company. An Industrial Company is entitled to certain tax benefits, including a deduction of the purchase price of patents or certain other intangible property rights at the rate of 12.5% per annum.

The tax laws and regulations dealing with the adjustment of taxable income for local inflation provide that Industrial Enterprises, such as us, are eligible for special rates of depreciation deductions. These rates vary in the case of plant and machinery according to the number of shifts in which the equipment is being operated and generally range from 20% to 40% on a straight-line basis, a 30% to 50% on a declining balance basis for equipment first put into operation on or after June 1, 1989 (instead of the regular rates which are applied on a straight-line basis).

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

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



**Tax Benefits Under The Law for the Encouragement of Capital Investments, 1959**

**General**

Certain of our production facilities have been granted approved enterprise and benefited enterprise status pursuant to the Law for the Encouragement of Capital Investments, 1959, as amended, or the Investment Law, which provides certain tax and financial benefits to investment programs that have been granted such status. As of December 31, 2006, one benefited investment program is applicable to us, the period of tax benefits relating to which has not yet commenced, and will expire no later than 2017 (see below). The benefit period for all other programs (approved enterprises) expired in 2005.

The Israeli Investment Center has the discretion, within the funding limits set by the Government budget, to grant the status of an approved enterprise to projects submitted to it if such projects may promote the objectives of the Investment Law and it is desirable to encourage the implementation of the project by the grant of the approval.

The Investment Law provides that capital investments in production facilities (or other eligible facilities) may, upon application to the Israeli Investment Center, be designated as an approved enterprise. Each instrument of approval for an approved enterprise relates to a specific investment program, delineated both by the financial scope of the investment, including sources of funds, and by the physical characteristics of the facility or other assets.

In April 2005, the Israeli legislature passed an amendment to the Investment Law in which it revised the criteria for investments qualified to receive tax benefits not involving a government grant, referred to as a benefited enterprise. The primary changes are as follows:

Companies that meet the criteria of the alternative package of tax benefits track will receive those benefits without need for prior approval, rather, a company may claim the tax benefits offered by the Investment Law directly in its tax returns. In addition, there will be no requirement to file reports with the Investment Center. Audits will be the responsibility of the Income Tax Authorities as part of their tax audits. Companies may also approach the Israeli Tax Authority for a pre-ruling regarding its eligibility for benefits under the April 2005 amendment.

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Tax benefits of the alternative benefits track include lower tax rates or no tax depending on the area and the track chosen, lower tax rates on dividends and accelerated depreciation.

In order to receive benefits in the grant track or the alternative benefit track, the industrial enterprise must contribute to the economic independence of the Israeli economy, be competitive (as defined in the April 2005 amendment) and contribute to the gross local product in one of the manners stipulated in the amended Investment Law. Tax benefits would be available, subject to certain conditions (described below), to production facilities that generally derive more than 25% of their annual revenue from export, or that do not derive 75% or more of their annual revenue in a single market.

Upon the establishment of an enterprise, an investment of at least NIS 300 thousand in production machinery and equipment within three years is required in order for the investment to qualify for the alternative benefits track. For an expansion of an enterprise under the alternative benefits track, a company is required to invest within three years in production machinery and equipment the greater of NIS 300 thousand or a certain percentage of its existing production machinery and equipment.

The April 2005 amendment to the Investment Law generally does not apply to investment programs having an approved enterprise approval certificate from the Investment Center issued prior to December 31, 2004.

On September 20, 2006, we received a ruling from the Israeli Tax Authority approving our most recent investment plan as a benefited enterprise in lieu of the former approved enterprise status. Pursuant to such ruling, the former approved enterprise status of that investment plan was terminated by the Investment Center.

The benefited enterprise status granted to our investment plan provides for a tax exemption on undistributed earnings derived from the program for two years and a reduced tax rate for the remainder of the benefit period (see below). The benefit period with respect to such program has not yet commenced, and will expire no later than 2017.

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The tax benefits available under any instrument of approval relate only to taxable profits attributable to the specific program and are contingent upon meeting the criteria set out in the instrument of approval.

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

Subject to certain provisions concerning income subject to the alternative package of tax benefits (see below), any distributed dividends are deemed attributable to the entire enterprise, and the effective tax rate represents the weighted combination of the various applicable tax rates. A company may elect to attribute dividends distributed by it only to income not subject to the alternative package of tax benefits.

### *Tax Benefits*

Income derived from an approved enterprise is subject to corporate tax at the reduced rate of 25% (or lower in the case of a qualified foreign investor's company which is at least 49% owned by non-Israeli residents) until the earlier of (i) seven (or ten in the case of a foreign investor's company) consecutive years, commencing in the year in which the specific approved enterprise first generates taxable income (which income is not offset by deductions attributable to other sources), (ii) 12 years from the year of commencement of production or (iii) 14 years from the year of approval of the approved enterprise status. Income derived from an approved enterprise in Zone A, which is approved after January 1, 1997, is exempt from corporate tax for a period of two years and is subject to the above rates for the balance of the benefit period.

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A company owning an approved enterprise, which was approved after April 1, 1986, and before December 31, 2004 could elect to forego the entitlement to grants and to certain tax benefits otherwise available under the Investment Law, and apply for an alternative package of tax benefits. Qualified investments which were not approved before January 1, 2005 and meet the criteria of the alternative package of tax benefits track will receive the benefits without need for prior approval.

Under the alternative package of tax benefits, undistributed income from the approved enterprise is fully tax-exempt for a defined period. The tax exemption for approval granted prior to August 6, 1996 range between 2 and 10 years, depending principally upon the geographic location within Israel and the type of the approved enterprise. If the certificate of approval was granted after August 6, 1996, the tax exemption will be based upon the geographic location of the approved enterprise in Israel. On expiration of the tax exemption, the approved enterprise is eligible for the beneficial tax rate (25% or less in the case of a qualified foreign investor's company which is at least 49% owned by non-Israeli residents) for the remainder of the applicable period of benefits, as described above.

The tax benefits available to benefited enterprises are: (1) benefited enterprise situated in zone A may choose between (a) limited corporate tax rate of 11.5%; and (b) tax exemption from corporate tax on undistributed income; (2) benefited enterprise qualified as strategic investments is entitled to a tax exemption; (3) benefited enterprise situated in zone B or elsewhere (zone C) is entitled to tax exemption on undistributed income for six or two years, respectively, and to beneficial tax rate (25% or less in the case of a qualified foreign investor's company which is at least 49% owned by non-Israeli residents) for the remainder of the applicable period of benefits. Our plant is located in zone C.

Dividends paid out of income derived from an approved enterprise or benefited enterprise (or out of dividends received from a company whose income is derived from an approved enterprise or benefited enterprise) are generally subject to withholding tax at the rate of 15% (deductible at source). The rate of 15% is limited to dividends and distributions out of income derived during the benefits period and actually paid at any time up to 12 years thereafter. A company which elects the alternative package of tax benefits will be subject to corporate tax at the otherwise applicable rate of 25% (or lower in the case of a qualified foreign investor's company which is at least 49% owned by non-Israeli residents) in respect of the gross amount of the dividend if it pays a dividend out of income derived from its approved enterprise or benefited enterprise during the tax exemption period. Dividends paid to a qualifying non-resident out of the profits of benefited enterprise subject to 11.5% corporate tax are subject to withholding tax at the rate of 4%.

The tax benefits available to an approved enterprise and a benefited enterprise relate only to taxable income attributable to that specific enterprise and are contingent upon the fulfillment of the conditions stipulated by the Investment Law, the regulations published thereunder and the instruments of approval for the specific investments in the approved enterprises. In the event of our failure to comply with these conditions, the tax and other benefits could be rescinded, in whole or in part, and we might be required to refund the amount of the canceled benefits, with the addition of the Israeli consumer price index linkage differences and interest.

A company that qualifies as a foreign investor's company is entitled to further tax benefits relating to its approved enterprises and benefited enterprises. Subject to certain conditions, a foreign investor company is a company more than 25% of whose share capital (in terms of shares, rights to profits, voting and appointment of directors), and of whose combined share and loan capital, is owned, directly or indirectly, by persons who are not residents of Israel. Such a company with a foreign investment of over 25% will be eligible for an extension of the period of tax benefits for its approved and benefited enterprises (up to ten years) and further tax benefits (a reduced corporate tax rate of 10%-20%) should the foreign investment reach or exceed 49%. The rate of 15% applicable to dividends is effective for an unlimited period. No assurance can be given that we currently qualify or will qualify in the future as a foreign investor's company.

### ***Financial Benefits***

An approved enterprise is also entitled to a grant from the Government of Israel with respect to investments in certain production facilities located in designated areas within Israel, provided it did not elect the alternative package of tax benefits. Grants are available for enterprises situated in development areas and for high technology or skill-intensive enterprises in Jerusalem. An investment grant is computed as a percentage of the original costs of the fixed assets for which approved enterprise status has been granted.

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The termination or substantial reduction of any of the benefits available under the Investment Law could have a material adverse effect on our future investments in Israel.

### **Taxation Under Inflationary Conditions**

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

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

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

### **Capital Gains Tax and Taxation of Dividends**

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

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

Subject to certain transitional provisions relating to capital gains derived from the sale of assets, including our shares, purchased prior to January 1, 2003, the tax rate on capital gains, including capital gain from the sale of securities listed on a stock exchange, is generally a uniform rate of 20% for individuals and 25% for corporate bodies and substantial individual shareholders (who are, generally, shareholders of 10% or more of the shares of the company on the date of the sale of the shares or at any date during the 12 months before the sale). The tax rate on dividends is generally a uniform rate of 20% for individuals and non-resident corporate shareholders and 25% for substantial individual and substantial non-resident corporate shareholders. Dividends paid to an Israeli company by another Israeli company are not subject to tax, unless received out of income derived from approved enterprises or stems from income derived or accrued outside of Israel.

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

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For residents of other countries, the purchaser of the shares may be required to withhold capital gains tax on all amounts received for the sale of our ordinary shares, for so long as the capital gain from such a sale is not exempt from Israeli capital gains tax, and unless a different rate is provided in a treaty between Israel and the stockholder's country of residence.

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

If the shares were sold by Israeli residents, then (i) for the period ending December 31, 2002 their sale would be tax exempt so long as (1) the shares were listed on a stock exchange, such as, in our case, the NASDAQ Capital Market, which is recognized by the Israeli Ministry of Finance on December 31, 2002, and (2) we qualified as an Industrial Company or Industrial Holding Company under the law for Encouragement of Industry (Taxes) 1969, at the relevant times as provided by the Income Tax Ordinance [New Version], 1961, which we believe we so qualified and (ii) for the period commencing January 1, 2003, the sale of the shares would be, generally, subject to a 20% tax if sold by non-substantial individual shareholders and 25% tax if sold by a corporate body or a substantial individual shareholders. We cannot provide any assurance that the Israeli tax authorities will agree with the determination that we qualified as an Industrial Company at the relevant times.

On the distribution of dividends other than bonus shares (stock dividends) to individual Israeli residents shareholders or to non-Israeli shareholders, income tax applies at the rate of 20% or 25%, as described above, but is generally withheld at source at the rate of 20% (for as long as we are listed) or the lower rate payable with respect to dividends received out of income derived from approved enterprises (see Law for the Encouragement of Capital Investments, 1959 ), unless a double taxation treaty is in effect between Israel and the shareholder's country of residence which provides for a lower tax rate in Israel on dividends. The Convention between the State of Israel and the Government of the United States relating to relief from double taxation provides for a maximum tax of 25% on dividends paid to a resident of the United States. Dividends paid to an Israeli company by another Israeli company are not subject to corporate tax, unless received out of income derived from approved enterprises or unless the dividend stems from income produced or accrued abroad.

#### **Taxation of Non-Resident Holders of Shares**

Non-residents of Israel are subject to income tax on income accrued or derived from sources in Israel. Such sources of income include passive income such as dividends, royalties and interest, as well as non-passive income from services rendered in Israel. On distributions of dividends other than bonus shares or stock dividends, income tax at the rate of 20% (or 25% as described above), 12.5% for dividends not generated by an approved enterprise if the non-resident is a U.S. corporation and holds 10% of our voting power for a designated period, and 15% for dividends generated by an approved enterprise applies, unless a different rate is provided for based on a treaty between Israel and the shareholder's country of residence. Under the U.S.-Israel Tax Treaty, the maximum tax on dividends paid to a holder of ordinary shares who is a Treaty U.S. Resident will be 25%. However, under the Investment Law, dividends generated by an approved enterprise or benefited enterprise are, generally, taxed at the rate of 15%.

Subject to certain conditions, non-Israeli residents will be tax exempt on capital gain derived from investments in Israeli companies made within the period commencing July 1, 2005 through December 31, 2008, even if the capital gain was derived after such period and without derogating from any other capital gain tax exemption applying to non-Israeli resident under Israeli law or under any applicable double tax treaty.

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**Foreign Exchange Regulation and Withholding Taxes**

Non-residents of Israel who purchase ordinary shares and receive dividends, if any are declared, or any amounts payable upon the dissolution, liquidation or winding up of our affairs will be able to freely repatriate such amounts in non-Israeli currencies, pursuant to the general permit issued by the Controller of Foreign Currency at the Bank of Israel under the Currency Control Law, 1978, provided that we have withheld Israeli income tax with respect to such amounts, as may be applicable.

Under the general permit issued by the Controller of Foreign Currency, Israeli residents, including corporations, may generally purchase securities, including the ordinary shares, outside of Israel.

**UNITED STATES FEDERAL INCOME TAX CONSEQUENCES**

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

- broker-dealers,
- financial institutions,
- certain insurance companies,
- regulated investment companies,
- investors liable for alternative minimum tax,
- tax-exempt organizations,
- non-resident aliens of the U.S. or taxpayers whose functional currency is not the U.S. dollar,
- persons who hold the ordinary shares through partnerships or other pass-through entities,
- investors that actually or constructively own, or have owned, 10 percent or more of our voting shares, and
- investors holding ordinary shares as part of a straddle or appreciated financial position or a hedging or conversion transaction.

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

This summary does not address the effect of any U.S. federal taxation other than U.S. federal income taxation. In addition, this summary does not include any discussion of state, local or foreign taxation. You are urged to consult your tax advisors regarding the foreign and United States federal, state and local tax considerations of an investment in ordinary shares.

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

- an individual who is a citizen or, for U.S. federal income tax purposes, a resident of the United States;

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a corporation, or other entity treated as a corporation, created or organized in or under the laws of the United States or any political subdivision thereof;

an estate whose income is subject to U.S. federal income tax regardless of its source; or

a trust that (a) is subject to the primary supervision of a court within the United States and the control of one or more U.S. persons or (b) has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person.

### Taxation of Dividends

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

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

Subject to complex limitations, any Israeli withholding tax imposed on such dividends will be a foreign income tax eligible for credit against a U.S. Holder's U.S. federal income tax liability, subject to certain limitations set out in the Code (or, alternatively, for deduction against income in determining such tax liability). The limitations set out in the Code include computational rules under which foreign tax credits allowable with respect to specific classes of income cannot exceed the U.S. federal income taxes otherwise payable with respect to each such class of income. Dividends generally will be treated as foreign-source passive income category or general category income for United States foreign tax credit purposes. A U.S. Holder will be denied a foreign tax credit with respect to Israeli income tax withheld from dividends received on the ordinary shares to the extent such U.S. Holder has not held the ordinary shares for at least 16 days of the 31-day period beginning on the date which is 15 days before the ex-dividend date or to the extent such U.S. Holder is under an obligation to make related payments with respect to substantially similar or related property. Any days during which a U.S. Holder has substantially diminished its risk of loss on the ordinary shares are not counted toward meeting the 16-day holding period required by the statute. Further, there are special rules for computing the foreign tax credit limitation of a taxpayer who receives dividends subject to a reduced tax rate. The rules relating to the determination of the foreign tax credit are complex, and you should consult with your personal tax advisors to determine whether and to what extent you would be entitled to this credit.

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Subject to certain limitations, qualified dividend income received by a noncorporate U.S. Holder in tax years beginning on or before December 31, 2010 will be subject to tax at a reduced maximum tax rate of 15 percent. Distributions taxable as dividends paid on the ordinary shares should qualify for the 15 percent rate provided that either: (i) we are entitled to benefits under the income tax treaty between the United States and Israel (the *Treaty*) or (ii) the ordinary shares are readily tradable on an established securities market in the United States and certain other requirements are met. We believe that we are entitled to benefits under the *Treaty* and that the ordinary shares currently are readily tradable on an established securities market in the United States. However, no assurance can be given that the ordinary shares will remain readily tradable. The rate reduction does not apply unless certain holding period requirements are satisfied. With respect to the ordinary shares, the U.S. Holder must have held such shares for at least 61 days during the 121-day period beginning 60 days before the ex-dividend date. The rate reduction also does not apply to dividends received from passive foreign investment companies, see discussion below, or in respect of certain hedged positions or in certain other situations. U.S. Holders of ordinary shares should consult their own tax advisors regarding the effect of these rules in their particular circumstances.

### Disposition of Ordinary Shares

If you sell or otherwise dispose of ordinary shares, you will recognize gain or loss for U.S. federal income tax purposes in an amount equal to the difference between the amount realized on the sale or other disposition and the adjusted tax basis in ordinary shares. Subject to the discussion below under the heading *Passive Foreign Investment Companies*, such gain or loss generally will be capital gain or loss and will be

long-term capital gain or loss if you have held the ordinary shares for more than one year at the time of the sale or other disposition. In general, any gain that you recognize on the sale or other disposition of ordinary shares will be U.S.-source for purposes of the foreign tax credit limitation; losses will generally be allocated against U.S. source income. Deduction of capital losses is subject to certain limitations under the Code.

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

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

### Passive Foreign Investment Companies

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

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

If we are treated as a PFIC for any taxable year, dividends would not qualify for the reduced maximum tax rate, and, unless you elect either to treat your investment in ordinary shares as an investment in a qualified electing fund, or a QEF election, or to mark-to-market your ordinary shares, as described below:

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

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

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

you would be required to make an annual return on IRS Form 8621 regarding distributions received with respect to ordinary shares and any gain realized on your ordinary shares.

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

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

### **Backup Withholding and Information Reporting**

Payments in respect of ordinary shares may be subject to information reporting to the U.S. Internal Revenue Service and to U.S. backup withholding tax at a rate equal to the fourth lowest income tax rate applicable to individuals which, under current law, is 28%. Backup withholding will not apply, however, if you (i) are a corporation or come within certain exempt categories, and demonstrate the fact when so required, or (ii) furnish a correct taxpayer identification number and make any other required certification.

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

### **F. DIVIDENDS AND PAYING AGENTS**

Not applicable.

### **G. STATEMENT BY EXPERTS**

Not applicable.

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### **H. DOCUMENTS ON DISPLAY**

We are subject to the reporting requirements of the United States Securities Exchange Act of 1934, as amended, as applicable to foreign private issuers as defined in Rule 3b-4 under the Exchange Act, and in accordance therewith, we file annual and interim reports and other information with the Securities and Exchange Commission.

As a foreign private issuer, we are exempt from certain provisions of the Exchange Act. Accordingly, our proxy solicitations are not subject to the disclosure and procedural requirements of Regulation 14A under the Exchange Act, transactions in our equity securities by our officers and directors are exempt from reporting and the short-swing profit recovery provisions contained in Section 16 of the Exchange Act. In addition, we are not required under the Exchange Act to file periodic reports and financial statements as frequently or as promptly as U.S. companies whose securities are registered under the Exchange Act. However, we distribute annually to our shareholders an annual report containing financial statements that have been examined and reported on, with an opinion expressed by, an independent registered public accounting firm, and we file reports with the Securities and Exchange Commission on Form 6-K containing (among other things) press releases and unaudited financial information.

This annual report and the exhibits thereto and any other document we file pursuant to the Exchange Act may be inspected without charge and copied at prescribed rates at the following Securities and Exchange Commission public reference rooms at 100 F Street, N.E., Room 1580, Washington, D.C. 20549 and on the Securities and Exchange Commission Internet site (<http://www.sec.gov>) and on our website [www.eltekglobal.com](http://www.eltekglobal.com). You may obtain information on the operation of the Securities and Exchange Commission's public reference room in Washington, D.C. by calling the Securities and Exchange Commission at 1-800-SEC-0330. The Exchange Act file number for our Securities and Exchange Commission filings is 0-28884.



The documents concerning our company which are referred to in this annual report may also be inspected at our offices located at Sgoola Industrial Zone, Petach Tikva 49101, Israel.

**I. SUBSIDIARY INFORMATION**

Not applicable.

**ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISKS**

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

**Foreign Currency Exchange Risk**

We record our revenues and expenses in NIS. Our revenues are generally denominated in foreign currencies, primarily the U.S. dollar and Euro, while our expenses are primarily denominated in NIS, U.S. dollars, Euros, dollar-linked NIS and Euro-linked NIS. As a result, fluctuations in rates of exchange between NIS and non-NIS currencies may affect our operating results and financial condition. The NIS value of our U.S. dollar and Euro revenues decline if the NIS devaluates against the dollar and Euro. In addition, our expenses other than those paid in Israeli currency that are not-linked to other currencies are influenced by the devaluation of the NIS in relation to the U.S. dollar and the Euro. The NIS value of our U.S. dollar and Euro expenses increase if the NIS devaluates against the dollar and the Euro and other currencies other than NIS. In 2006, the U.S. dollar devaluated against the NIS by 8.2%.

We have engaged external consultants to assist us to manage our foreign exchange risk. From time to time in the past we have engaged in hedging transactions in order to partially protect ourselves from currency fluctuation and inflation risks and may use hedging instruments from time to time in the future.

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**Interest Rate Risk**

Our exposure to market risk for changes in interest rates relates primarily to our short-term credit lines, our non-linked and U.S. dollar linked long-term loans and our factoring agreement. These are principally denominated in (i) NIS and bear annual interest ranging from 6.95% to 7.10% as of December 31, 2006; and (ii) U.S. dollars and bear interest of 7.38% as of December 31, 2006. For purposes of specific risk analysis, we use sensitivity analysis to determine the impact that market risk exposure may have on the financial expenses derived from our short-term credit lines, long-term loans and factoring agreement. Our potential loss over one year that would result from a hypothetical change of 1% in the interest rate would be approximately \$58,000.

**ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES**

Not applicable.

**PART II**

**ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES**

None.

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

None.

**ITEM 15. CONTROLS AND PROCEDURES**

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

**ITEM 15T. CONTROLS AND PROCEDURES**

Not applicable.

**ITEM 16. [RESERVED]**

**ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT**

Our Board of Directors has determined that Mr. Eliyaho Tov, an outside director, meets the definition of an audit committee financial expert, as defined by rules of the Securities and Exchange Commission. For a brief listing of Mr. Tov's relevant experience, see Item 6.A. Directors, Senior Management and Employees - Directors and Senior Management.

**ITEM 16B. CODE OF ETHICS**

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

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**ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

**Fees Paid to Independent Registered Public Accountants**

The following table sets forth, for each of the years indicated, the fees paid to our independent registered public accountants, Somekh Chaikin, a member firm of KPMG International. All of such fees were pre-approved by our Audit Committee.

**Year Ended December 31,**

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Fees Paid to Independent Registered Public Accountants

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Services Rendered	Year Ended December 31,	
	2005	2006
Audit (1)	NIS 511	NIS 715
Tax (2)	28	25
Total	NIS 539	NIS 740

- (1) Audit fees relate to services that are normally provided in connection with statutory and regulatory filings or engagements, including services that generally only the independent registered public accounting firm can reasonably provide.
- (2) Tax fees relate to services performed by the tax division for tax compliance, planning and advice.

### Pre-Approval Policies and Procedures

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

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

Not applicable.

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

#### Issuer Purchase of Equity Securities

Neither we nor any affiliated purchaser has purchased any of our securities during 2006.

## PART III

### ITEM 17. FINANCIAL STATEMENTS

#### Consolidated and Company Financial Statements.

Report of Independent Registered Public Accounting Firm	F-1
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Consolidated and Company Consolidated Statements of Cash Flows

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Notes to the Consolidated and Company Financial Statements

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**ITEM 18. FINANCIAL STATEMENTS**

Not applicable.

**ITEM 19. EXHIBITS****Index to Exhibits**

<u>Exhibit</u>	<u>Description</u>
1.1	Memorandum of Association of the Registrant (1)
1.2	Articles of Association of the Registrant, as amended (2)
2.1	Specimen of Share Certificate (1)
4.1	Indemnity Agreement provided to Arieh Reichart dated December 5, 1996 and a schedule of similar indemnity agreements provided by the Registrant to its officers and directors (1)
4.2	2000 Stock Option Plan (3)
4.3	2005 Stock Option Plan (4)
4.4	Services Factoring Agreement dated July 8, 2003 (5)
4.5	Share Purchase Agreement between En-Eltek Netherlands 2000 B.V., Kubatronik-Leiterplatten GmbH, Mr. Alois Kubat, Mr. Thomas Kubat and Ms. Heike Heidenreich dated June 10, 2002 (6)
4.6	Extension of Put/Call Option Agreement among En-Eltek Netherlands 2000 B.V. and Mr. Alois Kubat dated May 4, 2005 (7)
8.1	List of Subsidiaries of the Registrant
12.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended
12.2	Certification by Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended
13.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
13.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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15.1 Consent of Somekh Chaikin, a member firm of KPMG International

- 
- (1) Filed as an exhibit to our registration statement on Form F-1, registration number 333-5770, as amended, filed with the Securities and Exchange Commission and incorporated herein by reference.
  - (2) Filed as Exhibit 3.2 to our Annual Report on Form 20-F for the year ended December 31, 2003 and incorporated herein by reference.
  - (3) Filed as Exhibit 10.4 to our Annual Report on Form 20-F for the year ended December 31, 2000 and incorporated herein by reference.

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- (4) Filed as Appendix A to the Proxy Statement for our 2005 Annual General Meeting of Shareholders filed on Report of Foreign Private Issuer on Form 6-K for the month of November 2005, and incorporated herein by reference.
  - (5) Filed as Exhibit 10.5 to our Annual Report on Form 20-F for the year ended December 31, 2002 and incorporated herein by reference.
  - (6) Filed as Exhibit 4.5 to our Annual Report on Form 20-F for the year ended December 31, 2004 and incorporated herein by reference.
  - (7) Filed as Exhibit 4.6 to our Annual Report on Form 20-F for the year ended December 31, 2004 and incorporated herein by reference.

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Eltek Ltd.

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**Consolidated and Company Financial Statements as of December 31, 2006**

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<u>Consolidated and Company Statements of Changes in Shareholders' Equity for each of the years ended December 31, 2004, 2005 and 2006</u>	F-5
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**Report of Independent Registered Public Accounting Firm**

**The Board of Directors and Shareholders  
Eltek Ltd.**

We have audited the accompanying balance sheets of Eltek Ltd. (the Company) and the consolidated balance sheets of the Company and its subsidiaries as of December 31, 2005 and 2006 and the related consolidated and Company statements of operations, changes in shareholders equity, and cash flows, for each of the years in the three-year period ended December 31, 2006. These Company and consolidated financial statements are the responsibility of the Company's Board of Directors and its Management. Our responsibility is to express an opinion on these consolidated and Company 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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Board of Directors and Management, as well as 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 financial position of the Company and of the Company and its subsidiaries as of December 31, 2005 and 2006 and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2006, in conformity with generally accepted accounting principles in Israel.

As discussed in Note 2C to these financial statements, the aforementioned financial statements are stated in reported amounts, in accordance with the accounting standards of the Israel Accounting Standard Board.

Generally accepted accounting principles in Israel vary in certain significant respects from U.S. generally accepted accounting principles. Information relating to the nature and effect of such differences with respect to the financial statements of the Company and of the Company and its subsidiaries is summarized in Note 29 to these financial statements.

As discussed in Note 2E to the consolidated financial statements effective January 1, 2006, the company applies Israeli Accounting Standard No. 20 (Revised) The Accounting Treatment of Goodwill and Intangible Asset with indefinite useful lives when Purchasing on Investee .

As discussed in Note 2O to the consolidated financial statement effective January 1, 2006, the Company applies Israeli Accounting Standard No. 22 Financial Instruments: Disclosure and Presentation .

As discussed in Note 2S to the consolidated financial statement, effective January 1, 2006 the Company applies Israeli Accounting Standard No. 21 Earnings per share .

/s/ Somekh Chaikin  
Somekh Chaikin  
Certified Public Accountants (Isr.)  
Member Firm of KPMG International

Tel Aviv, Israel  
June 27, 2007

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Eltek Ltd.

**Balance Sheets - Consolidated and Company**

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**Reported amounts (Note 2(B))**

Report of Independent Registered Public Accounting Firm The Board of Directors and Shareholders Eltek Ltd.

	Note	Consolidated		Company		Convenience translation into US Dollars Consolidated (Note 2H)
		December 31 2005	December 31 2006	December 31 2005	December 31 2006	December 31 2006
		NIS in thousands				
<b>Assets</b>						
<b>Current assets</b>						
Cash and cash equivalents	3	7,258	<b>8,576</b>	5,773	<b>7,796</b>	<b>2,030</b>
Receivables:						
Trade	4	* 22,990	<b>32,562</b>	* 21,704	<b>31,119</b>	<b>7,707</b>
Other	5	* 1,926	<b>1,103</b>	* 2,037	<b>2,321</b>	<b>261</b>
Inventories	6	16,051	<b>15,910</b>	13,991	<b>13,055</b>	<b>3,766</b>
Prepaid expenses		986	<b>813</b>	910	<b>735</b>	<b>192</b>
<b>Total current assets</b>		<b>49,211</b>	<b>58,964</b>	<b>44,415</b>	<b>55,026</b>	<b>13,956</b>
<b>Deferred taxes</b>	24	697	-	-	-	-
<b>Long-term investments</b>	7	-	-	8,627	<b>7,863</b>	-
<b>Property and equipment, net</b>	8	32,969	<b>34,997</b>	29,918	<b>32,008</b>	<b>8,283</b>
<b>Goodwill</b>	1; 9	3,735	<b>3,816</b>	-	-	<b>903</b>
<b>Total assets</b>		<b>86,612</b>	<b>97,777</b>	<b>82,960</b>	<b>94,897</b>	<b>23,142</b>

\* Reclassified

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

## Balance Sheets - Consolidated and Company

## Reported amounts (Note 2(B))

	Note	Consolidated		Company		Convenience translation Consolidated (Note 2H)
		December 31 2005	December 31 2006	December 31 2005	December 31 2006	December 31 2006
						Unaudited
						US\$ in thousands
						NIS in thousands
<b>Liabilities and shareholders' equity</b>						
<b>Current liabilities</b>						
Short-term credit and current maturities of long-term debts	10	17,561	<b>11,731</b>	17,561	<b>11,731</b>	<b>2,776</b>
Trade payables	11	25,176	<b>25,100</b>	24,273	<b>24,418</b>	<b>5,942</b>
Other liabilities and accrued expenses	12	10,914	<b>12,539</b>	9,843	<b>11,834</b>	<b>2,968</b>
Convertible debenture note	16	-	<b>1,844</b>	-	<b>1,844</b>	<b>436</b>
Total current liabilities		53,651	<b>51,214</b>	51,677	<b>49,827</b>	<b>12,122</b>
<b>Long-term liabilities</b>						
Long-term debts, excluding current maturities	13	7,607	<b>12,962</b>	7,607	<b>12,962</b>	<b>3,068</b>
Employee severance benefits, net	14	274	<b>344</b>	143	<b>163</b>	<b>82</b>
Total long-term liabilities		7,881	<b>13,306</b>	7,750	<b>13,125</b>	<b>3,150</b>
Minority interests		1,547	<b>1,312</b>	-	-	<b>310</b>
<b>Convertible debenture note</b>	16	1,820	-	1,820	-	-
<b>Commitments and contingent liabilities</b>	15					
<b>Shareholders' equity</b>	17					
Ordinary shares, NIS 0.6 par value						
Authorized 50,000,000 shares, issued and outstanding 5,624,011 shares as of December 31, 2006 (5,602,511 shares as of December 31, 2005)		29,765	<b>29,778</b>	29,765	<b>29,778</b>	<b>7,048</b>
Additional paid-in capital		54,553	<b>54,981</b>	54,553	<b>54,981</b>	<b>13,013</b>
Capital reserves related to loans from controlling shareholders		10,010	<b>10,010</b>	10,010	<b>10,010</b>	<b>2,369</b>



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	Consolidated		Company		Convenience translation Consolidated (Note 2H)
Cumulative foreign currency translation adjustments	1,916	<b>2,093</b>	1,916	<b>2,093</b>	<b>495</b>
Capital reserves	6,685	<b>6,685</b>	6,685	<b>6,685</b>	<b>1,582</b>
Accumulated deficit	(81,216)	<b>(71,602)</b>	(81,216)	<b>(71,602)</b>	<b>(16,947)</b>
<b>Total shareholders' equity</b>	<b>21,713</b>	<b>31,945</b>	<b>21,713</b>	<b>31,945</b>	<b>7,560</b>
Total liabilities and shareholders' equity	86,612	<b>97,777</b>	82,960	<b>94,897</b>	<b>23,142</b>

/s/ Amnon Shemer

/s/ Nissim Gilam

Arieh Reichart  
President, Chief Executive Officer

Amnon Shemer  
Chief Financial Officer

Nissim Gilam  
Chairman of the board of directors

Date: June 27, 2007

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

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Eltek Ltd.

Statements of Operations - Consolidated and Company

Reported amounts (Note 2(B))

	Note	Consolidated			Company			Convenience Translation into US Dollars (Note 2H)
								Consolidated
		Year ended December 31 2004	Year ended December 31 2005	Year ended December 31 2006	Year ended December 31 2004	Year ended December 31 2005	Year ended December 31 2006	Year ended December 31 2006
Revenues	18	125,002	144,429	<b>173,944</b>	108,785	128,459	<b>154,711</b>	<b>41,171</b>
Cost of revenues	19	(109,998)	(115,733)	<b>(136,526)</b>	(95,331)	(102,242)	<b>(121,038)</b>	<b>(32,313)</b>
Gross profit		15,004	28,696	<b>37,418</b>	13,454	26,217	<b>33,673</b>	<b>8,858</b>

NIS in thousands, (except earnings (loss) per NIS 1 par value of share capital)

Unaudited  
US\$ in thousands

								Convenience Translation into US Dollars (Note 2H)
Research and development expenses, net	20	-	(646)	<b>(687)</b>	-	(646)	<b>(687)</b>	<b>(163)</b>
Selling, general and administrative expenses	21	(18,265)	(19,862)	<b>(24,308)</b>	(15,054)	(16,361)	<b>(20,028)</b>	<b>(5,754)</b>
Amortization of goodwill	9	(593)	(593)	-	-	-	-	-
Operating income (loss)		(3,854)	7,595	<b>12,423</b>	(1,600)	9,210	<b>12,958</b>	<b>2,941</b>
Financial expenses, net	22	(2,948)	(2,656)	<b>(2,396)</b>	(2,281)	(2,381)	<b>(2,355)</b>	<b>(568)</b>
Other income (expenses), net	23	52	103	<b>24</b>	43	111	<b>(9)</b>	<b>6</b>
Income (loss) before tax benefit (expenses)		(6,750)	5,042	<b>10,051</b>	(3,838)	6,940	<b>10,594</b>	<b>2,379</b>
Tax benefit (expenses)	24	713	-	<b>(703)</b>	-	-	-	<b>(166)</b>
Income (loss) after tax benefit (expenses)		(6,037)	5,042	<b>9,348</b>	(3,838)	6,940	<b>10,594</b>	<b>2,213</b>
Company's share in losses of subsidiaries, net	7	-	-	-	(2,017)	(1,680)	<b>(980)</b>	-
Minority interests		182	218	<b>266</b>	-	-	-	<b>63</b>
Net income (loss)		(5,855)	5,260	<b>9,614</b>	(5,855)	5,260	<b>9,614</b>	<b>2,276</b>
Basic net earnings (loss) per share		* (1.07)	* 0.94	<b>1.71</b>	* (1.07)	* 0.94	<b>1.71</b>	<b>0.41</b>
Diluted net earnings (loss) per share		* (1.07)	* 0.81	<b>1.39</b>	* (1.07)	* 0.81	<b>1.39</b>	<b>0.33</b>
Weighted average shares used to compute basic net earnings (loss) per share		5,492	5,575	<b>5,617</b>	5,492	5,575	<b>5,617</b>	<b>5,617</b>
Weighted average shares used to compute diluted net earnings (loss) per share		5,492	6,785	<b>6,954</b>	5,492	6,785	<b>6,954</b>	<b>6,954</b>

\* Restated, see Note 2S.

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

### Statements of Changes in Shareholders' Equity - Consolidated and Company

#### Reported amounts (Note 2(B))

Number of ordinary Shares*	Ordinary shares	Additional paid-in capital	Capital reserves related to loans	Cumulative foreign currency translation	Capital reserves	Accumulated deficit	Total shareholders' equity
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from adjustments  
controlling                       
shareholders  
                    

(NIS thousands, except number of shares)

<b>Balance as of December 31, 2003</b>	4,885,651	29,334	51,985	10,010	2,004	6,685	(80,621)	19,397
<b>Changes during the year</b>								
Conversion of convertible note	606,060	364	515	-	-	-	-	879
Foreign currency translation adjustments	-	-	-	-	570	-	-	570
Net loss	-	-	-	-	-	-	(5,855)	(5,855)
<b>Balance as of December 31, 2004</b>	5,491,711	29,698	52,500	10,010	2,574	6,685	(86,476)	14,991
<b>Changes during the year</b>								
Exercise of employee stock options	110,800	67	2,053	-	-	-	-	2,120
Foreign currency translation adjustments	-	-	-	-	(658)	-	-	(658)
Net income	-	-	-	-	-	-	5,260	5,260
<b>Balance as of December 31, 2005</b>	5,602,511	29,765	54,553	10,010	1,916	6,685	(81,216)	21,713
<b>Changes during the year</b>								
Exercise of employee stock options	21,500	13	428	-	-	-	-	441
Foreign currency translation adjustments	-	-	-	-	177	-	-	177
Net income	-	-	-	-	-	-	9,614	9,614
<b>Balance as of December 31, 2006</b>	5,624,011	29,778	54,981	10,010	2,093	6,685	(71,602)	31,945

US\$ in thousands (Note 2H)

<b>Convenience translation year ended December 31, 2006 (Unaudited)</b>	7,048	13,013	2,369	495	1,582	(16,947)	7,560
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\* Ordinary shares of a par value of NIS 0.6 each.

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

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Eltek Ltd.

**Statements of Cash Flows - Consolidated and Company**

**Reported amounts (Note 2(B))**

**Convenience translation into US Dollars (Note 2H)**

	Consolidated		Company		Consolidated		Convenience translation into US Dollars (Note 2H)
	Year ended December 31 2004	Year ended December 31 2005	Year ended December 31 2006	Year ended December 31 2004	Year ended December 31 2005	Year ended December 31 2006	Year ended December 31 2006
	NIS thousands						US\$ in thousands
							(Unaudited)
<b>Cash flows from operating activities:</b>							
Net income (loss)	(5,855)	5,260	<b>9,614</b>	(5,855)	5,260	<b>9,614</b>	<b>2,276</b>
<b>Adjustments to reconcile net income (loss) to net cash flows provided by operating activities:</b>							
Accrued interest and inflationary and exchange rate impact on							
long- term debts	12	555	<b>(690)</b>	12	555	<b>(690)</b>	<b>(163)</b>
Depreciation	13,428	10,904	<b>10,379</b>	11,766	9,630	<b>9,592</b>	<b>2,457</b>
Amortization of goodwill	593	593	-	-	-	-	-
Loss (gain) on disposal of fixed assets, net	(86)	(103)	<b>(24)</b>	(77)	(111)	<b>9</b>	<b>(6)</b>
Company's share in losses of subsidiaries, net	-	-	-	2,017	1,680	<b>980</b>	-
Minority interests	(182)	(218)	<b>(266)</b>	-	-	-	<b>(63)</b>
Increase (decrease) in employee severance benefits, net	103	(767)	<b>67</b>	92	(813)	<b>20</b>	<b>16</b>
Decrease (increase) in trade receivables	*(3,813)	*836	<b>(9,544)</b>	*(3,077)	*488	<b>(9,415)</b>	<b>(2,259)</b>
Decrease (increase) in other receivables and prepaid expenses	*1,090	*(1,331)	<b>1,003</b>	*1,095	*(1,248)	<b>(109)</b>	<b>237</b>
Decrease (increase) in inventories	(379)	(2,544)	<b>189</b>	(290)	(2,083)	<b>936</b>	<b>44</b>
Increase (decrease) in trade payables	1,192	904	<b>(1,906)</b>	1,491	851	<b>(1,658)</b>	<b>(451)</b>
Increase (decrease) in other liabilities and accrued expenses	2,452	15	<b>1,912</b>	2,623	(93)	<b>2,302</b>	<b>453</b>
Accrued interest on convertible note	147	172	<b>172</b>	147	172	<b>172</b>	<b>40</b>
Interest and exchange rate differentials relating to subsidiaries, net	-	-	-	(764)	(222)	<b>(38)</b>	-
Deferred taxes	(753)	-	<b>713</b>	-	-	-	<b>169</b>
Net cash provided by operating activities	<u>7,949</u>	<u>14,276</u>	<u><b>11,619</b></u>	<u>9,180</u>	<u>14,030</u>	<u><b>11,715</b></u>	<u><b>2,750</b></u>

\* reclassified

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

## Reported amounts (Note 2(B))

	Consolidated			Company			Convenience translation into US Dollars (Note 2H)
	Year ended December 31 2004	Year ended December 31 2005	Year ended December 31 2006	Year ended December 31 2004	Year ended December 31 2005	Year ended December 31 2006	Year ended December 31 2006
	NIS thousands						US\$ in thousands
(Unaudited)							
<b>Cash flows provided by (used in) investing activities:</b>							
Investment in subsidiary	-	-	-	(90)	(69)	-	-
Purchase of fixed assets	(1,470)	(12,628)	(9,638)	(1,189)	(12,067)	(8,985)	(2,282)
Proceeds from sale of fixed assets	188	164	31	177	115	-	8
Net cash used in investing activities	(1,282)	(12,464)	(9,605)	(1,102)	(12,021)	(8,985)	(2,274)
<b>Cash flows provided by (used in) financing activities:</b>							
Decrease in short- term credit	(726)	(1,603)	(2,857)	(726)	(1,603)	(2,857)	(676)
Repayment of long-term loans	(6,164)	(7,499)	(7,972)	(6,164)	(7,499)	(7,972)	(1,887)
Long-term loans received	-	8,310	11,191	-	8,310	11,191	2,649
Exercise of employee stock options	-	2,120	441	-	2,120	441	104
Repayment of credit from fixed assets payables	-	-	(1,510)	-	-	(1,510)	(359)
Net cash provided by (used in) financing activities	(6,890)	1,328	(707)	(6,890)	1,328	(707)	(169)
<b>Adjustments from translation of financial statements of foreign entity</b>	126	(156)	11	-	-	-	5
<b>Net increase (decrease) in cash and cash equivalents</b>	(97)	2,984	1,318	1,188	3,337	2,023	312
<b>Cash and cash equivalents at beginning of the year</b>	4,371	4,274	7,258	1,248	2,436	5,773	1,718
<b>Cash and cash equivalents at end of the year</b>	4,274	7,258	8,576	2,436	5,773	7,796	2,030

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

## Statements of Cash Flows - Consolidated and Company (cont'd)

## Reported amounts (Note 2(B))

						Convenience translation into US Dollars (Note 2H)
Consolidated			Company			Consolidated
Year ended December 31 2004	Year ended December 31 2005	Year ended December 31 2006	Year ended December 31 2004	Year ended December 31 2005	Year ended December 31 2006	Year ended December 31 2006
						(Unaudited)
NIS thousands						US\$ in thousands

### Supplemental cash flow information

#### Non-cash activities:

Conversion of convertible note into share capital	879	-	-	879	-	-	-
Purchase of fixed assets not yet paid	-	-	1,507	-	-	1,507	357

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

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Eltek Ltd.

### Notes to the Consolidated and Company Financial Statements

(All amounts in thousands of reported NIS, except where otherwise stated)

#### Note 1 General

- a. Eltek Ltd. ( the Company ) was incorporated in Israel in 1970. The Company manufactures and supplies advanced printed circuit boards ( PCB ), complex multi-layer back-panels, flex and flex rigid circuit boards for electronic equipment. The principal markets of the Company are in Israel and Europe.
- b. The Company s stock has been publicly traded on NASDAQ Capital Market since 1997.

#### Acquisition of Kubatronik Leiterplatten GmbH

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

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On June 10, 2002, the Company acquired 76% of the shares of Kubatronik Leiterplatten GmbH ( Kubatronik ) for the consideration of 2.6 million (NIS 11.8 million as of the date of acquisition) See Note 2(E)(1).

Pursuant to the agreement, the seller has until December 31, 2007, the right to require the Company to purchase ( Put option ), and the Company has the right to require the seller to sell to the Company ( Call option ), the seller's remaining 24% interest in Kubatronik. The acquisition price for the remaining 24% interest varies depending on several factors. Through the date of these financial statements the seller has not approached the Company to exercise the put option. The fair value of the above option was calculated based on the Black and Scholes model.

The acquisition resulted in the recognition of goodwill in the amount of 1.1 million (NIS 5 million as of the date of acquisition) see Note 9.

### Note 2 Significant Accounting Policies

#### A. Basis of preparation of financial statements

The financial statements have been prepared in accordance with accounting principles generally accepted in Israel ( Israeli GAAP ), which vary in certain significant respects from accounting principles generally accepted in the United States of America ( U.S. GAAP ) as described in Note 29.

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Eltek Ltd.

### Notes to the Consolidated and Company Financial Statements

(All amounts in thousands of reported NIS, except where otherwise stated)

### Note 2 Significant Accounting Policies (cont d)

#### B. Definitions

Certain terms used in these financial statements are defined as follows:

- (1) Related parties as defined in Opinion No. 29 of the Institute of Certified Public Accountants in Israel ( ICPAI ) are:
  - (a) Parties, one of which directly or indirectly
    - (1) owns 10% or more of the issued share capital of the other party, or of its voting rights or of the rights to appoint its directors, or
    - (2) has the right to appoint its Chief Executive Officer ( CEO ), or
    - (3) acts as its director or CEO.
  - (b) Any corporate body in which a party mentioned in (a) above owns 25% or more of its issued share capital or of its voting rights or of the rights to appoint its directors.
  - (c) Spouses and minor children of the parties mentioned in (a) above.
  - (d) Interested parties as defined in Section 1 of the Israeli Securities Law:
    - (1) The holder of five percent or more of the issued share capital or voting rights of a company, a person who has the right to appoint one or more directors of a company or its CEO, a person serving as the CEO or as a director, an entity in which a person as described above holds twenty five percent or more of its issued share capital or of its voting rights, or has the right to appoint twenty five percent or more of its directors.

- (2) A subsidiary of a company, other than a nominee company.
- (2) Subsidiaries companies whose financial statements are fully consolidated with those of the Company, whether held directly or indirectly.
- (3) CPI Israeli consumer price index as published by the Israeli Central Bureau of Statistics.
- (4) NIS New Israeli Shekels.
- (5) Adjusted amount the nominal historical amount adjusted in accordance with the provisions of Opinions 23, 34, 36 and 37 of the ICPAI.
- (6) Reported amount The adjusted amount as at the transition date (December 31, 2003), with the addition of amounts in nominal historical values that were added after the transition date and less amounts eliminated after the transition date. (See Note 2C).
- (7) Adjusted financial reporting Financial reporting based on the provisions of Opinions 23, 34, 36, 37 and 50 of the ICPAI.
- (8) Nominal financial reporting Financial reporting based on reported amounts.

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Eltek Ltd.

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**Notes to the Consolidated and Company Financial Statements**

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**(All amounts in thousands of reported NIS, except where otherwise stated)**

**Note 2 Significant Accounting Policies (cont d)**

**C. Financial statements reported New Israeli Shekels (NIS)**

- (1) In October 2001, the Israeli Accounting Standards Board (IASB) published Accounting Standard No. 12, Discontinuance of Adjustment of Financial Statements. Pursuant to this standard and in accordance with Israeli Accounting Standard No. 17 that was published in December 2002, the adjustment of financial statements for the effect of inflation was discontinued as of January 1, 2004. Until December 31, 2003, the Company continued to prepare adjusted financial statements in accordance with Opinion No. 36 of the ICPAI. The adjusted amounts included in the consolidated and Company financial statements as at December 31, 2003 became the new basis for the nominal financial report as of January 1, 2004. The Company has implemented the provisions of Accounting Standard No. 12 and has accordingly discontinued the adjustments as of January 1, 2004.
- (2) Amounts of non-monetary assets do not necessarily reflect their realizable value or current economic value, but only the reported amounts of such assets.
- (3) The term cost in these financial statements means the reported amount of cost.
- (4) The financial statements of certain subsidiaries are stated on the basis of the changes in the exchange rates of their relevant functional currencies.

Balance sheets:

- a. Non-monetary items are stated at reported amounts.
- b. Monetary items are stated in the balance sheet at their nominal historical values as at balance sheet date.



Statement of operations:

- a. The Company's equity in the operating results of investee companies and the share of minority shareholders in the results of subsidiaries are determined on the basis of the reported financial statements of those companies.
- b. Income and expenses derived from non-monetary items included in the balance sheet are derived from the difference between the reported amounts of the opening balance and the reported amounts of the closing balance.
- c. The other income and expense items (such as sales, cost of revenues, etc.) are presented at their nominal historical values.

**D. Translation of foreign entity operations**

As of January 1, 2004 the Company implemented Accounting Standard No. 13, Effect of Changes in Exchange Rates of Foreign Currency of the Israeli Accounting Standard Board. The standard discusses the translation of transactions in foreign currency and the translation of financial statements of foreign subsidiaries for the purpose of including them in the financial statements of the reporting entity. The standard provides rules for classifying foreign operations as foreign investee or as an integrated investee, on the basis of the indications described in the standard and the use of discretion, and it provides the method for translating the financial statements of foreign investees, as follows:

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Eltek Ltd.

**Notes to the Consolidated and Company Financial Statements**

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(All amounts in thousands of reported NIS, except where otherwise stated)

**Note 2 Significant Accounting Policies (cont d)**

**D. Translation of foreign entity operations (cont d)**

The financial statements of a foreign subsidiary are translated into Israeli currency as follows:

- (1) The assets and liabilities, both monetary and non-monetary, are translated according to the closing exchange rate including the goodwill arising upon the acquisition of the subsidiary.
- (2) Income and expense items are translated according to the average exchange rate, on a quarterly basis.
- (3) All the resulting exchange rate differences are classified as a separate item of shareholders' equity until the disposal of the net investment.

**E. Principles of consolidation**

1. The consolidated financial statements include the accounts of the Company and its subsidiaries (EN-Eltek, Kubatronik, Eltek International and Eltek Europe).
2. The excess of cost of acquisition of Kubatronik over the fair value at date of acquisition of the identifiable assets and liabilities acquired, was charged to goodwill. Goodwill was amortized on the straight line basis over a period of 10 years. As of January 1, 2006, the Company applies Israeli Accounting Standard No. 20 The Accounting Treatment of Goodwill and Intangible Asset when Purchasing an Investee (As No. 20). As a result, no amortization is recorded and instead an examination of impairment in value is performed once a year or more frequent if events or changes in circumstances indicate that there may be an impairment in the value of goodwill.

3. All intercompany transactions and balances were eliminated in consolidation.

**F. Rate of exchange and linkage bases**

1. a. Monetary assets and liabilities denominated in, or linked to, foreign currencies have been recorded based on the representative exchange rate prevailing at the balance sheet date as published by the Bank of Israel.
- b. Non-monetary assets and liabilities denominated in, or linked to foreign currencies have been recorded based on the representative exchange rate prevailing on the transaction date as published by the Bank of Israel.
- c. Transactions denominated in foreign currency are recorded upon their initial recognition according to the exchange rate in effect on the date of the transaction. Exchange rate differences arising upon the settlement of monetary items or upon reporting the Company's monetary items at exchange rates that are different than those by which they were initially recorded during the period, or reported in previous financial statements, are charged to income or expenses.

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Eltek Ltd.

**Notes to the Consolidated and Company Financial Statements**

(All amounts in thousands of reported NIS, except where otherwise stated)

**Note 2 Significant Accounting Policies (cont d)**

**F. Rate of exchange and linkage bases (cont d)**

2. Balances linked to the CPI are recorded pursuant to contractual linkage terms of the specific assets and liabilities.
3. Details of the CPI and the representative exchange rates are as follows:

	Israeli CPI	Exchange rate of one US dollar	Exchange rate of one Euro
	Points	NIS	NIS
For the year ended:			
December 31, 2004	180.74	4.308	5.877
December 31, 2005	185.05	4.603	5.447
<b>December 31, 2006</b>	<b>184.69</b>	<b>4.225</b>	<b>5.564</b>
	%	%	%
Changes during the year ended:			
December 31, 2004	1.21	(1.62)	6.22
December 31, 2005	2.39	6.85	(7.32)
<b>December 31, 2006</b>	<b>(0.19)</b>	<b>(8.21)</b>	<b>2.1</b>

**G. Estimates and assumptions in the financial statements**

The preparation of the financial statements in conformity with generally accepted accounting principles (GAAP) requires 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 periods.

These are management's best estimates based on experience and historical data, however, actual results may vary from these estimates.

**H. Convenience translation (unaudited)**

For the convenience of the reader, the reported consolidated NIS figures of December 31, 2006 have been presented in U.S. dollar thousands (unaudited), translated at the representative rate of exchange as of December 31, 2006 (NIS 4.225 = U.S. Dollar 1.00). The U.S. dollar amounts so presented should not be construed as representing amounts receivable, payable or incurred in U.S. dollars or convertible into U.S. dollars.

**I. Cash and cash equivalents**

Cash equivalents are considered by the Company to be highly-liquid investments which include short-term bank deposits with an original maturity of three months or less from deposit date and which are not encumbered by a lien.

**Notes to the Consolidated and Company Financial Statements**

(All amounts in thousands of reported NIS, except where otherwise stated)

**Note 2 Significant Accounting Policies (cont d)**

**J. Allowance for doubtful accounts receivable**

The allowance for doubtful accounts receivable is determined based on management's estimate of the aged receivable balance considered uncollectible, based on historical experience, aging of the receivable and information available about specific debtors, including their financial condition and volume of their operation.

**K. Inventories**

Inventories are recorded at the lower of cost or market value. Cost is determined on the moving average basis.

**L. Property and equipment**

1. Assets are recorded at cost.
2. Depreciation on property and equipment is calculated on the straight-line method over the estimated useful lives of the assets.

Annual rates of depreciation are as follows:

	<b>Mostly</b>	<b>Range</b>
	%	%
Machinery and equipment	15	5-33
Office furniture and equipment	6	6-33

	Mostly	Range
Motor vehicles	20	15-30
Leasehold improvements	10	10-25

The cost of maintenance and repairs is charged to expenses as incurred. The cost of significant renewals and improvements is added to the carrying amount of the respective asset.

### 3. Fixed assets financing transactions

Fixed assets under a capital lease are stated as assets of the Company on the basis of ordinary purchase prices (without the component of financing), and they are depreciated according to the usual rates of depreciation applicable to such assets. The lease payments payable in the forthcoming years, net of the interest component included in them, are included in liabilities. The interest in respect of such amounts is accrued on a current basis and is charged to earnings.

The Company signed financing agreements with two of its equipment suppliers (see Note 13B), to acquire machinery and equipment with long-term payment terms. These acquisitions are recorded in the financial statements as capital leases. Depreciation is computed by the straight line method over the machinery's useful life.

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Eltek Ltd.

## Notes to the Consolidated and Company Financial Statements

(All amounts in thousands of reported NIS, except where otherwise stated)

### Note 2 Significant Accounting Policies (cont d)

#### M. Investments in investee companies

Investments in subsidiaries are stated in the Company's financial statements under the equity method, that is, at cost plus the Company's share of the post-acquisition gains or losses.

The excess of the cost of the investment over the fair value of identified assets net of the fair value of identified liabilities (after allocation of taxes resulting from temporary differences) as at the date of acquisition is recorded as goodwill.

Until January 1, 2006, the Company applied Israeli Accounting Standard No. 20 Amortization of Goodwill. According to the standard, goodwill was systematically amortized over the period of its useful life (10 years).

As from January 1, 2006, the Company implements the provisions of Accounting Standard No. 20 (Revised), The Accounting Treatment of Goodwill and Intangible Assets with indefinite useful lives when Purchasing an Investee Company.

Accordingly, goodwill is not systematically amortized. Instead, the Company examines whether there has been an impairment in the value of the goodwill and intangible assets deriving from the acquisition of a subsidiary, once a year or more frequently if events or changes in circumstances indicate that there may have been an impairment in the value of the assets.

Amortization in respect of identified goodwill, the amortization of which was discontinued as of January 1, 2006, amounts to NIS 593 thousand and NIS 593 thousand for the years ended December 31, 2005 and 2004 respectively. The financial statements for periods prior to the implementation of the Standard were not restated.

#### N. Deferred taxes

Effective January 1, 2005, the Company applies Israeli Accounting Standard No. 19 Accounting for Income Taxes. Income taxes are provided on the basis of the liability method of accounting. Under the liability method, deferred tax assets and liabilities are recognized for the future tax consequences of differences between the carrying amounts of existing assets and liabilities and their respective tax bases, as well as tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years when these temporary differences are expected to be recovered or settled. A valuation allowance is established to reduce the deferred tax asset to the amount expected to be realized. The transition to the new standard did not have an effect on the Company.

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Eltek Ltd.

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**Notes to the Consolidated and Company Financial Statements**

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**(All amounts in thousands of reported NIS, except where otherwise stated)**

**Note 2 Significant Accounting Policies (cont d)**

**O. Convertible note**

The debentures are convertible into a fixed number of the Company's ordinary shares at the discretion of the holder of those debentures.

Until December 31, 2005, convertible debentures, the conversion of which was not probable as at balance sheet date, were presented as long-term liabilities according to their liability value at that date. Convertible debentures, the conversion of which was probable as at balance sheet date, were presented under a quasi-capital item at the higher of their liability value or capital value as at balance sheet date.

As from January 1, 2006, the Company applies Israeli Accounting Standard No. 22, Financial Instruments: Disclosure and Presentation. As a result of the new Standard, the Company classified the convertible note, net of issuance costs, as a current liability (see also Note 16).

**P. Impairment in value of assets**

The Company applies Israeli Accounting Standard No. 15 Impairment in Value of Assets (hereinafter AS No. 15). AS No. 15 provides procedures which a company must apply in order to ensure that its assets in the consolidated balance sheet (to which the standard applies), are not presented at an amount which is in excess of their recoverable amount, which is the higher of the net selling price and the value in use (the present value of the estimated future cash flows expected to be derived from use and disposal of the asset).

AS No. 15 applies to all the assets in the consolidated balance sheet except inventories, tax assets and monetary assets (excluding monetary assets which are investments in investee companies that are not subsidiaries). In addition, the standard provides rules for presentation and disclosure with respect to assets whose value has been impaired. When the value of an asset in the consolidated balance sheet is higher than its recoverable amount, the Company recognizes an impairment loss for the difference between the carrying amount of the asset and its recoverable amount. The loss thus recognized will be reversed only in the event of changes occurring in the estimates that were used to determine the recoverable value of the asset since the date on which the most recent impairment loss was recognized.

**Q. Revenue recognition**

The Company recognizes revenues when products are shipped and the customer takes ownership and assumes risk of loss, collection of the relevant receivable is probable, persuasive evidence of an arrangement exists and the sale price is fixable or determinable. Commission income is accounted for on the accrual basis.

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**Notes to the Consolidated and Company Financial Statements**

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(All amounts in thousands of reported NIS, except where otherwise stated)

**Note 2 Significant Accounting Policies (cont d)****R. Research and development**

Research and development costs, net of grants from the Office of the Chief Scientist in the Ministry of Industry and Trade of the Government of Israel (OCS), are expensed as incurred. See also Note 20.

**S. Earnings per share**

As from January 1, 2006, the Company implemented Accounting Standard No. 21, Earnings per Share (hereinafter the Standard) of the Israel Accounting Standards Board. In accordance with the provisions of the Standard, the Company calculates basic earnings per share with respect to earnings or loss, and basic earnings per share with respect to earnings or loss from continuing operations, which is attributable to the ordinary shareholders. The basic earnings per share is calculated by dividing the earnings or loss attributable to the ordinary shareholders with the weighted average number of ordinary shares outstanding during the period. In order to calculate the diluted earnings per share the Company adjusted the earnings or loss attributable to the ordinary shareholders, and the weighted average number of outstanding ordinary shares, in respect of the effects of all the dilutive potential ordinary shares (such as convertible debentures and options). The Company's share in the earnings of investee companies was calculated according to its portion in the earnings per share of such investee companies multiplied by the number of shares held by the Company.

Following the initial implementation of the Standard, the comparative data regarding the earnings (loss) per share for prior periods were restated. The effects of the initial implementation of the Standard amounted to an increase (decrease) in the basic earnings per share in the amount of NIS (0.35) and NIS 0.29 for the years ended December 31, 2005 and 2004, respectively, and to an increase (decrease) in the diluted earnings per share in the amount of NIS (0.48) and NIS 0.29 for the year ended December 31, 2005 and December 31, 2004, respectively.

**T. Share-based payments**

Prior to January 1, 2006, the Company applied the intrinsic-value-based method of accounting presented by U.S. Accounting Principles Board (APB) Opinion No. 25 Accounting for Stock issued to Employees and related Interpretations including U.S. Financial Accounting Standard Board (FASB) interpretation No. 44 Accounting for Certain Transactions involving Stock Compensation, an interpretation of APB Opinion No. 25, to account for its share-based payments. Under this method, compensation expenses are recorded only if the market price of the underlying stock exceeds the exercise price on the date of grant.

As from January 1, 2006, the Company implemented Israeli Accounting Standard No. 24, Share-Based Payments (hereinafter AS No. 24). In accordance with the provisions of AS No. 24, the Company recognizes share-based payment transactions in the financial statements, including transactions with employees or other parties that are settled by equity instruments, cash or other assets. Share-based payment transactions in which goods or services are received are recognized at their fair value. The Company did not have share-based payment transactions to which AS No. 24 applies.

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Eltek Ltd.

**Notes to the Consolidated and Company Financial Statements**

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(All amounts in thousands of reported NIS, except where otherwise stated)

**Note 2 Significant Accounting Policies (cont d)**

**U. Segment reporting**

Segment reporting is presented according to Israeli Accounting Standard No. 11 Segment Reporting. Accordingly, the Company reports on geographical segments identified based on the location of its markets and customers.

**V. Reclassification**

Certain prior years amounts have been reclassified in conformity with current years financial statements presentation

**W. Derivative financial instruments**

Derivative financial instruments, are stated in the financial statements at their fair value. Changes in fair value are recognized in the Consolidated and Company statement of operations as financing item.

The fair value of derivative financial instruments is determined on the basis of their market values or the quotations of financial institutions. In the absence of a market value or financial institution quotation the fair value is determined on the basis of a valuation model.

**X. Newly published accounting standards**

1. In August 2006, IASB published Accounting Standard No. 26, Inventory (hereinafter AS No. 26). AS No. 26 provides guidelines for determining the cost of inventory and its subsequent recognition as an expenses as well as for determining impairment in value of inventory written down to net realizable value. AS No. 26 also provides guidelines regarding cost formulas used to allocate costs to various types of inventory. AS No. 26 will apply to financial statements for periods beginning on January 1, 2007 or thereafter.

Implementation of AS No. 26 is not anticipated to have a material effect on the Company's and consolidated results of operations and financial position.

2. In September 2006, the Israel Accounting Standards Board published Accounting Standard No. 27, Fixed Assets (hereinafter AS No. 27). AS No. 27 prescribes rules for the presentation, measurement and derecognition of fixed assets and for the disclosure required in respect thereto. AS No. 27 provides, inter alia, that upon the initial recognition of a fixed asset, the entity shall include in the cost of the item all the costs it will incur in respect of a liability to dismantle and remove the item and to restore the site on which it was located. Furthermore, AS No. 27 provides that a group of similar fixed asset items shall be measured at cost net of accumulated depreciation, and less impairment losses or, alternatively, at its revalued amount less accumulated depreciation, whereas an increased in the value of the asset to above its initial cost as a result of the revaluation will be directly included in the shareholders' equity under a revaluation reserve. Any part of a fixed asset item with a cost that is significant in relation to the total cost of the item shall be depreciated separately, including the costs of significant periodic examinations. AS No. 27 also provides that a fixed asset that was purchased in consideration for another non-monetary item in a transaction having a commercial substance shall be measured at fair value.

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Eltek Ltd.

**Notes to the Consolidated and Company Financial Statements**

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**(All amounts in thousands of reported NIS, except where otherwise stated)**

**Note 2 Significant Accounting Policies (cont d)****X. Newly published accounting standards (cont d)**

2. (cont d)

AS No. 27 is effective for periods beginning on January 1, 2007. An entity that on January 1, 2007 chooses for the first time to use the revaluation method for measuring fixed assets shall on this date recognize a revaluation reserve in the amount of the difference between the revalued amount of the asset on that date and its cost on the books. Furthermore, an entity that in the past, upon the initial recognition of a fixed asset, had not included in its cost the initial estimate of costs for dismantling and removing the asset and for restoring the site on which it is located will measure these costs as follows:

- (a) The aforementioned liabilities as at January 1, 2007 should be measured in accordance with generally accepted accounting principles;
- (b) The amount that would have been included in the cost of the relevant asset on the date on which the liability was initially incurred by capitalizing the amount of the liability mentioned in item (a) above to the date on which the liability was initially incurred hereinafter the capitalized amount);
- (c) The accumulated depreciation on the capitalized amount as at January 1, 2007 should be measured on the basis of the useful life of the asset as at that date.

The difference between the amount to be charged to the asset in accordance with items (b) and (c) above and the amount of the liability in accordance with item (a) above shall be included in retained earnings.

Other than the aforementioned, the Standard will be adopted on a retroactive basis.

The Company is examining the effect of the standard but at this point is unable to evaluate the effect of its implementation on the financial statements.

- 3. In July 2006, the IASB published Accounting Standard No. 29, Adoption of International Financial Reporting Standards ( IFRS ) (hereinafter AS No. 29). AS No. 29 provides that entities subject to the Israeli Securities Law 1968 that are required to report according to the regulations of this law, are to prepare their financial statements for periods beginning as from January 2008 according to IFRS. AS No. 29 permits early adoption as from financial statements published after July 31, 2006. The Standard does not apply to entities subject to Israeli Securities Regulations (Periodic and Immediate Reports of a Foreign Entity) 2000, the financial statements of which are not prepared in accordance with Israeli GAAP. Furthermore, the Standard provides that entities that are not subject to the Israeli Securities Law 1968 and not required to report according to the regulations of this law, are also permitted to prepare their financial statements according to IFRS as from financial statements published after July 31, 2006.

The initial implementation of IFRS will be effected along with the implementation of IFRS 1, the initial implementation of IFRS, for purposes of the transition.

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Eltek Ltd.

**Notes to the Consolidated and Company Financial Statements**

(All amounts in thousands of reported NIS, except where otherwise stated)

**Note 2 Significant Accounting Policies (cont d)****X. Newly published accounting standards (cont d)**



3. (cont d)

In accordance with the Standard, the Company is required to include in its annual financial statements for December 31, 2007, balance sheet data as at December 31, 2007 and statement of operations data for the year then ended, that have been prepared according to the recognition, measurement and presentation principles of IFRS.

The Company is examining the effect of the Standard on its financial statements and does not intend to implement IFRS earlier than required.

4. In December 2006, the Israel Accounting Standards Board published Accounting Standard No. 23. Standard No. 23 actually replaces the main provisions of the Israeli Securities Regulations (Financial Statement Presentation of Transactions between a Company and its Controlling Shareholder) that were amended in February 2007. Standard No. 23 provides that assets (other than an intangible asset with no active market) and liabilities included in a transaction between the entity and its controlling shareholder shall be measured on the date of the transaction at fair value and that the difference between the fair value and the consideration from the transaction shall be included in shareholders' equity. A debit difference is actually a dividend and accordingly reduces the retained earnings. A credit difference is actually an investment of the shareholder and shall therefore be presented under a separate item of shareholders' equity called capital reserve from transaction between an entity and its controlling shareholder .

Standard No. 23 shall apply to transactions between an entity and its controlling shareholder that are executed after January 1, 2007 and to a loan that was granted to a controlling shareholder or that was received from it before the date this Standard came into effect as from the date of it coming into effect.

Implementation of Standard No. 23 is not anticipated to have a material effect on the Company's results of operations and financial position.

5. In March 2007 the Israel Accounting Standards Board published Accounting Standard No. 30 "Intangible Assets". The Standard explains the accounting treatment of intangible assets and defines how to measure the book value of these assets, as well as the disclosures that are required. The Standard has been initially implemented retroactively, except as described below. As regards business combinations, the Standard is implemented with respect to business combinations that took place on January 1, 2007 or thereafter, whereas in respect of a research and development project acquired in a business combination that took place before January 1, 2007 and which meets the definition of an intangible asset on the date of acquisition, and was recorded as an expense on the date of acquisition, the entity shall recognize the research and development project in process as an asset on January 1, 2007 and make an allocation of taxes.

A research and development asset shall be recognized in the amount of its value on the date of acquisition less the amortization that would have accumulated from the date of acquisition until December 31, 2006 on the basis of the useful life of the asset, and less any accrued impairment losses. The amount of the adjustment shall be included in the balance of retained earnings as at January 1, 2007.

Implementation of Standard No. 30 is not anticipated to have a material effect on the Company's results of operation and financial position.

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Eltek Ltd.

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**Notes to the Consolidated and Company Financial Statements**

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**(All amounts in thousands of reported NIS, except where otherwise stated)**

**Note 2 Significant Accounting Policies (cont d)****Y. Factoring of financial assets**

In June 2003, the Company entered into an accounts receivable factoring agreement with U Bank. Under the terms of the agreement, the Company is able to factor receivables, with U Bank on a non-recourse basis, provided that U Bank approves the receivables in advance. In some cases, the Company continues to be obligated in the event of commercial disputes, (such as product defects) unrelated to the credit worthiness of the customer. The Company accounted for the factoring of its financial assets in accordance with the provisions of Statement of Financial Accounting Standard ( SFAS ) No. 140, Accounting for Transfer and Servicing of Financial Assets and Extinguishment of Liabilities issued by the FASB.

There have been no instances in which the Company has had to reimburse U Bank for accounts receivables as a result of a commercial dispute.

As at December 31, 2006, no trade receivables were factored. (As at December 31, 2005, net trade receivables amounting to NIS 2,435 thousand were factored).

**Note 3 Cash and Cash Equivalents**

	Consolidated		Company	
	December 31 2005	December 31 2006	December 31 2005	December 31 2006
NIS	310	2,427	310	2,427
U.S. dollars	5,529	5,270	5,456	5,270
Euro	1,418	802	6	98
Others	1	77	1	1
	<b>7,258</b>	<b>8,576</b>	<b>5,773</b>	<b>7,796</b>

As for pledges on assets, see Note 15A.

**Notes to the Consolidated and Company Financial Statements**

(All amounts in thousands of reported NIS, except where otherwise stated)

**Note 4 Trade Receivables**

	Consolidated		Company	
	December 31 2005	December 31 2006	December 31 2005	December 31 2006
Israeli customers	11,662	18,283	11,662	18,283

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	Consolidated		Company	
Foreign customers	* 12,515	<b>15,689</b>	* 11,146	<b>14,211</b>
Checks receivable	514	<b>604</b>	514	<b>604</b>
	* 24,691	<b>34,576</b>	* 23,322	<b>33,098</b>
Allowance for doubtful accounts	* (1,701)	<b>(2,014)</b>	* (1,618)	<b>(1,979)</b>
	* 22,990	<b>32,562</b>	* 21,704	<b>31,119</b>

As at December 31, 2006, two customers accounted for NIS 11,201 thousand of net trade receivables (34.4% of the total consolidated net trade receivables) (Company 36%).

As at December 31, 2005, one customer accounted for NIS 5,681 thousand of net trade receivables (24.7% of the total consolidated net trade receivables) (Company 26.2%).

As for pledges on assets. See Note 15A.

\* Reclassified

**Note 5 Other Receivables**

	Consolidated		Company	
	December 31 2005	December 31 2006	December 31 2005	December 31 2006
Employees	124	<b>173</b>	120	<b>173</b>
Subsidiary	-	-	333	<b>1,320</b>
Advances to suppliers	90	<b>76</b>	32	<b>76</b>
Government of Israel and other institutions	1,122	<b>479</b>	1,121	<b>479</b>
Government of Germany	357	<b>361</b>	320	<b>259</b>
Other receivables	* 233	<b>14</b>	* 111	<b>14</b>
	* 1,926	<b>1,103</b>	* 2,037	<b>2,321</b>

\* Reclassified

**Note 6 Inventories**

	Consolidated		Company	
	December 31 2005	December 31 2006	December 31 2005	December 31 2006
Raw materials:				
On hand	8,496	<b>8,646</b>	7,568	<b>7,333</b>
In transit	101	<b>256</b>	99	<b>256</b>
Work-in-process	5,485	<b>4,391</b>	4,758	<b>4,073</b>

	Consolidated		Company	
Finished products	1,969	<b>2,617</b>	1,566	<b>1,393</b>
	16,051	<b>15,910</b>	13,991	<b>13,055</b>

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Eltek Ltd.

### Notes to the Consolidated and Company Financial Statements

(All amounts in thousands of reported NIS, except where otherwise stated)

#### Note 7 Long-Term Investments

	Company	
	December 31 2005	December 31 2006
<b>A. Investments in subsidiaries:</b>		
Cost of shares	* 12,459	<b>12,459</b>
Loans to subsidiaries**	* 2,147	<b>2,186</b>
Accumulated losses	(7,895)	<b>(8,875)</b>
Adjustments from translation of financial statements	1,916	<b>2,093</b>
	8,627	<b>7,863</b>

\* Reclassification

\*\* The loans to subsidiaries do not bear interest and do not have repayment dates.

	Company	
	December 31 2005	December 31 2006
<b>B. Changes in the investments in subsidiaries</b>		
Balance at the beginning of the year	10,674	<b>8,627</b>
Changes during the year:		
Share of losses	(1,680)	<b>(980)</b>
Accrued loan interest and investments made during the year	291	<b>39</b>
Adjustments from the translation of financial statements	(658)	<b>177</b>

	Company	
Balance at the end of the year	8,627	7,863

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Eltek Ltd.

## Notes to the Consolidated and Company Financial Statements

(All amounts in thousands of reported NIS, except where otherwise stated)

## Note 8 Property and Equipment, Net

## A. Consolidated

	December 31, 2006				
	Machinery and equipment	Leasehold improvements	Motor vehicles	Office furniture and equipment	Total
<b>Cost</b>					
Balance as of December 31, 2005	143,873	28,115	700	6,631	179,319
Additions	10,747	1,755	-	206	12,708
Disposals	(1,038)	(446)	-	(24)	(1,508)
Translation adjustments of subsidiary	337	47	10	98	492
Balance as of December 31, 2006	153,919	29,471	710	6,911	191,011
<b>Accumulated Depreciation</b>					
Balance as of December 31, 2005	117,920	21,652	553	6,225	146,350
Depreciation during the year	8,882	1,306	59	132	10,379
Disposals	(993)	(136)	-	(7)	(1,136)
Translation adjustments of subsidiary	288	33	10	90	421
Balance as of December 31, 2006	126,097	22,855	622	6,440	156,014
<b>Net balance as of</b>					

	December 31, 2006				
<b>December 31, 2006</b>	<b>27,822</b>	<b>6,616</b>	<b>88</b>	<b>471</b>	<b>34,997</b>
<b>Net balance as of December 31, 2005</b>	<b>25,953</b>	<b>6,463</b>	<b>147</b>	<b>406</b>	<b>32,969</b>

As for pledges on assets. See Note 15A.

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Eltel Ltd.

### Notes to the Consolidated and Company Financial Statements

(All amounts in thousands of reported NIS, except where otherwise stated)

#### Note 8 Property and Equipment, Net (cont d)

##### B. Company

	December 31, 2006				
	Machinery and equipment	Leasehold improvements	Motor vehicles	Office furniture and equipment	Total
<b>Cost</b>					
Balance as of December 31, 2005	128,439	25,913	166	2,157	156,675
Additions	10,396	1,531	-	110	12,037
Disposals	(370)	(446)	-	-	(816)
Balance as of December 31, 2006	138,465	26,998	166	2,267	167,896
<b>Accumulated Depreciation</b>					
Balance as of December 31, 2005	104,652	20,065	97	1,943	126,757
Depreciation during the year	8,285	1,223	11	73	9,592
Disposals	(327)	(134)	-	-	(463)
Balance as of December 31, 2006	112,610	21,154	108	2,016	135,888

December 31, 2006

<b>Net balance as of December 31, 2006</b>	<b>25,855</b>	<b>5,844</b>	<b>58</b>	<b>251</b>	<b>32,008</b>
<b>Net balance as of December 31, 2005</b>	<b>23,787</b>	<b>5,848</b>	<b>69</b>	<b>214</b>	<b>29,918</b>

As for pledges on assets, see Note 15A.

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Eltek Ltd.

### Notes to the Consolidated and Company Financial Statements

(All amounts in thousands of reported NIS, except where otherwise stated)

#### Note 9 Goodwill

The changes in the carrying amount of goodwill for the years ended December 31, 2005 and 2006 are as follows:

	Consolidated	
	December 31 2005	December 31 2006
Balance at the beginning of the year	4,656	3,735
Amortization	(593)	-
Translation adjustments	(328)	81
	<b>3,735</b>	<b>3,816</b>

#### Note 10 Short-Term Credit and Current Maturities of Long-Term Debts

	Annual interest rate at December 31 2006	Consolidated and Company	
		December 31 2005	December 31 2006
In NIS (unlinked)	6.95%-7.10%	10,217	8,000
In U.S. dollars	7.38%	1,105	465
Current maturities of long-term			

	Annual interest rate at December 31 2006	Consolidated and Company	
debts due to banks (Note 13A)		6,239	3,266
		17,561	11,731

As to pledges securing the credit, see Note 15A.

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Eltek Ltd.

### Notes to the Consolidated and Company Financial Statements

(All amounts in thousands of reported NIS, except where otherwise stated)

#### Note 11 Trade Payables

	Consolidated		Company	
	December 31 2005	December 31 2006	December 31 2005	December 31 2006
Israeli suppliers	18,670	19,498	18,670	19,498
Foreign suppliers	4,146	4,525	3,243	3,843
	22,816	24,023	21,913	23,341
Checks payable	2,360	1,077	2,360	1,077
	25,176	25,100	24,273	24,418
"Israeli suppliers" includes current maturities of long-term debt related to fixed assets financing transactions (Note 13B)	1,067	1,363	1,067	1,363

#### Note 12 Other Liabilities and Accrued Expenses

Consolidated		Company	
December 31 2005	December 31 2006	December 31 2005	December 31 2006



	Consolidated		Company	
Accrued payroll and related benefits	3,603	<b>3,951</b>	3,073	<b>3,595</b>
Provision for vacation and other employee benefits	2,900	<b>3,469</b>	2,704	<b>3,333</b>
Bonus to employees	200	<b>1,167</b>	200	<b>1,167</b>
Government of Israel and other institutions	120	-	120	-
Accrued expenses	3,425	<b>3,409</b>	3,273	<b>3,203</b>
Other liabilities	666	<b>543</b>	473	<b>536</b>
	<u>10,914</u>	<u><b>12,539</b></u>	<u>9,843</u>	<u><b>11,834</b></u>

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Eltek Ltd.

### Notes to the Consolidated and Company Financial Statements

(All amounts in thousands of reported NIS, except where otherwise stated)

#### Note 13 Long-Term Debts, Excluding Current Maturities

##### A. Banks

	Annual interest rate at December 31 2006	Consolidated and Company	
		December 31 2005	December 31 2006
	%		
<b>Linkage terms</b>			
U.S. dollar	6.88 - 7.53	3,846	<b>1,546</b>
CPI	5.3 - 6.7	2,615	<b>1,895</b>
Unlinked	5 - 8.4	4,924	<b>10,758</b>
		<u>11,385</u>	<u><b>14,199</b></u>
Less - current maturities		(6,239)	<b>(3,266)</b>
		<u>5,146</u>	<u><b>10,933</b></u>

Financial covenants in respect of the Company's credit facilities and long-term debt with one of its banks require the Company to maintain the higher of shareholders' equity, excluding intangible assets, of NIS 24.0 million or 23% of the Company's total assets (on a non consolidated basis). With another bank, the financial covenants require the Company to maintain the higher of tangible shareholders' equity of NIS 15.0 million or 15% of the Company's consolidated total assets, and the higher of tangible shareholders' equity of NIS 14.0 million or 14% of the Company's total assets (on a non consolidated basis). For these purposes, shareholders' equity includes the

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Company's outstanding convertible note and excludes prepaid expenses (except insurance). As of December 31, 2006, the Company was in compliance with these covenants.

**B. Long-term debt related to fixed assets financing transactions**

	Annual interest rate at December 31 2006	Consolidated and Company	
		December 31 2005	December 31 2006
	%		
<b>Linkage terms</b>			
U.S. dollars	4 - 5.88	3,528	<b>2,831</b>
CPI	6.35	-	<b>561</b>
Less - current maturities		(1,067)	<b>(1,363)</b>
		<u>2,461</u>	<u><b>2,029</b></u>
<b>Total long-term debt</b>		<u>7,607</u>	<u><b>12,962</b></u>

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Eltek Ltd.

**Notes to the Consolidated and Company Financial Statements**

(All amounts in thousands of reported NIS, except where otherwise stated)

**Note 13 Long-Term Debts, Excluding Current Maturities (cont d)**

**Consolidated and Company**

C. The aggregate maturities of long-term debt for each of the five years subsequent to December 31, 2006 and thereafter are as follows:

	Consolidated and Company	
	December 31 2005	December 31 2006
First year (current maturities)	7,306	<b>4,629</b>
Second year	3,540	<b>5,206</b>
Third year	1,699	<b>5,346</b>
Fourth year	1,551	<b>1,786</b>
Fifth year and thereafter	817	<b>624</b>

	Consolidated and Company	
	7,607	12,962
	14,913	17,591

As to pledges securing the loans, see Note 15A.

#### Note 14 Employee Severance Benefits, net

Under Israeli law and labor agreements, the Company is required to make severance and pension payments to their retired or dismissed employees and to employees leaving employment in certain other circumstances.

- The liability in respect of most of its non-senior employees is discharged by participating in a defined contribution pension plan and making regular deposits with a pension fund. The liability deposited with the pension fund is based on salary components as prescribed in the existing labor agreement. The custody and management of the amounts so deposited are independent of the Company and accordingly, such amounts funded (included in expenses on an accrual basis) and related liabilities are not reflected in the balance sheet.

In addition, occasionally, the Company deposits with a Central Severance Pay Fund ( CSPPF ) in respect of those obligations under the Israeli Severance Pay Law which may not be covered in full by the above arrangements.

- In respect of certain employees, the Company has an approval from the Israeli Ministry of Labor and Welfare, pursuant to the terms of Section 14 of the Israeli Severance Pay Law, 1963, according to which the current deposits in the pension fund and/or with the insurance company exempt it from any additional obligation to the employees for whom the said depository payments were made.
- In respect of the liability to other employees, individual insurance policies are purchased and deposits are made with recognized severance pay funds.

The liability for severance pay is calculated on the basis of the latest salary paid to each employee multiplied by the number of years of employment. The liability is covered by the amounts deposited including accumulated income thereon as well as by the unfunded provision.

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Eltek Ltd.

#### Notes to the Consolidated and Company Financial Statements

(All amounts in thousands of reported NIS, except where otherwise stated)

#### Note 14 Employee Severance Benefits, net (cont d)

- Kubatronik owns an insurance policy and makes regular deposits with an insurance company for securing pension rights on behalf of one of its key employees. Such amounts deposited and the related liabilities are reflected in the consolidated balance sheet.

In respect of its other employees, Kubatronik does not make any deposits for pension or retirement rights since such deposits are not required under the German law.

## 5. Details of the provision and amounts funded:

	Consolidated		Company	
	December 31 2005	December 31 2006	December 31 2005	December 31 2006
Liability for employee severance benefits	4,523	5,016	4,290	4,727
Assets held for severance benefits	(4,249)	(4,672)	(4,147)	(4,564)
Employee severance benefits, net	274	344	143	163

**Note 15 Commitments and Contingent Liabilities**

- A.
- The Company has pledged certain items of its equipment and the rights to any insurance claims on such items to secure its indebtedness with banks, as well as floating liens on all of its remaining assets in favor of the banks.
  - As a guarantee of the implementation of the approved projects and in compliance with the conditions of the approval (see Note 24A), pledges have been recorded on the Company's assets in favor of the State of Israel.
  - The Company has also pledged a machine and a computer system to suppliers to secure its indebtedness.
  - The Company has signed an agreement with a consulting company to incorporate the Theory of Constraint ( TOC ) into its operation. The purpose is to improve several operational measures identified by the Company's Management. Pursuant to the agreement in 2004, the Company paid consultation fees and agreed to pay bonuses to the consulting company based on its success. In the year ended December 31, 2004, the consulting company was not entitled to a bonus. During the year ended December 31, 2005 and 2006, the consulting company was entitled to a bonus of NIS 517 thousand and NIS 470 thousand, respectively. The agreement will expire on September 30, 2008.

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Eltek Ltd.

**Notes to the Consolidated and Company Financial Statements**

(All amounts in thousands of reported NIS, except where otherwise stated)

**Note 15 Commitments and Contingent Liabilities (cont d)**

- B. As of December 31, 2006, the Company and Kubatronik are committed to purchase equipment, services and inventories costing approximately NIS 9.2 million (Company NIS 8.9 million).
- C.
- The premises occupied by the Company and Kubatronik are leased under operating agreements which expire in February 2017 and June 2008, respectively.
  - Two parking areas that serve the employees of Kubatronik are leased under operating agreements which expire in December 2010.

3. The Company has signed several lease and maintenance agreements for production equipment with suppliers of equipment. Of such agreements, two principal agreements will expire in September 2009 and March 2010.
4. Three production machines are leased under operating agreements which will expire in September 2007, January 2008 and April 2009.
5. The Company has signed several other maintenance agreements for production equipment and software.
6. The majority of the Company's motor vehicles are leased under three year operating agreements.
7. Minimum future payments due under the above agreements are as follows:

	<u>Consolidated</u>	<u>Company</u>
	<u>December 31</u>	<u>December 31</u>
	<u>2006</u>	<u>2006</u>
First year	5,391	4,679
Second year	4,385	4,069
Third year	3,747	3,720
Fourth year	2,710	2,700
Fifth year and thereafter	15,533	15,533
	<u>31,766</u>	<u>30,701</u>

Payments required under operating lease agreements are charged to expense by the straight-line method over the periods of the respective leases.

**D. Indemnification agreement**

The Company entered into an indemnification agreement with its directors and officers and undertook to enter into the same agreement with future directors and officers, for losses incurred by a director or officer that will not exceed the lesser of US\$ 2,000,000 or 25% of the Company's shareholders' equity.

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Eltek Ltd.

**Notes to the Consolidated and Company Financial Statements**

(All amounts in thousands of reported NIS, except where otherwise stated)

**Note 16 Convertible Note**

In July 2003, the Company issued a convertible note (the Note) in the principal amount of \$500,000 to Merhav M.N.F Ltd. an Israeli private company controlled by the Company's major shareholder (Merhav).

The Note is due four years from its issuance date and bears interest at the rate of 10% per year, compounded on a quarterly basis.

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Merhav has the right, at any time, to convert the Note and any accrued interest thereon into ordinary shares of the Company at a price of \$ 0.33 per ordinary share, which was the price of the share at the time the terms of the Note were concluded. The Company may in its sole discretion repay the accrued interest on the principal of the Note to Merhav.

In January 2004, \$ 200,000 of the principal amount of the Note was converted into 606,060 ordinary shares.

As of December 31, 2006, the Note including accrued interest is convertible into 1,322,558 ordinary shares which at such date would have constituted 17.01% of the Company's ordinary shares after conversion.

**Note 17 Shareholders Equity**

**A. Authorized, issued and outstanding share capital in historical terms is as follows:**

	<u>Authorized</u>	<u>Issued and outstanding</u>	
	<u>December 31 2005 and 2006</u>	<u>December 31 2005</u>	<u>December 31 2006</u>
	<u>(in thousands)</u>	<u>(in thousands)</u>	<u>(in thousands)</u>
<b>Number of shares:</b>			
Ordinary Shares of par value NIS 0.6 each	50,000	5,603	5,624
<b>Amount in nominal NIS:</b>			
Ordinary Shares of par value NIS 0.6 each	30,000	3,362	3,374

**B. Options**

In August 2000, the Company adopted the Eltek Ltd. 2000 Stock Option Plan (the 2000 Plan). The 2000 Plan authorized the issuance of options to purchase an aggregate of 750,000 ordinary shares. The options generally (i) expire on the fifth anniversary of the date of grant, (ii) vest ratably over a three-year period and (iii) may not be exercised for a period of one year from the date of grant. The exercise prices of these options are equal to the market price of the underlying stock on the date of the grant.

As of December 31, 2006, options for the purchase of 20,000 ordinary shares having an exercise price of \$1.14 per share were outstanding under the 2000 Plan.

**Notes to the Consolidated and Company Financial Statements**

(All amounts in thousands of reported NIS, except where otherwise stated)

**Note 17 Shareholders Equity (cont d)**

**B. Options (cont d)**

Besides the above mentioned options, the Company does not intend to grant additional options under the 2000 plan.

In November 2005, the Board of Directors of the Company adopted and the Shareholders subsequently approved the Eltek Ltd. 2005 Stock Option Plan (the 2005 Plan). The aggregate number of options granted under the 2005 Plan amounted to 284,500 options. The

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options will expire two years from the date of the Shareholders' Approval of such plan, which was December 11, 2005, and no awards may be made under the 2005 Plan after December 31, 2005. Options granted under the 2005 Plan were fully vested upon their being awarded, and each option was designated as a Section 102(c) option of the Israeli tax ordinance. The exercise price per option was set to NIS 21 which equals the market price of the Company's ordinary shares on date of grant. See Note 24B.

As of December 31, 2006 the remaining unexercised option granted under the 2005 Plan are 267,400 options.

A summary of the Company's option plans and the options that were granted to the Company's employees and to the chairman of the board of directors is presented below:

	Number of options	Weighted average exercise price
		US\$
Balance as at December 31, 2003	453,333	4.16
Granted	20,000	1.14
Expired	(37,000)	1.75
Forfeited	(21,400)	4.38
Balance as at December 31, 2004	414,933	4.22
Granted	284,500	4.56
Exercised	(110,800)	4.38
Expired	(274,533)	4.38
Forfeited	(2,000)	4.38
Balance as at December 31, 2005	312,100	4.34
Granted	-	-
Exercised	(21,500)	4.76
Forfeited	(3,200)	4.97
Balance as at December 31, 2006	287,400	4.70

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Eltek Ltd.

### Notes to the Consolidated and Company Financial Statements

(All amounts in thousands of reported NIS, except where otherwise stated)

#### Note 17 Shareholders' Equity (cont'd)

##### B. Options (cont'd)

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The following table summarizes information concerning options outstanding at December 31, 2006:

Exercise prices		Number of options outstanding at December 31 2006	Number of options exercisable at December 31 2006	Remaining contractual life (in years)
U.S.\$	1.14	20,000	13,333	2.9
NIS	21	267,400	267,400	1
		<b>287,400</b>	<b>280,733</b>	

Note 18 Revenues

Revenues by activities

	Consolidated			Company		
	Year ended December 31 2004	Year ended December 31 2005	Year ended December 31 2006	Year ended December 31 2004	Year ended December 31 2005	Year ended December 31 2006
Sales of manufactured products	122,127	143,002	172,637	105,835	126,084	152,284
Sales of non-manufactured products	2,219	1,038	413	2,285	1,865	1,533
Commissions	656	389	894	665	510	894
	<b>125,002</b>	<b>144,429</b>	<b>173,944</b>	<b>108,785</b>	<b>128,459</b>	<b>154,711</b>

Customer who accounted for over 10% of the total consolidated revenues:

Consolidated			Company		
Year ended December 31			Year ended December 31		
2004	2005	2006	2004	2005	2006
12.3%	30.6%	25.2%	14.1%	34.4%	28.3%



## Notes to the Consolidated and Company Financial Statements

(All amounts in thousands of reported NIS, except where otherwise stated)

## Note 19 Cost of Revenues

	Consolidated			Company		
	Year ended December 31 2004	Year ended December 31 2005	Year ended December 31 2006	Year ended December 31 2004	Year ended December 31 2005	Year ended December 31 2006
Cost of materials and non-manufactured products <sup>(1)</sup>	42,117	45,823	<b>58,900</b>	38,550	43,251	<b>55,247</b>
Payroll and related benefits	35,699	37,409	<b>44,228</b>	29,228	30,964	<b>36,921</b>
Manufacturing expenses	19,491	23,540	<b>22,908</b>	16,265	19,935	<b>18,756</b>
Depreciation	13,136	10,710	<b>10,044</b>	11,561	9,489	<b>9,256</b>
Changes in inventories of finished products and work-in- process*	(445)	(1,749)	<b>446</b>	(273)	(1,397)	<b>858</b>
	<b>109,998</b>	<b>115,733</b>	<b>136,526</b>	<b>95,331</b>	<b>102,242</b>	<b>121,038</b>

\* Including changes in inventories of non-manufactured products.

(1) During the year ended December 31, 2006, one major supplier accounted for NIS 12,423 thousand (21.2% of the total consolidated materials and non-manufactured products purchase costs) (Company NIS 12,423 thousand (22%)).

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## Notes to the Consolidated and Company Financial Statements

(All amounts in thousands of reported NIS, except where otherwise stated)

## Note 20 Research and Development Expenses (Income), Net

	Consolidated and Company		
	Year ended December 31 2004	Year ended December 31 2005	Year ended December 31 2006
Payroll and payments to subcontractors	-	934	<b>1,230</b>
Raw materials	-	156	<b>107</b>

	Consolidated and Company		
Depreciation	-	25	<b>116</b>
Approved grants from the OCS	-	(469)	<b>(766)</b>
	-	646	<b>687</b>

In 2005, the Company was granted membership in OptiPac, a consortium within the framework of the MAGNET program of the OCS. The OptiPac target is to develop generic electro-optical packaging technologies for optical fiber based telecommunication systems and for several other industries and applications.

Under the terms of the consortium, each member of the consortium is provided with an advance for its research and development costs for a specific research and development project assigned to it by the consortium. The OCS reimburses 66% of such approved research and development expenses.

These reimbursements are contingent upon the Company submitting periodic reports prepared in accordance with the requirement of the OCS but are not contingent upon royalties or any future payments being made by the Company. The Company has been in compliance with such OCS requirements.

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#### Notes to the Consolidated and Company Financial Statements

(All amounts in thousands of reported NIS, except where otherwise stated)

#### Note 21 Selling, General and Administrative Expenses

	Consolidated			Company		
	Year ended December 31 2004	Year ended December 31 2005	Year ended December 31 2006	Year ended December 31 2004	Year ended December 31 2005	Year ended December 31 2006
Payroll and related benefits	8,437	9,467	<b>11,488</b>	6,416	7,174	<b>8,936</b>
Commissions	1,476	1,894	<b>2,471</b>	1,675	1,728	<b>2,055</b>
Export and delivery expenses	1,592	1,612	<b>2,197</b>	1,357	1,343	<b>1,720</b>
Office maintenance	890	849	<b>1,017</b>	674	661	<b>764</b>
Traveling	594	762	<b>768</b>	430	691	<b>715</b>
Depreciation	292	169	<b>84</b>	205	116	<b>84</b>
Professional services	2,215	2,786	<b>3,089</b>	1,809	2,370	<b>2,636</b>
Car maintenance	710	749	<b>834</b>	624	645	<b>767</b>
Investors relations	230	289	<b>264</b>	230	289	<b>264</b>
Other	1,829	1,285	<b>2,096</b>	1,634	1,344	<b>2,087</b>
	18,265	19,862	<b>24,308</b>	15,054	16,361	<b>20,028</b>

## Notes to the Consolidated and Company Financial Statements

(All amounts in thousands of reported NIS, except where otherwise stated)

## Note 22 Financial Expenses, Net

	Consolidated			Company		
	Year ended December 31 2004	Year ended December 31 2005	Year ended December 31 2006	Year ended December 31 2004	Year ended December 31 2005	Year ended December 31 2006
Interest and exchange rate expenses on long- term loans net of monetary erosion	864	1,050	505	864	1,050	505
Expenses on short-term credit and bank charges net of monetary erosion	1,465	1,541	1,421	1,450	1,522	1,401
Effect of exchange rate differences on expenses and net gain from derivative instruments	319	(268)	449	263	(237)	397
Expenses on convertible note	150	254	24	150	254	24
Other financing expenses (income), net	150	79	(3)	(446)	(208)	28
	<u>2,948</u>	<u>2,656</u>	<u>2,396</u>	<u>2,281</u>	<u>2,381</u>	<u>2,355</u>

## Note 23 Other Income (Expenses), Net

	Consolidated			Company		
	Year ended December 31 2004	Year ended December 31 2005	Year ended December 31 2006	Year ended December 31 2004	Year ended December 31 2005	Year ended December 31 2006
Gain (loss) on disposals of fixed assets, net	86	103	24	77	111	(9)
Other expenses	(34)	-	-	(34)	-	-
	<u>52</u>	<u>103</u>	<u>24</u>	<u>43</u>	<u>111</u>	<u>(9)</u>

**Notes to the Consolidated and Company Financial Statements****(All amounts in thousands of reported NIS, except where otherwise stated)****Note 24 Taxes on Income****A. Tax benefits under the Israeli Law for the Encouragement of Capital Investments, 1959 (the Law )**

1. Certain of the Company's investment programs in expanding its production facilities in Israel were granted approved enterprise status in accordance with the above Law. As of the date of these financial statements, one approved investment program is applicable to the Company.

The investment programs are based on the Alternative Benefits track and provide for tax benefits as follows: a zero tax rate on the Company's undistributed income arising from the revenue that is derived from the approved enterprise, for a period of two years, starting with the year in which the Approved Enterprise first earns taxable income. The income so derived in the five subsequent years will be subject to tax at a reduced rate of 25%. The period of tax benefit relating to one of these programs has not yet commenced, and will expire no later than 2016. The period of tax benefits for all other programs expired in 2005.

Entitlement to the above benefits is conditional upon the Company complying with the conditions stipulated by the Law and the regulations promulgated thereunder, as well as the criteria set forth in the approval for the specific investment in the approved enterprise. In the event of failure to comply with these conditions, the tax benefits may be cancelled, and the Company may be required to refund the amount of the cancelled benefits, together with CPI linkage adjustment and interest. See Note 15(A)(2) for a pledge registered in this respect.

The period of tax benefits described above is limited to 12 years from the commencement of production, or 14 years from the approval date, whichever is earlier.

The Law also grants entitlement to claim accelerated depreciation for tax purposes on machinery and equipment used by the approved enterprise.

Income of the Company not derived from the approved enterprise is subject to the regular corporate tax rate, which is 31% in 2006.

Dividends paid out of income derived from an approved enterprise (or out of dividends received from a company whose income is derived from an approved enterprise) are generally subject to withholding tax at the rate of 15% (deductible at source). The rate of 15% is limited to dividends and distributions out of income derived during the benefits period and actually paid at any time up to 12 years thereafter. A company which elects the Alternative Benefits track will be subject to corporate tax at the otherwise applicable rate of 25% in respect of the gross amount of the dividend if it pays a dividend out of income derived from its approved enterprise during the tax exemption period.

**2. Amendments to the Law**

On March 30, 2005, the Israeli Parliament approved a reform of the above Law. The primary changes are as follows:

- (a) Companies that meet the criteria of the Alternative Benefit track tax benefits will receive those benefits without prior approval. In addition, there will be no requirement to file reports with the Investment Center. Audits will be the responsibility of the Israeli Income Tax Authorities as part of their tax audits. Request for pre-ruling is possible.
- (b) Tax benefits of the Alternative track include lower tax rates or no tax depending on area and the path chosen, lower tax rates on dividends and accelerated depreciation.

**Notes to the Consolidated and Company Financial Statements****(All amounts in thousands of reported NIS, except where otherwise stated)****Note 24 Taxes on Income (cont d)****A. Tax benefits under the Law for the Encouragement of Capital Investments, 1959 (the Law )****2. Amendments to the Law (cont d)**

- (c) In order to receive benefits in the Grant Path or the Alternative Benefit track, the industrial enterprise must contribute to the economic independence of the Israel s economy in one of the following ways:
1. Its primary activity is in the Biotechnology or Nanotechnology fields and pre-approval has been obtained from the head of research and development at the OCS;
  2. Its revenue from a specific country is not greater than 75% of its total revenues that year;
  3. 25% or more of its revenues are derived from a specific market of at least 12 million residents.
- (d) Upon the establishment of an enterprise, an investment of at least NIS 300 thousand in production machinery and equipment within three years is required.
- (e) For an expansion, a company is required to invest within three years the greater of NIS 300 thousand in production machinery and equipment or a certain percentage of its existing production machinery and equipment.

The amendment to the Law does not retroactively apply for investment programs having an Approved Enterprise approval certificate from the Investment Center issued prior to December 31, 2004. Therefore, the amendments do not impact an existing Approved Enterprise which received written approval. The new tax regime shall apply for a new Approved Enterprise and for an Approved Enterprise expansion for which the first year of benefits is 2004 or thereafter.

**B. Taxation of employee stock option plans**

In respect to employee stock incentive plan, the 2003 Israeli tax reform codified past practice and determined three alternative tracks for taxing employee stock option plans. Where a trustee arrangement is in place, the employer can either claim an expense for tax purposes while the employee will be fully taxed up to the maximum marginal tax rate of 49% (the Ordinary Income Route ) or the Company can waive the tax expense deduction and the employee will pay a reduced tax rate of 25% (the Capital Gains Route ). Where there is no trustee arrangement, the employee is fully taxed and no expense deduction is allowed to the Company. There are detailed provisions for implementing these tracks. The tax reform s new regulations do not apply for options granted before December 31, 2002. The options granted by the Company during 2004 and 2005 were granted pursuant to the Capital Gains Route.

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**Notes to the Consolidated and Company Financial Statements****(All amounts in thousands of reported NIS, except where otherwise stated)**

**Note 24 Taxes on Income (cont d)****C. Amendments to the Income Tax Ordinance**

1. On June 29, 2004, the Knesset (the Israeli Parliament) passed the Law for the Amendment of the Income Tax Ordinance (Amendment No. 140 and Temporary Order) 2004 (the 2004 Amendment). The 2004 Amendment provides for a gradual reduction in the corporate tax rate from 36% to 30% in the following manner: 35% for the 2004 tax year, 34% for the 2005 tax year, 32% for the 2006 tax year and 30% for the 2007 tax year and thereafter.
2. On July 25, 2005 the Knesset passed the Law for the Amendment of the Income Tax Ordinance (No. 147 and Temporary Order) 2005 (the 2005 Amendment).

The 2005 Amendment provides for a gradual reduction in the corporate tax rate in the following manner: in 2006 the tax rate will be 31%, in 2007 the tax rate will be 29%, in 2008 the tax rate will be 27%, in 2009 the tax rate will be 26% and from 2010 onward the tax rate will be 25%. Furthermore, as from 2010, upon reduction of the company tax rate to 25%, real capital gains will be subject to tax of 25%.

The Company believes that both Amendments will have no significant impact on its financial position or results of operations, since it had not recognized deferred tax assets as of December 31, 2006.

**D. Adjustments for inflation**

The Israeli Income Tax Law (Inflationary Adjustments) 1985 (hereinafter the Law) is effective as from the 1985 tax year. The Law introduced the concept of measurement of results for tax purposes on a real (net of inflation) basis. The various adjustments required by the aforesaid law are designed to achieve taxation of income on a real basis. However, the earnings adjusted according to the tax laws are not identical to the earnings reported according to the accounting standards of the Israel Accounting Standard Board. As a result, differences arise between the reported income in the financial statements and the adjusted income for tax purposes.

**E. Carryforward tax losses**

As of December 31, 2006, the Company's tax loss carryforward was approximately NIS 41.7 million while its foreign subsidiary's tax loss carryforward was NIS 3.4 million. The carry-forward losses in Israel are linked to the Consumer Price Index in accordance with the law mentioned in D above, except for those of the subsidiary that keeps its books in foreign currency, and which are linked to the change in the foreign currency exchange rate. As of December 31, 2006, the Company has recorded a full valuation allowance on the deferred tax asset in respect of these losses, due to the uncertainty as to whether such assets will be realized in the foreseeable future.

The Company and its foreign subsidiary tax loss carryforwards do not have an expiry date.

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**Notes to the Financial Statements**

(All amounts in thousands of reported NIS, except where otherwise stated)

**Note 24 Taxes on Income (cont d)****F. Income tax assessments**

In Israel, the Company has received final tax assessments through the 1995 tax year. The tax years 1996-2001 are considered final due to limitation.

The Company's principal foreign subsidiary has received final tax assessments through the 2003 tax year.

The Company's other subsidiaries have not yet received any final tax assessments since incorporation.

**G. Reconciliation of the theoretical tax expense to the actual tax expense**

A reconciliation of the theoretical tax expense, assuming all income is taxable at the statutory rates applicable in Israel, and the actual tax expense, is as follows:

	Consolidated			Company		
	Year ended December 31 2004	Year ended December 31 2005	Year ended December 31 2006	Year ended December 31 2004	Year ended December 31 2005	Year ended December 31 2006
Income (loss) before taxes as Reported in the statement of operations	(6,750)	5,042	10,051	(3,838)	6,940	10,594
Primary tax rate	35%	34%	31%	35%	34%	31%
Tax expenses (benefit) calculated	(2,363)	1,714	3,116	(1,343)	2,360	3,284
Non-deductible operating expenses	160	153	175	160	153	175
Amortization of goodwill	216	202	-	-	-	-
Unrecognized Deferred taxes	1,544	(2,566)	(5,990)	1,445	(2,954)	(6,850)
Depreciation and Inflation impact	(261)	441	(118)	(262)	441	(118)
Translation adjustments	-	56	(16)	-	-	-
Changes in tax Rate	-	-	3,617	-	-	3,509
Foreign tax rate differential	(9)	-	(81)	-	-	-
Total	1,650	(1,714)	(2,413)	1,343	(2,360)	(3,284)
Tax (benefit) Expenses	(713)	-	703	-	-	-

All tax expenses (benefits) recorded for the years presented are deferred tax expenses (benefits) attributable to the foreign subsidiary.

(All amounts in thousands of reported NIS, except where otherwise stated)

**Note 24 Taxes on Income (cont d)****H. Deferred taxes**

	<u>Consolidated</u>
Balance as at January 1, 2005	753
Changes in 2005 that are not carried to income - translation adjustments	(56)
Balance as at December 31, 2005	<sup>(1)</sup> 697
Changes in 2006 that are not carried to income - translation adjustments	16
Cancellation of deferred taxes during 2006	<sup>(2)</sup> (713)
Balance as at December 31, 2006	<sup>(2)</sup> -

(1) The deferred taxes are in respect of losses carryforward of Kubatronik and were calculated according to the relevant tax rates in Germany.

(2) As of December 31, 2006, management has provided a full valuation allowance in respect of all the deferred tax asset.

**I. Deferred tax assets that were recognized:**

	<u>Consolidated</u>		<u>Company</u>	
	December 31 2005	December 31 2006	December 31 2005	December 31 2006
Total deferred tax assets	20,798	14,112	19,712	12,863
Less: deferred tax assets that were not recognized due to non-compliance with the conditions for recognizing deferred tax assets:				
Losses carryforward (in Israel)	18,374	11,294	18,374	11,294
Losses carryforward (outside Israel)	389	1,249	-	-
Severance pay	43	42	43	42
Vacation pay	793	953	793	953
Allowance for doubtful accounts	502	574	502	574
Total	(20,101)	(14,112)	(19,712)	(12,863)
Deferred tax assets that were recognized	697	-	-	-



Consolidated

Company

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**Notes to the Financial Statements****(All amounts in thousands of reported NIS, except where otherwise stated)****Note 25 Financial Instruments and Risk Management**

The Company is exposed to credit, interest and currency risks in the ordinary course of business. The Company uses derivative instruments in order to reduce the exposure to such risks.

**A. Credit risks**

The revenues of the Company and its subsidiaries derive mainly from sales to customers in Israel, countries of the European Union and the USA. Management of the Company regularly monitors the debts of customers, and the financial statements include specific provisions for doubtful debts which properly reflect, in the opinion of management the loss included in the debts the collection of which is doubtful.

As at December 31, 2006, the trade receivables balance includes material debts of a number of major customers, in respect of which there is a concentration of credit risk, as follows:

	December 31 2006
	NIS thousands
Customers	15,217
Less - Provisions for doubtful debts	4
Customers, net	15,213

In 2006, the sales to these customers were NIS 75 million.

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Eltek Ltd.

**Notes to the Financial Statements****(All amounts in thousands of reported NIS, except where otherwise stated)**

## Note 25 Financial Instruments and Risk Management (cont d)

## B. Effective interest rates analysis

In respect of income-earning financial assets and interest-bearing financial liabilities, the following tables indicates their average effective interest rates at the reporting date and the periods in which they mature.

		Consolidated							
		December 31, 2006							
Note	Average effective interest rate	Total	Up to one year	1-2 years	2-3 years	3-4 years	4-5 years	Over 5 years	
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	
<b>Instruments bearing fixed interest</b>									
Cash and cash equivalents:									
U.S. dollars	3	4.88%	3,804	3,804	-	-	-	-	-
Convertible debenture note	16	10%	1,844	1,844	-	-	-	-	-
Loans from banks:									
In NIS	13	8.08%	3,242	692	750	812	840	148	-
In NIS, linked	13	5.92%	1,895	534	408	432	436	85	-
Loans from fixed asset supplier:									
In NIS, linked	13	6.35%	561	222	236	103	-	-	-
U.S. dollars	13	5.85%	2,740	1,050	1,074	616	-	-	-
			<u>14,086</u>	<u>8,146</u>	<u>2,468</u>	<u>1,963</u>	<u>1,276</u>	<u>234</u>	<u>-</u>
<b>Instruments bearing variable interest</b>									
Bank credit:									
In NIS	10	6.97%	8,000	8,000	-	-	-	-	-
U.S. dollars	10	7.38%	465	465	-	-	-	-	-
Trade payables:									
In NIS	11	9.29%	476	476	-	-	-	-	-
Loans from banks:									
In NIS	13	6.88%	7,516	1,044	2,190	3,384	510	388	-
U.S. dollars	13	7.35%	1,546	997	549	-	-	-	-
Loans from fixed asset suppliers:									
In NIS	13	5.88%	91	91	-	-	-	-	-
			<u>18,094</u>	<u>11,073</u>	<u>2,739</u>	<u>3,384</u>	<u>510</u>	<u>388</u>	<u>-</u>

## Notes to the Financial Statements

(All amounts in thousands of reported NIS, except where otherwise stated)

## Note 25 Financial Instruments and Risk Management (cont d)

## C. Foreign currency risks

The Company is exposed to foreign currency risks from sales, purchases and loans denominated in currencies other than the Group's functional currency. The risks are mainly in respect of the US dollar, the euro and the pound sterling. The Group hedges at least 40%-50% of balances with its customers and suppliers denominated in foreign currency. The Company uses futures currency contracts in order to hedge its foreign currency risk. The futures currency contracts have a maturity date of less than one year from the date of the report. The futures currency contracts are renewed as necessary.

As at December 31, 2006, the Company opened forward exchange contracts which are intended to hedge exposure with respect to assets and liabilities in foreign currency, as described below:

	Currency receivable	Currency payable	Expiration date	Amount receivable	Amount payable	Fair value
Forward transaction:						
	US dollars	NIS	29.1.2007	-	1,295	(0.9)
	NIS	US dollars	29.1.2007	1,278	-	13.8

## D. Disclosures Regarding Fair Value of Financial Instruments

The Company's financial instruments consist primarily of cash and cash equivalents, trade and other receivables, trade payables, short-term credit and long-term debt. The carrying amounts of the short-term financial instruments, approximates their fair value because of the short maturity of these instruments.

The fair value of the derivatives is based upon their quoted market price as of the date of the balance sheet.

The fair value of the long-term loans and convertible debentures note and the market interest rates for computation of the fair values as at December 31, 2006 are as follows:

	Consolidated and Company		
	Market Interest rate	Fair value	Book value
Current financial liabilities:			
Convertible debentures note	7.6%	1,832	1,844
Long-term financial liabilities:			
Long-term bank loans, including current maturities	5.9%-8.1%	13,364	14,199
Other long-term loans, including current maturities	5.6%-6.0%	3,072	3,392

## E. Sensitive analysis

In managing its interest risks and currency risks, the Company strives to reduce the effect of short-term fluctuations on its profits. Conversely, in the long term, changes in foreign currency rates and interest have an effect on the profits of the Company.

As at December 31, 2006, the Company estimates that an increase of one percent in interest rates would reduce the pre-tax profits of the Company by the amount of NIS 245 thousand.

In addition, the Company estimates that an increase of one percent in the exchange rate of the dollar would have reduced the pre-tax profits of the Company by the amount of NIS 676 thousand for the year ended December 31, 2006.

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Eltek Ltd.

## Notes to the Financial Statements

(All amounts in thousands of reported NIS, except where otherwise stated)

### Note 26 Segment Reporting

The Company and its subsidiaries have three reportable geographic segments, i.e. Israel, Europe and others – mainly the United States and India.

	Year ended December 31, 2006				
	Israel	Europe	Other	Adjustments	Consolidated
External revenues for the segment	79,635	79,978	14,331	-	173,944
Internal revenues for the segment	1,835	5,296	-	(7,131)	-
<b>Total revenues for the segment</b>	<b>81,470</b>	<b>85,274</b>	<b>14,331</b>	<b>(7,131)</b>	<b>173,944</b>
Operating income (loss)	9,169	3,618	(141)	(223)	12,423
Financial expenses	(1,213)	(1,225)	(217)	-	(2,655)
Financial income	133	102	24	-	259
Other income (expenses), net	(9)	33	-	-	24
Company's share in losses of subsidiaries, net	-	-	-	-	-
Tax expenses	-	(703)	-	-	(703)
Minority interests	-	266	-	-	266
<b>Net income (loss)</b>	<b>8,080</b>	<b>2,091</b>	<b>(334)</b>	<b>(223)</b>	<b>9,614</b>
Total assets	45,338	51,030	10,770	(9,361)	97,777
Total liabilities	34,206	27,625	6,203	(2,202)	65,832

	Year ended December 31, 2006				
Capital expenditure	6,187	5,405	1,116	-	12,708
Depreciation and amortization	4,997	4,505	877	-	10,379

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Eltek Ltd.

## Notes to the Financial Statements

(All amounts in thousands of reported NIS, except where otherwise stated)

## Note 26 Segment Reporting (cont d)

	Year ended December 31, 2005				
	Israel	Europe	Other	Adjustments	Consolidated
External revenues for the segment	61,058	73,107	10,264	-	144,429
Internal revenues for the segment	1,204	7,774	65	(9,043)	-
Total revenues for the segment	62,262	80,881	10,329	(9,043)	144,429
Operating income (loss)	5,524	2,674	(506)	(97)	7,595
Financial expenses	(1,275)	(2,021)	(216)	340	(3,172)
Financial income	106	655	98	(343)	516
Other income (expenses), net	111	(8)	-	-	103
Company's share in losses of subsidiaries, net	*-	-	-	*-	-
Tax benefit	-	-	-	-	-
Minority interests	-	218	-	-	218
Net income (loss)	*4,466	1,518	(624)	*(100)	5,260
Total assets for the segment	45,573	42,429	7,016	(9,103)	85,915
Deferred taxes	-	697	-	-	697

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	Year ended December 31, 2005				
Total assets	45,573	43,126	7,016	(9,103)	86,612
Total liabilities	30,181	28,701	5,132	(935)	63,079
Capital expenditure	5,762	5,889	977	-	12,628
Depreciation and amortization	4,642	6,075	780	-	11,497

\* Reclassified

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Notes to the Financial Statements

(All amounts in thousands of reported NIS, except where otherwise stated)

Note 26 Segment Reporting (cont d)

	Year ended December 31, 2004				
	Israel	Europe	Other	Adjustments	Consolidated
External revenues for the segment	67,867	48,005	9,130	-	125,002
Internal revenues for the segment	60	8,750	-	(8,810)	-
Total revenues for the segment	67,927	56,755	9,130	(8,810)	125,002
Operating income (loss)	1,313	(4,039)	(1,078)	(50)	(3,854)
Financial expenses	(1,944)	(1,718)	(261)	649	(3,274)
Financial income	4	921	64	(663)	326
Other income, net	43	9	-	-	52
Company's share in losses of subsidiaries, net	*-	-	-	*-	-
Tax benefit	-	713	-	-	713
Minority interests	-	182	-	-	182

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	Year ended December 31, 2004				
Net loss	*(584)	(3,932)	(1,275)	*(64)	(5,855)
Total assets for the segment	45,866	38,280	6,603	(11,061)	79,688
Deferred taxes	-	753	-	-	753
Total assets	45,866	39,033	6,603	(11,061)	80,441
Total liabilities	39,283	34,922	5,228	(15,549)	63,884
Capital expenditure	743	627	100	-	1,470
Depreciation and amortization	7,345	5,686	990	-	14,021

\* Reclassified

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Eltek Ltd.

Notes to the Financial Statements

(All amounts in thousands of reported NIS, except where otherwise stated)

Note 27 Earnings (Losses) Per Share

	Year ended December 31, 2006		
	2004	2005	2006
	NIS in thousands		
<b>Weighted average number of shares and income (loss) used to compute basic earnings (loss) per share:</b>			
Income (loss) used to compute basic earnings (loss) per share	(5,855)	5,260	9,614
Weighted average number of shares used to compute basic net earnings (loss) per share (in thousands)	5,492	5,575	5,617

Year ended December 31, 2006

**Weighted average number of shares and income (loss) used to compute diluted net earnings (loss) per share:**

Income (loss) used to compute basic net earnings (loss) per share	(5,855)	5,260	<b>9,614</b>
Interest expenses and income (losses) of exchange rate on convertible note	-	254	<b>24</b>
Income (loss) used to compute diluted net earnings (loss) per share	(5,855)	5,514	<b>9,638</b>
Weighted average number of shares used to compute basic net earnings (loss) per share (in thousands)	5,492	5,575	<b>5,617</b>
Influence of conversion of convertible convertible note (in thousands)	-	1,198	<b>1,323</b>
Influence of conversion of option to share (in thousands)	-	12	<b>14</b>
Weighted average number of shares used to compute diluted net earnings (loss) per share (in thousands)	5,492	6,785	<b>6,954</b>

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**Notes to the Financial Statements**

(All amounts in thousands of reported NIS, except where otherwise stated)

**Note 28 Related and Interested Party Transactions**

		Consolidated and Company		
		Year ended December 31 2004	Year ended December 31 2005	Year ended December 31 2006
A.	Salaries and related expenses to interested parties <sup>(1)</sup>	1,382	1,427	<b>1,933</b>
B.	Interest and exchange rate expenses <sup>(2)</sup>	150	254	<b>24</b>



- (1) 5 persons in each year.
- (2) Expenses on convertible note (see Note 16).
- C. Loans to and other receivables from the subsidiaries included in the financial statements of the Company as at December 31, 2006 and 2005 is NIS 2,186 thousand and NIS 2,147 thousand, respectively (see Note 7).
- D. Compensation of directors**
- (1) The Company pays its Chairman of the Board of Directors a fee and reimburses him for various expenses that he incurs in connection with his service. Since 2005, the Company also provides him with a car. In addition, the Company compensates its external directors for their service.
- (2) The total cost of the above mentioned compensation in 2006 was NIS 519 thousand (in 2005 NIS 367 thousand, in 2004 NIS 321 thousand).

The transactions with related and interested parties were conducted at terms comparable with those of similar transactions with third parties.

**Note 29 Effect of Significant Differences Between Generally Accepted Accounting Principles in Israel and the United States**

The Consolidated and Company financial statements are prepared in accordance with Israeli GAAP which differs in certain significant respects from those followed in the United States of America. The significant differences are set out below:

**A. Effect of inflation**

The Company, in accordance with Israeli GAAP, included the effect of price level changes in the accompanying financial statements, as described in Note 2C until December 31, 2003.

U.S. GAAP does not provide for recognition of the effects of such price level changes. Such effects have not been included in the reconciliation to U.S. GAAP.

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Eltek Ltd.

**Notes to the Financial Statements**

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(All amounts in thousands of reported NIS, except where otherwise stated)

**Note 29 Effect of Significant Differences Between Generally Accepted Accounting Principles in Israel and the United States (cont d)**

**B. Liability for employee severance benefits**

According to Israeli GAAP, amounts funded by purchase of insurance policies or by deposits are deducted from the related accrued severance pay liability, and presented at a net amount.

According to U.S. GAAP, these balance sheet amounts (the amount of the related liability accrued and the related assets) should be presented gross, instead of net.

**C. Convertible debenture note**

Until December 31, 2005, under Israeli GAAP, the convertible note is presented on the balance sheet as a separate item between long-term liabilities and shareholders' equity, whereas under U.S. GAAP it should be presented as a liability.

As from January 1, 2006, there is no difference in the presentation between Israeli GAAP and U.S. GAAP.

**D. Goodwill amortization**

Until December 31, 2005, under Israeli GAAP, goodwill derived from the acquisition of Kubatronik (see Note 1) is being amortized on a straight-line basis over 10 years. Under U.S. GAAP, goodwill is not amortized but is evaluated for impairment in accordance with SFAS No. 142 Goodwill and Other Intangible Assets .

As from January 1, 2006, goodwill is not amortized under both Israeli GAAP and U.S. GAAP.

At the end of fiscal 2006, goodwill was evaluated and an impairment of NIS 2,105 was recorded under U.S. GAAP.

**E. Financial derivative**

As described in Note 1, the seller of Kubatronik's shares has the right to require the Company to purchase (put option), and the Company has the right to require the seller to sell to the Company (call option), the seller's remaining 24% stock ownership of Kubatronik. Under Israeli GAAP, there are no accounting consequences. Under U.S. GAAP, according to SFAS 150, Accounting for Certain Financial Instruments with characteristics of both Liabilities and Equity , those options are measured at fair value and presented as a net written put option.

**F. Cash flows**

**1. Changes in exchange rate**

According to Israeli GAAP, the effects of changes in exchange rates in cash and cash equivalents are reflected as cash flows from operating activities in the statement of cash flows.

Under U.S. GAAP, the effect of changes in exchange rates on cash and cash equivalents are presented separately in the statement of cash flows (see Note 29(H)(6)).

**2. Loans in respect of fixed assets financing arrangement treated as capital leases**

According to Israeli GAAP, long term financing arrangement in respect of acquisition of fixed assets, treated as capital leases are reflected in the statement of cash flows as cash flows from financing activities and investing activities for the acquisition of the fixed assets financed by the arrangement.

Under U.S. GAAP, as prescribed by SFAS 95, the above mentioned items are reflected as non-cash financing activities (see Note 29(H)(6)).

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**Notes to the Financial Statements**

(All amounts in thousands of reported NIS, except where otherwise stated)

**Note 29 Effect of Significant Differences Between Generally Accepted Accounting Principles in Israel and the United States (cont d)**

**G. Statement of other comprehensive income**

SFAS 130, Reporting Comprehensive Income requires that all items that are required to be recognized under accounting standards as components of comprehensive income be reported in a financial statement and displayed in the same prominence as other financial statements. It requires that an enterprise (a) classify items of other comprehensive income by their nature in a financial statement and (b)

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display the accumulated balance of other comprehensive income separately from retained earnings and additional paid in capital in the equity section of the statement of financial position.

**H. Effect on financial statements**

**1) Balance sheet items:**

	Consolidated	
	December 31 2005	December 31 2006
Israeli GAAP - Goodwill, net of amortization (D)	3,735	3,816
Employee severance benefit, net (B)	(274)	(344)
U.S. GAAP - Goodwill	5,796	3,816
Assets held for severance pay benefits	4,249	4,672
Liability in respect of employee severance benefits	(4,523)	(5,016)

	Consolidated	
	December 31 2005	December 31 2006
Israeli GAAP - Other liabilities and accrued expenses	10,914	12,539
U.S. GAAP - Net written put option (E)	54	619
Other liabilities and accrued expenses	10,968	13,158

**2) Statements of operations items:**

	Consolidated and Company		
	Year ended December 31	Year ended December 31	Year ended December 31
	2004	2005	2006
Net income (loss) reported under Israeli GAAP	(5,855)	5,260	9,614
Amortization of goodwill (D)	593	593	-
Impairment of goodwill (D)	-	-	(2,105)

	Consolidated and Company		
	(114)	60	(565)
Net written put option (E)	(114)	60	(565)
Net income (loss) under U.S. GAAP	(5,376)	5,913	6,944
Basic net earnings (loss) per share	(0.98)	1.06	1.24
Diluted net earnings (loss) per share	(0.98)	0.90	1.00

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## Notes to the Financial Statements

(All amounts in thousands of reported NIS, except where otherwise stated)

### Note 29 Effect of Significant Differences Between Generally Accepted Accounting Principles in Israel and the United States (cont d)

#### H. Effect on Financial Statements (cont d)

#### 3) Statement of other comprehensive income

	Consolidated and Company		
	Year ended December 31	Year ended December 31	Year ended December 31
	2004	2005	2006
Net income (loss) - U.S. GAAP	(5,376)	5,913	6,944
Foreign currency translation adjustments	699	(788)	221
Net comprehensive income (loss) - U.S. GAAP	(4,677)	5,125	7,165
<b>4) Shareholders' equity</b>			
Total shareholders' equity - Israeli GAAP	14,991	21,713	31,945
Accumulated amortization of goodwill (D)	1,469	2,062	(43)
Translation adjustments in respect of goodwill	129	(1)	43
Net written put option (E)	(114)	(54)	(619)
Total shareholders' equity - U.S. GAAP	16,475	23,720	31,326

#### 5) Statement of changes in shareholders' equity - US GAAP

	2004	2005	2006
Balance as of January 1	20,273	16,475	23,720
Conversion of convertible note	879	-	-
Exercise of employee stock options	-	2,120	441
Net income (loss)	(5,376)	5,913	6,944
Foreign currency translation adjustments	699	(788)	221
Balance as of December 31	16,475	23,720	31,326

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Eltek Ltd.

## Notes to the Financial Statements

(All amounts in thousands of reported NIS, except where otherwise stated)

### Note 29 Effect of Significant Differences Between Generally Accepted Accounting Principles in Israel and the United States (cont d)

#### H. Effect on Financial Statements (cont d)

##### 6) Condensed cash flows statement

	Consolidated		
	Year ended December 31 2004	Year ended December 31 2005	Year ended December 31 2006
Net cash provided by operating activities under Israeli GAAP	7,949	14,276	11,619
Changes in exchange rate included in above Note 29(F)(1)	3	(16)	266
Net cash provided by operating activities under U.S. GAAP	7,952	14,260	11,885
Net cash used in investing activities under Israeli GAAP	(1,282)	(12,464)	(9,605)
Purchase of fixed assets under financing arrangement - Note 29(F)(2)	-	2,830	1,671

	Consolidated		
Net cash used in investing activities under U.S. GAAP	(1,282)	(9,634)	(7,934)
Net cash provided by (used in) financing activities under Israeli GAAP	(6,890)	1,328	(707)
Loans in respect of financing arrangement - Note 29(F)(2)	-	(2,830)	(1,671)
Net cash used in financing activities under U.S. GAAP	(6,890)	(1,502)	(2,378)
Effect of exchange rates - changes on cash	123	(140)	(255)
Changes in cash and cash equivalents under Israeli GAAP	(97)	2,984	1,318
Changes in cash and cash equivalents under U.S. GAAP	(97)	2,984	1,318

The Company paid NIS 2,055 thousand, NIS 1,709 thousand and NIS 2,261 thousand for interest in 2006, 2005 and 2004, respectively.

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Eltek Ltd.

## Notes to the Financial Statements

(All amounts in thousands of reported NIS, except where otherwise stated)

### Note 30 Assets and Liabilities Analyzed by Currency and Linkage Basis

#### Consolidated

	December 31, 2006						Total
	Linked to CPI	Non-linked	Foreign currency U.S. dollars	Foreign currency Euro	Other foreign currency	Non-monetary items	
Cash and cash equivalents	-	2,427	5,270	802	77	-	8,576
Trade and other receivables and prepaid expenses	157	16,978	13,425	3,105	-	813	34,478
Inventories	-	-	-	-	-	15,910	15,910
Deferred taxes	-	-	-	-	-	-	-
Property and equipment, net	-	-	-	-	-	34,997	34,997

	December 31, 2006						
Goodwill	-	-	-	-	-	3,816	3,816
<b>Total assets</b>	<b>157</b>	<b>19,405</b>	<b>18,695</b>	<b>3,907</b>	<b>77</b>	<b>55,536</b>	<b>97,777</b>
Short-term credit and current maturities of long-term debts	8,533	1,736	1,462	-	-	-	11,731
Trade payables	222	14,048	7,659	3,159	12	-	25,100
Other liabilities and accrued expenses	1,055	8,828	1,716	940	-	-	12,539
Convertible note	-	-	1,844	-	-	-	1,844
Long-term debt, excluding current maturities	1,702	9,021	2,239	-	-	-	12,962
Employee severance benefits, net	-	163	-	181	-	-	344
Minority interests	-	-	-	-	-	1,312	1,312
<b>Total liabilities</b>	<b>11,512</b>	<b>33,796</b>	<b>14,920</b>	<b>4,280</b>	<b>12</b>	<b>1,312</b>	<b>65,832</b>
<b>Total shareholders' equity</b>	<b>(11,355)</b>	<b>(14,391)</b>	<b>3,775</b>	<b>(373)</b>	<b>65</b>	<b>54,224</b>	<b>31,945</b>

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Eltek Ltd.

## Notes to the Financial Statements

(All amounts in thousands of reported NIS, except where otherwise stated)

## Note 30 Assets and Liabilities Analyzed by Currency and Linkage Basis (cont d)

## Consolidated (cont d)

	December 31, 2005						
	Linked to CPI	Non-linked	Foreign currency U.S. dollars	Foreign currency Euro	Other foreign currency	Non-monetary items	Total
Cash and cash equivalents	-	310	5,529	1,418	1	-	7,258
Trade and other receivables and prepaid expenses	117	11,258	11,185	2,356	-	986	25,902
Inventories	-	-	-	-	-	16,051	16,051
Deferred taxes	-	-	-	697	-	-	697
Property and equipment, net	-	-	-	-	-	32,969	32,969
Goodwill	-	-	-	-	-	3,735	3,735
<b>Total assets</b>	<b>117</b>	<b>11,568</b>	<b>16,714</b>	<b>4,471</b>	<b>1</b>	<b>53,741</b>	<b>86,612</b>

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December 31, 2005

Short-term debt	1,526	12,198	3,837	-	-	-	17,561
Trade payables	-	14,070	8,110	2,980	16	-	25,176
Other liabilities and accrued expenses	1,597	6,517	1,460	1,330	10	-	10,914
Long-term debt, excluding current maturities	1,089	2,944	3,574	-	-	-	7,607
Employee severance benefits, net	-	143	-	131	-	-	274
Minority interests	-	-	-	-	-	1,547	1,547
<b>Total liabilities</b>	<b>4,212</b>	<b>35,872</b>	<b>16,981</b>	<b>4,441</b>	<b>26</b>	<b>1,547</b>	<b>63,079</b>
Convertible note	-	-	1,820	-	-	-	1,820
<b>Total shareholders' equity</b>	<b>(4,095)</b>	<b>(24,304)</b>	<b>(2,087)</b>	<b>30</b>	<b>(25)</b>	<b>52,194</b>	<b>21,713</b>

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Eltek Ltd.

Notes to the Financial Statements

(All amounts in thousands of reported NIS, except where otherwise stated)

Note 31 Subsequent Event

During the first quarter of fiscal 2007, the Company's board of directors approved, effective as of January 1, 2007, that the consolidated financial statements will be prepared in accordance with U.S. GAAP and the reporting currency will be changed from NIS to U.S. dollars, while the functional currency will remain NIS. The Company management believes that presenting consolidated financial statements in U.S. dollars in the future will provide more meaningful and relevant financial information to the Company shareholders.

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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.

ELTEK LTD.

By: /s/ Arie Reichart

Arie Reichart  
President and Chief Executive Officer



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By: /s/ Amnon Shemer

Amnon Shemer  
Chief Financial Officer

Dated: June 27, 2007

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