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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, D.C. 20549

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**FORM 20-F**

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

For the fiscal year ended December 31, 2013  
Commission File No. 0-11456

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**ELRON ELECTRONIC INDUSTRIES LTD.**

(Exact name of Registrant as Specified in Its Charter and Translation of Registrant's Name Into English)

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**ISRAEL**

(Jurisdiction of Incorporation or Organization)

**3 Azrieli Center, 42nd Floor, Tel-Aviv, Israel 6702301**  
(Address of Principal Executive Offices)

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**Yaron Elad, Vice-President & Chief Financial Officer**  
**Telephone: (972) 3-607-5555, Facsimile: (972) 3-607-5556**  
**3 Azrieli Center, 42nd Floor, Tel-Aviv, Israel 6702301**

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

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

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

Title of each class

Ordinary shares, nominal value 0.003 New Israeli Shekels per share

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

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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 29,743,767

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

Yes  No

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

Yes  No

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

Yes  No

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

Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

US GAAP

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

Other

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

Item 17  Item 18

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

Yes  No

## TABLE OF CONTENTS

	<u>Page No.</u>	
<b>PART I</b>		
<a href="#">Item 1.</a>	<a href="#">Identity of Directors, Senior Management and Advisers</a>	6
<a href="#">Item 2.</a>	<a href="#">Offer Statistics and Expected Timetable</a>	6
<a href="#">Item 3.</a>	<a href="#">Key Information</a>	6
<a href="#">Item 4.</a>	<a href="#">Information on the Company</a>	27
<a href="#">Item 4A.</a>	<a href="#">Unresolved Staff Comments</a>	53
<a href="#">Item 5.</a>	<a href="#">Operating and Financial Review and Prospects</a>	53
<a href="#">Item 6.</a>	<a href="#">Directors, Senior Management and Employees</a>	84
<a href="#">Item 7.</a>	<a href="#">Major Shareholders and Related Party Transactions</a>	111
<a href="#">Item 8.</a>	<a href="#">Financial Information</a>	117
<a href="#">Item 9.</a>	<a href="#">The Offer and Listing</a>	120
<a href="#">Item 10.</a>	<a href="#">Additional Information</a>	121
<a href="#">Item 11.</a>	<a href="#">Quantitative and Qualitative Disclosures About Market Risk</a>	146
<a href="#">Item 12.</a>	<a href="#">Description of Securities Other than Equity Securities</a>	146
<b>PART II</b>		
<a href="#">Item 13.</a>	<a href="#">Defaults, Dividend Arrearages and Delinquencies</a>	146
<a href="#">Item 14.</a>	<a href="#">Material Modifications to the Rights of Security Holders and Use of Proceeds</a>	146
<a href="#">Item 15.</a>	<a href="#">Controls and Procedures</a>	146
<a href="#">Item 16.</a>	<a href="#">[Reserved]</a>	147
<a href="#">Item 16A.</a>	<a href="#">Audit Committee Financial Expert</a>	147
<a href="#">Item 16B.</a>	<a href="#">Code of Ethics</a>	147
<a href="#">Item 16C.</a>	<a href="#">Principal Accountant Fees and Services</a>	148
<a href="#">Item 16D.</a>	<a href="#">Exemptions from the Listing Standards for Audit Committees</a>	148
<a href="#">Item 16E.</a>	<a href="#">Change in Registrant's Certifying Accountant</a>	148
<a href="#">Item 16E.</a>	<a href="#">Purchases of Equity Securities by the Issuer and Associate Purchasers</a>	148
<a href="#">Item 16G.</a>	<a href="#">Corporate Governance</a>	148
<b>PART III</b>		
<a href="#">Item 17.</a>	<a href="#">Financial Statements</a>	148
<a href="#">Item 18.</a>	<a href="#">Financial Statements</a>	149
<a href="#">Item 19.</a>	<a href="#">Exhibits</a>	149

## Introduction

As used in this annual report on Form 20-F (this "Annual Report"), the terms "we," "us," "our," the "Company" and "Elron" refer to Elron Electronic Industries Ltd. unless otherwise indicated.

For the purpose of this Annual Report, the terms "group companies" and "companies in our group" collectively refer to subsidiaries, associates and other companies in which we have direct or indirect holdings through our wholly-owned subsidiaries, Elbit Ltd., or Elbit, and DEP Technology Holdings Ltd., or DEP, including DEP's 50.1% subsidiary, RDC Rafael Development Corporation Ltd., or RDC, and RDC's 89% held subsidiary, R.D. Seed Ltd. (formerly Navitrio Ltd), or RDSeed. Our ownership interests in our group companies reflected in this Annual Report represent our beneficial ownership interests in the outstanding shares of these companies as of December 31, 2013 unless otherwise expressly indicated. Our outstanding beneficial ownership interests in the preferred shares of these companies are represented on an as-converted-basis, unless otherwise indicated. Except where expressly otherwise stated herein, our beneficial ownership interests do not take into account dilution due to the exercise of options or other convertible instruments and accordingly are subject to change as a result of the exercise of such options. Furthermore our fully diluted holdings do not take into account options or convertible loans when the amount of shares to be received upon their exercise or conversion, as applicable, is not known in advance. We have also indicated our direct holding and our share in the holding of RDC and RDSeed in a group company where applicable. The references in this Annual Report to the Statement of Financial Position items are as of December 31, 2013 unless otherwise indicated.

Please be advised that in order to make our disclosure more consistent with the information disclosed in our previous Annual Report and with our annual report in Hebrew prepared in accordance with Israeli securities laws and regulations, being filed simultaneously with this Annual Report (see also "Item 4.A – History and Development of the Company) certain information not required by this Annual Report on Form 20-F has been included.

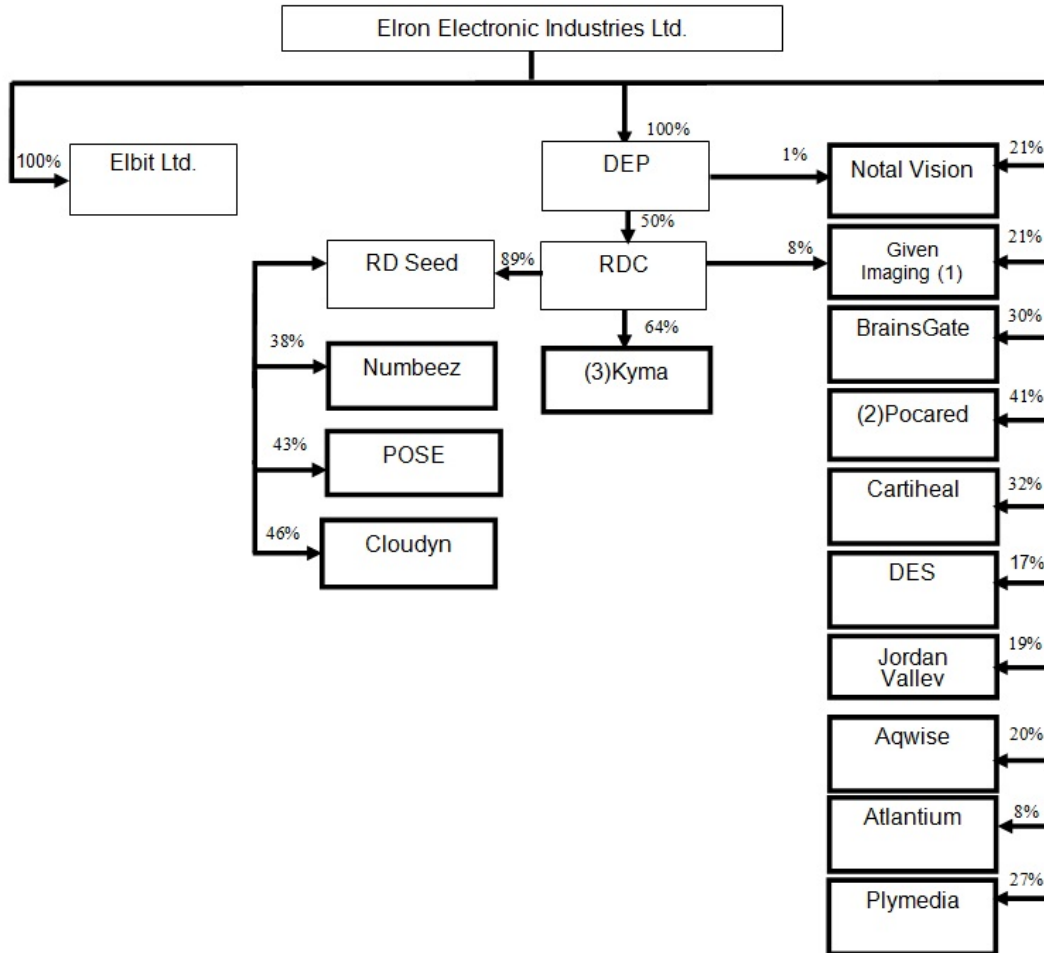
### Cautionary Note Regarding Forward-Looking Statements

This Annual Report includes certain "forward-looking" statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act") and within the meaning of Section 32A of the Israeli Securities Law, 1968. The use of the words "projects," "expects," "may," "plans" or "intends," or words of similar import, identify a statement as "forward-looking." There can be no assurance, however, that actual results will not differ materially from our expectations or projections. Factors that could cause actual results to differ from our expectations or projections include the risks and uncertainties described in this Annual Report under "Item 3 – Key Information – Risk Factors," as well as those discussed elsewhere in this Annual Report and in our other filings with the United States Securities and Exchange Commission (the "SEC").

Any forward-looking statements contained in this Annual Report speak only as of the date of this Annual Report, and we caution investors and potential investors not to place undue reliance on these statements. We undertake no obligation to update or revise any forward-looking statements. All subsequent written or oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the risk factors in "Item 3 – Key Information – Risk Factors" of this Annual Report.

**Group Companies Holdings Diagram**

The following is a diagram of our holdings in our group companies as of December 31, 2013, including the group operating companies held through our direct and indirect subsidiaries, DEP, RDC and RDSeed directly indicating our percentage interests in the outstanding share capital of our group companies (reflecting our holdings in ordinary shares and preferred shares on an as converted basis and not on a fully diluted basis):



- (1) In February 2014, we and RDC sold all of our holdings in Given Imaging, previously a significant group company. For more details regarding the business of Given Imaging and the Given Merger, see Item 4 below.
- (2) In January 2014, our shareholding in Kyma decreased to approximately 57.7% due to an investment by RDC and a new investor from the Ganot group. For more details regarding our investment in Kyma, see Item 4.A below.

**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**

**Selected Financial Data**

The following selected financial data for the years ended and as of December 31, 2009, 2010, 2011, 2012 and 2013 are derived from our audited consolidated financial statements, of which the Consolidated Statements of Financial Position as of December 31, 2009, 2010, 2011, 2012 and 2013, and the Consolidated Statements of Income, for each of the years ended December 31, 2011, 2012 and 2013 appear later in this Annual Report and have been prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, or IFRS. You should read the following selected financial data together with "Item 5 – Operating and Financial Review and Prospects" of this Annual Report, "Item 8 – Financial Information" of this Annual Report and our consolidated financial statements together with the notes thereto included elsewhere in this Annual Report. Please see Note 18 to our consolidated financial statements with respect to the computation of basic and diluted net earnings (loss) per ordinary share.

**Item 3. Key Information (Cont.)****Consolidated statements of income**

(in thousands of U.S. Dollars ("U.S. Dollars", "U.S. \$" or "\$"), except share and per share data)

	<b>Years ended December 31,</b>				
	<b>2009(*)</b>	<b>2010(*)</b>	<b>2011(*)</b>	<b>2012</b>	<b>2013</b>
<b>Income</b>					
Sales of goods	9,904	9,608	14,103	-	97
Gain from disposal and revaluation of investee companies and changes in holdings, net	35,238	165,449	34,605	39,426	8,416
Financial income	1,446	2,955	1,758	1,241	684
	<u>46,588</u>	<u>178,012</u>	<u>50,466</u>	<u>40,667</u>	<u>9,197</u>
<b>Cost and Expenses:</b>					
Cost of sales	4,824	3,948	5,823	-	59
Research and development expenses, net	25,699	18,209	18,184	6,869	3,929
Selling and marketing expenses	8,985	6,551	5,672	905	545
General and administrative expenses	15,865	13,577	10,474	7,190	7,193
Equity in losses of associates, net	10,514	10,863	10,374	8,357	11,868
Amortization of intangible assets	1,416	1,484	313	-	-
Financial expenses	5,434	3,031	4,173	2,052	561
Other expenses (income), net	2,230	3,136	9,560	(282)	(3,487)
	<u>74,967</u>	<u>60,799</u>	<u>64,573</u>	<u>25,091</u>	<u>20,668</u>
Income (loss) before taxes on income	(28,379)	117,213	(14,107)	15,576	(11,471)
Taxes on income (tax benefit)	(2,453)	6,112	602	(262)	(28,401)
Net income (loss)	<u>(25,926)</u>	<u>111,101</u>	<u>(14,709)</u>	<u>15,838</u>	<u>16,930</u>
Net income (loss) attributable to Elron's shareholders	(10,835)	66,333	(8,417)	4,357	17,935
Net income (loss) attributable to non-controlling interest	(15,091)	44,768	(6,292)	11,481	(1,005)
Net income (loss)	<u>(25,926)</u>	<u>111,101</u>	<u>(14,709)</u>	<u>15,838</u>	<u>16,930</u>
<b>Net income (loss) per share attributable to shareholders:</b>					
Basic gain (loss) per share	(0.36)	2.17	(0.34)	0.09	0.54
Weighted average number of ordinary shares used in computing basic gain (loss) per share (in thousands)	<u>29,650</u>	<u>29,655</u>	<u>29,660</u>	<u>29,664</u>	<u>29,743</u>
Diluted gain (loss) per share	(0.38)	2.17	(0.34)	0.09	0.54
Weighted average number of ordinary shares used in computing diluted gain (loss) per share (in thousands)	<u>29,650</u>	<u>29,666</u>	<u>29,660</u>	<u>29,664</u>	<u>29,743</u>

(\*) Retroactively adjusted (see Note 2.F in "Item 18 – Financial Statements" for the year ended December 31, 2013).

**Item 3. Key Information (Cont.) Consolidated Statement of Financial Position**

(in thousands of U.S. Dollars ("U.S. Dollars", "U.S. \$" or "\$"), except share and per share data)

	<b>As of December 31,</b>				
	<b>2009(*)</b>	<b>2010(*)</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
Cash, cash equivalents and short-term and long term investments	64,807	56,904	40,078	47,541	32,291
Assets held for sale	-	17,211	3,155	-	108,735
Investments in associate companies and in other companies and long term receivables	128,704	157,785	134,237	140,624	34,870
<b>Total assets</b>	<b>213,080</b>	<b>250,315</b>	<b>208,329</b>	<b>197,082</b>	<b>212,902</b>
<b>Total current liabilities</b>	<b>26,131</b>	<b>14,916</b>	<b>4,994</b>	<b>42,842</b>	<b>7,701</b>
Long term loans from banks and others	36,981	535	3,288	4,000	-
Long term loans from shareholders shareholders	16,737	-	-	-	-
<b>Total equity</b>	<b>122,093</b>	<b>219,470</b>	<b>194,083</b>	<b>184,919</b>	<b>199,815</b>
Equity attributable to Elron's shareholders	126,469	195,901	173,609	162,040	180,783
Capital stock	209,968	205,662	191,481	190,414	194,160

(\*) Retroactively adjusted (see Note 2.F in "Item 18 – Financial Statements" for the year ended December 31, 2013).**B. Capitalization and Indebtedness**See Item 5 "Operating and Financial Review and Prospects" – 5B "Liquidity and Capital Resources" and Item 5F "Tabular Disclosure of Contractual Obligations"**C. Reasons for the Offer and Use of Proceeds**

Not applicable.



## D. Risk Factors

### Specific Risks Affecting Elron

*Our financial results and our cash reserves are directly impacted by our ability to conclude "exit" transactions at significant values.* Our ability to conclude "exit" transactions for companies in our group at significant values is impacted, *inter alia*, by economic conditions, market conditions in the high technology and/or medical device industries, the status of the venture capital industry and capital markets and various regulatory and contractual limitations. Furthermore, the possibility of concluding "exit" transactions at significant values is dependent on the circumstances and characteristics of the group company whose sale is being considered (the demand for its solutions, uniqueness, size of the problem it is trying to solve, etc.) as well as the ability of our management and the management of companies in our group to lead successful exit transaction processes. To the extent that we are not able to conclude these types of transactions, our results of operations and cash resources will be adversely affected.

*If our cash resources are insufficient to finance our operations, we may be unable to obtain alternative sources of financing and consequently may be unable to invest in existing and new companies.* Our financial resources are dependent upon the proceeds of realization of our holdings in our group companies, loans and credit lines, and receipt of dividends from our group companies. In the absence of sufficient amounts of such financial resources, there is no assurance that we will be successful in raising additional capital for our activities and continued support of and investment in our existing and new companies.

*We may be deemed to be an investment company under the U.S. Investment Company Act of 1940.* Generally, a company must register under the Investment Company Act of 1940 as amended, or the 1940 Act, and comply with significant restrictions on operations and transactions with affiliates if it is engaged in the business of investing, owning, holding or trading securities and owns investment securities (as defined in the 1940 Act) exceeding 40% of the company's total assets, or if it holds itself out as being engaged primarily in the business of investing in, reinvesting or trading securities. The 1940 Act provides for various exemptions from the obligation to register thereunder, and in 1980 we received an order from the SEC, declaring that we are not an investment company under the 1940 Act. If certain of our investments were to adversely affect our status under the 1940 Act or if we were to cease to comply with the conditions of the order, we might need to dispose of or acquire other investments to avoid the requirement to register as an investment company on terms that may not be favorable to us. In addition, if we were deemed to be an investment company and therefore required to register as such under the 1940 Act, we would be unable to continue operating as we currently do, as a result of which our market value could be severely harmed.

*If we are characterized as a passive foreign investment company for U.S. federal income tax purposes, our U.S. shareholders may suffer adverse tax consequences.* Generally, if for any taxable year, after applying certain look-through rules (i) 75% or more of our gross income is passive income, or (ii) at least 50% of our assets (averaged quarterly over our taxable year) are held for the production of, or produce, passive income, then we may be characterized as a passive foreign investment company, or PFIC, for U.S. federal income tax purposes.

If we are characterized as a PFIC, our U.S. shareholders may suffer adverse tax consequences, including having gains realized on the sale of our ordinary shares taxed at ordinary income rates, rather than capital gain rates. Similar rules apply to distributions that are classified as "excess distributions". In addition, both gains upon disposition and amounts received as excess distributions could be subject to an additional interest charge by the United States Internal Revenue Service, or IRS. A determination that we are a PFIC could also have an adverse effect on the price and marketability of our ordinary shares.

We believe that in 2013 we were not a PFIC. However, since the determination of whether we are a PFIC is based upon such factual matters as the valuation of our assets and, in certain cases, the assets of companies held by us, there can be no assurance with respect to the position of the IRS or a court of law as to our status as a PFIC. Our analysis is based, among other things, upon certain assumptions and methodologies with respect to the values that we have used; our percentage ownership (by value), and the appropriate value of our ownership interest, in companies we have held; and the manner in which we have allocated the aggregate value of our assets among our active assets and passive assets. There is no assurance that the IRS will not challenge our assumptions and methodologies. If the IRS were to challenge successfully such assumptions or methodologies, we may potentially be classified as a PFIC for 2013 or prior taxable years. Furthermore, there can be no assurance that we will not become a PFIC in the future.

There exists the possibility that we could become a PFIC in 2014 as a result of the completion of the Given Merger in 2014. However, based on preliminary projections and analysis conducted by us and our advisors, we believe there is a possibility that we may qualify for the "change in business exception" under Section 1298(b)(3) of the United States Internal Revenue Code and avoid being classified as a PFIC for 2014. The determination of whether the change in business exception applies to us will be affected by several factors, including the amount of our passive income in 2014, our deployment of the proceeds from the Given Merger, and our PFIC status in 2015 and 2016, many of which will not be determinable until after 2014. If we ultimately conclude that the change in business exception applies and we are not classified as a PFIC for 2014, we cannot assure you that the United States Internal Revenue Service will not challenge our conclusion or our assumptions used in reaching such conclusion. If there were such a challenge by the IRS, we could be classified as a PFIC for 2014, even if we are not a PFIC in 2015 or 2016. In addition, if we otherwise satisfy the requirements for the change in business exception, but then become a PFIC in either 2015 or 2016, then we would retroactively be ineligible to apply the change in business exception for 2014.

U.S. holders of our shares are urged to consult their tax advisors regarding the potential application and effects of the PFIC rules.

See "Item 10 – Additional Information – Taxation – U.S. Federal Income Tax Considerations – Tax Consequences If We Are a Passive Foreign Investment Company."

*It may be difficult to serve process or to enforce a U.S. judgment against us, our directors and our officers.* Since all of our directors and officers reside outside the United States, it may be difficult to effect service of process on us, our directors or officers within the United States. Furthermore, because most of our assets are located outside the United States, it may not be possible to enforce any judgment obtained in the United States against us or the aforementioned individuals in the United States. There is doubt as to the enforceability of civil liabilities under the U.S. Securities Act of 1933 and the Exchange Act in original actions instituted in Israel.

*Our principal shareholder, Discount Investment Corporation Ltd., or DIC, has the ability to direct our business and affairs.* As of December 31, 2013, DIC beneficially owned an aggregate of approximately 50.32% of our ordinary shares and is our controlling shareholder. As of the date of publication of this Annual Report, DIC has the power to elect a majority of the members of our board of directors. The majority of the members of our board of directors are officers or directors of DIC or of its controlling shareholders or affiliates of its controlling shareholders. Accordingly, DIC has the ability to direct our business and affairs. In addition, DIC's control over us may impose various regulatory restrictions on our activities. See risk factors below regarding anti-trust regulations, recommendations for increasing competitiveness in the Israeli economy, and Bank of Israel regulations on borrowing from Israeli banks. Furthermore, we entered into a Services Agreement with DIC pursuant to which, we receive substantially all of our managerial and administrative services through a staff employed by DIC within the framework of which a vice president of DIC serves as our Chief Executive Officer. The Services Agreement was renewed for an additional three year period commencing from May 1, 2012. For more information see "Item 7 – Major Shareholders and Related Party Transactions – Major Shareholders.. For more information regarding the creditors arrangement and change of control of IDB Development Ltd or IDBD, the controlling shareholder of DIC, see "Item 7–Major Shareholders and Related Party Transactions–Major Shareholders". Due to the new Israeli Law for Increasing Competitiveness and Reducing Market Concentration, DIC will be permitted to continue to control us until four years from date of publication of the law. For more information see "Risks Affecting Us and the Companies in Our Group".

*We have voluntarily delisted from the Nasdaq Global Select Market and may in the future seek to terminate our Exchange Act registration.* In view of the significant costs associated with maintaining a U.S. listing, our relatively limited number of U.S. holders of record and the fact that a substantial majority of the trading of our shares then occurred on the Tel Aviv Stock Exchange, or TASE, we voluntarily delisted our shares from the Nasdaq Global Select Market, or Nasdaq, on January 6, 2010. As a result of our delisting, we are required to comply with reporting requirements in accordance with both Israeli and applicable U.S. securities laws. To the extent that we comply with one of the deregistration conditions required under the applicable U.S. securities laws, it will be possible for us to effect a deregistration. The foregoing actions may have an adverse impact on the market price for our ordinary shares. If we are successful in terminating our Exchange Act registration, we will no longer be obligated to file reports with or furnish reports to the SEC, including annual reports on Form 20-F and reports on Form 6-K. After deregistration under the Exchange Act, we will continue to be governed by disclosure requirements under applicable Israeli law and regulations. For more information see "Item 4A – History and Development of the Company".

#### **Risks Affecting Us and the Companies in Our Group**

*Ongoing uncertainty regarding global and local economic conditions may adversely affect our and our group companies' results and financial condition and could lead to impairment charges.* The developments in the global markets and particularly in the Euro zone and in the United States, which include securities' prices and currencies' exchange rate fluctuations, as well as domestic developments, have affected and may affect our and our group companies' results of operations, liquidity, value of equity, value and exit potential of assets, business (including the demand for our group companies' products), financial covenants, ability to distribute dividends, ability to raise financing as required for day-to-day, long-term and R&D operations, allocation of resources, and availability and terms of financing from financial institutions and banks.

***Our financial results and financial condition are principally impacted by the results of operation of, and the value of our holdings in, our group companies.*** We are exposed to the volatility of the value of our holdings in these companies. If our group companies experience difficulties in the future, or if there are adverse changes in their fair value, we may need to write-down or write-off the carrying value of our holdings and our business and financial results and/or the value of our assets will be adversely affected. In addition, changes in the value of our holdings in our group companies may have an adverse effect on our market value. We regard the changes described herein as being in the ordinary course of our business.

***Our financial results significantly depend on the results of operations of our group companies, which continue to invest heavily in their development and of which most have generated losses.*** Our results of operations are directly impacted by the results of operations of our group companies which are consolidated in our financial statements or are accounted for on an equity or fair value basis. To the extent any of these companies have poor financial results or encounter difficulties in their operations, our financial results will be negatively impacted. Many of these companies are in the development stage and have not yet generated significant revenues, if at all, have incurred losses, and have invested heavily in research and development and marketing of their products. We anticipate that the majority of these companies will continue to record losses in the future.

***We compete with other entities for acquisition and investment opportunities.*** As part of our overall strategy, we pursue opportunities for acquisitions of, and investments in, Israeli companies and Israel-related technology companies. The success of a number of Israeli companies, has prompted potential investors to seek investment opportunities in Israel, which has allowed many Israeli high-technology companies to gain direct access to Israeli and foreign public securities markets and financial and strategic acquisition potentials. We compete for acquisition and investment opportunities with other established and well-capitalized entities such as strategic investors (large technology companies which invest in their field of activity or tangential fields), venture capital funds, private equity funds and other investors. There can be no assurance that we will be able to identify acquisition or investment opportunities upon favorable terms. Our failure to effect further acquisitions or investments in the future may hinder our ability to grow and could harm our business, financial condition and results of operations.

***We may face difficulties in our ability to dispose of our shares in companies in our group.*** We are subject to regulatory limitations, including lock up periods according to applicable securities laws, anti-trust laws as well as contractual limitations, all of which may limit the possibilities for disposing of our holdings in our group companies. Rights of first refusal, tag-along, bring along, veto rights and similar rights which may restrict transfer of shares may limit our ability to dispose of our shares in our privately held group companies. Furthermore, due to the limitations of U.S. and Israeli securities laws, material non-public information in relation to our publicly traded group companies to which we may become exposed because of service of our members of personnel on the boards of directors of companies in our group, and contractual and legal limits on the tradability of the shares we own or control, may create difficulties in our ability to dispose of our shares in these companies in our group at a time and in a manner we deem suitable.

*Our ability to invest in companies or conclude exit transactions may be adversely affected and/or prevented by anti-trust regulations both in Israel and abroad.* The Israeli and international anti-trust laws may adversely affect and even prevent our or our group companies' ability to invest in companies or to effect exit transactions. Certain of these transactions may be subject to the approval of the General Director of the Israeli Anti-Trust Authority, or the General Director, which approval may be denied or given with certain conditions. Due to the fact that IDB Development Corporation, or IDBD, holds more than 50% of our shares, any enquiry as to whether an investment transaction needs to be reported to or to receive the consent of the General Director is extensive in its scope, taking into account other companies within the IDBD group of companies. In addition, since our group companies may become involved in or be the subject of cross border transactions, foreign anti-trust approvals in countries in which the parties to the transaction operate, such as the United States and Europe, may also be required, which may in turn delay or prevent such transactions from taking place.

*The Israeli Promotion of Competition and the Reducing of Centralization Law may adversely affect our business.* In December 2013, the Israeli Promotion of Competition and the Reducing of Centralization Law was published and some of the provisions apply to us, namely in the following respects:

- a. According to the Law's provisions, "reporting corporations" (generally speaking, corporations whose securities are held by the public) structured as pyramids are restricted to two tiers of reporting corporations (while a company lacking a controlling shareholder will not count as a first-tier company). This means that as of the date of publication of this Annual Report, we are considered a fourth-tier company. So long as we are considered a fourth-tier company according to the Law, we are entitled to continue controlling reporting companies that are under our control as of the Law's publication, for up to four years after the publication of the Law. Our controlling shareholder, DIC, is considered as of the publication of this Annual Report a third-tier company that is entitled to continue controlling us for up to four years after the Law's publication.
- b. As long as we shall continue to be considered at least a third-tier company according to the Market Concentration Law, starting six months after the Law's publication, our board of directors will be required to consist of a majority of independent directors, and the number of our external directors will be required to constitute at least half of our board members, less one (rounded up) and will include no less than two external directors.

The above may materially adversely impact us, inter alia, taking into account the restrictions on our holding structure, our ability to acquire control in public companies traded in Israel and the value of such holdings, our ability to take public in Israel companies which we control. In addition, this law may impact on our control structure.

***We and our group companies are subject to regulatory requirements and restrictions in Israel and various other countries.*** Our and our group companies' operations are subject to regulation in Israel and additional countries in which we and our group companies operate or wish to operate. The regulatory requirements and restrictions in Israel to which we and our group companies are subject may be different and even in conflict with the regulatory requirements and restrictions applicable to us and our group companies in other countries. If this occurs, it will adversely affect our business.

***We have indemnification obligations which survive exit transactions and may not receive the entire proceeds due to us from exit transactions of our group companies.*** During the execution of exit transactions, we, as shareholders of our group companies, and/or our group companies are often called upon to make representations and warranties to the acquirer about the relevant group company and to, under certain circumstances, indemnify the acquirer for damages should such representations or warranties prove to be inaccurate. In addition, a portion of the sale proceeds is often held in escrow as security for the indemnification obligations, which may expose us to the risk of ultimately not receiving all or part of such portion of the proceeds should the representations and warranties prove to be inaccurate. Also, certain proceeds may be contingent upon future performance of such companies following the exit transaction and over which we have no control and accordingly, there is no assurance that such proceeds will be ultimately paid to us in full or at all. Should we not receive the entire proceeds due to us from exit transactions of our group companies in the circumstances described above, it may affect our results of operations and financial condition. Regarding representations and deposit of moneys in escrow in connection with the sale transactions of Medingo, Starling, Wavion and Sync-Rx, see "Item 4.A – History and Development of the Company" below. In addition, representations were given by our group companies in the past and by us in the framework of the sale of other companies previously sold by us.

***The market price of our ordinary shares is subject to fluctuations.*** The market price of our ordinary shares has fluctuated significantly over time. The following factors, among others, may significantly impact the market price of our ordinary shares:

- any slowdown of the global economic condition;
- the market price of our group companies that are or may become publicly traded;
- low trading volume of our ordinary shares, which has decreased and may further decrease following our delisting from Nasdaq;
- announcements by our group companies (or by us regarding our group companies), their competitors or other third parties of technological innovations, new products, regulatory developments, new clinical data regarding current or future products or earnings or losses;
- delays or failures in the development of products of our group companies;
- periodic variations in results of operations of our group companies;
- factors that generally affect the market for stocks of medical device and other companies;

- political, economic or other developments affecting Israel and its region; and
- quarter-to-quarter fluctuations in our financial results.

**Many of our group companies may face difficulties in obtaining future financing on favorable terms or at all.** Many of our group companies are in the development stage and have extensive research and development and marketing costs and limited revenues, if any. In order to succeed, these companies may require additional capital to fund these costs. Their ability to obtain financing is impacted by general economic conditions, the condition of the capital markets and the condition of the venture capital industry. If these companies have difficulties obtaining financing from their current shareholders or from external financing sources, their continued operations may be at risk and such difficulties may materially adversely affect their results of operations and financial performance. This would also adversely affect our financial performance and results of operations.

**Bank of Israel regulations limit our and our group companies' ability to borrow from Israeli banks.** Bank of Israel regulations limit the ability of Israeli banks to extend credit in excess of certain levels to companies and individuals considered to be in an associate group, which effectively limit the amount available to companies within such group for borrowing from such banks. We and our group companies are part of the IDBD group of affiliated companies, which is one of the largest groups of affiliated companies in Israel. The IDBD group includes many Israeli companies that may require, or that hold ownership interests in companies that may require, extensive credit facilities from Israeli banks for the operation of their businesses. These regulations may result in difficulties for us and our group companies in obtaining or increasing bank financing, if required, from Israeli banks, and may affect our and their ability to make investments for which bank credit is required or to invest in companies that received large credit facilities from certain Israeli banks as well as their ability to conduct certain business activities in cooperation with parties who received such credit facilities.

**Our results, and the value of our investments, are affected by volatility in the securities markets.** Securities markets in general are volatile, even more so with negative economic developments, and are particularly volatile for publicly traded high-technology companies, including companies that have a significant presence in Israel. Although the volatility of these companies' securities is not necessarily related to their operating performance, such volatility may result in these companies experiencing difficulties in raising additional financing required to effectively operate and grow their businesses as well as difficulties in executing exit transactions in these companies. These difficulties and the volatility of the securities markets in general, and specifically during economic slowdowns, have affected and may continue to affect our and our group companies' ability to realize our investments or to raise financing, which in turn may result in us having to record impairment charges.

*There is no assurance that our subsidiary, RDC, will be able to continue to develop technologies and/or new companies.* Our wholly-owned subsidiary, DEP, holds 50.1% of the outstanding shares and voting rights of RDC, which was established by DEP together with the predecessor of Rafael Advanced Defense Systems Ltd., or Rafael, pursuant to an agreement entered into in 1993. RDC has first rights to commercialize certain technologies of Rafael for the development of products for use in non-military markets. For more information, see "Item 10C – Additional Information – Material Contracts." Our ability to continue to grow and develop and to build new companies within RDC could be harmed, and our business, financial condition and results of operations could be adversely affected, if we are unable to realize the full potential value of RDC's agreement with Rafael as a result of any of the following:

- Rafael does not cooperate with RDC in the realization of RDC's rights under the agreement;
- Rafael or RDC does not identify existing technology, or Rafael does not develop new technology, that is identified suitable for being commercialized in non-military markets;
- RDC does not reach agreement with Rafael on the terms of the use of technology for commercial purposes;
- RDC is unable to obtain continued financing from its shareholders or otherwise, if and when required; or
- RDC faces difficulties in securing financial resources to support new and existing innovations.

*Most of our group companies are dependent upon proprietary technology, which may be infringed by, or may infringe upon, the proprietary technology of others.* Most of our group companies depend significantly on their proprietary technology for their success. Like many other technology companies, most of these companies rely on a combination of protection laws within the field of patents, copyrights and trademarks together with non-disclosure agreements, confidentiality clauses in their agreements, including employment agreements, and technical measures to establish and protect proprietary rights in their products. However, these legal means may not adequately protect our group companies' rights or permit them to acquire or maintain any competitive advantage. The process of issuing a patent may sometimes be lengthy and may not always result in patents issued in a form that will be advantageous to our group companies, or at all, and patents and applications for patents may be challenged, invalidated or circumvented by third parties. The life time of a patent is usually fixed for 20 years from the date of the filing of the application for registration of the patent. During the protection period, the patent holder is required, in certain countries, to pay periodic fees to maintain the rights in the patent. In some countries, there are special arrangements with respect to patents, in the framework of which the patent holder may, subject to the conditions set forth in the relevant legislation, apply for an extension of the patent period for an additional period of time over and above the original patent period. An extension application usually entails payment of fees and additional costs. There is no certainty that in the countries that allow an extension, it will indeed be granted at the end of the proceedings defined in the laws of such countries. In addition, there is no certainty that applications for the registration of a patent that shall have been filed by our group companies shall result in the registration of a patent and/or that there will be no attempts by third parties to challenge those patents registered by the companies, and even sue for the revocation thereof. In addition, the mere fact of a patent being registered does not prevent competitors of our group companies from manufacturing products which are identical to products of our group companies, but rather entitles patent holders to sue such infringing competitors for infringement of their registered patents.



Our group companies may not be able to enforce their proprietary rights under the laws of certain jurisdictions. Our group companies may not be able to successfully protect their technology because of, among other reasons:

- Some foreign countries may not protect their proprietary rights as fully as do the laws of the United States;
- Competitors of our group companies may be issued patents that will prevent our group companies from using technologies, designs or methods that our group companies would like to integrate into their products;
- Enforcing their rights may be time consuming and costly, thereby diverting management's attention and company resources;
- Measures such as entering into non-disclosure agreements afford us and our group companies only limited protection;
- Unauthorized parties may attempt to copy aspects of our group companies' products and develop similar products or to obtain and use information that they regard as proprietary; and
- Competitors may independently develop products that are substantially equivalent or superior to our group companies' products or that circumvent their intellectual property rights.

In addition, others may assert infringement claims against our group companies, which could have a material adverse impact on the group companies. In addition, the cost of responding to infringement claims could be significant, regardless of whether the claims are valid.

If our group companies do not adequately protect their intellectual property, their competitors or other parties could make similar products and compete more efficiently with our group companies.

If our group companies do not adequately protect their intellectual property as described above, it could materially adversely affect their business, their financial condition and their results of operations and as a result, this could materially adversely affect our financial position and results of operations.

***The technological fields within which our group companies operate involve a high level of risk and uncertainty.*** Penetration into the technological fields within which our group companies operate involves a high level of risk and uncertainty and requires the investment of considerable sums of money and time. Our group companies may fail in either the development of their products including additional products or new applications based on developed platforms, expansion of the pipeline of products, manufacturing of the products, or obtaining the necessary approvals for commercializing the products and selling their products in significant quantities directly or through strategic partnerships or license agreements and maintaining a competitive advantage over time. The research and development of each product in its respective technological field within which our group companies operate, particularly companies in the medical device field, takes many years and requires the employment of high quality development personnel. Every product development project entails many scientific and engineering complexities and extensive technological know-how is required for the development of the product. The absence of technological and business know-how and suitable technological infrastructure may lead to a delay or failure in the product development. In addition, there is also the risk that after completion of the development and approval processes, a competitor may have developed superior technology, which gives it a competitive advantage. Furthermore it is difficult to transition from development stage to marketing and manufacturing stage operations, including establishing commercial manufacturing capabilities and establishing sales and marketing infrastructure. The ability to penetrate markets in circumstances where there is no competing product is also dependent on the ability of our group companies to educate their potential customers of the possibilities for the use of the product and its advantages. Delays, difficulties or failures associated with developing, manufacturing, or marketing products, or associated with new product introductions or product enhancements, could materially adversely affect the financial condition and results of operations of these companies and, as a result, our financial condition and results of operation.

**Many of our group companies experience intense competition.** Many of our group companies experience competition from companies with significantly greater financial, technical, marketing and public relations resources, who have easier market access, better operational infrastructure, longer operating histories, larger installed client bases, greater name recognition, more established relationships and alliances in their industries and offer a broader range of products and services. As a result, these competitors may be able to respond more quickly to new or emerging technologies or changes in clients' requirements, benefit from greater purchasing economies, offer more aggressive products and services pricing or devote greater resources to the promotion of their products and services. If our group companies are unable to successfully compete, their businesses, financial condition and results of operations could be seriously harmed, and as a result could also negatively affect our financial condition and results of operations.

**Israeli government programs in which certain of our group companies participate may be terminated or reduced in the future and may be restrictive in their terms.** Certain of our group companies participate in programs of the Office of the Israeli Chief Scientist, or, the OCS, and the Israel Investment Center, from which they receive grants of between 20% and 50% of the research and development expenses and other benefits for the financing of a portion of their research and development expenditures in Israel. In consideration for receiving a grant from the OCS, the company receiving the grant, or, the Recipient Company, is obligated to pay the OCS royalties from the revenues generated from the sale of products (and related services) or services developed (in all or in part) according to, or as a result of, a research and development program funded by the OCS (at rates which are determined under the Israeli Encouragement of Industrial Research and Development Law, 1984 and related regulations, or the R&D Law), up to the aggregate amount of the total grants received by the OCS, plus annual interest (as determined in the R&D Law). Any intellectual property developed using the OCS grants and any right derived therefrom must be fully and originally owned by the Recipient Company unless transfer thereof is approved in accordance with provisions of the R&D Law.

The terms of such OCS programs may restrict the ability of our group companies which received funds from the OCS to manufacture products and/or transfer know-how or technologies outside of Israel (as further detailed below). The benefits available under these programs depend on our group companies meeting specified conditions. There is no assurance as to availability or the level of the OCS grants in the future.

The Recipient Company is subject to certain obligations under the R&D Law. The pertinent obligations are as follows:

- **Local Manufacturing Obligation:** Products developed as a result of OCS funded R&D must, as a general matter, be manufactured in Israel. The transfer of manufacturing capacity outside of Israel, in whole or in part, is subject to the OCS's prior written approval (except for the transfer of less than 10% of the manufacturing capacity in the aggregate) and the payment of royalties at an increased rate (between 120% and 300% of the amount of the grant (depending on the manufacturing volume that is performed outside of Israel), less royalties already paid to the OCS). A company also has the option of declaring in its OCS grant application an intention to exercise a portion of the manufacturing capacity abroad, thus avoiding the need to obtain additional approval. Under the R&D Law it is clarified that even in the case where approval has been granted to manufacture outside Israel within the framework of approval of an R&D plan and in the case of the transfer of manufacturing at a rate that does not require the approval of the research committee (i.e. at a rate of up to 10%), a company is obligated with regard to the transfer of manufacturing outside of Israel, to pay increased royalties to the State of Israel, at the rates set forth in the R&D Law.
- **Know-How transfer limitation:** The R&D Law restricts the ability to transfer know-how funded by the OCS outside of Israel. Transfer of OCS funded know-how outside of Israel requires prior OCS approval and is subject to certain payment to the OCS calculated according to formulae provided under the R&D Law. The OCS approval to transfer know-how created, in whole or in part, in connection with an OCS-funded project to a third party outside Israel where the transferring company remains an operating Israeli entity is subject to payment of a redemption fee to the OCS calculated according to a formula provided under the R&D Law that is based, in general, on the ratio between the aggregate OCS grants to the company's aggregate investments in the project that was funded by these OCS grants, multiplied by the transaction consideration. The transfer of such know-how to a party outside Israel where the transferring company ceases to exist as an Israeli entity is subject to a new redemption fee formula that is based, in general, on the ratio between aggregate OCS grants received by the company and the company's aggregate R&D expenses, multiplied by the transaction consideration. This new formula came into effect in November 2012. The R&D Law establishes a maximum payment of the redemption fee paid to the OCS under the above mentioned formulas and differentiates between two situations: (i) in the event that the company sells its OCS funded know-how, in whole or in part, or sells it as part of an M&A transaction, and subsequently ceases to conduct R&D activity in Israel, the maximum redemption fee under the above mentioned formulas shall be no more than 6 times the amount received (plus annual interest) for the applicable know-how being transferred, or the entire amount received from the OCS as applicable; (ii) in the event that following the transactions described above (i.e. asset sale of OCS funded know-how or transfer as part of an M&A transaction) the company continues to conduct its R&D activity in Israel (for at least three years following such transfer and keeps on staff at least 75% of the R&D employees it retained for the six months before the know-how was transferred), then the company is eligible for a reduced cap of the redemption fee of no more than 3 times the amounts received (plus annual interest) for the applicable know-how being transferred, or the entire amount received from the OCS, as applicable.

It should be noted that there is no assurance that our group companies will receive the required approvals from the OCS for any proposed transfer outside of Israel of technology and/or know-how developed with OCS funding, if such will be required.

In the event that group companies which received grants from the OCS, request to manufacture OCS funded products outside Israel or to sell their OCS funded know-how or a part thereof to a non-Israeli entity, including within the framework of the sale of that company or its assets, the approval of the OCS will be required and this will involve additional payments to the State of Israel.

The restrictions under the R&D Law will continue to apply even after our relevant group companies have repaid the full amount of royalties payable pursuant to the grants.

The restrictions, among others, may limit the ability of our group companies that receive grants to conclude transactions with international companies, including "exit" transactions. In addition, if our group companies fail to comply with the conditions imposed by the OCS, they may be required to refund the grants received immediately together with interest and penalties, and if they violate the provisions of the R&D Law, they may also be subject to criminal charges. In addition, the Government of Israel may from time to time audit sales of products which it claims incorporate technology funded through OCS programs and this may lead to additional royalties being payable on additional products. This may materially adversely affect the financial condition and results of operations of our group companies and as a result, our financial condition and results of operations may be materially adversely affected.

In addition, the OCS is in the process of exploring the possibility of promulgating regulations, including the consideration due to the State of Israel for the granting of licenses to use know-how developed as a result of research financed by the OCS. Such regulations may have an effect on us and our group companies receiving OCS grants, in respect of the amount of their payments to the OCS for the grant of sub-licenses to third parties. As of the date of filing of this Annual Report, we are unable to assess the effect, if any, of the promulgation of such regulations on our group companies.

***We and our group companies may have difficulty retaining key employees.*** Our success and the success of our group companies depends, in large part, on a limited number of key personnel in the management, scientific, technological and technical fields. In addition, future success will depend, in part, on attracting and retaining highly qualified personnel and with respect to us, personnel who can also serve effectively as directors of our group companies. There can be no assurance that our group companies will be able either to retain present personnel or to acquire additional qualified personnel as and when needed. The loss of the services of key personnel of our group companies and the failure to attract highly qualified personnel may materially adversely affect our group companies' financial condition and results of operation and as a result, our financial condition and results of operation may be materially adversely affected.

We also depend, inter alia, on attracting and retaining highly qualified personnel. There can be no assurance that we will be able to retain or attract optimally qualified personnel to provide such services to us, which could have a negative impact on our financial conditions and results of operation.

***Certain of our group companies depend on international operations.*** Most of our group companies depend on sales to customers outside of Israel. We expect that international sales will continue to account for a significant portion of these companies' revenues for the foreseeable future. As a result, negative changes in international, political, economic or geographic events could result in significant shortfalls in orders or revenues. These shortfalls could cause the business, financial condition and results of operations of these companies to be harmed and as a result negatively impact on our financial condition and results of operations. Some of the risks of doing business internationally include:

- unexpected changes in regulatory requirements;
- international geographical events;
- fluctuation of the New Israeli Shekel / U.S. Dollar representative rate of exchange;
- inability of our group companies and their subcontractors to obtain export licenses;
- imposition of tariffs and other barriers and restrictions;
- burdens of complying with a variety of foreign laws;
- political and economic instability;
- changes in diplomatic and trade relationships; and
- acts of terror.

Some of these factors, such as the ability to obtain export licenses and changes in diplomatic relations, may be affected by Israel's overall political situation. See "Conditions in Israel may affect our operations and the operations of our group companies." In addition, the economic and political stability in the countries where our group companies' major customers and suppliers are located may also impact our group companies' business.

***Conditions in Israel may affect our operations and the operations of our group companies.*** We and most of our group companies conduct principal operations in Israel, and therefore are directly affected by the political, economic, and military conditions affecting Israel and the Middle East. In particular, we could be adversely affected by:

- any major hostilities involving Israel;
- increasing tension with Iran;
- 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;
- a significant downturn in the economic or financial condition of Israel;
- a significant downgrading of Israel's international credit rating;

- labor disputes and strike actions; and
- political instability.

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 in degree and intensity, has led to security and economic problems for Israel, including among others, periodic disruption of day-to-day civilian activity in different parts of Israel. Armed conflicts in recent years with both Hezbollah, a Lebanese Islamist Shiite militia group, and Hamas, a Palestinian Islamic Resistance Movement, have further strained relations between Israel and the Palestinians. Any further escalation in these hostilities or any future armed conflict, political instability or violence in the region could have a negative effect on our and our group companies' business and financial condition, harm our and our group companies' results of operations and adversely affect our share price or the share prices of our group companies that are publicly traded. No predictions can be made as to whether or when a final resolution of the region's problems will be achieved or the nature thereof and to what extent the situation will impact Israel's economic development.

*Our and our group companies' operations could be disrupted as a result of the obligation of personnel in Israel to perform military service.* All non-exempt male adult permanent residents of Israel under a specified age, as a general rule, are obligated to perform military reserve duty and may be called to active duty under emergency circumstances. Our operations and those of our group companies could be disrupted by the absence for a significant period of one or more of our or our group companies' personnel. While we and our group companies have operated effectively despite these conditions in the past, we cannot assess what impact these conditions may have in the future, particularly if emergency circumstances arise.

*The results of operations of our group companies may be harmed by foreign currency exchange rate fluctuations.* To the extent that our group companies are based in Israel and have international operations, or operate only in Israel but conduct their business in different currencies, their revenues, expenses, assets and liabilities, are not necessarily in the same currency, and therefore they are exposed to foreign exchange rate fluctuations. In particular, our functional currency, as well as that of most of our group companies, is the U.S. dollar. However salaries and related expenses of our expenses as well as expenses related to the DIC Service Agreement (See "Item 7 – Related Party Transactions – Major Shareholders") and other operating expenses are denominated in NIS. If the NIS continues to strengthen against the U.S. dollar, it will harm our and our group companies' results of operations and cash resources. We hold a significant portion of our cash balances in dollars; however, in the future, changes may take place from time to time in the amounts of these balances, in how we maintain our cash, and the portion of cash we hold in each currency, based on business developments and future decisions.

*Product liability claims could adversely affect the business results of our group companies, especially those operating in the medical device industry.* Product liability is an inherent risk for our group companies operating in the medical device industry. A product liability claim, regardless of its merit or eventual outcome, could result in substantial costs to a group company and a substantial diversion of management attention. A product liability claim or any product recalls could also harm a group company's reputation and result in a decline in revenues. Substantial damages awards have been made in some jurisdictions against medical device companies based upon claims for injuries allegedly caused by the use of their products. There can be no assurance that a future product liability claim or series of claims brought against our group companies would not have a material adverse effect on their financial condition or the results of operations, or that coverage limits of product liability insurance would be adequate. This in turn could have a material adverse effect on our financial condition and results of operations.

***Product regulation may adversely affect the ability of our medical device group companies to bring new products to market or to continue to supply existing products to the market.*** Our medical device group companies are subject to strict government controls on the development, manufacture, labeling, distribution and marketing of products, including with regard to financial arrangements and kickbacks to financial institutions and healthcare officials. They must obtain and maintain regulatory approval for their products from regulatory agencies before products may be sold in a particular jurisdiction. Each regulatory authority may impose its own requirements and delay or refuse to grant approval, even though a product has been approved in another country. Regulatory delays, the inability to successfully complete clinical trials, claims and concerns about safety and efficacy, new discoveries, patents and products of competitors and related patent disputes and claims about adverse side effects are only a few of the factors that could adversely affect the realization of product registration. Noncompliance with applicable regulatory requirements can require the investment of more time and resources in the development of products, stop product development and result in enforcement action which may include recalling products, ceasing product marketing, paying significant fines and penalties, and similar regulatory actions which could limit product sales, delay or halt product shipments and/or delay new product clearances or approvals, any of which may thereby materially adversely affect such group companies' businesses. This in turn could have a material adverse effect on our financial condition and results of operations.

***Because the medical device industry is litigious, our medical device group companies are susceptible to intellectual property suits that could cause our medical device group companies to incur substantial costs or pay substantial damages or prohibit them from selling their products.*** There is a substantial amount of litigation over patent and other intellectual property rights in the medical device industry. Whether or not a product infringes a patent involves complex legal and factual issues, the determination of which is often uncertain. Infringement and other intellectual property claims, with or without merit, can be expensive and time-consuming to litigate and can divert management's attention from the concerned company's core business as well as result in the payment of damages or even prevent the concerned company from selling its products and accordingly could materially adversely affect our group companies' financial condition and results of operation and as a result this could also materially adversely affect our financial condition and results of operations.

***If our medical device group companies are unable to obtain reimbursement coverage from third-party healthcare payors for procedures using their products, or if reimbursement is insufficient to cover the costs of purchasing their products, demand for their products may be adversely affected.*** If physicians, hospitals and other healthcare providers are unable to obtain sufficient coverage and reimbursement from third-party payors for products produced by our medical device group companies, or if reimbursement is insufficient to cover the costs of purchasing our medical device group companies' products or does not adequately compensate physicians and health care providers as compared with alternative procedures, our medical device group companies may be unable to generate sufficient sales to support their businesses. In addition, our medical device group companies could be adversely affected by changes in reimbursement policies of governmental or private healthcare payors to the extent any such changes affect reimbursement amounts or availability for procedures in which their products are used. Accordingly, this could materially adversely affect our group companies' financial condition and results of operations and as a result could also materially adversely affect our financial condition and results of operations.

*The development of products by our group companies in the medical device field is dependent upon the success of clinical trials.* The continued development of many of the products being developed by our group companies engaged in the medical device field, is dependent upon the performance of clinical trials and subject to, and contingent upon, the success of such trials at each one of the regulatory stages. The performance of clinical trials is dependent upon a variety of factors, including the ability to recruit appropriate candidates for such trials. A slower than expected pace of recruiting and/or a delay in recruiting candidates for the trials may derive from various factors, such as low incidence of patients meeting the trial's criteria, competition between companies over the participation of trial candidates, a change in candidates' readiness to volunteer for the trial and lack of funds. Furthermore, the need for the consent of various clinical research bodies for the performance of the trials, receipt of the regulatory approvals for performance of the trials, and the structure of the trials (trial protocol, manner of analysis of results etc.), regulatory changes, as well as the possibility of unexpected side effects of the group companies' products may all constitute obstacles in the path to successful completion of the clinical trials, and may delay or even stop the continued performance of the clinical trials and lead to postponement of receipt of the approvals and permits as aforesaid. Therefore, it is impossible to know when clinical trials will be completed, if at all. Accordingly this could materially adversely affect our group companies' financial condition and results of operation and as a result could also materially adversely affect our financial condition and results of operations.

*Our medical device companies experience significant uncertainty at the research and development stage.* Most of our medical device companies are in the research and development stage. In light of the uncertainty that they will succeed in developing their various products, in demonstrating their products efficiency, safety, and cost-benefit, and/or in penetrating relevant markets, in the event of the failure in the technological development of products of our group companies and/or the failure to obtain the required approvals from the authorized regulatory authorities in order to market their products and/or successfully penetrate into the relevant market, our investment in these companies may ultimately be lost and as a result could materially adversely affect our financial condition and results of operations.



Below is a table grading the influence of the above described risk factors on the Company:

	<i>Risk Factor Influence on the Company</i>		
	<i>Major Influence</i>	<i>Medium Influence</i>	<i>Minor Influence</i>
<b><u>Specific Risks Affecting Us</u></b>			
<i>Our financial results and our cash reserves are directly impacted by our ability to conclude "exit" transactions at significant values</i>	✓		
<i>If our cash resources are insufficient to finance our operations, we may be unable to obtain alternative sources of financing and consequently may be unable to invest in existing and new companies.</i>	✓		
<i>We may be deemed to be an investment company under the U.S. Investment Company Act of 1940.</i>			✓
<i>If we are characterized as a passive foreign investment company for U.S. federal income tax purposes, our U.S. shareholders may suffer adverse tax consequences.</i>			✓
<i>It may be difficult to serve process or to enforce a U.S. judgment against us, our directors and our officers.</i>			✓
<i>Our controlling shareholder, Discount Investment Corporation, or DIC, has the ability to control our business and affairs.</i>			✓
<i>We have voluntarily delisted from the Nasdaq Global Select Market and may in the future seek to terminate our Exchange Act registration.</i>			✓
<b><u>Risks Affecting Us and the Companies in Our Group</u></b>			
<i>Ongoing uncertainty regarding global and local economic conditions has adversely affected and may continue to adversely affect our and our group companies' results and financial condition and could lead to impairment charges</i>	✓		
<i>Our financial results and financial condition are principally impacted by the results of operation of, and the value of our holdings in, our group companies.</i>	✓		
<i>Our financial results significantly depend on the results of operations of our group companies, which continue to invest heavily in their development and have generated losses.</i>	✓		
<i>We compete with other entities for acquisition and investment opportunities.</i>		✓	
<i>We may face difficulties in our ability to dispose of our shares in companies in our group.</i>	✓		
<i>Our ability to invest in companies or conclude exit transactions may be adversely affected and/or prevented by anti-trust regulations both in Israel and abroad.</i>			✓

	Risk Factor Influence on the Company		
	Major Influence	Medium Influence	Minor Influence
<i>The Israeli Promotion of Competition and the Reducing of Centralization Law may adversely affect our business</i>	✓		
<i>We and our group companies are subject to regulatory requirements and restrictions in Israel and various other countries</i>		✓	
<i>We have indemnification obligations which survive exit transactions and may not receive the entire proceeds due to us from exit transactions of our group companies.</i>			✓
<i>The market price of our ordinary shares is subject to fluctuations.</i>	✓		
<i>Many of our group companies may face difficulties in obtaining future financing on favorable terms or at all.</i>	✓		
<i>Bank of Israel regulations limit our and our group companies' ability to borrow from Israeli banks.</i>			✓
<i>Our results, and the value of our investments, are affected by volatility in the securities markets.</i>	✓		
<i>There is no assurance that our subsidiary, RDC, will be able to continue to develop technologies and/or new companies.</i>		✓	
<i>Most of our group companies are dependent upon proprietary technology, which may be infringed by, or may infringe upon, the proprietary technology of others.</i>	✓		
<i>The technological fields within which our group companies operate involve a high level of risk and uncertainty.</i>	✓		
<i>Many of our group companies experience intense competition.</i>		✓	
<i>Israeli government programs in which certain of our group companies participate may be terminated or reduced in the future and may be restrictive in their terms.</i>			✓
<i>We and our group companies may have difficulty retaining key employees.</i>	✓		
<i>Certain of our group companies depend on international operations.</i>			✓
<i>Conditions in Israel may affect our operations and the operations of our group companies.</i>			✓
<i>Our and our group companies' operations could be disrupted as a result of the obligation of personnel in Israel to perform military service.</i>			✓
<i>The results of operations of our group companies may be harmed by foreign currency exchange rate fluctuations.</i>			✓
<i>Product liability claims could adversely affect the business results of our group companies, especially those operating in the medical device industry.</i>			✓

	<i>Risk Factor Influence on the Company</i>		
	<i>Major Influence</i>	<i>Medium Influence</i>	<i>Minor Influence</i>
<i>Product regulation may adversely affect the ability of our medical device group companies to bring new products to market or to continue to supply existing products to the market.</i>	✓		
<i>Because the medical device industry is litigious, our medical device group companies are susceptible to intellectual property suits that could cause our medical device group companies to incur substantial costs or pay substantial damages or prohibit them from selling their products.</i>	✓		
<i>If our medical device group companies are unable to obtain reimbursement coverage from third-party healthcare payors for procedures using their products, or if reimbursement is insufficient to cover the costs of purchasing their products, demand for their products may be adversely affected.</i>		✓	
<i>The development of products by our group companies in the medical device field is dependent upon the success of clinical trials.</i>	✓		
<i>Uncertainty experienced by our medical device companies during the research and development stage</i>	✓		

**Item 4. Information on the Company**

**A. History and Development of the Company**

We are an operational holding company that focuses on building and enhancing technology companies. Our current group companies include companies at different stages of development and business maturation, operating in various technology fields such as medical device and other fields.

Our primary goal is to create value for our shareholders by enhancing and realizing our holdings, whether through exit transactions or public offerings, in parallel with the identification of other new investment opportunities in companies with potentially significant returns. For this purpose, we strive for significant holdings in companies and act towards enhancing their value through involvement in their management and direction. We are involved in the management of our group companies by means of active membership on their boards of directors and board committees and providing active assistance to management. We are directly involved in matters of policy guidance, strategic planning, marketing, selecting and manning senior management positions, determining the business plan, approving investments and budgets, development and operational guidance, assistance in creating strategic partnerships, and the overall ongoing monitoring of our group companies' performance.

Within our business strategy framework, and with the intent to continue investing in new companies, we examine a broad range of proposals for investment and strategic cooperation in a broad range of technology fields, including through RDC, which has first rights to commercialize military technologies developed by Rafael in civilian markets. We hold 50.1% of the issued and outstanding shares and voting rights of RDC and Rafael holds the remaining 49.9%. RDC seeks to identify technological projects and invest in companies in diverse fields that will either commercialize Rafael's military technologies or which will be benefited by Rafael's technology and know-how. For details about the agreement with Rafael, see Item 10C – Additional Information – Material Contracts below and for more information about RDC, see "Item 4.B below.

Both our legal name and our commercial name is Elron Electronic Industries Ltd. We were incorporated in Israel in 1962. The principal legislation under which we operate is the Israeli Companies Law, 1999. Our shares are publicly traded under the symbol "ELRN" on the TASE and in the over-the-counter market in the United States under the symbol "ELRNF". Our corporate headquarters and registered office is located at 3 Azrieli Center, 42nd Floor, Tel-Aviv 6702301, Israel, Tel. 972-3-607-5555, Fax. 972-3-607-5556, e-mail: info@elron.com. Our web site address is www.elron.com. Information contained on our website is not part of this Annual Report.

- **Investment in Notal.** In July 2013, Notal signed an investment agreement with its major shareholders, including us, in the amount of \$10 million to be advanced in two installments out of which our share was approximately \$1.94 million and an option to participate in an additional installment in the amount of \$5 million, in consideration for Preferred C shares and warrants for Preferred C shares. This agreement is an additional extension of the investment agreement signed in October 2010. Our holding in Notal did not change significantly resulting from the extension of the investment agreement.
- **Transfer of Shares of RDSeed to RDC.** In July 2013, we transferred our shares in RDSeed, including any rights and obligations in connection therewith to RDC in consideration for \$5 million, subject to adjustments. As a result, RDSeed became an RDC subsidiary.
- **RDC's Investment in RDSeed.** In July 2013, RDSeed signed an investment agreement with RDC, in the amount of \$2 million in consideration for Preferred A shares following which RDC holds approximately 89% of RDSeed's outstanding shares.
- **Enablence Settlement.** In September, 2013, a settlement agreement was signed between Enablence Technologies Inc., or Enablence, and the debenture-holders, including us for the partial repayment of the debentures. According to the settlement agreement, out of the consideration Enablence paid to the debenture-holders, we received consideration, as follows: approximately \$1.7 million in cash, of which an amount of \$0.4 million was paid in Enablence shares which were purchased for cash by an Enablence shareholder as part of the settlement agreement; and 5,880,104 Enablence shares (constituting approximately 4% of Enablence's outstanding shares), which were subject to a four month lockup period in accordance with Canadian securities legislation. In addition, pursuant to the settlement agreement, the debenture-holders, including us, waived the outstanding debt and released Enablence from any claims in connection with the debentures. As a result of the settlement agreement, we recorded in the third quarter of 2013 a net gain in the amount of approximately \$3.5 million in respect of a partial cancellation of the impairment recognized in 2011.

- **Merger of Given Imaging and Covidien.** In December 2013, Given Imaging announced that it signed a definitive agreement to be acquired by a member of the Covidien group for a cash consideration of \$30 per share by way of a reverse triangular merger, or Given Merger. In February 2014, the Given Merger was completed. As a result, we and RDC received approximately \$204 million and approximately \$80 million (approximately \$61 million after tax), respectively, in consideration for all our and RDC's holdings in Given's shares. As result of the completion of the Given Merger, we will record, in the first quarter of 2014, a net gain (after tax) currently in the amount of approximately US\$107 million which includes our share in the gain RDC is expected to record in respect of the transaction. In addition, in the fourth quarter of 2013, we recorded net deferred tax assets in the amount of approximately US\$29 million (including tax reserve recorded in the books of RDC), mainly with respect to carry forward losses which are expected to be utilized as a result of the transaction. As a result of the Transaction, the credit line in the amount of \$15 million granted to us by Silicon Valley Bank and as security for which shares of Given held by us were pledged, was cancelled.
- **New Investment in D.E.S Dry Eye Solutions.** In December 2013, we invested \$0.5 million in D.E.S Dry Eye Solutions Ltd., or DES. DES is developing a device for the treatment of dry eye. Following the investment, we hold approximately 17% of the issued and outstanding shares of DES. We were also granted an option to invest approximately \$3 million which upon exercise would result in us holding approximately 30% of the issued and outstanding shares of DES.

The following are the significant investments and divestitures that we and our group companies completed in 2011 and 2012, and including subsequent investments in the same group companies in 2013 and 2014, in chronological order:

- **Starling Merger and Liquidation.** In May 2012, a merger transaction was completed whereby an Israeli private company, wholly owned by us and RDC, which was founded shortly before the merger transaction and which had no business activity, was merged with and into Starling Advanced Communications Ltd., or Starling, in accordance with the Israeli Companies Law. The registered shareholders of Starling's shares on the record date, apart from us and RDC, transferred their Starling shares to us and RDC in consideration for NIS 0.87 (approximately \$0.23) for each ordinary share. Starling's shares were delisted from trading on the TASE on May 15, 2012, on which date Starling became a private company. The aggregate merger consideration amounted to approximately NIS 1.6 million (approximately \$0.42 million) which was paid by us and RDC in proportion to each party's respective post-merger holdings in Starling. In 2012, it was decided to voluntarily liquidate Starling. Later that year, a liquidator was appointed and Starling was subsequently liquidated.

- **Medingo – Additional Consideration.** In May 2012, a supplement agreement was signed with F. Hoffmann La-Roche Ltd., or Roche (which, in 2010 acquired Medingo Ltd., or Medingo, then 92% held by us and RDC) according to which, as additional consideration in lieu of the selling shareholders' right under the original sale agreement to contingent consideration payments up to \$40 million, the acquirer agreed to pay the selling shareholders an aggregate lump sum of \$19 million (the "Immediate Consideration"). Our and RDC's share in the Immediate Consideration was approximately \$1.4 million and \$14.1 million respectively and we recorded in the second quarter of 2012 a net gain (net of non-controlling interest) of approximately \$8.5 million. Simultaneously with this payment, the escrow deposit held in connection with the sale in the amount of \$27 million was released and paid to the selling shareholders. Our and RDC's share in the escrow deposit was approximately \$2.7 million and \$19.9 million, respectively. See also "Sale of Medingo" below in this Item 4.
- **Elron Distribution.** In June 2012, our board of directors declared a dividend in the aggregate amount of \$15 million or \$0.50573 per share. The dividend was paid on July 23, 2012.
- **RDC Distribution.** In June 2012, RDC distributed a cash dividend in the aggregate amount of approximately \$17.8 million. Our share of this dividend amounted to approximately \$8.9 million. The remaining balance of the dividend amount was distributed to Rafael.
- **RDC Loan Repayment.** In June 2012, RDC repaid its entire debt to its shareholders (us and Rafael) in the aggregate amount of \$6.6 million (including principal and interest), of which our share was approximately \$3.3 million.
- **Investment in Cartiheal.** In July 2012, we completed an initial investment of \$2.5 million in Cartiheal (2009) Ltd., or Cartiheal, as part of a financing round led by U.M. Accelmed Medical Partners L.P. and Access Medical Ventures LLC.. In addition, we and the other shareholders participating in the investment round have an option to invest an additional \$5 million (out of which we have the option to invest an additional \$2.5 million). Following the investment, we held approximately 24% of CartiHeal's outstanding shares and approximately 28% on a fully diluted basis.

In September 2013, we, together with the other investors, exercised warrants to purchase additional preferred shares of Cartiheal, of which we invested \$2.5 million. Following the warrant exercise, we hold 32.3% of Cartiheal's outstanding shares.

- **Aqwise Investment and Share Sale.** In July 2012, we sold a portion of our holdings in Aqwise – Wise Water Solutions Ltd., or Aqwise, to a third party who completed an initial investment in Aqwise. We received an amount of approximately \$1.9 million for the sale of our holding and from the repayment of shareholders loans by Aqwise. Following the completion of the transaction, our holding in Aqwise's outstanding shares decreased from approximately 34% to approximately 19.8%, and approximately 18% on a fully diluted basis, and we recorded in the third quarter of 2012 a net gain of approximately \$3.9 million.

- **Sale of Sync-Rx.** In November 2012, the sale of all the shares of Sync-Rx Ltd., or Sync-Rx, a company approximately 87% held by RDC, to Volcano Corporation (Nasdaq: VOLC) was completed for an aggregate consideration of approximately \$17.25 million. Sync-Rx develops an online image processing system designed to optimize and facilitate coronary catheterization. RDC's share in the consideration amounted to approximately \$15.8 million (of which an amount of approximately \$3.1 million was deposited in escrow for a period of 18 months). As a result, we recorded a net gain (net of non-controlling interest) in the fourth quarter of 2012 of approximately \$8.6 million.
- **Investments in Pocared.**

In January 2011, we together with other shareholders of Pocared invested an aggregate of \$5.8 million in exchange for Series F preferred shares of Pocared, of which we invested approximately \$2.6 million. In addition, loans previously provided by shareholders in the amount of approximately \$9.2 million, including \$4.1 million provided by us, were converted into the same class of shares. In addition, the shareholders had the option at their discretion to invest up to an additional \$11.2 million, in three additional installments, pro rata to their holdings of Pocared. In June 2011, September 2011 and January 2013, the additional three installments were completed out of which our share was approximately \$5.1 million.

In August 2011, we together with other shareholders of Pocared, purchased the holdings of another shareholder in Pocared, which to that date constituted approximately 5% of Pocared's outstanding shares, in consideration for approximately \$2 million, of which our share was approximately \$0.9 million. Following these transactions, our shareholding of Pocared increased to 37% on a fully diluted and to 41% on an as converted basis.

In May 2013, Pocared signed an investment agreement with its major shareholders, including us, whereby a total amount of up to \$10 million would be advanced in two installments in consideration for additional Preferred F shares. The first installment in respect of this investment in the amount of approximately \$3 million of which our share was approximately \$1.4 million was advanced in the same month. This agreement was in addition to the previous investment in Preferred F shares. Elron's holding in Pocared did not change significantly as a result from this investment agreement.

In October 2013, Pocared's major shareholders, including us granted Pocared a loan in the amount of \$2 million of which our share was approximately \$900,000.

In February 2014, Pocared's shareholders, including us, granted Pocared an additional loan in the amount of \$2 million of which our share was approximately \$1.5 million.

- **Investment in Kyma.** In January 2011, we invested \$4 million in Kyma in addition to an amount of \$1 million invested in Kyma in 2010, thereby increasing our shareholdings to 65% of Kyma's outstanding shares.

In March 2011, we transferred our shares in Kyma to RDC in consideration for \$5 million representing amount invested by us in Kyma (including transaction costs), following which we held approximately 33% of Kyma indirectly, and approximately 65% on a consolidated basis. In September 2011, RDC entered into a share purchase agreement with Kyma whereby RDC undertook to invest \$2.5 million in Kyma in three installments during 2012. Following completion of the transaction, we held approximately 37% of Kyma indirectly, and approximately 73% on a consolidated basis.

In September 2011, RDC entered into a share purchase agreement with Kyma whereby RDC undertook to invest \$2.5 million in Kyma in three installments during 2012. Following completion of the transaction, we held approximately 37% of Kyma indirectly and approximately 73% on a consolidated basis.

In October 2013, Kyma, RDC and a new investor completed an investment agreement in the amount of \$6 million advanced in two installments in consideration for Preferred C shares of which RDC's share was approximately \$2 million. In addition, the new investor also received warrants for Preferred C shares which will afford the new investor the option to invest in Kyma an additional amount of \$4 million. The first installment of \$3 million (of which RDC invested \$1 million) was invested in October 2013 following which RDC's holding in Kyma's outstanding shares decreased to approximately 64% and the second installment of \$3 million (of which RDC invested \$1 million) was invested in January 2014 following which RDC's holding in Kyma's outstanding shares decreased to approximately 57.7% and assuming the exercise of the warrants, RDC's holding is expected to decrease to approximately 38% on a fully diluted basis. After the first installment which also brought about a change in Kyma's board of directors, RDC lost control over Kyma and commencing from the fourth quarter of 2013, the investment in Kyma will be accounted for under the equity method of accounting. As a result and in accordance with IFRS provisions, we recorded, in the fourth quarter of 2013, a net gain of approximately \$1.7 million attributable to our shareholders (a consolidated net gain in the amount of approximately \$2.8 million)

- **Establishment of RDSeed.** In May 2011, we, together with a co-founder, founded RDSeed, in order to invest in companies based on technologies in the fields of electronic commerce, mobile applications, cloud computing applications, social networks, medical and pharmaceutical digital applications and other related fields. We held 80% of RDSeed's outstanding shares. In June 2011, we completed our first investment in RDSeed in the amount of \$1.5 million. During 2012, we invested an additional amount of \$2.5 million in RDSeed, the proceeds of which were used to invest in Cloudyn, Pose, Numbeez and RDSeed's in house Cemmerce activity. In January 2013, we invested an additional amount of \$1 million in RDSeed. In July 2013, we transferred our shares in RDSeed to RDC. See "Transfer of Shares in RDSeed to RDC" in this Item 4 above.



- **Loans to RDC.** In May 2011, we and Rafael entered into a loan agreement with RDC, each committing to advance \$5 million to RDC. A loan of \$2 million was immediately advanced to RDC of which our share was \$1 million. In October 2011, an additional amount of \$4.5 million in respect of this loan was advanced to RDC of which our share was \$2.25 million. These loans were repaid in full in June 2012.
- **Investment in BrainsGate.** In July 2011, BrainsGate Ltd., or BrainsGate, signed an investment agreement with its major shareholders, including us, raising approximately \$20 million in three equal installments of which our share is approximately \$7.1 million. The installments in the aggregate amount of \$20 million were advanced in August 2011, January 2012 and July 2012. Following completion of the round, we hold 30% of BrainsGate's outstanding share capital and approximately 27% of its fully diluted share capital.
- **Sale of Starling's Business.** In September 2011, an asset sale agreement for the sale of Starling's entire business in the field of non-military satellite communication systems to a major international company, a world leader in the communications market, in consideration for payment in the aggregate amount of approximately \$11.3 million, was completed and came into effect. As a result of the transaction, we recognized an approximately \$4.7 million net gain (net of non-controlling interest). This amount takes into account expenses in respect of an inventory write-down and provisions for repairs and the termination of agreements with customers and suppliers following the decision of Starling's board of directors to cease its operations.

In addition, simultaneously with the transaction's completion, we and RDC completed the purchase of Elbit Systems Ltd.'s entire holding in Starling (approximately 16% of the outstanding shares), pro rata between us, in consideration of an aggregate sum of approximately \$0.3 million. Following the purchase, our holding (including indirectly through RDC) in Starling increased from approximately 67% to approximately 83% (our direct holding increased from approximately 31% to approximately 39%, and RDC's direct holding increased from approximately 36% to approximately 44%).

In order to enable Starling to execute the transaction and to fully and timely pay all of its commitments, including its commitments to the holders of its Series A debentures (the "Debentures"), on the closing date of the transaction we and RDC made available to Starling a credit facility in an amount of \$11 million. In November 2011, Starling fully prepaid its Debentures, such that Starling paid each holder of par value NIS 1 of the Debentures an amount equal to the par value of the Debenture as of the prepayment date (that is, principal, accrued interest and linkage up to the prepayment date which amounted to approximately \$6.9 million). Our and RDC's share in the prepayment sum amounted to approximately \$2.75 million and \$1.55 million, respectively. It should be noted that the Debentures held by us and RDC, and the Debentures held by the Clal Finance Ltd. Group, a company controlled by indirect controlling shareholders of the Company, were paid according to the same terms as those which applied to the rest of the Debenture holders.

As a result of the transaction, Starling ceased to be a main group company for us. (See "Item 4B – Business Overview" regarding the criteria for determining that a group company is a main company.)

In November 2011, we and RDC approached Starling's shareholders with a full tender offer to purchase all the shares held by them. The tender offer was not successful.

See also "Starling Merger" above in this Item 4.

- **Sale of Safend.** In September 2011, all the shares of Safend Ltd., or Safend, were sold to Wave Systems Corp., a NASDAQ-traded supplier of data protection solutions, or Wave, in consideration for approximately \$12.8 million, consisting mostly of shares of Wave, based on their trailing 10-day average closing price on the Nasdaq prior to the closing date of the sale. Safend, which was approximately 25% held by us prior to its sale, provides endpoint data protection solutions for corporations. In consideration for the aforesaid sale, we received shares of Wave amounting to approximately \$2.7 million based on their trailing 10-day average closing price on the Nasdaq prior to the closing date of the sale, and recorded an approximately \$2.3 million net gain in the third quarter of 2011.
- **Sale of Wavion.** In November 2011 we sold, by way of merger, all the shares of Wavion Ltd., or Wavion, an approximately 67% held subsidiary of ours, to Alvarion Ltd. (Nasdaq: ALVR), or Alvarion, in consideration of aggregate proceeds of approximately \$26.5 million. Out of the consideration Alvarion paid for the purchase of all the shares, we received an amount of approximately \$16.2 million (of which an amount of approximately \$2 million was deposited in escrow and released in February 2013 of which we received \$1.9 million). In addition, in the second quarter of 2012, we received an additional amount of approximately \$1.3 million with respect to consideration contingent upon Wavion's revenues in the fourth quarter of 2011. As a result of this sale, we recorded a net gain in the fourth quarter of 2011 of \$21.4 million. In February 2013, we received the escrow deposit in the amount of approximately \$1.9 million.
- **Credit Line.** In November 2011, we entered into a binding agreement with Silicon Valley Bank (the "Bank") to receive a credit line in the amount of \$30 million for a period of up to 18 months (the "Credit Period"). The credit line was obtained in order to diversify and ensure additional sources of financing towards continued investing in companies held by us and new companies and to finance our ongoing operations. During the Credit Period, we were entitled to draw down loans from the credit line for periods of up to 3 years from the date of each respective drawdown, at the Wall Street Journal prime rate of interest plus 0.75% per annum. According to the terms of the credit line, we were able to make early repayment of all the loans without any cost. At the time the credit line was actually utilized, we pledged shares directly held by us in Given Imaging in an amount equal to maintain a 3.25 ratio of the market value of the pledged shares (based on their trailing 5-day average closing price prior to the computation date) to the amount of credit utilized. Pursuant to the credit agreement, should the ratio of the market value of the pledged shares to the credit amount utilized decrease below 3, then we would either pledge additional Given Imaging shares or repay a portion of the credit utilized in order to maintain a coverage ratio of 3.25, or provide alternative collateral acceptable to the Bank.

In April 2012, we drew down \$5 million of the facility against a pledge of 1,130,000 shares of Given Imaging.

In August 2012, we repaid \$1 million of the facility utilized and in January 2014, subsequent to the reporting date, Elron prepaid the rest of the loan balance, in the amount of \$4 million.

In April 2013, we entered into an agreement with the Bank to extend the credit line in the amount of \$25 million which included a \$10 million facility capable of being utilized until December 31, 2013 (which was not utilized by us) and an additional \$15 million facility which was capable of being utilized until October 30, 2014. As a result of the completion of the Given Merger, the credit line with the Bank was terminated.

## **B. Business Overview**

We operate in one field of activity (considered one reportable segment, in accordance with IFRS 8, Segments), namely the investment in and enhancing the value of companies engaged in various technology fields and realizing such investments through exit transactions or public offerings.

The description below presents details regarding our holdings in main group companies (including through RDC and its subsidiary, RDSeed). It should be noted that, in addition, we have holdings of less than 10% in other companies as well as companies undergoing liquidation.

From our point of view, a main company is a company that is significant from our perspective because it meets one of the quantitative or qualitative criteria which were adopted by us as specified below:

- (a) Qualitative criterion – a company which constitutes a main company from our perspective, even though it does not meet our quantitative criterion below, due to our significant investment commitments, significant risks and exposure in connection with our investment, the potential inherent in the investment from management’s perspective, or significant value (current or potential).
- (b) Quantitative criterion – a company in which the total investment in our Statement of Financial Position exceeds 10% of our equity.

From among our group companies, as of the period covered by this Annual Report, the following companies: RDC, Pocared and BrainsGate meet at least one of the criteria specified above, and are therefore deemed as main group companies. In February 2014, we sold our holdings in Given Imaging, which was a main group company, pursuant to the Given Merger. (For more details, see Item 4 above). The above list may change from time to time due to changes arising from the sale of a company, investments in companies, or decreases in their value.

Following are details regarding our holdings in our group companies (including, through RDC and RDSeed<sup>1</sup>), presented in alphabetical order, as of December 31, 2013:

Group company name	Business	Basis of presentation in the Financial Statements	Rights to appoint directors	Percentage of shareholdings and voting rights	Fully diluted percentage of shareholding and voting rights	Amount Invested by Elron and in the Aggregate) in \$ million)
AQWISE - WISE WATER TECHNOLOGIES LTD	Development manufacturing and marketing of biological and waste water treatment solutions for industrial and municipal markets	Fair Value	Two directors (out of eleven directors)	19.81%	17.94%	Elron: 4.9 Total: 13
ATLANTIUM TECHNOLOGIES INC	Development manufacturing and marketing of ultra violet based water disinfection solutions	Fair Value	One director (out of seven directors)	7.77%	6.60%	Elron: 13.7 Total: 65
BRAINSGATE LTD	Development of a device for the treatment of ischemic stroke within 24 hours	Equity Method	One director (out of five directors)	29.86%	26.82%	Elron: 21 Brainsgate: 70
CARTIHEAL (2009) LTD	Development of an implant for repair of articular cartilage and osteochondral defects	Equity Method	One director (out of five directors)	32.31%	27.27%	Elron: 5 Total: 13

<sup>1</sup> In equity and voting. In this table, all of RDC's and RDSeed's rights are applied to us.

Group company name	Business	Basis of presentation in the Financial Statements	Rights to appoint directors	Percentage of shareholdings and voting rights	Fully diluted percentage of shareholding and voting rights	Amount Invested by Elron and in the Aggregate
CLOUDYN SOFTWARE LTD	Development and marketing of solutions for the optimization of cloud computing costs and resources	Consolidated	Three directors (out of five directors)	51.00% of voting rights and 45.94% of shareholdings (by RDSeed only)	51.00% of voting rights and 43.33% of shareholdings (by RDSeed only)	RDSeed & Total: 3
DES DRY EYE SOLUTIONS LTD	Development of a device for treatment of dry eye	Equity Method	One director (out of four directors)	17%	30%	Elron: 0.5 Total: 1.2
GIVEN IMAGING LTD <sup>2</sup>	Development manufacturing and marketing of diagnostic products for the visualization and detection of gastrointestinal tract disorders	Held for Sale	Public company. Two directors serving are officers of Elron (out of nine directors serving)	28.61% (8.05% by RDC)	26.26% (7.39 % by RDC)	Elron and RDC: 110 Total: Not relevant due to public company
JORDAN VALLEY SEMICONDUCTORS LTD	Development manufacturing and marketing of metrology equipment for manufacturing process control in the semiconductor industry	Fair Value	One director (out of eight directors)	18.83%	16.95%	Elron: 8.1 Total: 35

<sup>2</sup> In February 2014, we and RDC sold our respective holdings in Given Imaging pursuant to the Given Merger. For more details, see Item 4.A above- A History and Development of the Company.

Group company name	Business	Basis of presentation in the Financial Statements	Rights to appoint directors	Percentage of shareholdings and voting rights	Fully diluted percentage of shareholding and voting rights	Amount Invested by Elron and in the Aggregate
KYMA MEDICAL TECHNOLOGIES LTD	Development of a remote patient monitoring solution for congestive heart failure patients	Equity Method	Two directors (out of four directors)	64.41% (by RDC only)	45.80% (by RDC only)	RDC: 8.5 Total: 10.5
R.D.SEED LTD	Incubation and development of companies in the digital field (cloud, networks, applications)	Consolidated	Three directors (out of three directors)	88.76% (held by RDC only)	88.76% (held by RDC only)	RDSeed & Total: 7
NOTAL VISION INC	Development , manufacturing and marketing of systems and services for remote monitoring of AMD patients	Fair Value	One director (out of seven directors)	22.34%	18.07%	Elron: 7.5 Total: 32
NUMBEEZ LTD	Development of a blogging platform where users create, track and share the interesting numbers in their lives	Equity Method	One director (out of three directors) – not actually appointed by RDSeed	37.85% (by RDSeed only)	34.29% (by RDSeed only)	RDSeed & Total:0.6
PLYMEDIA ISRAEL(2006) LTD	Development and marketing of advertising exchange services	Equity Method	One director (out of five directors)	26.74%	19.25%	Elron: 2.5 Total: 6
POCARED DIAGNOSTICS LTD	Development of a microbiological laboratory system performing rapid and automated diagnosis	Equity Method	Two directors (out of six directors)	41.35%	36.35%	Elron: 27 Total: 66
POSE LTD)	Development of an online cash register, inventory management, and retail website management system	Equity Method	Two directors (out of four directors)	43.30% (by RDSeed only)	45.16% (by RDSeed only)	RDSeed & Total: 1.0.
RDC – RAFAEL DEVELOPMENT CORPORATION LTD	Incubation and development of companies based on or reliant on Rafael technology	Consolidated	Five directors (out of Nine directors)	50.10%	50.10%	Not Relevant

## **Our Group Companies**

It should be noted that in the descriptions of our group companies below, we sometimes provide data obtained from outside sources in order to provide an indication of the size of the market in which they operate, and/or (in the case of our medical devices companies) to provide an indication of the healthcare system's need (in their eyes) for their products. These references do not provide any indication of their market potential or suggest that their products target the entire market.

### ***Life Cycle and Regulation of Medical Device Companies***

Based on our knowledge and the data in our possession as of the end of the period covered by this Annual Report, generally and in principle, companies seeking approval for the marketing of medical devices are required to undergo various stages of development and regulatory approval before marketing the product, including a series of clinical trials, as specified below, it being noted that there may be changes in the steps and/or additional steps in accordance with the specific circumstances of each company and its products:

- (i) Proof of technological feasibility – at this stage, preliminary tests are performed, the purpose of which is to prove the effectiveness of the technology.
- (ii) Prototype design – at this stage, ex-vivo experiments and other experiments are usually performed for the purpose of developing the device and determining its effectiveness.

- (iii) Preclinical studies – at this stage, testing is usually performed on animals, the purpose of which is to examine the safety and effectiveness of the device before testing it on humans.
- (iv) Clinical trials – at this stage, trials are performed on humans. For every clinical trial, a detailed operational plan is determined in advance (trial protocol) including complete details relating to the clinical trial. The trial protocol defines the trial endpoints (primary and secondary), the target population of the trial (sample size and inclusion/exclusion criteria), trial design (controlled, randomized, open label or blinded), definition of trial success, the timing and method of outcome assessment, and other matters. (In a controlled trial, participants are assigned to one of at least two groups – one which receives the treatment under investigation (the trial group), and the other of which (the control group) receives either the standard treatment or a placebo. In a randomized study, participants are assigned to groups of a clinical trial by chance. In an open label trial, all parties involved with the trial know which participants have been assigned which arm. In a single-blinded trial, only the participants are unaware which group the participants have been assigned. In a double-blinded trial, neither party knows which participants have been assigned which group.) The trial protocol requires the pre-approval of the approval committee and the authorized regulatory authority in the relevant country or territory, as detailed below. The clinical trial stage includes several sub-stages:
  - a. Trials for the purpose of completion of development of the device – at this stage trials are performed, the purpose of which is the completion of development of the device, on issues such as the device’s stability, the consistency of its features and others. At this stage, for the first time, feedback is received on the device from doctors and sampled patients making use thereof. As a principle, these trials will be open lable and will include a limited number of subjects.
  - b. Trials for the purpose of proving the safety and efficiency of the device – at this stage, and as part of the regulatory process, trials are performed for the purpose of proving the safety of the device. In accordance with the selected regulatory process and/or in order to ensure that the device will be adopted by the medical community, the company may be required to conduct trials in order to prove the efficiency of the device. As a principle, these trials will be randomized and will include a large number of medical centers and subjects.
  - c. Trials for the purpose of proving economic efficiency – often, in order to qualify for reimbursement for the cost of the device and/or in order to ensure that the device will be adopted by the medical community, the company may also be required to conduct trials, the purpose of which is to prove economic efficiency of the use of the device.
- (v) The filing of an application for approval to market the device – after receiving positive results in the clinical trials proving the safety and effectiveness of the device (in accordance with the regulatory requirements), the company, at this stage, applies to the relevant regulatory body for approval to market the device, such as the FDA or the European Union, as described below.



- (vi) Commercialization of the device – in the event that the regulatory body in a particular country approves the device for marketing, the company will be entitled to market it in such country. The extent of the reimbursement for the cost of the device by government bodies and/or insurance companies may, in some cases, affect the sales potential of the device.

To the best of our knowledge, in reliance on publicly available information, a condition for conducting human clinical trials in any country which signed the Helsinki Declaration is the receipt of pre-approval from the bodies authorized to approve human clinical trials and compliance with the principles set forth in the Helsinki Declaration. In order to conduct human clinical trials in these countries, approval is required from the Helsinki Committee, an independent institutional committee at the medical center where the trial is conducted, which supervises and approves the trial. The doctor, who is the principal investigator who performs the research for the company at the medical center, submits the trial protocol to the committee. After discussion, during which the committee examines, *inter alia*, whether the trial protocol complies with the ethics requirements, the protocol is approved (often subject to changes determined by the committee) and thereafter the trial can commence. Any change in the protocol requires an update and re-filing for approval by the committee.

To the best of our knowledge, in order to conduct clinical trials in Israel, approval of the Helsinki Committee is required by virtue of the Israel Public Health Regulations (Clinical Trials on Human Subjects) - 1980, as well as to notify or to receive required approvals from the Israeli Ministry of Health. Furthermore, to the best of our knowledge, in order to conduct human trials in the United States, one is required to obtain equivalent approval from an independent institutional committee at the medical center at which the trial is conducted, namely the institutional review board, or IRB, acting by virtue of U.S. Federal law.

In addition, use of a medical device for clinical trials in the United States which has not been approved for marketing is conditional upon the receipt of a special exemption from marketing approval from the FDA, namely, an Investigational Device Exemption or IDE.

Approval for marketing of medical products is subject to stringent standardization review and requirements in each country. The regulatory proceedings for receipt of the necessary approvals comprise various stages; the developing company being required, at every stage, to meet the conditions and criteria of the relevant health authorities such as the Ministry of Health in Israel, the FDA, or the European Union. Approval granted by a regulator in one country does not ensure that approval will be received by a regulator in another country. However, approval which is granted by a regulator considered more stringent (the U.S. or Western Europe) will usually facilitate receipt of approvals elsewhere in the world. The process of receiving the necessary regulatory approvals in each of the countries involves significant expenses, including the appointment of a local representative and investment in skilled and professional manpower, and lasts for a relatively long period of time, up to several years, mainly in countries with stringent standards. However, in countries with less stringent requirements, the process may take a significantly shorter period of time. The following is a brief overview of laws and regulations to which our medical device group companies are subject:

1. *CE Certification ("CE Mark") for the marketing of a medical device in Europe* – To the best of our knowledge and in reliance on publicly available information, commercialization of medical devices in member countries of the European Union is regulated by directives adopted by the European Union. The European Union presently requires that all medical products bear the CE mark, an international symbol of adherence to quality assurance standards and demonstrated clinical effectiveness. The extent of evidence that the manufacturer is required to provide in order to be permitted to affix the CE mark on its products is dependent upon the classification of the device. There are four classes, in accordance with the level of risk related to the use of the device. The determination of the level of risk is done in accordance with criteria, which includes, *inter alia*: the duration of continued use of the device, whether the device is sterile or performs measurement, the level of invasiveness of the device, whether the device is implanted or is active, whether the device impacts on biological or chemical makeup of the body's liquids, whether the device impacts on the functioning of important organs, whether the device includes a medicinal parameter and other criteria. With respect to a CE Mark for low risk products, a declaration by the manufacture regarding compliance with the relevant directive is sufficient. For higher risk products, compliance with the Medical Device Directive, as certified by a recognized European Notified Body, permits the manufacturer to affix the CE mark on its products.
2. *Procedure for receipt of FDA clearance for the marketing of a medical device in the United States* – To the best of our knowledge and in reliance on publicly available information, the FDA is a federal agency in the United States whose role is to protect the American public's health by establishing and enforcing a high product standard and through various regulatory requirements, which will ensure the safety and effectiveness of products such as drugs which are intended for human and veterinary use, biological products and medical devices. FDA requirements include, inter alia, the manufacturing of the medical devices in accordance with quality system regulation (QSR), receipt of a scientifically based submission file on the medical device, the appointment of an American agent, and, if required, provision of an opportunity for FDA representatives to supervise the manufacturing procedure at the plant. The FDA classifies medical devices into three categories in accordance with the level of risk involved in their use. The classification level determines the extent of checks and reviews which the company is required to conduct in order to obtain approval to market the medical device. As a principle, the higher the risk, the more tests and regulations are added.
  - a. Class I – devices which do not pose any risk or pose a low risk to the health of the public, and therefore, there is no requirement to submit an application to obtain a formal approval, but rather it is sufficient to follow the FDA's instructions (e.g. toothbrushes, band-aids).

- b. Class II – devices which present a risk to the health of the public, but are not life-threatening (such as an electronic thermometer or contact lenses). This category requires that an application be filed under a Premarket Notification 510(k) proceeding, or 510(k), which is a relatively short proceeding during which it is demonstrated to the FDA that the medical device for which the clearance is sought is substantially equivalent, with respect to intended use, safety and treatment efficiency, to an existing product or "predicate device" – a device that has already been through the approval process and which is not subject to a Premarket Approval, or PMA, proceeding.
  - c. Class III – devices that are intended to help support or sustain life and pose a risk, innovative devices with respect to which the level of danger is unknown, or devices which are not equivalent to a predicate device. Requests for FDA approval of these sorts of devices are filed in a PMA process which is longer than the 510(k) process and includes a lengthy scientific review, significantly broader clinical trials and a compulsory examination of the manufacturing site. In the case that a device is classified as Class III device due to the absence of a predicate device and not due to a high level of risk, an application may be made to the FDA to classify the device as Class II through a de novo process and thereby avoid a PMA process.
3. *Procedure for receipt of the approval of the Ministry of Health for the marketing of a medical device in Israel* – To the best of our knowledge, in reliance on publicly available information, a medical device company requires the approval of Israel's Ministry of Health's Unit for Medical Means and Devices, or MOH Medical Devices Unit, to market its medical device in Israel. Medical devices are defined as a device, instrument, chemical substance, biological or technological product, which is used in medical treatment, or which is required for the action of a device or instrument which is used for treatment and which is not intended, in essence, to act as a medicinal measure. The MOH Medical Devices Unit is responsible for granting import permits of various types for medical devices and monitoring the marketing of medical devices in Israel.

## **1. Our Main Group Companies**

### ***Given Imaging***

Given Imaging was incorporated in Israel in January 1998. Given Imaging has developed the Given System, a proprietary wireless imaging system for visual examination of the gastrointestinal ("GI") tract. The system uses a miniaturized video camera contained in a capsule, referred to as the PillCam™ capsule, which is ingested by the patient and delivers high quality color images in a painless and noninvasive manner. The Given System consists of three principal components:

- a single-use, disposable PillCam color-imaging capsule that is ingested by the patient;
- a portable data recorder and sensors that are worn by the patient; and

- a proprietary software, known as RAPID, for downloading, processing and analyzing recorded data.

In 2001, Given Imaging commenced marketing the Given System with the PillCam SB capsule for visualizing and detecting disorders of the small bowel. PillCam SB is cleared for marketing in the United States, the European Union and Japan, which are Given Imaging's principal markets. In November 2004, Given Imaging began marketing and sale of the PillCam ESO capsule for visualization of the esophagus. In the second half of 2007, Given Imaging began selling the first generation of its PillCam COLON capsule in Europe. Given received the CE mark for this capsule in late 2009, the clearance by Japan's Pharmaceuticals & Medical Devices Agency (PMDA) in July 2013 and the FDA approval in February 2014. The clearance of PillCam COLON is limited in each country to specific approved indications.

Given Imaging has direct or indirect wholly-owned subsidiaries in the United States, Brazil, the Netherlands, Germany, France, Australia, Hong Kong, Vietnam, Japan and Singapore.

In December 2008, Given Imaging acquired the Bravo pH monitoring business from Medtronic, Inc. The Bravo pH monitoring system is the only wireless, catheter-free pH test for Gastro Esophageal Reflux Disease, or GERD, and uses a disposable capsule temporarily placed in the esophagus that measures pH levels and transmits the data to an external receiver. pH testing is considered the standard test for diagnosing GERD.

In April 2010, Given Imaging acquired privately-held Sierra Scientific Instruments ("Sierra"), now known as Given Imaging (Los Angeles) ("GILA"), for approximately \$35 million in cash. GILA is a leading provider of specialty diagnostic devices for the gastrointestinal tract. GILA's primary business is the development, manufacture and sale of high-resolution pressure systems, also known as high resolution manometry, for the diagnosis of motility disorders within the GI tract. GILA's high resolution manometry systems are sold under the name ManoScan. Since sales began in 2004, GILA has produced and installed ManoScan™ systems world-wide and supported numerous clinical procedures. GILA also markets and sells catheter-based pH and impedance monitoring systems. As part of the acquisition, Given Imaging acquired 100% of the shares of GILA's subsidiary, a Vietnamese company, which manufactures catheters.

In October 2012, Given Imaging acquired from The SmartPill Corporation ("SmartPill"), a U.S. based-company, assets related to the SmartPill® GI Monitoring System for \$6 million plus an earn-out component. The SmartPill® is an ingestible capsule that uses sensor technology to measure pH, pressure and temperature in the gastrointestinal tract. The SmartPill System measures gastric emptying and the transit time of solid and liquid content through the entire gastrointestinal tract and is used to evaluate motility disorders such as gastroparesis and constipation.

On February 27, 2014 the Given Merger was completed and Given Imaging's shares were delisted from any stock exchange on which they were traded and Given Imaging ceased to be a publicly-traded company and became a privately-held company that is a wholly-owned subsidiary of Covidien. For more details regarding the Given Merger, see Item 4 above.

### **BrainsGate**

BrainsGate, a private company incorporated in Israel, was established and commenced its activities in 2000. We completed our initial investment in BrainsGate in 2005.

We hold approximately 30% of BrainsGate's outstanding share capital and approximately 27% of its fully diluted share capital. The other principal shareholders of BrainsGate include Pitango, Infinity Group, Cipio Partners, Boston Scientific, Johnson & Johnson and Agate Medical Investments.

BrainsGate is developing a minimally invasive platform for the treatment of patients suffering from Central Nervous System (CNS) diseases. BrainsGate's platform technology involves electrical stimulation of the sphenopalatine ganglion (SPG), a nerve center located behind the nasal cavity, to augment cerebral blood flow, without affecting the body's other systems, such as the blood pressure system. This treatment could be acute (short term, for hours or several days) or chronic (long term, from several months to years). BrainsGate's main product under development ("ISS") is designed to treat ischemic stroke. Another potential application based on the ISS system which BrainsGate is evaluating, is intended to treat vascular dementia.

According to the World Health Organization, 15 million people worldwide suffer a stroke annually. Of these, 5 million people die and another 5 million people are left permanently disabled (see World Health Organization "Global Burden of Stroke" in *The Atlas of Heart Disease and Stroke*, 2004: [http://www.who.int/cardiovascular\\_diseases/en/cvd\\_atlas\\_15\\_burden\\_stroke.pdf](http://www.who.int/cardiovascular_diseases/en/cvd_atlas_15_burden_stroke.pdf)). According to the American Heart Association, in the United States, an estimated 6.8 million people have had a stroke, and each year approximately 795,000 people experience a new or recurrent stroke (*American Heart Association -Heart Disease and Stroke Statistics* report – 2014 update). Projections show that by 2030, an additional 4 million people will have had a stroke, a 20.5% increase in prevalence from 2012 (*Heart Disease and Stroke Statistics* report – 2014).

However, to the best of BrainsGate's knowledge, the current treatment for stroke patients, including treatment with tPA protein, a clot dissolving medicine, is very limited due to the fact that existing treatments are approved for use during a very short time frame following the stroke. This time frame which was only 3 hours was extended to 4.5 hours in 2009 (see "Expansion of the Time Window for Treatment of Acute Ischemic Stroke with Intravenous Tissue Plasminogen Activator", in the journal *Stroke*, August 2009 issue) but it still represents a narrow time frame. Treating a patient outside such time frame increases the risk of brain hemorrhage by ten (see "Guidelines for the Early Management of Patients with Ischemic Stroke" in the journal *Stroke*, April 2003 issue) and accordingly is not approved. Most patients arrive at hospitals after the approved time frame. Indeed, research shows that in 2009 only 3.4%-5.2% of stroke patients in the United States received tPA treatment (*Heart Disease and Stroke Statistics* report – 2014). In fact, between 15% to 30% of stroke survivors are left permanently disabled (*Heart Disease and Stroke Statistics* report – 2014). The total cost of stroke in the United States is expected to be \$95 billion in 2015, \$119 billion in 2020 and \$148 billion in 2025 and \$185 billion in 2030. The lifetime cost per person of a stroke is \$140,048 and includes hospitalization, rehabilitation, and follow up treatment (*American Heart Association Heart Disease and Stroke Statistics* report – 2014 Update, Circulation, 258).

87% of strokes are ischemic. (The remaining cases of stroke are hemorrhagic. Hemorrhagic stroke occurs when blood supply to the brain tissue is interrupted, usually as a result of a burst blood vessel (*Heart Disease and Stroke Statistics* report – 2010)). Ischemic stroke occurs when blood supply to the brain is blocked, usually as a result of a blood clot. Symptoms occur suddenly and lead to death of brain tissue in the blocked area. The dead cells in this area release toxic materials causing death of additional brain tissue in the surrounding area, known as the ischemic penumbra. Death of brain tissue in the blocked area occurs within minutes and is inevitable, however, damage in the ischemic penumbra occurs only a few hours thereafter, and thus can be prevented (see the Internet Stroke Center's website: [http://www.strokecenter.org/education/ais\\_pathogenesis/22\\_ischemic\\_penumbra.htm](http://www.strokecenter.org/education/ais_pathogenesis/22_ischemic_penumbra.htm)). In spite of this, due to the short time frame approved for treatment, to the best of BrainsGate's knowledge, damage in the ischemic penumbra is not prevented in most cases, as most patients, as stated above, arrive for treatment after the treatable time frame. Preventing damage in the ischemic penumbra is the goal of the ISS system being developed by BrainsGate.

BrainsGate's ISS system is designated for use for up to 24 hours after onset of stroke. The system operates by electrical stimulation of the SPG through a tiny electrode. The SPG is responsible, inter alia, for regulating blood flow to the brain. Stimulating the SPG using the ISS widens the blood vessels in the brain thus increasing blood flow to the brain, and thus could prevent the death of cells in the ischemic penumbra. The treatment includes activation of the electrode for several hours a day for a few days after the stroke occurs as long as implantation and initial activation take place in a 24 hour post-stroke time frame.

An additional application BrainsGate is considering based on the ISS system is treatment of vascular dementia. Vascular dementia is an illness characterized by a chronic decrease in blood flow to the brain, and causes cognitive impairment (see "Pharmacotherapy and Prevention of Vascular Dementia" in the journal *CNS & Neurological Disorders – Drug Targets*, May 2011 issue). Vascular dementia is the second most common form of dementia after Alzheimer's disease in older adults (*CNS & Neurological Disorders – Drug Targets*, May 2011). To the best of BrainsGate's knowledge, there is currently no approved treatment for vascular dementia.

The development and approval of BrainsGate's product for marketing is subject to the requirements and regulatory approval processes described in this "Item 4.B" above.

In 2010, BrainsGate completed a controlled, randomized, double-blinded clinical trial on approximately 300 patients at medical centers worldwide. Analysis of the trial results strengthened the assessment that the ISS has a considerable clinical effect, which is stronger than the effect found in currently available and approved stroke treatments. BrainsGate indicated that these results only represent an indication and are not sufficient to obtain regulatory approval.

In June 2011, BrainsGate commenced a controlled, randomized, double-blinded clinical trial to prove the ISS's safety and efficacy, which is expected to support BrainsGate's planned PMA submission to the FDA. To date, BrainsGate has enrolled 410 patients at 67 medical centers in the United States, Europe and Asia. During the coming weeks, follow up data will be received with respect to 350 patients on the basis of which an interim analysis of the trial will be performed by the DSMB – Data and Safety Monitoring Board, an independent committee, monitoring the trial being conducted by BrainsGate. As a result of the interim analysis, the number of patients required for the trial may change and the time for completion of the trial may also change.

BrainsGate is aware that there are several companies currently engaged in its field that compete or may compete with BrainsGate.

Since its inception and until the date of filing this Annual Report, approximately \$70 million has been invested in BrainsGate, out of which we invested approximately \$21 million.

BrainsGate has 18 patents and 7 pending patent applications. The patents help protect the technology developed by BrainsGate, potential applications of its technology and the medical technique as to where the electrode is placed and the use of medical technology.

BrainsGate is headquartered in Caesarea, Israel. As of December 31, 2013, BrainsGate had 33 employees.

BrainsGate is in the development stages and has not commenced sales. In the circumstances, BrainsGate's activities depend on its ability to raise additional financial resources to finance its activities.

#### ***Pocared***

Pocared, a private company incorporated in Israel, was established in 2004 and commenced its activities in 2005. We completed our initial investment in Pocared in 2007.

We hold approximately 41% of Pocared's outstanding share capital and approximately 36% of its fully diluted share capital. The other principal shareholders of Pocared are SCP VitaLife Partners and Naftali Investments.

Pocared is developing a real-time and automated laboratory system for infectious diseases diagnosis. Pocared's diagnostic system uses optical technology and an algorithm for data analysis. The system is designed for use by major microbiological laboratories and hospitals as an alternative to the current microbiological diagnostic method of growing pathogen cultures, which is manual, lengthy, and expensive. The system is designed to diagnose infections in body fluids such as urine, swabs (throat, nasal, and others), blood, sputum, and cerebrospinal fluid.. The system's first application is diagnosis of Urinary Tract Infection, or UTI. To the best of Pocared's knowledge, over 125 million urine cultures are performed each year worldwide.

To the best of Pocared's knowledge, current microbiology practice is a labor intensive process, taking 24-72 hours and requiring formally trained personnel. The procedure entails numerous steps including culture growing of contaminants for 24-72 hours, after which the culture is exposed to a reagent in order to identify the pathogens based on their reaction to the reagent. Therefore, doctors must wait an average of 48-72 hours before they can prescribe evidence-based treatment. As a result, medical treatments (usually antibiotics) are administered in excess, and are often determined post facto to have been unnecessary. To the best knowledge of Pocared, 70% of the urine cultures performed in laboratories in the United States each year return with negative results

Pocared's system is designed to enable automatic and rapid diagnosis, and to perform a large number of tests simultaneously, thus reducing the average diagnostic time, and significantly increasing output in comparison with current practice. A shortened diagnostic process, in Pocared's estimation, is expected to optimize medical treatment by enabling evidence-based treatment and reducing the amount of unnecessary antibiotics that are prescribed. In addition, Pocared's system is intended to operate without the need for specialized laboratory technicians or use of reagents. The optimization of medical treatment, increased output, and elimination of need for professional staff and use of reagents in Pocared's estimation, are expected to result in cost savings for its potential customers.

Pocared was awarded internal standard authorization ISO 13845 which specifies requirements for quality management systems in the medical industry. In December 2011, Pocared received the CE mark in accordance with the applicable European directive for the manufacturing and marketing of in-vitro diagnostic medical devices. The development and approval for marketing of Pocared's system in the United States is subject to the requirements and regulatory approval processes described in this "Item 4B" above.

In July 2013, Pocared commenced the collection of urine samples for a diagnostic trial to prove the efficacy of its system's first application, UTI diagnosis. The trial is intended to support its planned FDA submission. The trial is being carried out at five of the world's leading medical centers. Until now, Pocared has collected 4,400 samples out a total of 15,000 samples. Pocared expects to complete the trial during 2014.

To the best of Pocared's knowledge, there are several companies currently engaged in its field that compete or may compete with Pocared.

Since its inception and until the date of filing this Annual Report, approximately \$ 68 million has been invested in Pocared, out of which we invested approximately \$29 million.

Pocared has 22 patents, and 27 pending patent applications. These patents help protect the technology developed by Pocared, the potential diagnostic applications of this technology and the use of the diagnostic technology. Pocared has a material license agreement with a foreign company for the technology used for pre-analytical sample processing which is material to its operations .



Pocared's headquarters are in Rehovot, Israel. As of December 31, 2013, Pocared had 24 employees. Pocared also has a subsidiary in the United States where it employs 6 employees as of December 31, 2013.

Pocared is currently in development stages and has not commenced sales. In the circumstances, Pocared will require additional financial resources to finance its operations.

## **RDC**

RDC, a private company, incorporated in Israel, was established by DEP together with the predecessor of Rafael pursuant to an agreement entered into in 1993. DEP holds 50.1% of the outstanding shares and voting rights of RDC, while Rafael holds the remaining 49.9%. RDC has first refusal rights to commercially exploit certain technologies of Rafael for the development of products for use in non-military markets. For more information, see "Item 10C – Additional Information – Material Contracts".

RDC seeks to identify technological projects and invest in companies in diverse fields that will either commercialize Rafael's military technologies or which will be benefited by Rafael's technology and know-how. Following identification of such projects, RDC develops the relevant technologies, and in the case of military technologies, adapts them for commercial use, initially by utilizing its own management and funding resources, thereafter by spinning off activities into independent companies and at later stages from external funding. Rafael also grants RDC companies that commercialize its technologies licenses to use such technologies.

Following is a brief review of the companies held by RDC, as of the date of filing this Annual Report:

### *Kyma*

Kyma is developing a remote patient monitoring (RPM) device for Congestive Heart Failure (CHF) patients. As of the date of this Report, RDC holds approximately 57% of the outstanding share capital of Kyma and 38% of the fully diluted share capital of Kyma. The system is aimed to improve patients' wellbeing mainly by reducing recurrent hospitalizations, especially those relating to accumulation of fluids in the lungs. The system, which is non-invasive and very small, is built around a novel sensor that assesses changes in thoracic fluid level, and also collects vital signs readings.

According to the American Heart Association (*Heart Disease and Stroke Statistics* report – 2014) approximately 5.1 million people in the United States suffer from heart failure of which 4.3 million people suffer from CHF. There are 825,000 new cases of heart failure in the United States each year. The estimated cost of CHF in the United States is expected to amount to \$24 billion in 2015, \$30 billion in 2020, \$38 billion in 2025 and \$47 billion in 2030. Total costs includes direct and indirect costs. "Direct cost" refers to health expenditures such as the cost of physicians and other professionals, hospital services, prescribed medications, home health care, and other medical durables, while "indirect cost" refers to lost productivity that results from morbidity and premature mortality. In 2012, the direct costs of CHF (not only CHF) represented 68% of the total costs of CHF.

According to the American Heart Association report, CHF is the illness with the largest number of return hospitalizations capable of being prevented. In 2004, there were 1.1 million hospitalizations due to CHF, the charges in relation to which amounted to \$29 billion. According to the New England Healthcare Institute, remote patient monitoring for heart failure has the potential to yield annual national cost savings of up to \$6.4 billion (*Remote Physiological Monitoring: Research Update*, 2009). Kyma's system received CE certification and CSA approval (a medical electrical equipment safety standard). Kyma expects to file its submission for FDA approval in the first half of 2014.

#### *RDSeed*

RDSeed was established by us and another founder with the aim of investing in companies at early stages in the digital field (internet, cloud, applications and software). RDC holds approximately 89% of RDSeed's outstanding share capital.

In July 2013, we transferred our shares in RDSeed to RDC in consideration for \$5 million (the amount invested by us in RDSeed from the date of its establishment until its sale to RDC). The young ventures held by RDSeed benefit from support of RDSeed in business development, marketing and sales, technology (via Rafael), and with respect to legal and finance matters. RDSeed's holdings as of the date of filing this Annual Report include: Cloudyn (approximately 46% held by RDSeed), which is developing solutions for the optimization of cloud computing costs and resources; Pose (approximately 43% held by RDSeed), which is developing an online cash register, inventory management, and retail website management system, and Numbeez (approximately 38% held by RDSeed), which is developing a micro-blogging platform that helps users create, track and share the interesting numbers in their lives.

In February 2014, RDC's shares in Given Imaging were sold pursuant to the Given Merger. For more information regarding the Given Merger, see Item 4A "The Merger of Given Imaging and Covidien". In addition, RDC holds shares in certain inactive companies and/or companies under voluntary liquidation.

As of December 31, 2013, RDC had 2 employees.

Based on its estimates at December 31, 2013, RDC believes that its existing resources are sufficient to fund its and its group companies' operations, and to fund any investments it may carry out in existing and new companies for at least the next 12 months. It is noted that in light of the completion of the Given Merger as a result of which all the shares held by us and RDC were sold, RDC received proceeds of approximately \$80 million (approximately \$61 million after tax).

## 2. Other Group Companies

- Aqwise develops manufactures and provides biological water and wastewater treatment solutions for the industrial and municipal markets. We hold approximately 19.8% of Aqwise's outstanding share capital and approximately 18% of Aqwise's fully diluted share capital.
- Atlantium, develops manufactures and provides ultraviolet-based water disinfection solutions. We hold approximately 8% of Atlantium's outstanding share capital and approximately 7% of Atlantium's fully diluted share capital.
- Cartiheal is developing an implant for repairing cartilage and osteochondral defects in loadbearing joints, such as the knee. We hold approximately 32% of Cartiheal's outstanding share capital and approximately 27% of Cartiheal's fully diluted share capital. There are \$35 million people in the United States who suffer from degenerative changes in their joints. The implant has a unique structure, comprising of marine aragonite with biological modifications. The implant biodegrades in the implantation site, and promotes the regeneration of native cartilage and subchondral bone in its place. Existing treatments have succeeded in regenerating "hyaline-like" cartilage only, which has limited durability. The company is conducting a series of clinical trials at medical centers in Europe to evaluate the safety and efficiency of the implant. Preliminary results indicate an improvement in the pain level. Cartiheal's implant has received CE certification.
- Jordan Valley develops manufactures and provides metrology solutions for manufacturing process control in the semiconductors industry. Jordan Valley's revenues in 2013 amounted to \$26.2 million, compared with \$27.5 million in 2012 and \$35.2 million in 2011. According to analyst reports, the semi-conductor capital equipment market is expected to grow by approximately 22% from \$32 billion in 2013 to \$39.5 billion in 2014 (Forecast: Semiconductor Manufacturing Equipment, Worldwide, 3Q13). We hold approximately 19% of Jordan Valley's outstanding share capital and approximately 17% of Jordan Valley's fully diluted share capital. The metrology system that Jordan Valley is developing includes innovative and advanced technologies enabling, inter alia, measurement of thickness, density and chemical composition of thin layers that compose the semiconductors integrated circuits designated for the semiconductor and compound markets. Lately Jordan Valley developed, and started marketing and selling innovative product, for detection of Non Visual Defects and strain in Silicon substrate, in device production. Jordan Valley's technology is considered most suitable for manufacturing process control of DRAM, NAND & NOR Flash, Logic and Compound, especially suitable for modern mobile products such as smartphones and palm computers, LED and Solar. The size of the worldwide metrology market was estimated by VLSI Research in July 2010 at approximately \$1.5 billion per year (*Long-Term IC Manufacturing Equipment History and Forecast, 2004-2012*). The above information is being presented merely as an indication of the size of the market in which Jordan Valley operates and does not suggest that the products under development by Jordan Valley will be directed towards this whole market.

- Notal Vision Inc develops manufactures and provides a system and services for remote monitoring of AMD patients at risk of vision loss, for the early detection of important visual changes. AMD is a main cause of the severe loss of sight and blindness amongst adults aged 60 and over and affects approximately 10 million people in the United States (obtained from the website of the National Eye Institute, or NEI). There are two types of AMD, dry (without appearance of blood vessels) and wet (with the appearance of blood vessels). The wet AMD is responsible for 90% of blindness cases. Notal Vision's product enables early identification of the onset of wet AMD and as a result, early treatment and preservation of eyesight. The NEI invited Notal Vision to conduct a trial with 1,500 patients at 44 leading eye centers in the United States. After an interim analysis of the results showing exceptional positive efficacy, the NEI prematurely stopped the trial. The results showed that approximately 90% of the patients that use Notal Vision's device preserved their functional eyesight when they moved to wet AMD compared to 60% of the patients who did not use the device. Notal Vision has appointed a marketing and sales team and has commenced marketing the product and has received a reimbursement code (CPT code) in the United States effective as of the beginning of 2015. Notal is in negotiations with Medicare (a United States government health program for citizens over the age of 65) regarding reimbursement coverage and payment. We hold approximately 22% of Notal Vision's outstanding share capital and approximately 18% of Notal Vision's fully diluted share capital.
- Plymedia develops and provides digital advertising exchange platform services . We hold approximately 27% of Plymedia's outstanding share capital and approximately 19% of Plymedia's fully diluted share capital. Plymedia's revenues in 2013 amounted to \$10.7 million compared to \$4 million in 2012.

### **C. Organizational Structure**

As of December 31, 2013, DIC, an Israeli company, held approximately 50.32% of our total outstanding shares. In March 2009, we and DIC entered into a Services Agreement. Pursuant to the agreement effective for a period of three years from May 1, 2009 and renewed for an additional period commencing from May 1, 2012, we receive managerial and administrative services from a staff employed by DIC. For additional information about DIC, see "Item 7—Major Shareholders and Related Party Transactions—Major Shareholders." For our holdings in our group companies, see the information in "Business Overview" above.

### **D. Property, Plants and Equipment**

Our corporate headquarters and executive offices are located in Tel Aviv, Israel. These offices, which measure approximately 980 square meters, are leased at an annual rent of approximately \$0.4 million. We have made available a portion of our leased office space and other office facilities to RDC for an annual amount of approximately \$0.1 million. For details regarding IDBD's and DIC's use of our premises, see "Item 7B".

We believe that our facilities are adequate for our operations as currently conducted. In the event that additional facilities are required, we believe that we could obtain them at commercially reasonable prices.

**Item 4A. Unresolved Staff Comments**

Not applicable.

**Item 5. Operating and Financial Review and Prospects**

**Overview**

We are an operational holding company actively involved in investing in, building and enhancing companies operating in various technology fields and increasing their value either through exit transactions or public offerings. Founded in 1962, we have been a major force in the development of the Israeli high technology industry by building Israeli and Israel-related companies with technologies in the fields of medical imaging, advanced defense electronics, telecommunications, semiconductors and software products and services. Our group companies currently comprise companies at various stages of development that are engaged in a variety of technology fields, such as the development of medical devices and others.

Technology fields in which our group companies operate are characterized by the high degree of risk inherent in their products, their continuous technological innovation and their penetration into world markets, which require investment of considerable resources and continuous development efforts. The future success of our group companies is dependent upon our group companies' (i) technological quality (ii) ability to successfully complete the development of their products and obtain regulatory approval, (iii) ability to successfully transition from development to manufacturing and from manufacturing to marketing, (iv) intellectual property and protection thereof, (v) prices and nature of their products in comparison to their competitors (vi) ability to introduce new products to the markets at the right time, while offering cost effective solutions suitable to their customers' needs and (vii) ability to raise financing and the condition of the capital markets.

In order to assess fully the current state of our business, results of operations and capital resources, as well as our ability to realize upon our strategic goal, please see the discussion below regarding the effect on us and our group companies of current global economic developments.

Our goal is to build and realize value for our shareholders through the sale to third parties of a portion or all of our holdings in, or the issuance of shares by, our group companies, while simultaneously seeking opportunities, as appropriate to acquire or invest in new and existing companies at different stages of development including early stage and more mature companies. We believe that this strategy provides the ability to increase shareholder value as well as to create capital to support the growth of our group companies and to invest, as appropriate, in new opportunities. The nature of our business, therefore, may cause volatility in our results of operations, depending on the transactions that occur within a particular period.

Our strategy regarding investments in new and existing companies is based on the following principles:

1. Investing over the long term in Israeli or Israel-related companies with innovative technologies.
2. Identifying and exploiting investment opportunities with significant exit potential.
3. Focusing on investments which afford us influence and operational involvement.
4. Actively enhancing our group companies' value by taking an active role in their management, by means of the following: active membership on their boards of directors; hands-on assistance to their management; assistance in the advancement of their technology; forming strategic relationships, providing access to capital; providing development and operational guidance; business plan preparation; strategic planning; marketing; planning investments and budgets; finance; manning senior management positions; and overall ongoing monitoring of our group companies' performance.
5. Exploiting opportunities to exit group companies.

Within the framework of these principles and with the intention of continuing to invest in new companies, we examine a broad range of proposals for investment and strategic cooperation in a broad range of technology fields, including through RDC, which has first rights to commercially exploit military technologies developed by Rafael for non-military uses. It should be noted that our strategy allows us to take actions which deviate from the above principles in circumstances where our management believes that the specific circumstances justify such deviation.

Our net income (or loss) in any given period is due, for the most part, to the results of operations of those of our group companies which are accounted by us under the consolidation or equity method of accounting and dispositions and changes in our holdings of group companies as well as impairment charges and headquarter costs.

As most of our group companies are technology companies which have not yet generated significant revenues, if at all, and which invest considerable resources in research and development and in marketing activities, without further exit transactions, we have experienced, and expect to continue to experience, losses in respect of these companies to the extent they are accounted by us under the consolidation or equity method of accounting, as well as impairment charges for those investments in which the carrying amount will exceed the fair value.

Our capital resources in any given period are primarily affected by the extent of our investment in existing and new companies, the realization of certain holdings and available credit lines or loans, as well as the impact of any dividends or distributions to our shareholders and/or from our affiliates. As a holding company, our ability to increase or realize existing holdings or acquire new holdings is affected by the markets in which they operate and capital markets as well as by applicable regulatory limitations with respect to our group companies or companies whose shares we intend to acquire or realize.

The results of operations of our group companies, and consequently, our results of operations and capital resources, are affected by general economic conditions as well as by factors specifically related to the markets in which they operate and capital markets which significantly affect the ability of our group companies to raise financing and our ability to dispose of holdings and realize gains from our holdings.

#### **Venture Capital Industry Status**

The ability of our group companies, and our medical device companies in particular, to obtain financing is affected by developments and trends in the venture capital, or VC, industry. Our ability to exit companies, and in particular, medical device companies, is also affected by developments and trends in the VC industry.

Available market data for 2013 and the preceding years, indicate a trend of slowed VC investment activity as well slowed M&A activity. This trend requires local investors to provide longer-term support to their companies rather than execute early exits, in the process of which they enhance the value of these companies, grooming them for later-stage, but higher-value exits. In other words, the path to exit is longer, but the returns are higher.

Slower VC investment activity is attributable in part to a lack of adequate resources, evidenced by a decline in VC fundraising, and a proliferation of micro-VC funds. VC money is primarily allocated to follow-on investments (67%), and even in the case of first-time investments, the share of early-stage investments is only 57%. The trend is the same in public offerings, where IPOs are on the decline, and follow-on offerings on the rise. The current climate is risk-averse, in which investors are looking for quicker, more predictable exits. It is notable that most of the capital raised in Israel was through foreign capital. The upside to this trend for Israeli investors manifests itself in significantly larger exits (despite a smaller number of deals), and the highest ever return-on-equity.

The above trend is present in the medtech sector as well, but more pronounced, due to additional market developments, namely, regulatory challenges with the FDA, uncertain reimbursement, and lower growth prospects, which have led investors to become more risk-averse. U.S. medtech VC funding is the lowest in at least the past seven years, and the 12 largest venture rounds were later stage. Part of the gap created by the decline in VC investments is being filled by corporate funds. In Israel, the life science sector nonetheless continues to attract the largest share of investments. The trend of larger exits is especially evident in this sector in Israel, with total proceeds in 2013 exceeding the annual average for the sector since 2004 by approximately 150%. That said, recent medtech developments have bred cautious buyers along with cautious investors, and M&A deals with milestone payments comprise approximately one-third of deals, with milestone payments making up more than one-third of total deal value.

Sources: IVC-KPMG Israeli VC Fund Raising Survey – 2013 Summary; IVC-KPMG Israeli High-Tech Company Capital Raising Survey – 2013 Summary; IVC High-Tech Exits Report 2013; The "MoneyTree™ Report" by PricewaterhouseCoopers and National Venture Capital Association based on data from Thomson Reuters; "The Pulse of the Industry: Medical Technology Report 2013" by Ernst & Young; Thomson Reuters & National Venture Capital Association.

### **Critical Accounting Policies**

On January 6, 2010, further to the delisting of our shares from the NASDAQ (see above under: "Item 4 – Information on the Company"), we commenced reporting in accordance with the reporting obligations under the Israel Securities Law (1968) applicable to reporting companies in Israel which are not dual-listed. As a result, we changed our financial reporting principles from U.S. GAAP to International Financial Reporting Standards, as issued by the International Accounting Standards Board, or IASB (IFRS). As permitted under the Exchange Act and the regulations promulgated thereunder our consolidated financial statements were prepared in conformity with IFRS (without reconciliation to U.S. GAAP).

The preparation of our consolidated financial statements for the year ended December 31, 2009 were our first consolidated financial statements prepared in accordance with IFRS. Our significant accounting policies are more fully described in Note 2 in "Item 18 – Financial Statements".

Certain accounting principles require us to make certain estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions upon which we rely are reasonable based upon information available to us at that time. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities as of the date of the financial statements, as well as the reported amounts of revenues and expenses during the periods presented. To the extent there are material differences between these estimates, judgments or assumptions and actual results, our financial statements will be affected. The significant accounting policies that we believe are the most critical to aid in fully understanding and evaluating our reported financial results include the following:

- Principles of accounting for holdings in group companies – basis of consolidation, equity method of accounting
- Business combinations and fair value adjustments
- Impairment of investments in group companies and financial assets
- Impairment of intangible assets
- Accounting for income taxes
- Provisions
- Financial assets including financial assets measured at fair value
- Fair value measurement of contingent consideration



## Principles of Accounting for Holdings in Group Companies – basis of consolidation, equity method of accounting

### *Consolidation.*

In May 2011 the IASB issued a new suite of new accounting standards regarding consolidation of financial statements and related issues. The new suite of standards replaced standards regarding consolidation of financial statements and joint arrangements and included a number of changes with respect to investments in associates. The Standards are applied for these financial statements for the first time. The Standard is adopted prospectively. IFRS 10, Consolidated Financial Statements ("IFRS 10") resulted in several changes to our method of determining whether or not group companies will be consolidated.

IFRS 10 replaces the requirements of IAS 27 Consolidated and Separate Financial Statements and the requirements of SIC-12 Consolidation – Special Purpose Entities with respect to the consolidation of financial statements. IFRS 10 introduces a new single control model for determining whether an investor controls an investee and should therefore consolidate it. The current IAS 27 model assumes control exists when we own more than 50% of the outstanding voting securities of a company so that we have the power to govern the financial and operating policies of a company so as to obtain benefits from its activities. According to the new model, we control a group company upon gaining "Effective Control" or more particularly, when we are (1) exposed, or have rights, to variable returns from our involvement with that group company, (2) have the ability to affect those returns through our power over that group company and (3) the ability to use our power over the group company by affecting our return. In addition, IFRS 10 states that 'De facto' power should be considered when assessing control. This means that the existence of De facto control could require consolidation. When assessing control under the new model, only substantive potential voting rights will be taken into account. The structure, reasons for existence and conditions of potential voting rights should be considered..

Companies over which we have control are accounted for under the consolidation method of accounting. Control is achieved when we are exposed, or have rights, to variable returns from our involvement with the investee and have the ability to affect those returns through our power over the investee. Potential voting rights are considered when assessing whether we have control, only when its substantive. The consolidation of the financial statements commences on the date on which control is obtained and ends when such control ceases.

Under the consolidation method, a controlled company's assets and liabilities are included within our consolidated statement of financial position and its income items, expense items and other comprehensive income items are included within our consolidated income statement and statement of comprehensive income. Non-controlling interests in subsidiaries represent the equity in subsidiaries not attributable, directly or indirectly, to a parent. Non-controlling interests are presented in equity separately from the equity attributable to the equity holders of the Company. Profit or loss and components of other comprehensive income are attributed to the Company and to non-controlling interests. Losses are attributed to non-controlling interests even if they result in a negative balance of non-controlling interests in the consolidated statement of financial position. A transaction with the non-controlling interests which does not result with a loss of control, whether a sale or an acquisition, is accounted for as an equity transaction.

In a business combination achieved in stages, equity rights in the acquiree that had been previously held by the acquirer prior to obtaining control are measured at the acquisition date at fair value and included in the acquisition consideration by recognizing the gain or loss resulting from the fair value measurement, including amounts whose recognition in other comprehensive income was deferred.

Contingent consideration in a business combination is measured, initially at fair value and subsequent changes in the fair value of the contingent consideration, which do not represent adjustments to the acquisition cost in the measurement period, are not recognized as goodwill adjustments. If the contingent consideration is classified as a financial derivative, it will be measured at fair value through profit or loss.

**Equity Method.** Companies over which we have significant influence or the ability to significantly influence the financial and operating policies, but not control over their operations as stated above, are considered associates, and are accounted for using the equity method of accounting. Our consolidated financial statements include our share of the income (expenses) and other comprehensive income (loss) of associates, after adjustments required to align the accounting policies with those of ours, from the date that significant influence commences until the date that significant influence ceases or until the investment in associate is classified as held for sale in accordance with IFRS 5. When our share of losses exceeds our interest in an associate, the carrying amount of that interest (including any long-term investments) is reduced to zero and the recognition of further losses is discontinued except to the extent that we have an obligation to support the associate or have made payments on behalf of the associate, or have granted it loans or guarantees.

In circumstances where we invest in associates through a preferred security or other senior security, we recognize our share in the associate's gains or losses based on the ownership level of the particular associate's security or loan held by us to which the equity method is being applied.

For further discussion regarding our investments, see "Impairment of Investments in Group Companies" below. For further discussion regarding financial assets measured at fair value, see "Financial assets" below.

#### **Business Combinations and Fair Value Adjustments**

Business combinations are accounted for using the purchase method of accounting, under which the total purchase price is allocated to interest in the acquired company's assets and liabilities based on their estimated fair values, and the remainder, if any, is attributed to goodwill.

The aggregate purchase price of any investment accounted for under either the consolidation or the equity method of accounting is allocated to identifiable net assets, intangible assets other than goodwill, such as In-Process Research and Development, or IPR&D, and the residual value is allocated to goodwill. The amortization of amounts allocated to finite-lived intangible assets other than goodwill is calculated in accordance with the expected economic benefit from the assets in each period, on the basis of the estimated useful life of each group of assets.

Estimating the fair value of certain assets acquired and liabilities assumed is judgmental in nature and often involves the use of significant estimates and assumptions, mainly with respect to intangible assets. While there are a number of different methods for estimating the value of intangible assets acquired, the primary method we use is the discounted cash flow approach. Some of the more significant estimates and assumptions inherent in the discounted cash flow approach include projected future cash flows, including their timing, a discount rate reflecting the risk inherent in the future cash flows and a terminal growth rate. Another area which requires judgment that can impact our results of operations is estimating the expected useful lives of the intangible assets. To the extent intangible assets are ascribed with longer useful lives, there may be less amortization expenses recorded in any given period. As we and our group companies operate in industries that are rapidly evolving and extremely competitive, the value of the intangible assets, their respective useful lives and the investments in companies is exposed to future adverse changes that can result in a charge to our results of operations (see "Impairment of Investments in Group Companies and Financial Assets Carried at Amortized Cost" below).

#### **Impairment of Investments in Group Companies and Financial Assets Carried at Amortized Cost**

At the end of each reporting period, we assess whether there is any objective evidence of impairment of an investment in a group company that is not consolidated. This evaluation is judgmental in nature. Whenever events or changes in circumstances indicate that the carrying amount of the investment is not recoverable and the carrying amount of the investment exceeds its recoverable amount, the investment is written down to its recoverable amount by a charge to our results of operations. The recoverable amount is the higher of fair value less costs of sale and value in use.

An evaluation of fair value is dependent upon specific facts and circumstances. Factors that are considered by us in this determination include financial information (including, among others, budgets, business plans, projections and financial statements), the value at which independent third parties have invested or have committed to invest, and independent appraisals, if available. Evidence of impairment may include, among others, general market data, a decline in stock market prices, recurring operating losses, failure of research and development efforts, extremely negative deviation from the business plan, specific conditions affecting the investment, such as in the industry, and subsequent rounds of financing at an amount below the cost basis of the investment. This list is not all inclusive, and we weigh all quantitative and qualitative factors in determining if any objective evidence of impairment of an investment exists and a decline in value of an investment has occurred. As we operate in industries that are rapidly evolving and extremely competitive, it is possible that our estimates could change in the near term and there can be no assurance that an additional write-down or write-off of the carrying value will not be required in the future.

Examination of impairment in value of an investment in associates is made based on the overall investment. Accordingly, a loss recognized from impairment in value of an investment is not allocated specifically to goodwill included in the investment but, rather, it is allocated to the entire investment. Therefore, the full amount of the loss from impairment in value may be cancelled if the conditions required for cancellation exist.

In 2013 and 2012 we recorded income from partial a reversal of impairment with respect to our holdings in Enablene debentures in an amount of approximately \$3.5 million and \$0.3 million, respectively. In 2011 we recorded impairment charges in the amounts of \$5.8 million, mainly with respect to our investments in BPT Bio Pure Technology Ltd., or BPT, and Enablene debentures.

### *Impairment of Intangible Assets*

Intangible assets with a finite useful life are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its net selling price (fair value less selling expenses). In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For purposes of testing impairment of identifiable assets, the assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets, or the cash-generating unit. An impairment loss is recognized if the carrying amount of an asset or the cash-generating unit to which it relates exceeds the estimated recoverable amount. In 2011, 2012 and 2013, we did not record any impairment of intangible assets. In the valuation of fair value we use judgment as to which is the most appropriate method to use for measuring fair value and as to what assumptions to use in implementing the methodology chosen. As we operate in industries that are rapidly evolving and extremely competitive, changes in the assumptions and estimates may affect the carrying value of the intangible assets, and could result in an additional impairment charge to our results of operations. At December 31, 2013, consolidated intangible assets amounted to approximately \$4.5 million (approximately \$4.9 million as of December 31, 2012 and 2011).

### **Accounting for Income Taxes**

At the end of each reporting period, we are required to estimate our income taxes. This process requires us to estimate our actual current tax liabilities and make an assessment of temporary differences resulting from differing treatment of items for tax and accounting purposes. In order to recognize deferred tax assets we must assess the likelihood that our net deferred tax assets will be realized through future taxable income to the extent we believe that realization is probable. Management judgment is required in determining our provision for income taxes and our deferred tax assets and liabilities and tax exposures. Our judgment as to the probability to realize our net deferred tax assets is largely based upon interpretations of certain tax laws and estimates and assumptions mainly with respect to our control over realization and returns on investments in our group companies in the near future.

As a result of the Given Merger (see also Item 4), we recorded in 2013 a deferred tax asset in the amount of \$28.9 million in respect of the temporary difference from the investment in Given Imaging and in respect of carryforward losses that are expected to be utilized in 2014, due to the expected gain from this transaction. As of December 31, 2012 and 2011, we did not recognize any deferred tax asset.

The balance of tax liabilities as of December 31, 2013 was \$5.4 million, as of December 31, 2012 was \$4.5 million, and as of December 31, 2011 was \$5 million. The abovementioned tax liability includes mainly a tax liability in respect of the sale of Medingo attributed to RDC and the temporary difference from RDC's investment in Medingo and Given Imaging. This liability was partially set off by a deferred tax asset in respect of RDC's carryforward losses that are expected to be utilized in 2014, due to the Given Merger.

As of December 31, 2013, we and our subsidiaries had carryforward losses in Israel of approximately \$328 million.

## **Provisions**

A provision is recognized when we have a present obligation (legal or constructive) as a result of a past event and a reliable estimate can be made of the amount of the obligation and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation. If the effect is material, provisions are measured according to the estimated future cash flows discounted using a pre-tax interest rate that reflects the market assessments of the time value of money and, where appropriate, those risks specific to the liability.

## **Financial assets**

*Initial recognition.* Financial instruments are recognized initially at fair value plus any directly attributable transaction costs, unless they are subsequently measured at fair value.

*Subsequent measurement.* After the initial recognition, we measure our financial assets at amortized cost or at fair value, as follows:

*Financial assets measured at amortized cost.* In subsequent periods, a financial asset is measured at amortized cost, using the effective interest method while deducting any impairment losses, if both of the following conditions are met:

- The asset is held within a business model whose objective is to hold assets in order to collect the contractual cash flows.
- The contractual terms of the financial asset give rise, on specified dates, to cash flows that are solely payments of principal and interest on the principal amount outstanding.

*Financial assets measured at fair value.* Financial assets that are equity instruments are measured in subsequent periods at fair value and the changes will be recognized in the statement of income or in other comprehensive income, in accordance with the election of the accounting policy on an instrument-by-instrument basis. If the equity instruments are held for trading, they must be measured at fair value through statement of income. Fair value of investments in equity instruments of private companies is usually measured using the Discounted Future Earnings Method, Company Security Transaction Method ("CSTM") and Option Pricing Model ("OPM"), see Note 6 in "Item 18 – Financial Statements".

With regard to financial assets measured at fair value through other comprehensive income, gains, losses and impairment are not recognized in the statement of income, even upon disposal. Changes in fair value of these assets are credited to "Reserve from financial assets measured at fair value through other comprehensive income". When we sell these assets, we classify the gain or loss in respect with the asset sold from the capital reserve into accumulated deficit.

*Fair value measurement of contingent consideration.* Fair value of contingent consideration from sale of a business which is expected to be received upon occurrence of certain future events is initially recorded at fair value. Such fair value requires assumptions with respect to the occurrence and timing of future events and respective inflows, which may not be within our control. In the rare circumstances in which the fair value cannot be reliably determined due to significant variability in the range of reasonable fair value estimates for the contingent consideration, and since the probabilities of the various estimates within the range cannot be reasonably assessed and used in estimating fair value, we do not recognize the respective gain of this consideration, until sufficient information is obtainable, if at all. In 2010, we completed the sale of Medingo. The net gain we recorded in 2010 in respect of the sale of Medingo, did not include recognition of the contingent consideration element as it could not be reliably estimated until the final resolution of the contingency in 2012. (see Note 3.C.2.d in "Item 18 – Financial Statements").

**Basis of Presentation**

**Consolidation.** Our consolidated financial statements include the accounts of Elron and the accounts of all of our direct or indirect (through DEP, RDC and RDSeed) controlled subsidiaries. The following are our main subsidiaries:

Year ended December 31,		
2013	2012	2011
RDC	RDC	RDC
SmartWave <sup>1</sup>	SmartWave <sup>1</sup>	Starling <sup>5</sup>
RDSeed <sup>2</sup>	RDSeed <sup>2</sup>	Sync-Rx <sup>6</sup>
Cloudyn <sup>3</sup>	Cloudyn <sup>3</sup>	SmartWave <sup>1</sup>
POSE <sup>5</sup>	Kyma <sup>4</sup>	RDSeed <sup>2</sup>
		Cloudyn <sup>3</sup>
		Kyma <sup>4</sup>

<sup>1</sup> Consolidated since its establishment in November 2011.

<sup>2</sup> Consolidated since its establishment in May 2011.

<sup>3</sup> Consolidated since initial investment in November 2011.

<sup>4</sup> Consolidated since we obtained control in January 2011 and until we lost control in October 2013.

<sup>5</sup> Consolidated since we obtained control in July 2013..

**Equity Method.** Our main group companies held by us or through DEP, RDC and RDSeed accounted for under the equity method of accounting include:

Year ended December 31,					
2013		2012		2011	
BrainsGate	DES <sup>6</sup>	BrainsGate	PLYmedia	Atlantium <sup>4</sup>	PLYmedia
Cartiheal <sup>1</sup>	PLYmedia	Cartiheal <sup>1</sup>	POSE <sup>3</sup>	Aqwise <sup>5</sup>	
NuLens		Given Imaging <sup>7</sup>		BrainsGate	
Numbeez <sup>2</sup>		NuLens		Given Imaging	
Pocared		Numbeez <sup>2</sup>		NuLens	
		Pocared		Pocared	

<sup>1</sup> Since initial investment in July 2012.

<sup>2</sup> Since initial investment in September 2012.

<sup>3</sup> Since initial investment in October 2012 and until obtaining control in July 2013.

<sup>4</sup> Through June 2012.

<sup>5</sup> Through July 2012.

<sup>6</sup> Since initial investment in December 2013.

<sup>7</sup> Until December 2013, when the investment was classified as held for sale .

*Financial assets measured at fair value:*

Year ended December 31,		
2013	2012	2011
Aqwise <sup>1</sup>	Aqwise <sup>1</sup>	Enablence
Atlantium <sup>2</sup>	Atlantium <sup>2</sup>	GigOptix Inc., or GigOptix <sup>5</sup>
Enablence	Enablence	Jordan Valley
Jordan Valley	Jordan Valley	Notal Vision <sup>3</sup>
Notal Vision <sup>3</sup>	Notal Vision <sup>3</sup>	Wave <sup>6</sup>
Whitewater Ltd <sup>4</sup>	Whitewater Ltd <sup>4</sup>	Whitewater Ltd <sup>4</sup>

<sup>1</sup> Since July 2012.

<sup>2</sup> Since June 2012.

<sup>3</sup> Since October 2010.

<sup>4</sup> Since May 2011.

<sup>5</sup> Sold during 2012.

<sup>6</sup> Sold during 2012.

**A. Operating Results**

*Year Ended December 31, 2013 compared with Year Ended December 31, 2012 and Year Ended December 31, 2011*

The following table sets forth the net results of our operations in the reported periods:

	Year ended December 31,		
	2013	2012	2011
	(millions of \$, except per share data)		
	Audited		
Income (loss) attributable to Elron's shareholders	17.9	4.4	(8.4)
Income (loss) per share attributable to Elron's shareholders	0.54	0.09	(0.34)

The net gain and loss attributable to our shareholders is mainly comprised of: 1. our share in the losses of our group companies, 2. gains and losses from exit transactions, revaluation of investments, and changes in holdings, 3. corporate operating expenses and 4. tax benefit (taxes on income):\*

	Year ended December 31,		
	2013	2012	2011
	(millions of \$)		
<b>Losses in respect of group companies:</b>			
Our share in net losses of group companies, net	(10.5)	(10.6)	(22.5)
Excess cost amortization	(4.0)	(4.4)	(4.7)
Revaluation (impairment) of investments in group companies and financial assets	3.5	(1.1)	(5.9)
<b>Total</b>	<b>(11.0)</b>	<b>(16.1)</b>	<b>(33.1)</b>
<b>Gain from exit transactions, changes in holdings, and revaluation of investments (net of tax)</b>	<b>6.4</b>	<b>24.8</b>	<b>29.8</b>
<b>Corporate operating expenses</b>	<b>(5.4)</b>	<b>(3.9)</b>	<b>(4.9)</b>
<b>Tax benefit (taxes on income)</b>	<b>28.7</b>	<b>0.1</b>	<b>(0.3)</b>
<b>Other</b>	<b>(0.8)</b>	<b>(0.5)</b>	<b>0.1</b>
<b>Income (loss) attributable to Elron's shareholders</b>	<b>17.9</b>	<b>4.4</b>	<b>(8.4)</b>

\* The results summarized in the table are presented net of non-controlling interest.

**Losses in respect of group companies:**

**Our share in the net losses of our group companies.** As previously mentioned, most of our group companies are technology companies which have not yet generated significant revenues, if at all, and which invest considerable resources in research and development and in marketing activities. According to accounting principles, these companies' investments in the development of their products are recorded as they occur in their statement of statement of income as an increase in R&D expenses (insofar as these expenses are not capitalized as intangibles assets as is permitted, according to accounting principles, only when technological feasibility has been established). Therefore, as our group companies increase their investments in order to develop their products and advance their business, they cause us to record greater losses in respect of our share in their losses.

The loss we recorded in 2013 in respect of our share in the net losses of our group companies (net of non-controlling interest) resulted mainly from the losses of Pocared, BrainsGate, Cartiheal and RDSeed and it was partially offset by our share of the net profit of Given Imaging.

The loss we recorded in 2012 in respect of our share in the net losses of our group companies (net of non-controlling interest) resulted mainly from the losses of Pocared, BrainsGate, NuLens Ltd. ("Nulens"), Kyma and RDSeed and it was partially offset by our share of the net profit of Given Imaging.

The loss we recorded in 2011 in respect of our share in the net losses of our group companies (net of non-controlling interest) resulted mainly from the losses of Starling, Wavion (sold in November 2011), NuLens, BrainsGate and Pocared and it was partially offset by our share of the net profit of Given Imaging.



**Excess cost amortization.** We record amortization expenses in respect of excess cost attributed to investments in group companies, which are usually generated upon investment in such companies or when the accounting method applied is changed from the equity method to consolidation. Excess cost amortization expenses in 2013, 2012 and 2011 were recorded primarily in respect of excess costs attributed to our holding in Given Imaging.

**Impairment charges of investments in group companies and financial assets.** At each reporting date we examine whether there is any evidence that would indicate that our investment in our group companies and financial assets is impaired.

In 2013, as a result of a settlement agreement with Enablex, we recorded a net gain in the amount of approximately \$3.5 million in respect of a partial cancellation of the impairment recognized in 2011. In 2013 we did not record any impairment charges in respect of investments in group companies and financial assets.

In 2012, we recorded an impairment charge in respect of our holding in Nasdaq-traded Wave shares, primarily due to a decrease in their share price. (In 2012, we sold our entire holding in Wave shares, except for shares deposited in escrow upon their receipt in the sale of Safend in September 2011).

In 2011, we recorded an impairment charge in respect of our holding in Enablex debentures, as there is significant doubt as to Enablex's ability to repay the debentures, and in respect of our investment in BPT following a decrease in its fair value. (In 2011, BPT's board of directors decided to cease its operations).

**Gain (Loss) from exit transactions, changes in holdings, and revaluation of investments:**

Gains and losses from exit transactions, changes in holdings, and revaluation of investments recorded at fair value in 2013 resulted mainly from:

- An approximately \$3.4 million gain from an increase in Notal Vision's fair value;
- An approximately \$3.3 million gain (net of non-controlling interest) from a decrease in our holding in Given Imaging as a result of options granted to Given Imaging employees having been exercised or having expired;
- An approximately \$1.7 million gain (net of non-controlling interest) from the decrease in holding and the loss of control in Kyma;
- An approximately \$1.7 million loss from a decrease in Jordan Valley's fair value.

Gains and losses from exit transactions, changes in holdings, and revaluation of investments recorded at fair value in 2012 resulted mainly from:

- An approximately \$8.5 million gain (net of non-controlling interest) from the sale of Sync-Rx
- An approximately \$8.5 million gain (net of non-controlling interest) as a result of the additional consideration received from the sale of Medingo completed in 2010;
- An approximately \$3.9 million gain from the sale of a portion of our holding and a decrease in our holding in Aqwise;
- An approximately \$1.8 million gain from an increase in Notal Vision's fair value;

Gains and losses from exit transactions, changes in holdings, and revaluation of investments recorded at fair value in 2011 resulted mainly from:

- An approximately \$21.4 million gain from the sale of Wavion by way of merger to Alvarion Ltd;
- An approximately \$4.7 million gain (net of non-controlling interest) from Starling's sale of its business;
- An approximately \$2.3 million gain from the sale of Safend to Wave;
- An approximately \$1.6 million gain (net of non-controlling interest) from a decrease in our holding in Given Imaging as a result of options granted to Given Imaging employees having been exercised or having expired;
- An approximately \$1.2 million loss from a decrease in Jordan Valley's fair value.

***Corporate operating expenses:***

Corporate operating expenses mainly include general and administrative expenses.

The increase in corporate operating expenses in 2013 compared with 2012 resulted primarily from granting annual bonus to company officers in accordance with the company's compensation policy, while in 2012 no bonus was granted, fluctuation of the exchange rates and as a result of an increase in the expenses of the service agreement with DIC.

The decrease in corporate operating expenses in 2012 compared with 2011 resulted primarily from expenses incurred in respect of "phantom options" granted in 2011 (see "Item 6") and from a decrease in professional services.

***Tax benefit (taxes on income):***

Tax benefit in 2013 resulted primarily from recording a deferred tax asset of approximately \$28.9 million with respect to temporary differences related to the investment in Given Imaging and with respect to tax losses carry forward which are likely to be utilized in 2014, due to the expected gain from the Given Merger. This amount was partially offset by RDC which recorded taxes on income due to a tax reserve of approximately \$0.3 million (net of non-controlling interest) with respect to temporary differences related to the investment in Given Imaging for tax and accounting purposes (the tax reserve was partially offset by a deferred tax asset with respect to carryforward losses)

The following table summarizes our annual consolidated statements of profit and loss:

	Year ended December 31,		
	2013	2012	2011
	(millions of \$)		
	Audited		
Income from sales	0.1	-	14.1
Gain from disposal and revaluation of group companies, and changes in holdings, net	8.4	39.4	34.6
Financial income	0.7	1.2	1.8
<b>Total income</b>	<b>9.2</b>	<b>40.6</b>	<b>50.5</b>
Cost of sales	0.1	-	5.8
Research and development expenses, net	3.9	6.9	18.2
Selling and marketing expenses	0.5	0.9	5.7
General and administrative expenses	7.2	7.2	10.5
Equity in losses of associates, net	11.9	8.3	10.3
Amortization of intangible assets	-	-	0.3
Financial expenses	0.6	2.1	4.2
Other expenses (income), net	(3.5)	(0.3)	9.6
<b>Total costs and expenses</b>	<b>20.7</b>	<b>25.1</b>	<b>64.6</b>
Income (Loss) before taxes on income	(11.5)	15.5	(14.1)
Tax benefit (taxes on income) ( )	28.4	0.3	(0.6)
<b>Net Income (Loss)</b>	<b>16.9</b>	<b>15.8</b>	<b>(14.7)</b>
Income (Loss) attributable to the Company's shareholders	17.9	4.4	(8.4)
Income (Loss) attributable to non-controlling interest	(1.0)	11.4	(6.3)
<b>Basic and diluted income (loss) per share attributable to the Company's shareholders (in \$)</b>	<b>0.54</b>	<b>0.09</b>	<b>(0.34)</b>

#### Income

**Income from Sales.** Income from sales in 2013 included income that were first recognised in Cloudyn . Income from sales in 2011 amounted to \$14.1 million and included income from sales of Wavion, which was sold in November 2011.

**Gains from Disposal and Revaluation of Group Companies and Changes in Holdings, net.** In 2013, gains from disposal and revaluation of group companies and changes in holdings, net, amounted to \$8.4 million, which resulted primarily from: the \$4.1 million gain from a decrease in our holding in Given Imaging as a result of options granted to Given Imaging employees having been exercised or having expired; the \$3.4 million gain from the increase in Notal Vision's fair value mainly due to the positive results which were achieved in the AREDS2 clinical trials; the \$2.8 million gain from the decrease in holding and the loss of control in Kyma due to an investment in the company by a new investor; and a \$1.7 million loss from a decrease in Jordan Valley's fair value. In 2012, gains from disposal and revaluation of group companies and changes in holdings, net, amounted to \$39.4 million, which resulted primarily from: the \$17.0 million gain from the sale of Sync-Rx; the \$15.6 million gain from the additional consideration received from the sale of Medingo completed in 2010; the \$3.9 million gain from the sale of a portion of our holding and a decrease in our holding in Aqwise; the \$1.8 million gain from the increase in Notal Vision's fair value mainly due to progress made in the clinical trials it is conducting and a \$0.8 million gain from a decrease in our holding in Given Imaging as a result of options granted to Given Imaging employees having been exercised or having expired. In 2011 gains from disposal and revaluation of group companies and changes in holdings, net, amounted to \$34.6 million, which resulted primarily from: the \$21.4 million gain from the sale of Wavion; the \$9.6 million gain from Starling's sale of its business; the \$2.3 million gain from the sale of Safend; the \$2.1 million gain from the decrease in our holding in Given Imaging due to the exercise and expiry of options of Given Imaging employees, the \$1.2 million loss from a decrease in Jordan Valley's fair value; and a \$0.4 million gain from the initial consolidation of Kyma.

**Financial Income.** Financial income amounted in 2013 to \$0.7 million and resulted mainly from interest income on deposits and from translation differences. The financial income in 2012 amounted to \$1.2 million and resulted mainly from interest income on deposits, and from a change in the fair value of our holding in GigOptix shares. The financial income in 2011 amounted to \$1.8 million and resulted mainly from interest income on bank deposits.

**Expenses**

**Cost of sales.** Please see explanation regarding "Income from sales" section above.

**Operating expenses.** Operating expenses were comprised mainly of research and development expenses, net, sales and marketing expenses, and general and administrative expenses of our and our subsidiaries' corporate operations:

	Year ended December 31,		
	2013	2012	2011
	(millions of \$)		
Corporate	5.5	3.9	4.9
RDC	1.5	1.2	1.7
Kyma <sup>1</sup>	1.9	3.0	2.6
Wavion <sup>2</sup>	-	-	11.5
Starling <sup>3</sup>	-	0.7	9.9
RDSeed <sup>4</sup>	1.9	2.8	0.7
Other <sup>5</sup>	0.9	3.4	3.0
	11.7	15.0	34.3

<sup>1</sup> Ceased to be consolidated in October 2013

<sup>2</sup> Sold in November 2011.

<sup>3</sup> Sold its business in September 2011 and was liquidated in 2012.

<sup>4</sup> Established in May 2011. Includes operating expenses of subsidiary Cloudyn and from the third quarter of 2013 also the operating expenses of Pose since we increased our holding and obtained control.

<sup>5</sup> In 2013 includes Smartwave. In 2012 includes mainly Sync-Rx (sold in November 2012) and Smartwave.

**Corporate:** The increase in 2013 compared with 2012 resulted primarily from granting annual bonus to company officers in accordance with the company's compensation policy, while in 2012 no bonus was granted, fluctuation of the exchange rates and as a result of an increase in the expenses of the service agreement with DIC. The decrease in 2012 compared with 2011 resulted primarily from expenses incurred in respect of "phantom options" granted in 2011 (see "Item 6"), and from a decrease in professional services.

*RDC:* The increase in 2013 compared with 2012 resulted primarily from an increase in the number of employees. The decrease in 2012 compared with 2011 resulted primarily from spinning off Smartwave's activities at the end of 2011 into an independent company.

*Kyma:* The decrease in 2013 compared with 2012 resulted primarily due to a decrease in the research and development expenses due to the completion of the implantable product development stage and due to cease of consolidation of Kyma from the forth quarter of 2013. The increase in 2012 compared with 2011 resulted primarily from an increase in its research and development and general and administrative expenses due to an acceleration in preclinical and clinical trials of its patch product.

*Starling:* The decrease in 2012 resulted primarily from the sale of Starling's business in September 2011 and from the decision of Starling's board of directors to cease its operations followed by its liquidation in 2012.

*RDSeed:* The decrease in 2013 compared with 2012 resulted primarily from a decrease in the research and development expenses in with regard to the Cemmerce project in which RDSeed ceased to invest during 2013, from the decrease in the number of employees in RDSeed and from the decrease in the the research and development expenses in the subsidiary Cloudyn. The increase in 2012 compared with 2011 resulted primarily from an increase in research and development expenses and marketing efforts of the Cemmerce project, and from the consolidation of Cloudyn's results, in which it initially invested in the fourth quarter of 2011.

*Equity in net losses of associates.* Our share of net losses of associates resulted from our holdings in certain investments that are accounted for under the equity method (see above under "Basis Of Presentation"). Our share of net losses of associates amounted to \$11.9 million in 2013 compared with \$8.3 million in 2012 and \$10.3 million in 2011. The increase in our share in the net losses of associates in 2013 compared with 2012 resulted primarily from an increase in Pocared's loss due to the progress in the sample collection for Pocared's FDA diagnostic trial and also from expenses resulting from the process of improving the sample processing procedure of the system Pocared is developing, and from an increase in Cartiheal's loss due to the clinical trial it is conducting. In 2013, there was also a decrease in Given Imaging's income due to a one-time tax expense and expenses related to the Given Merger (see "Highlights of the Results of Operations of Our Main Group Companies" below). The decrease in our share in the net losses of associates in 2012 compared with 2011 resulted primarily an increase in Given Imaging's income (see "Highlights of the Results of Operations of Our Main Group Companies" below), and from the disposal of Safend in 2011, which generated losses in this period.

We expect that most of our group companies will continue to recognize losses in future periods, as they invest significant resources in research and development and sales and marketing activities and have not yet generated significant revenues, if at all. Our results of operations will therefore be affected by the extent of our share of their net losses (to the extent they are reported under the equity or consolidation method of accounting).

**Highlights of the Results of Operations of Our Main Associates:**

*Given Imaging reported the following operating results (according to IFRS):*

	Year ended December 31, 2013 (millions of \$)	Increase (Decrease) %	Year ended December 31, 2012 (millions of \$)	Increase (Decrease) %	Year ended December 31, 2011 (millions of \$)
Revenues	190.8	5.7%	180.5	1.4%	177.9
Operating income	14.4	8.2%	13.3	8.2%	12.3
Net income attributable to shareholders	9.3	(38.2)%	15.1	103.1%	7.4

The increase in Given Imaging's revenues in 2013 compared with 2012 resulted from an increase in revenues in Given Imaging's three areas of operation. The increase in operating income in 2013 compared with 2012 resulted mainly from the increase in revenues and increase in gross profit. The decrease in net income in 2013 compared with 2012 resulted mainly from a one-time tax expense and expenses related to the Given Merger.

The increase in Given Imaging's revenues in 2012 compared with 2011 resulted from an increase in sales of its functional diagnostic products in the Americas, which was partially offset by a decrease in sales in the EMEA and APAC regions. The increase in operating income in 2012 compared with 2011 resulted mainly from the increase in revenues and from an improvement in gross profit. The increase in net income in 2012 compared with 2011 resulted mainly from the improvement in operating income and from a decrease in tax expenses in these periods.

*Pocared reported the following operating results (according to IFRS):* Pocared's net loss in 2013 amounted to \$10.7 million compared with \$7.1 million in 2012, and \$5.5 million in 2011. Pocared is in the development stage and has not yet commenced sales. Pocared's loss mainly results from research and development expenses. The increase in loss in 2013 compared with 2012 was mainly due to the progress in the Pocared's FDA diagnostic trial and also from expenses resulting from the process of improving the sample processing procedure of the system Pocared is developing. The increase in loss in 2012 compared with 2011 was mainly due to expenses resulting from the process of improving the sample processing procedure of the system Pocared is developing and from Pocared's preparations for clinical trials.

*BrainsGate reported the following operating results (according to IFRS):* BrainsGate's net loss in 2013 amounted to \$6.4 million, compared with \$6.1 million in 2012 and \$7.6 million in 2011. BrainsGate is in the development stage and has not yet commenced sales. BrainsGate's loss mainly results from research and development expenses. The increase in loss in 2013 compared with 2012 was mainly due to accelerated patient enrollment in its clinical trial. The decrease in loss in 2012 compared with 2011 was mainly due to expenses incurred in 2011 resulting from the commencement of clinical trials (see "Item 4 – Information on the Company").

**Highlights of the Results of Operations of Our Subsidiaries:**

*Income and losses of consolidated and associate companies directly held by us, for the year ending December 31, 2013*

	Comprehensive income			Interest	
	Income (Loss)	Other Comprehen- sive income	Dividend income	Interest income	Date received
(millions of \$)					
<b>Subsidiaries:</b>					
RDC	(1.0)	1	-	-	-
<b>Associates:</b>					
Given Imaging	9.3	(0.1)	-	-	-
BrainsGate	(6.4)	-	-	-	-
Pocared	(10.7)	-	-	-	-
Plymedia	0.1	-	-	1	2017

<sup>1</sup> Represents amount less than \$0.1 million

*Income and losses of a consolidated company held through RDC for the year ending December 31, 2013*

	Comprehensive income			Interest	
	Income (Loss)	Other Comprehen- sive income	Dividend income	Interest income	Date received
(millions of \$)					
<b>Subsidiaries:</b>					
RDSeed	(1.4)	-	-	-	-
<b>Associates:</b>					
Kyma	(3.1)	-	-	-	-

Income and losses of a consolidated company held through RDSeed for the year ending December 31, 2013

	Comprehensive income			Interest	
	Income (Loss)	Other Comprehen- sive income	Dividend income	Interest income	Date received
	(millions of \$)				
<b>Subsidiaries:</b>					
Cloudyn	(1.1)	-	-	-	-
Pose	(0.8)	-	-	-	-

**Financial Expenses.** Financial expenses amounted in 2013 to \$0.6 million compared with \$2.1 million in 2012 and \$4.2 million in 2011. The financial expenses in 2013 resulted mainly from interest on the loan drawn down under the credit line agreement with Silicon Valley Bank, and from commissions and other expenses related to this credit line. The financial expenses in 2012 resulted mainly from a change in the fair value of our holding in Wave shares. The financial expenses in 2011 resulted mainly from translation differences accumulated on loans granted to Starling by us and RDC, from expenses incurred in respect of Starling's liability to the Office of the Chief Scientist, and from an increase in the market value of Starling's convertible debentures.

**Other Expenses (Income), net.** Other income, net, amounted to \$3.5 million in 2013 compared with \$0.3 million in 2012 and other expenses of \$9.6 million in 2011. Other income in 2013 resulted primarily from a gain from the settlement agreement with Enablene. Other income in 2012 resulted primarily from partial consideration received from Enablene debentures (see below) and from a stamp duty provision recorded in past years that was cancelled. This income was partially offset by a provision for contingent liabilities. Other expenses, net, in 2011 resulted mainly from: a \$4.1 million impairment charge in respect of our holding in Enablene debentures, due to significant doubt as to Enablene's ability to repay the debentures at that time; a \$1.8 million impairment loss in respect of our holding in BPT; and expenses in the amount of \$3.2 million in respect of an inventory write-down recognized by Starling. These expenses were offset by other income, net, resulting primarily from: an approximately \$0.4 million gain from the sale of a portion of our holding in GigOptix shares; and an approximately \$0.1 million gain from the sale of our holding in EVS.

**Taxes on Income (Tax Benefit).** Tax benefit in 2013 resulted primarily from recording a deferred tax asset of approximately \$28.9 million with respect to temporary differences related to the investment in Given Imaging and with respect to tax losses carry forward which are likely to be utilized in 2014, due to the expected gain from the Given Merger. This amount was partially offset by RDC which recorded taxes on income due to a tax reserve of approximately \$0.5 million with respect to temporary differences related to the investment in Given Imaging for tax and accounting purposes (this tax reserve was partially offset by a deferred tax asset with respect to carryforward losses).

In 2012 and 2011, a tax benefit and tax expenses of approximately \$0.3 million and \$0.6 million respectively were recorded in respect of RDC.



## Quarterly Results

The following tables set forth the net results of our operations in the reported periods:

	Year ended	Three months ended			
	December 31, 2013	March 31, 2013	June 30, 2013	September 30, 2013	December 31, 2013
	(millions of \$, except per share data)				
	Unaudited				
Income (Loss) attributable to Elron's shareholders	17.9	(5.5)	(2.2)	1.7	23.9
Income (Loss) per share attributable to Elron's shareholders	0.54	(0.20)	(0.09)	0.04	0.79

	Year ended	Three months ended			
	December 31, 2012	March 31, 2012	June 30, 2012	September 30, 2012	December 31, 2012
	(millions of \$, except per share data)				
	Unaudited				
Income (Loss) attributable to Elron's shareholders	4.4	(6.2)	3.1	(0.5)	8.0
Income (Loss) per share attributable to Elron's shareholders	0.09	(0.22)	0.09	(0.03)	0.25

As previously mentioned, the net gain and loss attributable to our shareholders mainly comprises of: 1. our share in the losses of our group companies, 2. gains and losses from exit transactions, revaluation of investments, and changes in holdings, 3. corporate operating expenses and 4. tax benefit (taxes on income):\*\*

	Three months ended			
	March 31, 2013	June 30, 2013	September 30, 2013	December 31, 2013
	(millions of \$)			
	Unaudited			
<b>Losses in respect of group companies:</b>				
Our share in net losses of group companies, net	(3.5)	(1.5)	(1.1)	(4.3)
Excess cost amortization	(1.0)	(1.0)	(1.0)	(1.0)
Impairment of investments in group companies and financial assets, net	-	-	3.5	-
Total	(4.5)	(2.5)	1.5	(5.3)
<b>Gain from exit transactions, changes in holdings, and revaluation of investments (net of tax)</b>	0.2	1.7	1.4	3.1
<b>Corporate operating expenses</b>	(1.0)	(1.0)	(1.1)	(2.4)
<b>Tax benefit (taxes on income)</b>	-	-	*	28.7
<b>Other</b>	(0.2)	(0.3)	(0.1)	(0.2)
<b>Income (loss) attributable to Elron's shareholders</b>	(5.5)	(2.2)	1.7	23.9

	Three months ended			
	March 31, 2012	June 30, 2012	September 30, 2012	December 31, 2012
	(millions of \$)			
	Unaudited			
<b>Losses in respect of group companies:</b>				
Our share in net losses of group companies, net	(3.4)	(2.6)	(2.4)	(2.3)
Excess cost amortization	(1.2)	(1.1)	(1.0)	(1.0)
Impairment of investments in group companies and financial assets, net	(0.1)	(1.2)	(0.1)	0.3
Total	(4.7)	(4.9)	(3.5)	(3.0)
<b>Gain (Loss) from exit transactions, changes in holdings, and revaluation of investments (net of tax)</b>	(0.5)	9.5	3.8	12.0
<b>Corporate operating expenses</b>	(1.0)	(1.0)	(0.9)	(1.0)
<b>Tax benefit</b>	-	0.1	*	*
<b>Other</b>	*	(0.6)	*	0.1
<b>Income (loss) attributable to Elron's shareholders</b>	(6.2)	3.1	(0.5)	7.9

\* Represents amount less than \$0.1 million.

\*\* The results summarized in these tables are presented net of non-controlling interest.

**Our share in the net losses of group companies.** The loss we recorded in the fourth quarter of 2013 in respect of our share in the net losses of our group companies (net of non-controlling interest) resulted mainly from the losses of Pocared, BrainsGate Cartiheal and RDSeed. The loss we recorded in the fourth quarter of 2012 in respect of our share in the net losses of our group companies (net of non-controlling interest) resulted mainly from the losses of Pocared, BrainsGate, Cartiheal and RDSeed which was partially offset by our share in the gain recorded by Given Imaging

**Excess cost amortization.** Excess cost amortization expenses in the fourth quarter of 2013 and 2012 were recorded primarily in respect of excess costs attributed to our holding in Given Imaging.

**Impairment charges of investments in group companies and financial assets.** In the fourth quarter of 2012, we recorded income in the amount of \$0.3 million in respect of partial consideration received from Enablence debentures.

**Gain (Loss) from exit transactions, changes in holdings, and revaluation of investments.** The gains and losses from exit transactions, changes in holdings, and revaluation of investments recorded at fair value in the fourth quarter of 2013 resulted mainly from the \$2.1 million gain from an increase in Notal Vision's fair value, a \$1.7 million gain (net of non-controlling interest) from the decrease in holding and the loss of control in Kyma, a \$0.7 million gain (net of non-controlling interest) from a decrease in our holding in Given Imaging as a result of options granted to Given Imaging employees having been exercised or having expired; These gains were offset by an approximately \$0.9 million loss from a decrease in Jordan Valley's fair value.

The gains and losses from exit transactions, changes in holdings, and revaluation of investments recorded at fair value in the fourth quarter of 2012 resulted mainly from the \$8.5 million gain from the sale of Sync-Rx, the approximately \$1.7 million gain from an increase in Notal Vision's fair value, and from an approximately \$1.2 million gain (net of non-controlling interest) from the liquidation of Starling. These gains were offset by an approximately \$1.1 million loss from a decrease in Jordan Valley's fair value.

The following tables summarize our quarterly consolidated statements of profit and loss:

	Year ended	Three months ended			
	December 31, 2013	March 31, 2013	June 30, 2013	September 30, 2013	December 31, 2013
	Audited	Unaudited			
		(millions of \$)			
Income from sales	0.1	-	-	-	0.1
Gain from disposal and revaluation of group companies, and changes in holdings, net	8.4	0.3	1.9	1.9	4.2
Financial income	0.7	0.3	0.2	0.1	0.1
Total income	9.2	0.7	2.1	2.1	4.4
Cost of sales	0.1	-	-	-	0.1
Research and development expenses, net	3.9	1.3	1.0	1.2	0.4
Selling and marketing expenses	0.5	0.1	0.1	0.1	0.2
General and administrative expenses	7.2	1.5	1.5	1.5	2.7
Equity in losses of associates, net	11.9	3.6	1.6	1.3	5.4
Financial expenses	0.6	0.1	0.2	0.1	0.1
Other expenses (income), net	(3.5)	*	*	(3.5)	*
Total costs and expenses	20.7	6.6	4.4	0.7	8.9
Income (Loss) before taxes on income	(11.5)	(5.9)	(2.3)	1.3	(4.5)
Tax benefit	28.4	-	-	*	28.4
Net income (loss)	16.9	(5.9)	(2.3)	1.3	23.9
Income (Loss) attributable to Elron's shareholders	17.9	(5.5)	(2.2)	1.7	23.9
Income (Loss) attributable to non-controlling interest	(1.0)	(0.5)	(0.1)	(0.4)	*
Basic and diluted income (loss) per share attributable to Elron's shareholders	0.54	(0.20)	(0.09)	0.04	0.79

	Year ended	Three months ended			
	December 31, 2012	March 31, 2012	June 30, 2012	September 30, 2012	December 31, 2012
	Audited	Unaudited			
	(millions of \$)				
Gain (Loss) from disposal and revaluation of group companies, and changes in holdings, net	39.4	(0.5)	16.6	3.8	19.5
Financial income	1.2	0.5	0.4	0.3	0.2
Total income	40.6	0.04	17.0	4.1	19.7
Research and development expenses, net	6.9	1.4	1.7	1.8	1.9
Selling and marketing expenses	0.9	0.1	0.1	0.3	0.3
General and administrative expenses	7.2	1.9	2.3	1.4	1.6
Equity in losses of associates, net	8.3	3.2	1.8	1.6	1.8
Financial expenses	2.1	0.5	1.3	0.2	0.3
Other expenses (income), net	(0.3)	-	0.5	0.01	(0.8)
Total costs and expenses	25.1	7.1	7.7	5.3	5.1
Income (Loss) before taxes on income	15.5	(7.1)	9.3	(1.2)	14.6
Tax benefit	0.3	-	0.1	0.07	0.03
Net income (loss)	15.8	(7.1)	9.4	(1.1)	14.7
Income (Loss) attributable to Elron's shareholders	4.4	(6.2)	3.1	(0.5)	8.0
Income (Loss) attributable to non-controlling interest	11.4	(0.9)	6.3	(0.6)	6.7
Basic and diluted income (loss) per share attributable to Elron's shareholders	0.09	(0.22)	0.09	(0.03)	0.25

\* Represents amount less than \$0.1 million.

## B. Liquidity and Capital Resources

### Financial Position

	<u>December 31, 2013</u>	<u>December 31, 2012</u>
	<u>(audited)</u>	
	<u>(millions of \$)</u>	
Total assets in the consolidated statement of financial position	212.9	197.1
Investments in associate companies and assets measured at fair value (including assets held for sale)	143.6	136.8
Other long-term receivables	*	3.8
Current assets (excluding assets classified as held for sale)	35.8	51.4
Intangible assets, net	4.4	4.9
Deferred tax	28.9	-
Current liabilities	7.7	2.9
Long-term liabilities	5.4	9.3
Total liabilities	13.1	12.2
Equity including non-controlling interest	199.8	184.9

\* Represents amount less than \$0.1 million.

Shareholders' equity attributable to our shareholders at December 31, 2013, was approximately \$180.8 million, representing approximately 85% of the total assets as reflected in the Statement of Financial Position, compared with \$162.0 million at December 31, 2012, representing approximately 82% of total assets as reflected in the Statement of Financial Position. The increase in shareholders' equity resulted mainly from the other comprehensive income attributable to shareholders in the amount of \$ 15.8 million in 2013.

Consolidated working capital at December 31, 2013 amounted to \$136.8 million (including assets held for sale) compared with \$48.5 million at December 31, 2012. The increase in working capital resulted from the classification of the investment in Given as held for sale.

With respect to the claim against Elron and others in connection with the sale of the shares of Elscint in 1999, and the provision in our financial statements of an immaterial amount in order to cover the financial resources that may be required of us in order to expunge the claim, if any, see note 15.A to the Financial Statements. The costs in connection with litigating the claim are unknown and there is no certainty as to the amount of financial resources which would be required to order to expunge the claim.

**Our and RDC's primary cash flows <sup>1</sup>**

	Year ended		Three months ended	
	December 31, 2013	December 31, 2012	December 31, 2013	December 31, 2012
	Audited		Unaudited	
	(millions of \$)			
Investments in our and RDC's group companies <sup>1</sup>	(13.0)	(17.4)	(4.3)	(1.3)
Proceeds received from disposal of our and RDC's non-current investments	4.1	59.1	0.4	15.8
Raising of our debt	-	5.0	-	-
Repayment of our debt	-	(1.0)	-	-
Repayment of RDC's loans <sup>2</sup>	-	(3.3)	-	-
Dividend distributed by Elron	-	(15)	-	-
Dividend distributed by RDC <sup>2</sup>	-	(8.9)	-	-

<sup>1</sup> The amounts presented include RDC's and RDSeed's cash flows in full (100%) in addition to our cash flows, but do not include the cash flows of their subsidiaries.

<sup>2</sup> Including Rafael's share only in the loans granted/repaid and the dividend distributed.

**Cash balance**

Consolidated cash and deposits at December 31, 2013, were approximately \$32.3 million compared with \$47.5 million at December 31, 2012. At December 31, 2013, our and RDC's cash and deposits were \$19.7 and \$11.0 million, respectively, compared with \$25.1 and \$20.3 million, respectively at December 31, 2012.

**Uses of cash**

The main uses in cash in 2013 were investments and loans to group companies in the amount of \$9.6 million by us and \$3.4 million by RDC. Also, cash was used to pay corporate and RDC's operating expenses, as detailed above under "Operating Results".

The main uses in cash in 2012 were investments and loans to group companies in the amount of \$13.2 million by us and \$4.2 million by RDC. Also, cash was used to distribute a dividend to our shareholders in the amount of \$15.0 million, to prepay \$1.0 million out of our debt to Silicon Valley Bank, as detailed below, and to pay corporate and RDC's operating expenses, as detailed above under "Operating Results". In addition, in 2012 RDC's cash was used to prepay its entire debt to its shareholders in the amount of \$6.5 million, of which our share amounted to \$3.25 million (approximately \$3.3 million including interest), and to distribute a cash dividend to its shareholders in the amount of approximately \$17.8 million, of which our share amounted to approximately \$8.9 million.

Investments in group companies during 2013 and 2012 are detailed in the following table (for additional details see Note 3 in "Item 18 – Financial Statements"):

	Elron		RDC	
	2013	2012	2013	2012
	(millions of \$)			
	Audited			
<b>Consolidated companies<sup>1</sup></b>				
Kyma <sup>2</sup>	-	-	1.0	2.5
SmartWave	-	-	1.0	1.0
Sync-Rx <sup>3</sup>	-	-	-	0.5
Starling <sup>4</sup>	-	0.2	-	0.2
Pose <sup>5</sup>	-	0.6	0.4	-
Cloudyn	0.5	0.8	0.9	-
	<u>0.5</u>	<u>1.6</u>	<u>3.3</u>	<u>4.2</u>
<b>Associates and other investments</b>				
Brainsgate	-	4.7	-	-
NuLens <sup>6</sup>	0.3	2.7	-	-
Cartiheal	2.5	2.5	-	-
Notal Vision	1.9	1.2	-	-
Numbeez	-	0.5	0.1	-
Pocared <sup>7</sup>	3.9	-	-	-
DES	0.5	-	-	-
	<u>9.1</u>	<u>11.6</u>	<u>0.1</u>	<u>-</u>
<b>Total investments</b>	<u>9.6</u>	<u>13.2</u>	<u>3.4</u>	<u>4.2</u>

<sup>1</sup> The amounts exclude our investment in RDSeed in the amounts of \$1.0 million and \$2.5 million in 2013 and 2012, respectively, and an amount of \$2.0 million RDC invested in RDSeed in 2013. These investments do not affect the cash included in the consolidated financial statements.

<sup>2</sup> Subsequent to December 31, 2013 and through the date of the filing of this Annual Report, we invested approximately \$1.0 million in Kyma.

<sup>3</sup> Sold in November 2012.

<sup>4</sup> Sold its business in September 2011 and was liquidated in 2012. The amounts include the purchase of Starling shares from the public in 2012.

<sup>5</sup> Consolidated since we obtained control in July 2013. Subsequent to December 31, 2013 and through the date of the filing of this Annual Report, we invested approximately \$0.2 million in Pose.

<sup>6</sup> Subsequent to December 31, 2013 and through the date of the filing of this Annual Report, we invested approximately \$0.1 million in NuLens.

<sup>7</sup> Subsequent to December 31, 2013 and through the date of the filing of this Annual Report, we invested approximately \$1.5 million in Pocared.

***Proceeds from the disposal of non-current investments***

Proceeds we and RDC received from the disposal of non-current investments in 2013 mainly included: proceeds we received in the amount of \$1.7 million from the settlement agreement with Enablece; proceeds we received in the amount of \$1.9 million from our share in the release of the deposit that was held in escrow in connection with the sale of Wavion that was completed in November 2011; and proceeds we and RDC received in the amount of \$0.1 and \$0.3 million, respectively, from the sale of Sela – Semiconductors Engineering Laboratories Ltd., or SELA, which was completed in 2009.

Proceeds we and RDC received from the disposal of non-current investments in 2012 mainly included: proceeds we and RDC received in the amount of \$2.7 and \$19.9 million, respectively, from our share in the deposit held in connection with the sale of Medingo, and subsequently released; proceeds we and RDC received in the amount of \$1.4 and \$14.1 million, respectively, from the sale of Medingo completed in 2010; proceeds RDC received in the amount of \$12.7 million from the sale of Sync-Rx; proceeds we received in the amount of \$1.9 million from the sale of a portion of our holding and in Aqwise and the repayment of shareholders loans granted to Aqwise; proceeds we received in the amount of \$1.3 million from the sale of Wavion completed in 2011; proceeds we received in the amount of \$0.9 million from the sale of Wave shares; proceeds we received in the amount of \$0.9 million from the sale of our remaining holding in GigOptix shares; proceeds we and RDC received in the amount of \$1.3 and \$1.5 million, respectively, from the partial repayment of a loan by Starling following its liquidation; and proceeds we and RDC received in the amount of \$0.1 and \$0.3 million, respectively, from the sale of. In addition, in consideration of the sale of Sync-Rx RDC received \$3.1 million that was deposited in escrow for a period of 18 months. This amount is presented under "other long-term receivables" in the statement of financial position as of December 31, 2012.

***Raising of debt and credit line***

In April 2012, we drew down \$5 million of the facility. In August 2012, we repaid \$1 million of the facility utilized.

As of December 2013 we had \$4 million debt to banks that was fully repaid on January 2014. On February 2014, following the completion of the Given Merger, the credit line with the Bank was terminated.

We believe that our existing capital sources will be sufficient to fund our and our subsidiaries' operations, and to fund any investments we may carry out in existing and new companies for at least the next twelve months.



### Dividend

In July 2012, we distributed a cash dividend to our shareholders in the amount of \$15 million (approximately \$0.51 per share). The dividend was distributed as a means for enabling our shareholders to share in our profits and positive operating results.

In June 2012, RDC distributed a cash dividend to its shareholders in the amount of approximately \$17.8 million. Our share in the dividend amounted to approximately \$8.9 million. The balance amount was distributed to Rafael.

In light of the completion of the Given Merger our board of directors will consider our financial needs including the possibility of the distribution of a dividend

### Our main group companies' cash flows<sup>1</sup>

	Cash flows from operating activities for the year ended December 31,		Cash balance as of December 31,		Note in "Item 18 – Financial Statements"
	2013	2012	2013	2012	
	(audited)				
	(millions of \$)				
BrainsGate <sup>2</sup>	(6.1)	(5.6)	9.2	8.7	3.B.4.c
Given Imaging <sup>2</sup>	23.7	27.8	44.1	35.4	3.B.4.a
Pocared <sup>2</sup>	(9.6)	(6.2)	0.8	2.0	3.B.4.b

<sup>1</sup> See "Item 4B – Business Overview" for details on the criteria for classifying a group company as a main company.

<sup>2</sup> In accordance with U.S. GAAP.

### Qualitative and Quantitative Disclosure About Market Risk

#### Market risks

Market risks relating to our operations result primarily from changes in interest rates, exchange rates, the consumer price index, and equity prices. In addition, we are indirectly exposed to market risks relating to the operations of our group companies. In order to limit our and our subsidiaries' exposure, we and our subsidiaries may enter, from time to time, into various derivative transactions. We do not use financial instruments for trading purposes. It is our policy and practice to use derivative financial instruments only to limit exposure. The handling of financial exposures, formulation of hedging strategy, supervision over, execution and provision of an immediate response to extraordinary developments in the various markets, is under the responsibility of the Chief Financial Officer, who acts in consultation with the Chief Executive Officer and members of the audit committee and the investment committee. An update regarding the implementation of our policy is presented to the members of the audit committee on a quarterly basis. We do not determine the risk management policy for our group companies. We and our subsidiaries did not have material derivatives positions as of December 31, 2013 and December 31, 2012.

**Interest Rate Risks.** We and our group companies are exposed to market risks resulting from changes in interest rates, relating primarily to our and RDC's loan obligations to banks and deposits. As of the date of filing of this Annual Report, we and RDC do not use derivative financial instruments to limit exposure to interest rate risk. At December 31, 2013, RDC had no external debt. However, at December 31, 2013 we had a \$4.0 million loan from Silicon Valley Bank and \$15.0 million unutilized variable interest credit facility. The loan was fully paid on January 2014. On February 2014, following the completion of the Given Merger, the credit line with the Bank was terminated. In addition, certain of our group companies have variable interest loans and therefore, an increase in interest rates would result in an increase in their financial expenses and may lead to an increase in our financial expenses.

The following table sets forth the repayment dates of our and our subsidiaries financial liabilities

Liabilities	2014	2015	2016	2017	No specific repay- ment date	Total	Fair value
	(equivalent to millions of \$)						
Variable rate (\$)	4.0	-	-	-	-	4.0	4.0
Average interest rate	WSJ +0.75%	-	-	-			

**Exchange Rate Risk.** Since most of our group companies have operations in Israel, our main exposure, if any, results from changes in the exchange rate between the New Israeli Shekel and the U.S. dollar. Our functional currency, as well as that of most of our group companies, is the U.S. dollar. Our policy is to reduce exposure to exchange rate fluctuations by having, to the extent possible, most of our and our group companies' assets and liabilities, as well as most of the revenues and expenditures in U.S. dollars, or U.S. dollar linked. However, salaries and related expenses, as well as expenses related to the DIC Service Agreement (see "Item 7 – Related Party Transactions– Major Shareholders") and other operating expenses are denominated in NIS. It is our and our group companies' policy to use derivative financial instruments, from time to time, to limit exposure to changes in the exchange rate between the NIS and the U.S. dollar or to keep a portion of our and our group companies' resources in NIS against a portion of its future NIS expenses and against liabilities denominated in NIS. If the NIS should strengthen against the U.S. dollar, it may harm our and our group companies' results of operations. We keep a material portion of our resources in U.S. dollar, however, in the future, changes may take place from time to time in our cash balances, in how we maintain our cash, and the portion of cash we hold in each currency based on business developments and future decisions.

**Consumer Price Index (CPI) Risk.** We are engaged in a Services Agreement with DIC (described under "Item 7 – Major Shareholders and Related Party Transactions–Related Party Transactions") and we and several group companies of ours are engaged in several lease agreements that are linked to the NIS CPI for various time periods, which are impacted by changes in the CPI. A sharp rise in the inflation rate may lead to a significant increase in our and our group companies' expenses.

**General Market Risks.** As we and our group companies hold most of our cash and cash equivalents, short-term and long-term investments and other financial instruments in various financial institutions with high credit ratings, we do not have significant concentrations of credit risk. Our policy is spreading out our cash investments among the various institutions. We believe this represents a conservative investment policy primarily intended to preserve our cash resources

**Equity Price Risk.** We are exposed to fluctuations in the fair value of our holdings in our group companies.. Changes in the fair value of our private holdings including holdings accounted for under the equity method of accounting or as financial assets measured at fair value (such as Jordan Valley and Notal Vision) may affect our results of operations and may have a significant effect on our market value. We view the volatility in the fair value of these companies as part of our ordinary course of business.

**Sensitivity analyses of sensitive financial instruments included in the consolidated financial statements as of December 31, 2013, in accordance with changes in market factors**

For details on sensitivity analyses of sensitive financial instruments please see Note 20 to our consolidated financial statements.

#### **C. Research and Development**

According to our group companies (excluding Given Imaging which does not publish any guidance regarding its R&D expenses), their aggregate projected investment in R&D activities during 2014 will total approximately \$44.4 million.

The combined R&D costs of all group companies amounted to approximately \$62.3 million in 2013, \$60.2 million in 2012 and \$72.2 million in 2011. The increase in R&D costs in 2013 as compared with 2012 resulted mainly from the increase in R&D costs in Pocared and Cartiheal.. The decrease in R&D costs in 2012 as compared with 2011 resulted mainly from the sale of certain investments, mainly Safend and Wavion and Starling's sale of its business. Our consolidated R&D costs amounted to \$3.9 million in 2013, \$6.9 million in 2012 and \$18.2 million in 2011. The decrease in consolidated R&D costs in 2013 as compared with 2012 was primarily due to the sale of Sync-Rx in November 2012 and from the decrease in holding and the loss of control in Kyma in October 2013.

The decrease in consolidated R&D costs in 2012 as compared with 2011 and 2011 was primarily due to the sale of Wavion in November 2011 and Starling's sale of its business in 2011.

#### **D. Trend Information**

See "Global Economic Status" and "Venture Capital Industry Status" above.

## E. Off-Balance Sheet Arrangements

There are no off-balance sheet transactions.

## F. Tabular Disclosure of Contractual Obligations

At December 31, 2013, we and our subsidiaries had material contractual obligations which are expected to affect our consolidated cash flow in future periods, which included lease obligations and payments of bank credits, bank loans and loans from others, including short term loans taken by our subsidiaries, in each case due in future periods as set forth in the table below (the following amounts include predicted accrued interest and are presented in millions of \$):

Type of Obligation	2014	2015	2016	2017	2018	Total
Loan from banks and others	4.0	-	-	-	-	4.0
Leases	0.4	0.4	0.2	-	-	1.0

## Item 6. Directors, Senior Management and Employees

### A. Directors and Senior Management

As of the date of filing of this Annual report, our executive officers and directors are as follows:

#### Directors

Name	Age	Position
Arie Mientkavich <sup>(5)</sup>	71	Chairman of the board of directors
Gad Arbel <sup>(1) (2) (3) (5)</sup>	65	External Director
Avraham Asheri <sup>(1) (5)</sup>	76	Director
Prof. Gabi Barbash	64	Director
Amiram Erel <sup>(5)</sup>	66	Director
Arie Ovadia <sup>(1) (3) (4) (5)</sup>	65	Director
Ehud Rassabi <sup>(1) (2) (3) (5)</sup>	60	External Director
Hadar Udler	41	Director

#### Executive Officers

Name	Age	Position
Ari Bronshtein	44	Chief Executive Officer
Yaron Elad	36	Vice-President & Chief Financial Officer

- (1) Member of our audit committee.
- (2) External director under the Israeli Companies Law.
- (3) Independent Director under the Israeli Companies Law.
- (4) Designated "financial expert" under the Sarbanes-Oxley Act of 2002.
- (5) Designated "financial expert" under the Israeli Companies Law.

*Arie Mientkavich* joined Elron as Chairman of the board of directors in January 2007. He served as deputy chairman of the board of IDB Holding Corporation Ltd or IDBH from May 2006 until January 2014. He also serves as chairman of the board of RDC, and as a director of Given Imaging from July 2007 until February 2014. Since July 2006, he has also served as the deputy chairman of the board of Gazit Globe Ltd. and chairman of the board of Gazit Globe Israel (Development) Ltd and subsidiaries or affiliates thereof including as chairman of the board of directors of A.Drori Ltd. and as a director of Ronson Europe, BV. From November 1997 to January 2006, Mr. Mientkavich served as chairman of the board of Israel Discount Bank Ltd. and several of its major subsidiaries which includes the Israel Discount Bank of NY and the Mercantile Discount Bank. From 1987 to 1997, he served as active chairman of the board of the Israel Securities Authority, the Israeli equivalent of the SEC. From 1979 to 1987, Mr. Mientkavich served as general counsel to the Israeli Ministry of Finance. During the years 1972 through 1979, he served in a number of positions in the Israeli Ministry of Finance. Mr. Mientkavich was also a member of the board of the Israel Land Administration and of El Al Israel Airlines. Mr. Mientkavich is chairman of the board of trustees of the Academy of the Quality of Government Movement (the "Movement") in Israel, and was honored with the award of Knight of Quality Government in 1995 by the Movement. He is also chairman of the Public Council of Yad Sarah, a voluntary organization in the field of humanitarian support of public health. In addition, Mr. Mientkavich serves as chairman of the Public Committee, in conjunction with the Yad VeShem Holocaust Center, for the documentation of the contribution of the Holocaust Survivors to the Establishment of the State of Israel and has been active in the organization of the annual March of the Living to the concentration camps. In addition, Mr. Mientkavich is a member of each of the Licenses Committee and Advisory Committee of the Bank of Israel and serves on the Advisory Board of the Israel Defense College. Mr. Mientkavich holds degrees in Political Science and in Law from The Hebrew University of Jerusalem, and was admitted to the Israeli Bar in 1972.

*Gad Arbel* joined Elron as an external director in October 2008 and was reappointed as an external director for a second three year term in 2011. He serves as Chairman of our audit committee as of December 2010 and Chairman of our compensation committee and as a member of our investment committee. Mr. Arbel provides consulting services in the economic financial field and serves as an outside director and member of the investment committee at Psagot Mutual Funds (2005) Ltd. Mr. Arbel also serves as a director and chairman of the audit committee of the Managing Association of the Compulsory Vehicle Insurance (the Pool) Ltd., as a member of the Administrative Committee of the Veteran Pension Funds of Israel and as a member of the Board of the College of Management Academic Studies. Mr. Arbel has also served as: director and chairman of the Compliance Committee of the Israel Discount Bank of New York (from 2006-2008); director of Discount Bancorp (from 2007-2008); and director and chairman of the audit committee of the Israel Discount Bank Ltd. (from 2001-2007). From 1997-2001, Mr. Arbel served as a vice president and member of the executive management of the United Mizrahi Bank, heading the Capital Market and Investments Division responsible for, among other things, the departments of securities, provident funds, deposits and savings, private banking and capital market subsidiaries. From 1988-1992, Mr. Arbel served as the Commissioner of Capital Market, Insurance and Savings in the Ministry of Finance of the State of Israel; and from 1983-1987, served in New York as the Chief Fiscal Officer of the Government of Israel for the Western Hemisphere. Mr. Arbel has a B.A. in Economics and an M.B.A., each from the Hebrew University of Jerusalem, Israel.

*Avraham Asheri* joined Elron as a director in December 1999. He serves as a member of our audit committee, chairman of our investment committee and until December 2010, as chairman of our audit committee. He is an economic and financial advisor. Mr. Asheri is a member of the boards of directors of Elbit Systems Ltd., Koor Industries Ltd. and Radware Ltd. Mr. Asheri was the president and chief Executive Officer of Israel Discount Bank from November 1991 until July 1998. Prior to joining Israel Discount Bank in 1983 as senior executive vice president and as a member of its management committee, Mr. Asheri held the position of director general of the Ministry of Industry and Trade. During his 23 years at the Ministry of Industry and Trade and at the Ministry of Finance, Mr. Asheri held several key offices in Israel and abroad, including managing director of the Investment Center in Israel, and Trade Commissioner of Israel to the United States. Mr. Asheri holds a Bachelors degree in Economics and Political Science from The Hebrew University of Jerusalem.

*Prof. Gabi Barbash* joined Elron as a director in May 2003. Since 1999, Prof. Barbash has been director general of the Tel-Aviv Sourasky Medical Center, and between 2000 and 2003, he served as chairman of the board of directors of Teuza Venture Capital Fund. Between 1998 and 2000, Prof. Barbash was the chairman of the Israeli National Transplant Center. Between 1996 and 1999, Prof. Barbash served as the director general of the Israeli Ministry of Health. From 1995 to 1998, Prof. Barbash was a member of the Scientific Committee of the Interdisciplinary Center for Technological Analysis and Forecasting at Tel Aviv University. Prof. Barbash was the director general of the Sourasky Medical Center from 1993 and 1996. In addition, from 1986 to 1993, Prof. Barbash was the deputy director of the Sheba Medical Center and from 1990 to 1993, he was director of the Rehabilitation Hospital of the Sheba Medical Center. Prof. Barbash is a director of Clal Biotechnology Ltd. and Chairman of the start-up "Oplon". Prof. Barbash holds an M.D. degree from The Hebrew University of Jerusalem, Hadassah Medical School and a Masters degree in Public Health from Harvard University.

*Amiram Erel* served as the Chairman of our board of directors from November 1999 through January 2007 and continues to serve as a director of Elron. He also served as our Chief Executive Officer from November 1999 to December 2001. Mr. Erel also serves as Chairman of the board of directors of Cellcom Israel Ltd from 2005 and as deputy Chairman of the board of directors of Makhteshim-Agan Industries Ltd. (where he served from 2006 and as a director and from January 2011 through October 2011 as Chairman of the board of directors). Mr Erel also serves as a director of Shufersal Ltd., Knafaim Holdings Ltd. and Dan hotels Ltd. Mr. Erel also served as President and Chief Executive Officer of DIC from 2001 to 2013. From March to December 2007, Mr. Erel also served as the Chief Executive Officer of Netvision Ltd., where he served prior to March 2007 and from 2008 to 2011, as Chairman of the board of directors. From 1997 to 1999, he served as President and Chief Executive Officer of Bezeq – The Israeli Telecommunications Corporation Ltd. Mr. Erel served as the chairman of the executive committee of the Manufacturers Association of Israel from 2005 to 2009 and from 2009 to 2011 he served as the chairman of the Israel Export & International Cooperation Institute. Mr. Erel holds a B.Sc. in electrical engineering from the Technion, Israel Institute of Technology.

*Dr. Arie Ovadia* joined Elron as a director in March 2007. He serves as a member of our investment committee, and as of December 2011, as a member of our audit committee. He also serves a member of our compensation committee. In December 2011, Dr. Ovadia was approved by the board of directors as having the qualifications of an Independent Director under Israeli law. He serves as Chairman of Giron Development & Building Ltd., Destiny Holdings (1993) Ltd., Teva Naot Distribution Ltd., Naot Shoes Cooperative Agriculture Society For Business Ltd., Nadlan.com Israel Ltd. and Peer Stream Ltd. He is a Managing Partner of Shamrock Israel Growth Fund Advisor Ltd. He is a director of Discount Bank Ltd., Shamrock Cinema City Ltd., Destiny Investment 1993 Ltd., Destiny Assets 1991 Ltd., Israel Petrochemical Ltd., Strauss Group Ltd., Skylex Corporation Ltd., Compugen Ltd., Carmel Olefins Ltd., I.Q.S Shalev Ltd., (previously served as chairman), E.Q.S. Hydraulic Ltd., Maztech Technologies Ltd., Maxtech Networks Communication Ltd., Mantisvision Ltd., VyryaNet Ltd., Adams Market G.M. Ltd., A.A. Consultants Ltd., A.A. Adav Consultants and Managing 2007 Ltd., Aantz Consultants Ltd., Binyamin Ovidia Consultants 2007 Ltd G. I. Tech Ltd. and Oil Refineries Ltd. He holds a B.A. in Economics and an M.B.A from Tel Aviv University. He also holds a Ph.D. in Economics from the University of Pennsylvania, Wharton School.

*Ehud Rassabi* joined Elron as a director in March 2012. He serves as a member of our audit committee, investment committee and compensation committee. Mr. Rassabi is an accountant and provides expert opinions in the fields of economics, class actions, valuations and mediations. Mr. Rassabi served as Chief Executive Officer of Emed Real Estate Development and Investments Ltd. until March 2011. He serves as an external director of Electra Ltd., Bank Yahav for State Employees, Goldbond Group Ltd., Harel Finance, Securities & Trade Ltd. and Israeli News Company Ltd. Mr. Rassabi is past Chairman and currently Honorary President of Israeli-Japan Friendship Society and Chamber of Commerce and is honorary Consul of the Social Democratic Republic of Sri Lanka. Mr. Rassabi serves as Chairman of Ilan – Israeli Foundation for Handicapped Children (on a voluntary basis), Chairman (on a voluntary basis) of the audit committee of the Society for the Friends of Tel Aviv University and President of Lahav Office of Self employed and Businesses in Israel (on a voluntary basis) . Mr. Rassabi holds a Bachelor of Arts degree in Accounting and Economics from Tel Aviv University.

*Hadar Udler* joined Elron as a director in November 2011. She is Vice-President, general counsel and corporate secretary of A.Drori Group Ltd. She served as an Attorney at Goldfarb, Levy, Eran, Meiri, Tzafirir & Co. Law Offices (currently Goldfarb Seligman & Co. Law Offices) since 1999, and she was a Partner in said firm (in the Corporate and Securities Department) since 2008 until 2010. From 2010 until December 8, 2013, Ms. Udler served as Corporate Secretary of IDBD and IDBH. She holds an L.L.B. degree from Tel Aviv University.

*Ari Bronshtein* has served as Chief Executive Officer of Elron since June 2010 after serving as co-Chief Executive Officer of Elron since May 2009. Mr. Bronshtein serves as a director of RDC, and Pocared and served as a director of Given Imaging until February 2014. From March 2006 to April 2009, Mr. Bronshtein served as a director of Elron. In January 2006, Mr. Bronshtein joined DIC as vice president. From 2004 to 2005, Mr. Bronshtein served as vice president and head of the Economics and Business Development division of Bezeq – The Israeli Telecommunications Corporation Ltd. Mr. Bronshtein currently serves as a director of CellCom Israel Ltd. and other companies within the IDB group. Mr. Bronshtein holds a Bachelors degree in Finance and Management and a Masters degree in Finance and Accounting, both from Tel Aviv University.

Yaron Elad joined Elron in July 2007 as Comptroller and in January 2010 was appointed as Vice President and Chief Financial Officer. From 2001 to 2007, Mr. Elad worked for BDO Israel, a leading Israeli auditing firm, as manager in the auditing and technical department. Mr. Elad is a director of RDC, Chairman of the board of directors of RDSeed and a director of Cloudyn and Jordan Valley Semiconductors. From 2001 to 2007, Mr. Elad was a lecturer at Tel Aviv University and other academic institutions. In addition, Mr. Elad lectured at The Institute of Certified Public Accountants in Israel and various Israeli government ministries. Mr. Elad holds a Bachelor of Arts degree in Accounting and Economics from Tel Aviv University (cum laude) and a Masters of Science degree in Finance from Tel Aviv University. Mr. Elad has been a licensed CPA in Israel since 2004.

**B. Compensation**

During the year ended December 31, 2013, we paid aggregate remuneration of approximately \$1,145 million, 000 to our directors and officers as a group who served in the capacity of director or executive officer during such year. See "Item 7—Major Shareholders and Related Party Transactions—Related Party Transactions" regarding compensation of directors who are controlling shareholders. This does not include payments by DIC to officers of the Company employed by DIC as part of the Services Agreement (see "Item 7—Major Shareholders and Related Party Transactions—Related Party Transactions").

The following table sets forth the approximate aggregate compensation paid by us during the fiscal year ended on December 31, 2013 to all of our directors and officers.

<b>2013<sup>(1) (2)</sup></b>	<b>Cash and Cash-Equivalent Forms of Compensation (in thousands of U.S. \$) Salaries, Fees, Directors' Fees, Commissions and Bonuses</b>
All Directors as a group, consisting of 9 persons as of December 2013	1,145
All Officers as a group,	-

(1) Does not include payments by DIC to officers of the Company employed by DIC as part of the Services Agreement.

(2) See below –"Payments paid during the period of this Annual Report to the five highest salary recipients amongst our and our subsidiaries officers".



The salary of our officers and the rest of the staff working for us, with the exception of the salary of the Chairman of our board of directors (and with the exception of special bonuses to officers and staff members as aforesaid), is not paid by us but by DIC. In accordance with the Services Agreement with DIC (see "Item 7 – Major Shareholders and Related Party Transactions – Major Shareholders"), we may grant special bonuses to our officers and other staff working for us and who are employed by DIC subject to our compensation policy described below.

In light of the global economic status, our chairman of the Board of Directors and the executive officers waived a portion of their compensation for a period of one year commencing September 2012. As part of this, the monthly compensation waived by the chairman of the board of directors amounts to 25% of the total monthly cost of his employment, and the monthly compensation waived by our CEO and vice presidents (whose compensation is paid by DIC under the Services Agreement) amounts to 10%-15% of the total monthly cost of their employment. In addition, commencing as of January 1, 2014, Mr. Mientkavich agreed to reduce his monthly salary to NIS 85,000 as long as our compensation policy that was approved on January 12, 2014 shall be in effect and applicable to him. For further details, see in this Item 6B below.

#### ***Compensation of Officers and Directors***

Pursuant to the Israel Companies Law, Israeli public companies are required to establish a compensation committee and to approve a compensation policy regarding the compensation and terms of employment of their directors and officers.

The compensation policy must be approved by a company's board of directors after considering the compensation committee's recommendations. The compensation policy also requires the approval of the general meeting of the shareholders, which approval must satisfy one of the following: (i) the majority should include at least a majority of the shares of the voting shareholders who are non- controlling shareholders or do not have a personal interest in the approval of the compensation policy (abstentions shall not be taken into account), or (ii) the total number of votes against the proposal among the disinterested shareholders does not exceed 2% of the voting rights in the company. The Israeli Companies Law provides that the compensation policy must be re-approved every three years, in the manner described above.

The Israel Companies Law stipulates procedures for the approval of compensation arrangements with officers and directors of Israeli public companies, including a requirement to obtain shareholders' approval for any transaction with an "office holder" (as defined below in "Item 10 – Additional Information – Memorandum and Articles of Association") with respect to such office holder's compensation arrangements and terms of engagement, if they are not in accordance with the company's compensation policy, and for any transaction with our CEO with respect to its compensation arrangements.

On December 7, 2012, our board of directors established a compensation committee comprising the external directors, Messrs. Gad Arbel and Ehud Rassabi, and our independent director, Dr. Arie Ovadia. Mr. Gad Arbel was appointed as Chairman of the Compensation Committee.

On January 12, 2014, our shareholders approved the adoption of a compensation policy for officers and directors of the Company and its application to the chairman and with respect to the bonus plan, its application to the CEO of the Company. In addition, the compensation policy with respect to the bonus plan only was applied to another officer, the Vice-President and Chief Financial Officer.

The compensation policy determines provisions and limits in relation to the fixed parameters of the officer's compensation (salary, social and related benefits and reimbursement of costs) and determines that the Company is permitted to award an annual bonus to its officers subject to a threshold condition and subject to satisfaction of measurable goals related to our performance and the performance of our group companies, as will be determined at commencement of each year as well as the return on our share. The policy determines limits to the annual bonuses in relation to each officer. The comprehensive policy was published as an annex to the Notice convening our special shareholders meeting which was submitted on Form 6K to the Securities and Exchange Commission on December 5, 2013.

For details concerning the terms of employment of the chairman, the CEO and the CFO of the Company and in relation to the annual bonus granted to them for 2013 in accordance with the compensation policy, see further below in this Item 6B.

**Payments paid during the period of covered by this Annual Report to the five highest salary recipients amongst our and our subsidiaries' officers**

The following are the details required according to Israeli Securities Law regulations regarding compensation paid, to the best of our knowledge, to the five highest salary recipients amongst our and our subsidiaries' officers.

Of the five highest salary recipients among our and our subsidiaries' senior officers, three are officers at Given Imaging. Resolutions regarding the remuneration terms of officers at Given Imaging are made by the authorized corporate organs of Given Imaging.

Information on recipient				Compensation for services (thousands of \$)					Total
Name	Position	Date of employment	Type of Position	Share-holdings (Fully diluted)	Salary	Bonus	Share-based payments	Management fee	
Nahum (Homi) Shamir	Chief Executive Officer and President of Given Imaging	April, 2006	100%	-	489 (1)	582(2)	574 (3)	-	1,645
Yuval Yanay	Chief Financial Officer of Given Imaging	August, 2005	100%	-	491 (4)	482 (5)	292(6)	-	1,265
Ari Bronshtein	Chief Executive Officer of Elron	May, 2009 (7)	(7)	-	463 (8)	487 (9)	-	-	950
Arie Mientkavich	Chairman of the Board of the Company	January ,2007	50%	-	546 (10)	(11) 213	55(11), (12)	-	814
Skip Baldino	President of Given USA	June 2010	100%	-	370(13)	172 (14)	232(15)	-	774

The following are the details required according to Israeli Securities Law regulations regarding compensation paid, to the best of our knowledge, to senior officers of ours not specified in the above table, in their capacity as our officers and as officers of our subsidiaries.

Information on recipient				Compensation for services (thousands of \$)					Total
Name	Position	Date of employment	Type of Position	Shareholdings (Fully diluted)	Salary	Bonus	Share-based payments	Management fee	
Yaron Elad	Vice President and Chief Financial Officer	May, 2009 (16)	100% (16)	-	219(17)	205 (18)	-	-	424

- (1) The amount paid by Given Imaging includes all of the following components: 12 monthly salaries of NIS 133,000 each (approximately \$38,000), social benefits and related benefits, as customary in the United States, health insurance and car allowance. The engagement between the parties shall terminate 24 months after the date on which either party shall provide the other written notice of his desire to terminate the engagement according to the employment agreement.
- (2) The amount of the bonus for 2013 (the "Annual Bonus") was determined in accordance with the bonus plan for 2013 for the officer, which was approved at the beginning of the same year by the compensation committee, the audit committee and the board of directors of Given Imaging. According to the bonus plan, a target amount was predetermined for the officer in respect of 2013, which is equal to 150% of his total current salaries in this year. The Annual Bonus for the officer was dependent upon two components as specified below, the weight of each component being expressed as a certain percentage of the said target amount. Most of the Annual Bonus was dependent upon the component of achieving certain pre-determined sales and net profit targets for Given Imaging on a consolidated basis in 2013, which are expressed in a matrix method according to various possible combinations between sales and profit as aforesaid, and could range between 50% and 150% of the weight of such component in the bonus plan, according to the extent of achievement of such targets, whilst in the event that the sales level or net profit level is lower than a certain pre-determined minimum threshold, no bonus will be paid in respect of this component. This portion of the 2013 annual bonus was based on Given Imaging's achievement of performance goals for 2013 calculated at 88% of the target level representing Given Imaging's projected performance at the time the Given Merger was signed and announced. The balance of the Annual Bonus was dependent upon the component of achieving certain predetermined personal targets for the officer in accordance with his areas of responsibility, some of which are measurable (such as fulfillment of certain predefined tasks) and some qualitative (such as general level of performance) according to the evaluation of Given Imaging's board of directors. Based on all of the components of the said bonus plan, the Annual Bonus for the officer could reach up to a maximum sum of approximately 200% of the total current salaries of the officer in 2012. The calculation and amount of the actual Annual Bonus were also approved by the compensation committee, the audit committee and the board of directors of Given Imaging, and its general meeting.

- (3) In his capacity as President of Given Imaging, Given Imaging allotted to Mr. Shamir stock options as well as restricted share units under its option plan and restricted share unit grant plan, as follows:
- (a) In May 2006, Given Imaging allotted to Mr. Shamir options for the purchase of 300,000 ordinary shares of Given Imaging at an exercise price of \$17.78 per share, exercisable in 4 equal annual installments starting from the first, second, third and fourth anniversary, respectively, of the date of grant. In addition, at the same time, Given Imaging allotted to Mr. Shamir 100,000 restricted share units of Given Imaging, exercisable under terms identical to the terms of the options which were granted on that date.
  - (b) In July 2007, Given Imaging allotted to Mr. Shamir options for the purchase of 100,000 ordinary shares of Given Imaging at an exercise price of \$29.42 per share, exercisable in 4 equal annual installments starting from the first, second, third and fourth anniversary, respectively, of the date of allotment thereof.
  - (c) In June 2008, Given Imaging allotted to Mr. Shamir options for the purchase of 100,000 ordinary shares of Given Imaging at an exercise price of \$16 per share, exercisable in 4 equal annual installments starting from the first, second, third and fourth anniversary, respectively, of the date of allotment thereof.
  - (d) In August 2009, Given Imaging allotted to Mr. Shamir options for the purchase of 125,000 ordinary shares of Given Imaging at an exercise price of \$11.55 per share, exercisable in 4 equal annual installments starting from the first, second, third and fourth anniversary, respectively, of the date of allotment thereof.
  - (e) In June 2010, Given Imaging allotted to Mr. Shamir 57,000 restricted share units, 50% of which are locked-up for up to two years and 25% for up to three and four years, respectively, from the allotment date.
  - (f) In May 2011, Given Imaging allotted to Mr. Shamir 42,750 restricted share units, 50% of which are locked-up for up to two years and 25% for up to three and four years, respectively, from the allotment date.

(g) In May 2012, Given Imaging allotted to Mr. Shamir 35,000 restricted share units, 50% of which are locked-up for up to two years and 25% for up to three and four years, respectively, from the allotment date.

The amount indicated in the "Share-Based Payments" column represents the expense recorded by Given Imaging in its financial statements for 2013, according to accounting standard IFRS 2, in respect of the grant of options and restricted share units to Mr. Shamir, as specified above. All options and restricted share units expired or were exercised by the time of the completion of the Given Merger.

- (4) The amount paid by Given Imaging includes all of the following components: 12 monthly salaries, 90% linked to the consumer price index (as of December 2013 – NIS 118,000 (approximately \$34,000)), social benefits and related benefits, as customary, and loss of earning capacity insurance. The engagement between the parties shall terminate 9 months after the date on which either party shall provide the other written notice of his desire to terminate the engagement according to the employment agreement.
- (5) The amount of the bonus for 2013 (the "Annual Bonus") was determined in accordance with the bonus plan for 2013 for the officer, which was approved at the beginning of the same year by the compensation committee, the audit committee and the board of directors of Given Imaging. According to the bonus plan, a target amount was predetermined for the officer in respect of 2013, which is equal to 100% of his total current salaries in this year. The Annual Bonus for the officer was dependent upon two components as specified below, the weight of each component being expressed as a certain percentage of the target amount. Most of the Annual Bonus was dependent upon the component of achieving certain pre-determined sales and net profit targets for Given Imaging on a consolidated basis in 2013, which were expressed in a matrix method according to various possible combinations between sales and profit as aforesaid, and could range between 50% and 200% of the weight of such component in the bonus plan, according to the extent of achievement of such targets, while in the event that the sales level or net profit level were lower than a certain pre-determined minimum threshold, no bonus would be paid in respect of this component. This portion of the 2013 annual bonus was based on Given Imaging's achievement of performance goals for 2013 calculated at 88% of the target level representing Given Imaging's projected performance at the time the Given Merger was signed and announced. The balance of the Annual Bonus was dependent upon the component of achieving certain personal targets predetermined for the officer in accordance with his areas of responsibility, some of which are measurable (such as fulfillment of certain predefined tasks) and some qualitative (such as general level of performance) according to the evaluation of Given Imaging's CEO. Based on all of the components of the said bonus plan, the Annual Bonus for the officer could reach up to a maximum sum of approximately 170% of the total current salaries of the officer in 2013. The calculation and amount of the actual Annual Bonus were also approved by the compensation committee, the audit committee and the board of directors of Given Imaging.

- (6) In his capacity as CFO of Given Imaging, Given Imaging allotted to Mr. Yanai stock options as well as restricted share units under its option plan and restricted share unit grant plan, as follows:
- (a) In March 2007, Given Imaging allotted to Mr. Yanai options for the purchase of 65,000 ordinary shares of Given Imaging at an exercise price of \$20.74 per share, exercisable in 4 equal annual installments starting from the first, second, third and fourth anniversary, respectively, of the date of allotment thereof.
  - (b) In February 2008, Given Imaging allotted to Mr. Yanai options for the purchase of 65,000 ordinary shares of Given Imaging at an exercise price of \$16.04 per share, exercisable in 4 equal annual installments starting from the first, second, third and fourth anniversary, respectively, of the date of allotment thereof.
  - (c) In February 2009, Given Imaging allotted to Mr. Yanai options for the purchase of 70,000 ordinary shares of Given Imaging at an exercise price of \$8.20 per share, exercisable in 4 equal annual installments starting from the first, second, third and fourth anniversary, respectively, of the date of allotment thereof.
  - (d) In February 2010, Given Imaging allotted to Mr. Yanai 32,000 restricted share units, 50% of which are locked-up for up to two years and 25% for up to three and four years, respectively, from the date of allotment thereof.
  - (e) In May 2011, Given Imaging allotted to Mr. Yanai 24,000 restricted share units, 50% of which are locked-up for up to two years and 25% for up to three and four years, respectively, from the allotment date.
  - (f) In March 2012, Given Imaging allotted to Mr. Yanai 10,000 restricted share units, 50% of which are locked-up for up to two years and 25% for up to three and four years, respectively, from the allotment date.
  - (g) In February 2013, Given Imaging allotted to Mr. Yanai 17,000 restricted share units, 50% of which are locked-up for up to two years and 25% for up to three and four years, respectively, from the allotment date.

The amount indicated in the "Share-Based Payment" column represents the expense recorded by Given Imaging in its financial statements for 2013, according to accounting standard IFRS 2, in respect of the grant of options and restricted share units to Mr. Yanai, as specified above. All options and restricted share units expired or were exercised by the time of the completion of the Given Merger.

- (7) Mr. Bronshtein is not employed by us, but by DIC, and within the framework of his position, he also serves as our CEO, in accordance with the Services Agreement with DIC.
- (8) The amount includes all of the following components that are paid by DIC and not by us: 12 monthly salaries linked to the consumer price index (as of December 2013 – NIS 97,000 per monthly salary (approximately \$28,000)), social benefits and related benefits as customary, car allowance (including gross-up) and loss of earning capacity insurance. The engagement between Mr. Bronshtein and DIC shall terminate three months after the date on which either party shall provide the other written notice of its desire to terminate the engagement according to the employment agreement. Commencing from September 2012, Mr. Bronshtein waived 15% of his salary cost for one year.

(9) According to our compensation policy and the resolution adopted to apply the provisions of the variable compensation thereof to the CEO, including for 2013, the annual bonus to the CEO shall not exceed 12 times the monthly cost of his compensation (the "Bonus Cap") where the annual bonus is composed of a component based on the annual return on our share price (50% of the Bonus Cap, the maximum threshold determined for this index being a 20% annual return determined in NIS), a component that is based on measurable goals connected with the performance of the Company and its group companies (the "Measurable Goals") (35% of the Bonus Cap) and a discretionary performance evaluation component (15% of the Bonus Cap). Compliance with more than 100% of the maximum threshold of the share return component may grant more than 100% of this bonus component, such that in the case of an excess return of 5% and more above the maximum threshold, which was determined as aforesaid, an additional amount equal to one month's compensation cost shall be given, in addition to the bonus due to him for this component and subject to the Bonus Cap. In 2013, six Measurable Goals as aforesaid were determined for all of our officers where meeting the full goal entitles the officer to 100% of the bonus component for this goal and meeting an interim goal entitles the officer to 50% of the bonus component for this goal:

Name of Company	Full Goal	Interim Goal	Goal Accomplishment in 2013
BrainsGate	Recruiting 450 patients to FDA trial	Recruiting 350 patients for FDA trial	Interim goal accomplished
Pocared	Concluding FDA trial	collecting more than 1,000 samples for FDA trial	Interim goal accomplished
Kyma	External capital raising of 3\$ million	External capital raising of 1\$ million	Full goal accomplished
CartiHeal	Recruiting 50 patients for a clinical trial	Recruiting 40 patients for a clinical trial	Full goal accomplished
Notal Vision	Submitting PCT code for reimbursement	Concluding the AREDS trial	Full goal accomplished
Elron	Investments in two new companies by Elron or RDC	Investment in one new company by Elron or RDC	Interim goal accomplished

The CEO's bonus component for discretionary performance evaluation was determined by our compensation committee and board of directors on March 4, 2014 and March 11, 2014 respectively. According to the provisions of our compensation policy and since the Company met the threshold conditions set forth in the policy, Mr. Bronshtein is entitled to an annual bonus for 2013 in the sum of NIS1,691,000 which constitutes 11.8 times his monthly compensation cost. According to the principles of our compensation policy, a portion of the bonus in the amount of NIS143,000 (including linkage from December 31, 2013) shall be paid to Mr. Bronshtein shortly after the date of approval of the financial statements for 2014, subject to meeting threshold conditions set forth in the compensation policy.

- (10) The amount includes all of the following components: 12 monthly salaries, such that the salary is linked to the consumer price index and is updated accordingly once every 3 months (as of December 2013 – NIS 131,000 per monthly salary (approximately \$38,000)), social benefits and related benefits, as customary and accommodation expenses. In May 2007, our shareholders approved (following approval by our audit committee and board of directors) the engagement in an agreement with Mr. Arie Mientkavich for his employment as the Chairman of the board commencing January 8, 2007. According to the agreement, Mr. Mientkavich will be employed on a part-time (50%) basis. Commencing from September 2012, Mr. Mientkavich waived 25% of his salary cost for a period of one year. The engagement between the parties shall terminate 3 months after the date on which either party shall provide the other written notice of his desire to terminate the engagement according to the employment agreement. Since January 1, 2014, Mr. Mientkavich agreed to reduce his monthly salary to NIS 85,000 as long as our compensation policy that was approved on January 12, 2014 shall be in effect and applicable to him. The amount of the severance pay to which Mr. Mientkavich shall be entitled shall be calculated proportionally to the amount of Mr. Mientkavich's average fixed salary during the years of his service at Elron, such that the amount of the severance pay accumulated for each year shall be based on the salary that he actually received in that year. If and insofar as Mr. Mientkavich gives or receives notice of the termination of his office in the course of 2014, his compensation for or in lieu of the advance notice period shall be paid based on the last compensation that he received prior to the reduction. From 2015 onwards, his compensation for or in lieu of the advance notice period shall be paid based on his compensation on the date of termination of the employment.
- (11) According to our compensation policy and the resolution adopted to apply the provisions thereof to the Chairman, including for 2013, Mr. Mientkavich is entitled to receive an annual bonus which shall not exceed 12 times a bonus cap equal to the monthly cost of his compensation in accordance with principles described in sub paragraph 9 above. In light of Mr. Mientkavich's consent to reduce his fixed monthly compensation commencing from January 1, 2014, as described above, his bonus cap was reduced for 2013 in an amount equal to the difference between his annual fixed compensation cost for 2013 and the annual compensation cost determined in our compensation policy such that his bonus cap for 2013 was determined in the amount of NIS 739,000.

Mr. Mientkavich's bonus component for discretionary performance evaluation was determined by our compensation committee and board of directors on March 4, 2014 and March 11, 2014 respectively. According to the provisions of our compensation policy and since the Company met the threshold conditions set forth in the policy, Mr. Mientkavich is entitled to an annual bonus for 2013 in the sum of NIS739,000. According to the principles of our compensation policy, a portion of the bonus in the amount of NIS116,000 (including linkage from December 31, 2013) shall be paid to Mr. Mientkavich shortly after the date of approval of the financial statements for 2014, subject to meeting threshold conditions set forth in the compensation policy.

On March 10, 2011, our board of directors approved (following approval by our audit committee) a payment of a bonus to Mr. Mientkavich of NIS 1,200,000 (approximately \$334,000) for the year 2010. This bonus was not presented to the general meeting of the shareholders for approval, and has not been paid. Due to the fact that the bonus was not ultimately paid, despite having been approved, the Chairman approached us and proposed that the bonus will be a performance bonus in lieu of the cash bonus, such that the value of the performance bonus will be only approximately 45% of the value of the cash bonus that was previously approved but not paid, and will include an option component that is directly linked to our performance or to significant challenges facing us. Due to the importance of Pocared to us and to our holdings, it was proposed that in lieu of the aforementioned cash bonus, we approve the grant of (phantom) options of Pocared, namely the right to receive the benefit of the increase in value of certain of our Pocared shares, to the Chairman from our Pocared shares, which shall only be cash exercisable. On February 1, 2012, our shareholders (following approval of our audit committee and board of directors), approved the granting of phantom options with respect to 375,722 Preferred F Shares of Pocared to the Chairman, representing 2% of our holdings in Pocared's Preferred F Shares (approximately 0.5% of Pocared's share capital). The exercise price per share of each option shall be \$0.605, exercisable until the fourth anniversary of the date of approval by our shareholders.



The amount indicated in the "Share-Based Payment" column includes approximately \$18,000 which we recorded as an income in our financial statements for 2013 (as a result of the decrease in the value of the options), in respect to the grant of the phantom options, as specified above. For details on the board of directors' considerations regarding the Chairman's overall compensation, see "Item 6B" above.

- (12) In his capacity as a director at Given Imaging, Given Imaging allotted to Mr. Mientkavich stock options as well as restricted share units under its option plan and restricted share unit grant plan, as follows:
- (a) In July 2007, Given Imaging allotted to Mr. Mientkavich options for the purchase of 35,000 ordinary shares of Given Imaging at an exercise price of \$29.42 per share, exercisable in 4 equal annual portions starting from the first, second, third and fourth anniversary, respectively, of the date of allotment thereof.
  - (b) In June 2008, Given Imaging allotted to Mr. Mientkavich options for the purchase of 10,000 ordinary shares of Given Imaging at an exercise price of \$16 per share, exercisable from the first anniversary of allotment thereof.
  - (c) In August 2009, Given Imaging allotted to Mr. Mientkavich options for the purchase of 10,000 ordinary shares of Given Imaging at an exercise price of \$11.55 per share, exercisable from the first anniversary of allotment thereof.
  - (d) In June 2010, Given Imaging allotted to Mr. Mientkavich 4,545 restricted share units, that were locked-up until the general shareholders meeting of Given Imaging which took place at the end of May 2011.
  - (e) In May 2011, Given Imaging allotted to Mr. Mientkavich 4,545 restricted share units, that were locked-up until the date of Given Imaging's next general shareholders meeting which took place at the end of May 2012.
  - (f) In May 2012, Given Imaging allotted to Mr. Mientkavich 4,545 restricted share units.
  - (g) In October 2013, Given Imaging allotted to Mr. Mientkavich 5,233 restricted share units.

The amount indicated in the "Share-Based Payment" column includes approximately \$73,000 recorded by Given Imaging as an expense according to accounting standard IFRS 2, in respect of the grant of options and restricted share units to Mr. Mientkavich. All options and restricted share units expired or were exercised by the time of the completion of the Given Merger

- (13) The amount includes all of the following components: 12 monthly salaries of NIS 97,000 each (approximately \$28,000), social benefits and related benefits as customary in the United States, health insurance and car allowance. The engagement between the parties shall terminate 6 months after the date on which either party shall provide the other written notice of its desire to terminate the engagement according to the employment agreement.
- (14) The amount of the bonus for 2013 (the "Annual Bonus") was determined in accordance with the bonus plan for 2013 for the officer, which was approved at the beginning of the same year by the compensation committee, the audit committee and the board of directors of Given Imaging. According to the bonus plan, a target amount was predetermined for the officer in respect of 2013, which is equal to 60% of his total current salaries in this year. The Annual Bonus for the officer was dependent upon three components, the weight of each component being expressed as a certain percentage of the said target amount. Most of the Annual Bonus was dependent upon the component of achieving certain target sales in the Americas and could reach 110% of the weight of such component in the bonus plan. In the event that the sales level is lower than a certain pre-determined minimum threshold, no bonus will be paid in respect of this component. This portion of the 2013 annual bonus was based on Given Imaging's achievement of performance goals for 2013 calculated at 88% of the target level representing Given Imaging's projected performance at the time the Given Merger was signed and announced. The balance of the bonus was dependent upon the component of achieving certain predetermined personal targets for the officer in accordance with his areas of responsibility, some of which are measurable (such as fulfillment of certain predefined tasks) and some qualitative (such as general level of performance) according to the evaluation of Given Imaging's board of directors. Based on all of the components of the said bonus plan, the Annual Bonus for the officer could reach up to a maximum sum of approximately 110% of the total current salaries of the officer in 2013. The calculation and amount of the actual Annual Bonus were also approved by the compensation committee, the audit committee and the board of directors of Given Imaging.
- (15) In his capacity as President of the subsidiary of Given Imaging in the United States, Given Imaging allotted to Mr. Baldino restricted share units under its restricted share unit grant plan, as follows:
  - (a) In June 2010, Given Imaging allotted to Mr. Baldino 25,000 restricted share units, 50% of which are locked-up for up to two years and 25% for up to three and four years, respectively, from the allotment date.

- (b) In February 2011, Given Imaging allotted to Mr. Baldino 10,000 restricted share units, 50% of which are locked-up for up to two years and 25% for up to three and four years, respectively, from the allotment date
- (c) In March 2012, Given Imaging allotted to Mr. Baldino 15,000 restricted share units, 50% of which are locked-up for up to two years and 25% for up to three and four years, respectively, from the allotment date.
- (d) In February 2013, Given Imaging allotted to Mr. Baldino 16,000 restricted share units, 50% of which are locked-up for up to two years and 25% for up to three and four years, respectively, from the allotment date.

The amount indicated in the "Share-Based Payment" column represents the expense recorded by Given Imaging in its financial statements for 2013, according to accounting standard IFRS 2, in respect of restricted share units to Mr. Baldino as specified above. All options and restricted share units expired or were exercised by the time of the completion of the Given Merger.

- (16) Mr. Elad is not employed by us, but by DIC. Mr. Elad dedicates 100% of his time to fulfilling his capacity of our Vice President and Chief Financial Officer. For details regarding the period of employment of Mr. Elad by us prior to the commencement of his employment by DIC in accordance with Services Agreement, see "Item 6A" below.
- (17) The amount includes all of the following components that are paid by DIC and not by us: 12 monthly salaries linked to the consumer price index (as of December 2011 – NIS 50,000 per monthly salary (approximately \$14,000)), social benefits and related benefits as customary, car allowance and loss of earning capacity insurance. The engagement between Mr. Elad and DIC shall terminate one month after the date on which either party shall provide the other written notice of its desire to terminate the engagement according to the employment agreement. Commencing from September 2012, Mr. Elad waived 15% of his salary cost for one year.
- (18) According to our compensation policy and the resolution adopted to apply the provisions thereof to the CFO including for 2013, Mr. Elad is entitled to receive an annual bonus which shall not exceed 10 times a bonus cap equal to the monthly cost of his compensation in accordance with principles described in sub paragraph 9 above. Mr. Elad's bonus component for discretionary performance evaluation was determined by our compensation committee and board of directors on March 4, 2014 and March 11, 2014 respectively. According to the provisions of our compensation policy and since the Company met the threshold conditions set forth in the policy, Mr. Elad is entitled to an annual bonus for 2013 in the sum of NIS710,000 which constitutes 10 times his monthly compensation cost. According to the principles of our compensation policy, a portion of the bonus in the amount of NIS71,000 (including linkage from December 31, 2013) shall be paid to Mr. Elad shortly after the date of approval of the financial statements for 2014, subject to meeting threshold conditions set forth in the compensation policy.

### ***Agreements & Arrangements with Directors***

*Terms of Employment of Chairman of the board of directors.*

In May 2007, following approval of our audit committee and board of directors, our shareholders approved the terms of employment of the Chairman of our board of directors, Mr. Arie Mientkavich, commencing as of January 8, 2007. The principal terms of employment are described in this "Item 6B" above.

### **C. Board Practices**

Except for our Chairman of the board of directors, none of our directors have service contracts with us or any of our group companies that provide for benefits upon termination of employment. See "Item 6 – Directors, Senior Management and Employees – Agreements & Arrangements with Directors".

#### ***Board of Directors***

Our Articles of Association provide for a board of directors of not less than five members and no more than fifteen members, including external directors. Currently, we have 8 directors. Each director, other than external directors, is elected to serve until the end of the first annual meeting following their appointment. However, if no directors are elected at such annual meeting, the then-present directors will continue in office. The board of directors may appoint additional directors, provided that the total number of directors does not exceed the maximum number of fifteen as mentioned above. A director appointed as such will serve until the end of the next annual meeting held following his or her appointment, and he or she will be eligible for re-appointment. Notwithstanding any of the above, any director, other than external directors, may be removed from office by an ordinary resolution of a general shareholders' meeting or by two-thirds of the directors. A director need not hold any of our shares to qualify as one of our directors. Our Articles of Association provide that our board of directors may delegate its powers to its committees, subject to limitations determined by the Israeli Companies Law.

#### ***Independent Directors***

An "Independent Director" is defined under the Israeli Companies Law as an external director or a director who meets the following conditions: (i) satisfies certain conditions for appointment as an external director (as described below) and the audit committee has determined that such conditions have been met, and (ii) he or she has not served as a director of the company for more than nine consecutive years, with any interruption of up to two years in his or her service not being deemed a disruption in the continuity of such service.

Under the Israeli Companies Law's provisions, the audit committee must consist of at least three directors and must include all of the external directors. The majority of the members of the audit committee are required to be "independent". In addition, the quorum required for deliberations and resolutions is a majority of the audit committee's members, the majority of whom must be independent directors, and at least one of whom is an external director. Our directors who qualify as independent directors under the Israeli Companies Law are: Gad Arbel, Ehud Rassabi and Arie Ovadia, constituting a majority of the members of our audit committee.

### ***Substitute Directors***

Under our Articles of Association, any director, other than an external director, may, by written notice to us, appoint another person to serve as a substitute director and may also cancel such appointment at any time. The identity of a substitute director requires the approval of the board of directors. Under the Israeli Companies Law, the following persons may not be appointed as a substitute director: (i) any person who is not himself or herself qualified to be appointed as a director; (ii) a person who is already serving as a director; or (iii) a person who is already serving as a substitute director for another director. Nevertheless, a director may be appointed as a substitute director for a committee of the board of directors if he or she is not already serving as a member of the committee. Under the Israeli Companies Law, a substitute director may not be appointed as an external director except for a committee of the board of directors as described above, and provided that the substitute director is an external director who has "professional capability" or "financial and accounting expertise", according to the qualification of the relevant external director.

The term of appointment of a substitute director may be for one meeting of the board of directors, for a specified period or until notice is given of the cancellation of the appointment. To our knowledge, no director currently intends to appoint any other person as a substitute director, except if the director is unable to attend a meeting of the board of directors.

### ***External Directors***

The Israeli Companies Law requires Israeli companies with shares that have been offered to the public (i.e. public companies) to appoint at least two external directors. No person may be appointed as an external director if:

- the person is a relative of the controlling shareholder,
- the person or the person's spouse, siblings, parents, grandparents, descendants, spouses' descendants, siblings or parents, or the spouses of any of the foregoing (collectively, a "relative"), partner, employer, anyone that the person is subordinated to directly or indirectly, or any entity under the person's control, has as of the date of the person's appointment as external director, or had, within the two years preceding the date of the person's appointment as external director, any affiliation with the company, the controlling shareholder in the company, a relative of the controlling shareholder, or an entity in which, currently or within the two years prior to the appointment date, the controlling shareholder was the company or the company's controlling shareholder, and additionally, in a company without a controlling shareholder, or without a shareholder holding 25% or more of the voting rights in the company any affiliation, on the appointment date, with the chairman of the board of directors, the chief executive officer, a significant shareholder (a shareholder holding 5% or more of the company's shares or voting rights), or the senior financial officer

The term "affiliation" includes:

- an employment relationship;

- a business or professional relationship maintained on a regular basis, subject to certain exclusions;
- control; and
- service as an "office holder", as defined below in "Item 10 – Additional Information – Memorandum and Articles of Association", excluding service as a director who was appointed to serve as an external director in a company which is going to initially offer its shares to the public.

Without derogating from the above, no person may serve as an external director if the person's position or other business activities create, or may create, a conflict of interest with the person's responsibilities as a director or may otherwise interfere with the person's ability to serve as a director. A director in a certain company may not be appointed as an external director in another company if at the same time a director from the latter serves as an external director in the former. No person may serve as an external director if the person is an employee of the Israeli Securities Authority or of an Israeli stock exchange. Without derogating from the abovementioned, no person may serve as an external director if the person, the person's relative, the person's partner, the person's employer, anyone to whom the person is directly or indirectly subordinated, or any entity under the person's control, has a business or professional relationship with a party with which an affiliation is prohibited, even if the relationships are on an irregular basis, unless the relationships are negligible. No person may serve as an external director if the person received any direct or indirect compensation for the person's service as a director in the company, other than the directors' fees and expenses reimbursement to which the person is entitled. If, at the time an external director is to be appointed, all current members of the board of directors who are not controlling shareholders in the company or their relatives are of the same gender, then the appointed external director must be of the other gender.

Under the Israeli Companies Law, a public company is required to appoint as an external director, a person who has "professional capability" or a person who has "financial and accounting expertise," provided that at least one of the external directors must have "financial and accounting expertise." In addition, the board of directors of a public company is required to determine the minimum number of directors with "financial and accounting expertise." The qualifications for "professional capability" and "financial and accounting expertise" are determined by regulations adopted under the Israeli Companies Law. In March 2006, we determined the minimum number of directors with "financial and accounting expertise" serving on our board of directors to be two. The following directors have been designated as directors with financial and accounting expertise: Mr. Arie Mientkavich, Mr. Avraham Asheri, Mr. Gad Arbel, Mr. Ami Erel, Dr. Arie Ovadia and Mr. Ehud Rassabi.

External directors are to be appointed by a majority vote at a shareholders' meeting, provided that either:

- The majority of shares voted at the meeting, including at least a majority of the shares held by non-controlling shareholders, or by disinterested shareholders (unless the personal interest does not derive from relationships with the controlling shareholder), which voted at the meeting, vote in favor of appointment of the director, without taking abstentions into account. According to the Israeli Companies Law, a "controlling shareholder" is a person who has the ability to direct the activities of a company, other than if this power derives solely from his/her position on the board of directors or any other position with the company. A person is presumed to be a controlling shareholder if he or she holds half or more of the following: (i) voting rights in the general meeting, or (ii) rights to appoint directors or the chief executive officer; or

- The total number of shares held by the shareholders mentioned above, which voted against the election of the director, does not exceed two percent of the aggregate voting rights in the company.

The initial term of an external director is three years and may be extended for two additional three year periods, if the board of directors proposes the external director's appointment for another term and the appointment is approved by a majority vote at a shareholders' meeting as described above, or if one or more shareholders holding at least one percent of the aggregate voting rights in the company proposes the external director's appointment for another term and the appointment is approved by a majority vote at a shareholders' meeting, provided that:

- The majority of shares voted at the meeting exclude shares held by controlling shareholders, shares held by interested shareholders (unless the personal interest does not derive from relationship with the controlling shareholder), and abstentions.
- The total number of shares which voted for the election of the director which are held by non-controlling shareholders, or by disinterested shareholders (excluding interest that does not derive from a relationship with the controlling shareholder), exceeds two percent of the aggregate voting rights in the company. The Minister of Justice may amend this proportion.

There will be additional limitations on the appointment of such external director if proposed by a shareholder as described under a recent amendment to the Companies Law, Notwithstanding the above, a company may include a provision in its Articles of Association limiting the aggregate term of an external director to six years. Our Articles of Association do not include such provision.

Mr. Ehud Rassabi is currently serving his initial three year term as an external director which ends in March 2015, having been appointed in March 2012. Mr. Gad Arbel is currently serving his second three-year term as an external director which ends in October 2014. External directors may be removed only in a general meeting by the same majority vote of shareholders that is required for their election, or by a court, and in both cases, only if the external directors cease to meet the statutory qualifications for their appointment or if they violate their duty of loyalty to the company. Each committee that has been authorized to exercise any of the powers of a company's board of directors must include at least one external director, and all of the external directors must be members of the audit committee.

Under the Israeli Promotion of Competition and the Reducing of Centralization Law, as of June 11, 2014 and as long as we shall continue to be considered at least a third-tier company according to the such law, our board of directors will be required to consist of a majority of independent directors, and the number of our external directors will be required to constitute at least half of our board members after such half is reduced by one, rounded up, and include no less than two external directors. The law also stipulates special appointment provisions for such external directors.

An external director is entitled to compensation in accordance with the regulations adopted under the Israeli Companies Law and is otherwise prohibited from receiving any other compensation, directly or indirectly, in connection with the service provided as an external director.

#### ***Audit Committee***

The Israeli Companies Law requires public companies to appoint an audit committee. The responsibilities of the audit committee include: identifying irregularities in the management of the company's business; approving related party transactions as required by law and determining whether or not they are material and/or extraordinary; determining whether to carry out competitive procedures or other procedures before any engagement in transactions with controlling shareholders or in which a controlling shareholder has a personal interest; determining the approval procedures of transactions with controlling shareholders or in which a controlling shareholder has a personal interest that are immaterial and not negligible, and the types of such transactions that will be subject to the approval of the audit committee; examining the internal audit in the company, the performance of the internal auditor, and if the necessary resources and tools have been made available to the internal auditor considering the company's needs and size; examining the scope and fees of the independent auditor and providing recommendations to whomever approves these fees; determining procedures for handling employees' complaints regarding irregularities in the management of the company's business and providing these employees with the appropriate protection.

An audit committee must consist of at least three directors, including, as mentioned, all of the external directors of the company, and a majority of its members must be independent directors as defined in the Israeli Companies Law (see above). The chairman of the audit committee must be an external director. The chairman of the board of directors, any director employed by or otherwise providing services on a regular basis to the company, its controlling shareholder, or a company under the controlling shareholder's control, any director whose main source of income derives from the controlling shareholder, and a controlling shareholder or any relative of a controlling shareholder, may not be a member of the audit committee. The quorum required for deliberations and resolutions is a majority of the audit committee's members, the majority of whom must be independent directors as defined in Israel Companies Law, and at least one of whom is an external director.

The purpose of our audit committee, as stated in the committee's charter, is to oversee, the following on behalf of the Company's board of directors: (i) the integrity of our financial statements; (ii) the appointment, compensation, qualifications, independence and work of our independent auditors; (iii) our compliance with legal and regulatory requirements; and (iv) the performance of our internal audit and controls function. In addition, the committee will be responsible for: (v) determining any deficiencies in our business administration, *inter alia*, by consulting with our internal auditor or independent auditors and making proposals to the board of directors regarding ways of correcting such deficiencies, (vi) resolving whether to approve acts and transactions with related parties requiring the approval of the committee under sections 255 and 268 through 275 of the Israeli Companies Law, and (vii) establishing complaint procedures.



Both of our external directors, Ehud Rassabi and Gad Arbel, as well as Avraham Asheri and Arie Ovadia serve on the audit committee. All members of our Audit Committee meet the definition of independent directors under the SEC Rules. None of them is an associate person of us or has received any consulting, advisory or other compensatory fee from us, other than in their capacity as directors. We believe that Arie Ovadia qualifies as a financial expert under the SEC Rules. Mr. Gad Arbel is chairman of our audit committee.

We have adopted an internal enforcement program in the securities field (i.e., relating to the provisions of the Israel Securities Law, and its accompanying regulations, as well as the provisions of related laws including the provisions of the Israel Companies Law), whose purpose is to ensure and enforce our compliance and the compliance of our directors, other officers, and employees (and also related parties, insofar as the relevant laws apply to them) (the "Employees") to legal requirements in the securities field, including through procedures we have adopted and/or will adopt from time to time, in this field. The program determines arrangements relating, among other things, to the way the procedures are implemented in the Company, the existence of effective supervision, reporting, and monitoring mechanisms, and the determination of ways to handle and draw conclusions from failures and violations (insofar as they arise). The program was formulated based on our unique characteristics as a holding company and our operating environment, among other things, by carrying out a compliance review in the securities field and by mapping our compliance with the provisions of the Israel Companies Law, 1999.

Mr. Yaron Elad, our Chief Financial Officer, and Mr. Paul Weinberg, Adv., our Corporate Secretary, were appointed by our board of directors as internal enforcement officers. The internal enforcement officers' role is to ensure (themselves or through our other personnel) that the program is carried out efficiently and effectively, including by means of monitoring, holding training and absorption sessions, and updating our management and board of directors regarding the program's implementation and unusual events.

The procedures that we adopted and/or will adopt from time to time in the securities field constitute and will constitute an integral part of the enforcement program. These procedures include, among others, procedures relating to a public company's compliance with reporting requirements (including designated procedures for related parties and group companies), maintaining a culture of compliance, preventing fraud and manipulation, restricting the use of inside information, locating related party transactions, regulating the board of director's work and functions, and communicating with parties outside of the Company. We have also required our group companies and may require them from time to time to adopt procedures in various subjects whose purpose is to ensure our and the Employees' compliance with the provisions of the securities field. The procedures regulate activity and behavior norms as well as work processes whose purpose is to address and oversee central processes in the subjects they regulate.

The program is also subject to a periodic review of its suitability and to being updated, as necessary. We will continue to set and adopt additional procedures and update existing procedures, as necessary, in order to regulate additional processes, and to codify everyday practices and formulate additional procedures.

### *Financial Statements Committee*

The Israeli Companies Law requires public companies to appoint a financial statements committee whose function is to examine the company's financial statements and provide its recommendations to the board of directors before the latter approves them. On December 27, 2010, our board of directors appointed the audit committee to serve as our financial statements committee. The financial statements committee is the organ in charge of the oversight of the financial statements, and the board of directors is the organ in charge of approval of the financial statements.

All members of the financial statements committee comply with the rules set forth in the Israeli Companies Law, including being able to read and understand financial statements, and have provided us with declarations to that effect. In determining that the committee members are able to read and understand financial statements, we considered, inter alia, their education, experience, qualifications and knowledge on business-accounting matters and financial statements.

Prior to the independent auditor's audit, the committee conducts a discussion at which the independent auditor presents the annual financial statements audit plan. The committee holds discussions and makes recommendations to the board of directors regarding the approval process of the financial statements, and delivers its recommendations to the board of directors reasonably sufficient time prior to the approval of the financial statements by the board of directors, and reports thereto on any deficiency or problem, if any, having arisen during the examination. Our independent auditor is invited to and attends the committee's meetings, as well as the board meetings at which the financial statements are discussed and approved, at which he addresses the audit performed. In addition, the internal auditor attends the committee's meetings.

The committee examines, inter alia, through a detailed presentation by our officers and other company personnel, including our CEO and CFO, the following issues, and makes recommendations thereon to the board of directors: the material issues in the financial reporting, including transactions outside the ordinary course of business (if any), the material estimates and critical assessments used in the financial statements, the valuations, including their underlying assumptions and estimates, on which data in the financial statements are based, the integrity and appropriate disclosure in the financial statements, the reasonableness of the data, the accounting policies adopted and any changes therein, implementation of the principle of due disclosure in the financial statements and related information, the internal controls over the financial reporting and their effectiveness, and various aspects of risk control and management, both such that are reflected in the financial statements (such as the report on financial risks), and such that affect the reliability of the financial statements. If necessary, the committee requests comprehensive reviews on issues of particularly material impact.

The approval of the annual financial statements involves at least three meetings: Two of the financial statements committee, prior to the board of directors' meeting, for a comprehensive, in-principle discussion of the material reporting issues and the formulation of recommendations to the board of directors, and the third – of the board of directors, for discussion and approval of the financial statements.

### ***Compensation Committee***

Under the Israeli Companies Law, an Israeli public company has to nominate a compensation committee which has to be comprised of at least three directors including all of the external directors.

Both of our external directors, Ehud Rassabi and Gad Arbel, as well as Arie Ovadia serve on the compensation committee.

The role of the compensation committee is to recommend on a compensation policy for directors and officers and necessary updates; to approve certain terms of office and employment of directors and officers specified in the Israeli Companies Law; and to decide whether to exempt approval of terms of office for a CEO from shareholders' approval, in certain circumstances.

On November 26, 2013 our compensation committee approved, a compensation policy for officers of the Company, which was later approved by the company's Board of Directors and by the Company's shareholders.

### ***Internal Auditor***

Under the Israeli Companies Law, the board of directors of public companies must appoint an internal auditor, nominated by the audit committee. The role of the internal auditor is to examine, among other matters, whether the company's actions comply with the law and with orderly business procedure. Under the Israeli Companies Law, the internal auditor may be an employee of the company but not an office holder (as defined below in "Item 10 – Additional Information – Memorandum and Articles of Association"), an interested party, a relative of an office holder or an interested party, and he or she may not be the company's independent accountant or its representative. According to the Israeli Companies Law, an "interested party" is defined as a shareholder who holds 5% or more of the outstanding share capital or voting power, a director, a general manager or a shareholder who has the right to appoint at least one director or the general manager.

Doron Cohen, a partner of Fahn Kanne Control Management Ltd, a member of Grant Thornton International, is our internal auditor. Mr. Cohen's appointment as our internal auditor was approved by our audit committee in January 2004, and by our board of directors in March 2004, effective from February 1, 2004, after taking into consideration his education, qualifications and experience in internal audits, and the type, scope and complexity of our activity. Mr. Cohen holds a Bachelor's degree in business administration from the College of Management Academic Studies, specialty in accounting. Since 1998, Mr. Cohen has held the position of internal auditor in public and private companies, government bodies, and local authorities. Mr. Cohen is not an interested party or office holder of ours, or their relative, nor is he our independent auditor or anyone working on his behalf. Mr. Cohen does not fill any position in the Company apart from that of internal auditor. To the best of our knowledge, Mr. Cohen does not hold another position outside of the Company which creates or may create a conflict of interest with his position as our internal auditor. To the best of our knowledge, Mr. Cohen does not hold any of our shares or shares of our affiliates, nor does he have material business relations or other material ties with us or any of our affiliates. Our chairman of the board of directors is designated to be in charge of our internal auditor.

*Internal auditor's work plan:* Our internal auditor's work plan is a four-year plan, and is based on an update of a risk survey which was conducted by us dated January 21, 2007 and updated in 2011. Each year the four-year audit plan, including that year's plan, is updated and approved. The plan is updated and approved following deliberations that are held with our management and members of our audit committee, such that within 3-4 years most of the risk factors will be audited. The internal auditor is authorized to deviate from such plan subject to reporting to our audit committee and receiving its consent for the proposed change. In addition, the audit committee is authorized to direct the internal auditor to deviate from the audit plan during the year. In 2013, our internal auditor examined, inter alia, our compliance with the internal compliance plan, which adoption of such plan was finalized in 2012, and our compliance with the investment policy and sale of holdings. In addition, our internal auditor performed additional audits as part of the fraud prevention plan which was adopted by us.

*Audits abroad or of subsidiaries:* We have no overseas activity other than the holding of certain corporations outside of Israel. The annual internal audit plan addresses whether or not internal audits have been carried out in our material group companies, but does not address their activity in Israel or abroad. Some of our material group companies have their own internal auditors. Our internal audit plan does not include an audit of these companies. However, the internal auditor receives internal audit reports from the internal auditors of these companies insofar as the law permits.

*Scope of employment:* Approximately 500-700 hours per year according to the work plan, while in 2013, the internal auditor invested approximately 615 hours, which included audits carried out in our group company Pocared (70 hours) and BrainsGate (60 hours). In the opinion of our board of directors, the internal audit's work plan as well as the scope of employment which was determined to execute such plan are appropriate for our needs. Insofar as required, we are able to expand the aforesaid scope of employment.

*Conducting the internal audit:* The audit was conducted according to accepted professional standards, in accordance with the Israeli Internal Audit Law and the standards issued by the Institute of Internal Auditors. The audit committee and the board of directors relied on the internal auditor's reports pertaining to his compliance with professional standards according to which he conducts the audit.

*Access to information:* The internal auditor and his employees have access to information as provided in the Israeli Internal Audit Law, including continuous and direct access to our information systems and those of our group companies which are audited, including financial data.

*Internal auditor's reports:* Our internal auditor's reports are submitted in writing. The internal auditor's reports are distributed to the chairman of our board of directors, our management and our audit committee. During the period covered by this Annual Report, one internal audit report was submitted in respect of the 2012 work plan and three reports were submitted in respect of the 2013 work plan. The reports were distributed prior to the audit committee meetings at which these reports were discussed, on May 5, 2013, August 8, 2013, November 3, 2013 and November 7, 2012. An additional report in respect of the 2013 work plan was distributed prior to the audit committee meeting at which this reports was discussed on March 4, 2014.

*Board of directors' evaluation:* In the board of directors' opinion, the scope, nature and continuousness of our internal auditor's activity and his work plan are reasonable under the circumstances, and they fulfill our internal audit goals.

*Remuneration:* Our internal auditor is paid based on actual hours worked. The cost of our internal auditor's employment in 2013 was approximately NIS 135,000 (approximately \$37,000). In the opinion of the board of directors, the compensation paid to the internal auditor does not influence the exercise of his professional discretion.

#### **D. Employees**

In accordance with the Services Agreement entered into with DIC, we receive managerial and administrative services through staff employed by DIC, some of whom were previously employed by us. As a result, except for the Chairman of our board of directors, we do not employ any personnel.

Other than the CEO and CFO who are to be appointed by us subject to the approval of DIC and our board of directors, and except the comptroller, general counsel and corporate secretary who are proposed and appointed by us subject to the approval of DIC, the management services we receive from DIC are performed by persons designated by DIC, all of whom are employed or otherwise engaged by DIC. We are entitled to obligate DIC to terminate the engagement of any of the DIC employees engaged in our business. For more information, see "Item 7—Major Shareholders and Related Party Transactions—Related Party Transactions."

#### **Material Changes**

In November 2013, Mr. Dori Manor resigned as a director of the Company, and in January 2014, Ms. Rona Dankner resigned as director of the Company. In July 2013, Mr. Gadi Veinrib resigned as an officer of the Company. The following table sets forth, for the last three financial years, the number of our employees:

<b>As of December 31,</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
Management and Administration	1*	1*	1*

\* As of March 1, 2014, an additional 11 persons are employed by DIC and provide services to us through the Services Agreement entered into with DIC.

### *Israeli Employment Law and Practices*

Israeli employment laws, and extension orders based upon provisions of the collective bargaining agreements between the Histadrut (i.e., the General Federation of Labor in Israel) and the Coordination Bureau of Economic Organizations (including the Industrialists' Associations), are applicable to employees in Israel. These provisions concern principally the length of the work day, minimum wages, procedures for dismissing employees, determination of severance pay and other conditions of employment.

Israeli law generally requires payment of severance pay, upon the retirement or death of an employee or termination of employment under certain circumstances. The severance pay amounts to approximately one month salary for each year of employment. The severance pay may be funded through monthly allocations by the employer to a pension plan, as described below. Furthermore, Israeli employees and employers are required to pay predetermined sums to the National Insurance Institute, which is similar to the United States Social Security Administration. Such amounts also include payments for national health insurance. In addition, Israeli law requires employers to make mandatory pension payments on behalf of their employees.

Under the Israeli Law, the contribution of certain additional funds on behalf of employees to a pension plan (of which there are two main types: Managers' Insurance and Pension Fund, some employees combine between the two types) is required. A Pension Plan provides a combination of savings plan, insurance and severance pay benefits to the employee. As general practice, each employee contributes an amount equal to 5% of his or her salary, and the employer contributes between 13.3% and 15.8% of the employee's salary which also includes the mandatory pension payments required by applicable law and allocations to severance pay.

Pursuant to the Services Agreement, except for the Chairman of our board of directors, all of our staff are employed by DIC. Accordingly, except as provided otherwise in the Services Agreement, DIC shall determine the practices applicable to such employees.

### **E. Share Ownership**

The number of our ordinary shares beneficially owned by each of our directors, and by our directors and officers as a group, as of February 28, 2014, is Nil. This excludes shares beneficially owned by DIC, IDBD or IDBH.

### *Stock Option Plans*

During May 2003, our board of directors adopted the 2003 Option Plan which was subsequently ratified by our shareholders on November 30, 2003. Under this plan, options to purchase an aggregate of up to 500,000 ordinary shares may be granted. In March 2007, the 2003 option plan was increased by an additional 500,000 options to purchase 500,000 of our ordinary shares. The 2003 Option Plan provides that the exercise price per share shall be reduced by an amount equal to the amount of any dividend per share distributed. The optionees are entitled to exercise 25% of the amount granted, each year, commencing on first anniversary of the date of grant and expiring five years after the date of grant. In granting the options, the board of directors selected the capital gains tax track pursuant to the Israeli tax legislation which came into effect on January 1, 2003. On March 31, 2013, all options then outstanding under the Plan expired and accordingly, as of date of publication of this Annual Report, there were no options to purchase our ordinary shares granted to our officers and employees outstanding. For more details see "Item 10—Additional Information—Taxation—Employee Stock Options."

In February 2012, we granted the Chairman of our board of directors and another recipient phantom options in relation to our Pocared shares, namely the right to receive the benefit of the increase in value of certain of our Pocared shares, representing then 1.4% of Pocared's share capital. For details regarding the phantom options granted to the Chairman of our board of directors, see "Item 6B" above.

**Item 7. Major Shareholders and Related Party Transactions**

**A. Major Shareholders**

The following table sets forth, as of February 28, 2014 unless otherwise specified, the number of our ordinary shares beneficially owned by all shareholders known to us to beneficially own more than 5% of our ordinary shares, based on notifications provided to us shortly before the date of filing this Annual Report. The voting rights of our major shareholders do not differ from the voting rights of other holders of our ordinary shares. As of February 26, 2014, there were a total of 315 holders of record of our ordinary shares, of which 209 were registered with addresses in the United States. We believe that the number of beneficial owners is substantially greater than the number of record holders, because a large portion of our ordinary shares is held of record in broker "street names." As of March 1, 2014, United States holders of record held approximately 16.7% of our outstanding ordinary shares.

<u>Name and Address</u>	<u>Number of Ordinary Shares</u>	<u>Percent of Outstanding Ordinary Shares</u>	<u>Percent of Ordinar Shares on a fully diluted basis</u>
Discount Investment Corporation Ltd. (1) Tel Aviv, Israel	14,966,339	50.32%	50.32%

The above table does not include: (i) 142 of our ordinary shares held by indirect subsidiaries of IDBD for their own account; (ii) 1,342,098 of our ordinary shares (approximately 4.5% of our outstanding and fully diluted share capital) held for members of the public through, among others, provident funds, mutual funds, pension funds and insurance policies, which are managed by subsidiaries of Clal Insurance Enterprises Holdings Ltd., or Clal Insurance, an entity controlled by IDBD. Clal Insurance disclaims beneficial ownership of such shares; (iii) 2,158,144 of our ordinary shares (approximately 7.25% of our outstanding and fully diluted share capital) held for members of the public through, provident funds, mutual funds and exchange-traded funds managed by subsidiaries of Meitav Dash Investment Ltd. Meitav Dash Investment Ltd disclaims beneficial ownership of such shares; (iv) 3,202,728 of our ordinary shares (approximately 10.58% of our outstanding and fully diluted share capital) held for members of the public through, provident funds and mutual funds managed by subsidiaries of Yelin Lapidot Holdings Ltd. Yelin Lapidot Holdings Ltd. disclaims beneficial ownership of such shares; (v) any of our ordinary shares that may be deemed to be beneficially owned by directors by virtue of their affiliation with DIC. Each of our directors who is affiliated with DIC disclaims beneficial ownership of such shares.

(1) Our controlling shareholder is DIC which holds, as of the date of this Report, 50.32% of our issued and outstanding shares and voting rights. To our best knowledge, the controlling shareholder of DIC is IDBD which holds, as of the date of this Report, approximately 73.92% of the issued and outstanding shares and voting rights of DIC. IDBD is a private company wholly owned by IDBH. IDBD's debentures are listed for trade on the Tel Aviv Stock Exchange ("TASE"). The Tel Aviv District Court, in its decisions delivered in December 2013 and January 2014 approved a creditors' arrangement in IDBH according to a joint proposal of groups controlled by Messrs. Eduardo Elsztain and Mordechai Ben-Moshe (the "Elsztain-Xtra Group"). If this creditors' arrangement is carried out, the Elsztain-Xtra Group will become the controlling shareholder of IDBD. In addition, according to the court's decisions, Messrs. Eyal Gabay and Adv. Chagai Ulman were appointed as trustees for carrying out the creditors' arrangement and were granted, *inter alia*, powers to seize all of the assets of IDBH, including all of its holdings (100%) in IDBD. Until the approval of the creditors' arrangement, the control over IDBH and IDBD was held by Messrs. Nochi Dankner and Shelly Bergman, Avraham Livnat and Yitzhak and Ruth Manor. In January 2014 Mr. Nochi Dankner and Ganden Holdings Ltd. filed with the District Court a motion to set aside the aforesaid decision or alternatively to reexamine it and also filed appeals with respect to these decisions with the Israeli Supreme Court. In January 2014, Yitzhak and Ruth Manor sold all their indirect shareholdings in IDBH and ceased to be controlling shareholders in IDBH. Furthermore, until March 2014, a majority of Nochi Dankner's indirect shareholdings in IDBH were sold and close to the publication of this Report, Mr. Nochi Dankner owns, directly and indirectly, approximately 7.4% of the issued and outstanding shares of IDBH.

Based on the foregoing, IDBD may be deemed to share with DIC the power to vote and dispose of our ordinary shares held by DIC. IDBD disclaims beneficial ownership of such shares.

DIC's address is 3 Azrieli Center, 44th floor, Tel Aviv 6702301, Israel.

## **B. Related Party Transactions**

### *Classification of related party transactions as negligible transactions*

On January 14, 2010, we announced our policy determining the guidelines and rules for the classification of a transaction by us or by a company consolidated by us with a related party in which our controlling shareholder has a personal interest as a negligible transaction, as stipulated in Israel Securities Regulations. These rules and guidelines will also be used to examine the extent of disclosure in our immediate reports, annual reports and prospectuses (including shelf offering reports) pursuant to the Israeli Securities Law regarding a transaction by us, a corporation under our control and any associate company, with our controlling shareholder or in which our controlling shareholder has a personal interest in the approval thereof, as stipulated the applicable Israeli Securities Regulations.

In our ordinary course of business, we and our consolidated and associate companies conduct or may conduct transactions with related parties, and we or they have or may have commitments to conduct said transactions, including transactions of the types and with the characteristics set out below: transactions for the receipt of banking and financial services from banks and financial institutions (including management of provident funds and education funds contributed to by employers and employees); transactions for the purchase or sale of products and services (such as communications products and services, food products, paper products, tourism services, elementary insurances, vehicle leasing services, legal services); transactions for the lease of real estate assets.



In the absence of any special qualitative considerations given the specific circumstances, a transaction that is not extraordinary (in other words – it is conducted in the ordinary course of business, under market conditions, and does not have a material impact on us), it will be considered a negligible transaction, if the relevant criteria calculated for the transaction (one or more, as set out below) is less than one percent (1%) of our equity according to our most recent consolidated financial statements published by us, and if the transaction amount does not exceed \$1.2 million.

In respect of any related party transaction involved with a personal interest of our controlling shareholder, the relevant criteria for classifying it as a negligible transaction shall be calculated as follows: (A) in the purchase of a fixed asset (which is presented in our financial reports as an "asset that is not a current asset") – the amount of the transaction; (B) in the sale of a fixed asset (which is presented in our financial reports as an "asset that is not a current asset") – the profit/loss from the transaction; (C) in the incurrence of a monetary liability – the amount of the transaction; (D) in the purchase/sale of products (with the exception of a fixed asset) or services – the amount of the transaction.

In cases which, according to our discretion, all of the aforementioned quantitative criteria are irrelevant in determining whether the related party transaction is a negligible transaction, the transaction shall be evaluated based on other relevant criteria set by us, provided that the relevant criterion calculated for the transaction is lower than one percent (1%).

***Compensation of directors who are controlling shareholders***

The payment of compensation for holding the office as a director of ours and for participating in meetings of our board of directors and its committees, to directors who are our controlling shareholders, was approved on October 18, 2007 by our general meeting of shareholders (after approval by our audit committee and board of directors), in the maximum amounts stated in the Israel Companies Regulations. Due to a Israeli Companies Law requirement that related party transactions be limited to a three-year period (see "Item 10 – Additional Information – Articles of Association; Israeli Companies Law"), in December 2011, our audit committee and board of directors approved to continue to grant compensation to those of our directors who are controlling shareholders and/or affiliates thereof, or to those of our directors whose compensation for holding office is paid to a controlling shareholder of ours, who at the resolution date held office and who may hold office from time to time, for a three-year period commencing on October 24, 2011 (the date of the first general meeting convened after the amendment to the Israeli Companies Law came into effect). Pursuant to the Israeli Companies Regulations (Reliefs in Related Parties Transactions), 5760-2000, shareholders' approval was not required. Such compensation will not be paid to any of our directors who are paid employees of ours or a company controlled by us, or entitled to separate compensation from us or a company controlled by us for fulfilling a paid position in addition to the office of director, if any, so long as s/he is employed or is entitled to such separate compensation. The compensation received by the directors as aforesaid in 2012 is included in the compensation amounts in "Item 6B" above.

Of the sum of \$ 403,000 which we paid towards Directors' fees of 8 directors in total for the year 2013, a sum of approximately \$28,000 was paid to IDBH for the service of an officer thereof as a director of ours, a sum of approximately \$13,000 was paid to DIC for the service of an officer and an employee thereof as a director of ours, and a sum of approximately \$26,000 was paid to a former director, Dori Manor, a controlling shareholder of ours, for his office as a director of ours. Since September 2010, Ms. Rona Dankner, a director of ours and the daughter of our controlling shareholder, Mr. Nochi Dankner, waived the entire director's remuneration that she is entitled to receive from us (the amount is immaterial).

***Bonuses granted to directors and officers***

For details regarding bonuses granted to directors and officers, see "Item 6B" above.

***Services Agreement with DIC***

In March 2009, we entered into the Services Agreement with DIC. Pursuant to the Services Agreement, effective from May 1, 2009, we receive managerial and administrative services through staff employed by DIC that include providing us with personnel to discharge the functions of our CEO, CFO, comptroller, general counsel, corporate secretary, junior employee and administration employee services. On February 1, 2012, following approval of our audit committee and board of directors, our shareholders approved an amendment and a renewal of the Services Agreement for a further three year period which commenced from May 1, 2012. The services are provided by persons designated by DIC, certain of whom are appointed subject to our approval (our Chief Executive Officer and Chief Financial Officer are to be appointed by us following our proposal of such officers, and their approval by DIC and our board of Directors, and our comptroller, general counsel and corporate secretary are to be appointed by us following our proposal of such officers, and their approval by DIC) and all of whom are employed or otherwise engaged by DIC, at its expense. We are entitled to require DIC to terminate the engagement of any employees of DIC providing services to us. For these services, under the amended Services Agreement, we will pay DIC an annual fee equal to NIS 5.9 million linked to the Israeli consumer price index known as of December 31, 2013 (equivalent as of December 31, 2013 to approximately \$1.8 million). The term of the Services Agreement is three years, subject to either party having the right to terminate it on at least 120 days prior notice if DIC is no longer our largest shareholder.

Pursuant to the Services Agreement, we have agreed to indemnify DIC for any amounts DIC will be required to pay as a result of any legal or administrative proceeding initiated by any third party (other than persons engaged in performing the services on behalf of DIC) seeking to impose liability on DIC arising from any act or omission in performing the services, unless such act or omission amounted to gross negligence or was done other than in good faith. Moreover, DIC will not be responsible for any act or omission of any person engaged by it in performing the services unless such act or omission was made pursuant to the express instructions of DIC. In addition, we provide to persons engaged by DIC in performing functions of officers, indemnification letters with respect to liabilities to which they will become exposed by virtue of performing such functions. Such indemnification letters are provided by us as customarily provided by us to our officers prior to the date of the Services Agreement.

#### ***Agreements with IDBD***

In July 2010, following approval of our audit committee and board of directors, our shareholders approved an agreement between us and IDBD pursuant to which (i) we would agree to make available to IDBD, to the extent it so requested from time to time, available office rooms in our offices at 3 Azrieli Center, 42nd Floor, Tel Aviv, which are not actually used by us. In consideration for the use of available office rooms which IDBD shall wish to use, IDBD shall pay us an amount per square meter equal to the amount per square meter according to the rental fees (including management fees to the management company of the building in which our offices are located) and the municipality taxes which we pay for our offices. The calculation of the amount per such square meter shall be according to the total net area (in square meters) of our offices and office rooms which shall be used by IDBD without taking into account a pro rata share of the public areas located outside our offices. As of December 31, 2013, the consideration for such use amounts to approximately NIS179 (approximately \$52) per square meter per month, CPI-linked plus VAT as required by law. Following the approval of this arrangement, IDBD notified us that it intended to use of only one of the available rooms based on the above conditions. On August 8, 2011, our audit committee resolved to limit this transaction to a three-year period commencing on the date of such resolution. In addition, on March 8, 2011 our audit committee approved the use of one of the available rooms by DIC on the same terms. This arrangement with DIC is a negligible transaction for the Company.

In July 2010, following approval of our audit committee and board of directors, our shareholders approved an agreement between us and IDBD pursuant to which we would receive effective from January 1, 2010 IT support services from IDBD's IT support center in consideration for our and RDC's pro rata portion of the support center's costs in connection therewith, calculated pro rata to the number of users receiving IT support from the IDB support center. On August 8, 2011, our audit committee resolved to limit this transaction to a three-year period commencing on the date of such resolution.

#### ***Grant of Letters of Exemption and Indemnification to Officers and Directors***

In 2001, following the approval of our audit committee, board of directors and shareholders, and in accordance with the provisions of the Israeli Companies Law, we granted letters of indemnification to our directors and officers. The aggregate indemnification shall not exceed 25% of our shareholders equity according to our consolidated financial statements for the year ended December 31, 2000 amounting to approximately \$70 million, for all persons and cases to be indemnified. In addition, we exempted our directors and officers, to the extent permitted by law, from any liability towards us for any damage caused or that may be caused to us by them, if caused following a breach of their duty of care towards us. We continue to grant letters of exemption to our directors and officers who are not and/or whose relatives are not controlling shareholders and/or in the granting of which our controlling shareholders do not have a personal interest, in accordance with the above terms.

Following approval of our audit committee, board of directors and shareholders, commencing from February 2012, we grant amended letters of indemnification to all of our directors and our officers, including those who are and/or whose relatives are controlling shareholders and/or in the granting of which our controlling shareholders may have a personal interest. The indemnification amount that we shall pay to all of our officers, in the aggregate, including officers who serve or will serve, at our request, as officers of other companies, according to all of the amended letters of indemnification that shall be issued to them by us shall not exceed, in the aggregate, 25% (twenty five percent) of our equity (in U.S. dollars) according to our latest financial statements (annual or quarterly) that are known before actual payment of the indemnification. The letters of indemnification that were granted to officers and directors with respect to which our controlling shareholders may have a personal interest shall remain in effect until February 2021, with the exception of letters of indemnification that were granted to directors and to officers who and/or whose relatives are controlling shareholders, which will remain in effect for three years until February 2015.

Our indemnification obligation to our other directors and officers will remain in effect even after the end of the term of their service, provided that the actions with respect to which the indemnification is given were and/will be performed during the term of service, or during the period in which the indemnification was in effect, as applicable. The provisions of the amended indemnification letter approved in February 2012 will prevail over any previous undertaking or consent, whether written or oral, between us and the said directors / officers on the matters stated in the amended letter of indemnification, also in relation to events that occurred prior to grant of the amended indemnification letter, and before indemnification was requested from us in relation to such events, as long as the previous indemnification, if any, continues to apply and to be valid, subject to any law, in relation to any such event (even if the indemnification was requested from us after the amended letter was granted) if the terms and conditions of the amended indemnification letter worsen the terms and conditions of the indemnification in relation to such event.

#### ***Directors and Officers Insurance Policy***

On February 1, 2012, following approval of our audit committee and board of directors, our shareholders approved in advance our engagement in a directors' and officers' liability insurance policy from July 1, 2012 (the date of expiration of our current policy) through Clal Insurance Company Ltd. or through another insurer, for a period to be determined ("Initial Insurance Period"), and to approve, in advance, our engagement in an insurance policy after expiration of the Initial Insurance Period, all including by way of extension of the present policy and/or through the purchase of new policies, and which shall apply with respect to our directors and officers, as shall serve from time to time, including officers who or whose relatives are controlling shareholders. The engagement in such insurance policies is subject to our audit committee and board of directors having determined that no material changes occurred in the terms and conditions of the insurance compared with those of our current policy, and that the increase in the sum of the insurance premium shall not exceed 50% relative to the insurance premium paid for our current policy. This approval will remain in effect for three years from July 1, 2012. Following approval of our audit committee, the Policy was extended from January 1, 2014 until June 30, 2015 on the following terms:

- (1) The coverage under the Policy was limited to \$30 million per claim and in the aggregate during the policy period.
- (2) The premium amounts to \$166,310 for a period of 18 months (i.e. an annual premium of approximately \$110,873).

### C. Interests of Experts and Counsel

Not applicable.

### Item 8. Financial Information

#### A. Consolidated Statements and Other Financial Information

Our consolidated financial statements and other financial information are incorporated herein by reference to "Item 18 – Financial Statements" below.

#### Legal Proceedings

##### Investors' Claim

In November 1999, a number of shareholders of Elscint filed a claim in the District Court of Haifa, together with a request to approve certain causes of action set out in the claim, as a class action on behalf of the public shareholders of Elscint, and a request for certain causes of action to be treated as a derivative action against various defendants, including Elscint, Elbit Imaging, Elron and Europa Israel to which Elron sold its holdings in Elbit Imaging in May 1999, and certain officers in the defendant companies. The claim alleges, mainly, that Elbit Imaging is duty bound to make a tender offer for the shares of Elscint held by the public and that it unlawfully refuses to do so and, in addition, it raises allegations of preference of the interests of the defendants over those of Elscint and its public shareholders with respect to a number of transactions involving Elscint that the plaintiffs allege discriminated against Elscint's public shareholders.

In June 2007 the plaintiffs submitted to the Haifa District Court an updated statement of claim and request to approve the claim as a class action. The updated claim claimed compensation for damages sustained due to the alleged failure to effect the tender offer, but no longer sought an order compelling the tender offer. The updated statement of claim does not specify the monetary amount claimed, but did include various allegations relating to the manner of determining the damages claimed.

The Haifa District Court dismissed the plaintiffs' request to approve the claim as a class action but the plaintiffs appealed and in May 2012 the Supreme Court handed down a judgment in which it partially accepted the appeal filed by the plaintiffs regarding the District Court's rejection of the motion to approve their claim as a "class action" against the various defendants including the Company. In the said judgment, it was determined, inter alia, that the motion for approval of the claim as a "class action" was accepted with some modifications and directions as to the conduct of the proceeding as detailed in the judgment and the case was returned to the District Court to conduct the claim as a "class action" against all of the defendants, including the Company and its former officers as detailed in the said judgment. The main cause of action alleged against the Company is minority oppression of the minority shareholders of Elscint, such that control of Elscint was sold to someone who is anticipated to exploit the assets of the company in an unequal manner ("Sabotage Sale"). The Company denies the allegations against it in the action.

In September 2006 two additional claims were filed in the Haifa District Court against the same defendants and based substantially on the same facts of the claim detailed above, along with requests to recognize the claims as class actions. The claims are for an undisclosed amount. The court has determined that at this stage the defendants do not yet have to file statements of defense.

We have made a provision in our financial statements of an immaterial amount, which according to the estimation of our management, based, inter alia, on the opinion of our legal advisors, is sufficient to cover the financial resources that may be required of us in order to expunge the claim, if any.

Other than the above matters, neither we nor our subsidiaries are a party to any material litigation.

#### **Dividend Policy**

The details of the dividends distributed by us in the last two years are set forth below.

On June 25, 2012, our board of directors declared a dividend in the aggregate amount of \$15 million or \$0.51 (rounded down to nearest cent) per share. The dividend was paid on July 23, 2012 and did not require approval of the court.

Currently, we do not have any fixed dividend policy. The declaration of dividends is determined by the board of directors, subject to applicable law and taking into consideration our financial status, profitability, realization of assets and investment requirements.

In accordance with Israeli Companies Law, a company is permitted to distribute dividends out of its profits, provided additional conditions are satisfied. "Profits" are defined, for this purpose, as the higher of the retained earnings or the retained earnings accumulated over the previous two year period in accordance with the financial statements which in our case, is the latter. In accordance with Israeli Companies Law, in the absence of "Profits", a company can make a distribution with the approval of the court.

Accordingly, our accumulated profits available for distribution as of December 31, 2013, for the purposes of the "profits" test according to Section 302 of the Companies Law amounts to approximately \$19 million in accordance with Israeli Companies Law. In light of the completion of the Given Merger, we recognized a gain (relative to the minority shareholders) of the amount of approximately \$107 million. Please note that in 2011, we implemented the early adoption of IFRS 9 which will be applied retroactively.

In July 2012, the Israeli Securities Authority published the company regulations (Other Amounts Included in Shareholders' Equity that Will be Considered Retained Earnings), 2012 which neutralizes part of the impact of the adoption of IFRS 9 at the time of application of the "profits test" for the purposes of the distribution and determines that if the company had an investment in an equity instrument, which according to IFRS 9, changes in its fair value would be reflected in company's other comprehensive income, then the positive and negative amounts included in the shareholders equity of the company with respect to changes in the fair value of such investment will also be considered "retained earnings" provided that according to IAS 39, these amounts are reflected in the net income. The amount referred to above was calculated in accordance with these regulations.

In light of the completion of the Given Merger our board of directors will consider our financial needs including the possibility of the distribution of a dividend.

#### **Donations and Assistance to the Community**

We regard charitable contributions and assistance to the community in Israel as a very important and integral part of our overall activities. On August 10, 2011 our board of directors approved a donation policy, according to which up to 0.5% of our gains in respect of exit transactions shall be allocated to the donation budget ("the budget fund"), in effect as of the sale of Medingo in 2010, to be utilized over the course of several years. The budget fund not utilized during an exit year will be available for use in the ensuing years. In this meeting, the board of directors authorized our chairman as the officer responsible for implementing the policy.

During 2013, we donated approximately \$47,000. The main donations were to "Unit 188", an Israeli military unit.

#### **B. Significant Changes**

Except as otherwise disclosed in this Annual Report, no significant change has occurred since December 31, 2013.

**Item 9. The Offer and Listing****A. Offer and Listing Details****Markets and Share Price History**

Our ordinary shares are traded on the TASE and were traded on the Nasdaq Global Select Market until January 6, 2010 under the symbol "ELRN." Since January 7, 2010, our Ordinary shares have been traded in the over-the-counter market in the United States under the symbol "ELRNF." The following table sets forth, for the periods indicated, the high and low reported sales prices, which reflect the distribution of a dividend of \$3.00 per share in 2005 and a dividend of approximately \$0.5057 per share in 2012, of our ordinary shares on the U.S. market (in U.S. Dollars) and on the TASE (in NIS). The historical price per share of our ordinary shares on the U.S. market was adjusted manually as prices reflecting the automatic adjustment was not publicly available:

<b>Period</b>	<b>U.S. High (U.S. \$)</b>	<b>U.S. Low (U.S. \$)</b>	<b>TASE High (NIS)</b>	<b>TASE Low (NIS)</b>
<b>Annually</b>				
2009	7.23	0.97	25.25	4.74
2010	8.16	4.15	28.04	14.76
2011	5.51	2.89	18.02	11.09
2012	5.08	2.69	19.74	11.04
2013	8.62	4.41	30.27	16.51
<b>Quarterly</b>				
First Quarter 2012	4.20	3.44	15.09	13.26
Second Quarter 2012	4.34	2.95	15.95	12.06
Third Quarter 2012	3.34	2.69	13.50	11.04
Fourth Quarter 2012	5.08	3.04	19.74	13.13
First Quarter 2013	5.38	4.41	19.92	16.51
Second Quarter 2013	5.67	5.00	20.95	18.36
Third Quarter 2013	6.8	5.25	23.94	19.20
Fourth Quarter 2013	8.62	6.8	30.27	23.43
<b>Most recent six months</b>				
September 2013	6.8	5.56	23.94	20.56
October 2013	7.64	6.8	26.71	24.43
November 2013	7.79	7.14	27.93	25.71
December 2013	8.62	7.27	30.27	25.67
January 2014	9.26	8.59	32.68	30.55
February 2014	9.5	8.56	32.90	30.60
March 1, 2014 (through March 10, 2014)	9.51	9.28	33.40	32.87

**B. Plan of Distribution**

Not applicable

**C. Markets**

As noted above, our ordinary shares are traded on the TASE under the symbol "ELRN" and over-the-counter in the United States under the symbol "ELRNF. "

**D. Selling Shareholders**

Not applicable.



**E. Dilution**

Not applicable.

**F. Expenses of the Issue**

Not applicable.

**Item 10. Additional Information**

**A. Share Capital**

Not applicable.

**B. Memorandum and Articles of Association**

***Articles of Association; Israeli Companies Law***

Set forth below is a summary of certain provisions of our Memorandum of Association and our Articles of Association. This description is qualified in its entirety by reference to the full text of our Memorandum of Association and our Articles of Association, which are incorporated by reference as exhibits to this Annual Report.

On October 20, 1961, we were registered as a company with the Registrar of Companies in Israel. Our registration number with the Registrar of Companies is 52-0028036.

Our shareholders approved the adoption of our Articles of Association in March 2001 and adopted certain amendments thereto in December 2006 and on February 1, 2012. Our objective as stated in our Articles of Association and in our Memorandum of Association is to engage in any lawful activity. The amended Articles of Association including all amendments to date is being filed with this Annual Report as Exhibit 1.1.

We have currently outstanding only one class of securities, our ordinary shares, par value NIS 0.003 per share. No preferred shares are currently authorized. Holders of ordinary shares have one vote per share and are entitled to participate equally in the payment of dividends and share distributions and, in the event of our liquidation, in the distribution of assets after satisfaction of liabilities to creditors. According to our Articles of Association, any modification of the Articles of Association requires the approval of a special majority at a general meeting. A special majority is defined in our Articles of Association as at least a majority of 67% of the shareholders who voted at the general meeting, without taking abstaining votes into account.

The Israeli Companies Law and our Articles require that we hold our annual general meeting of shareholders each year no later than 15 months from the last annual meeting, at a time and place determined by the board of directors. Under Israeli law and regulations and our Articles of Association, notice of the meeting is required to be published in two widely distributed daily newspapers published in Hebrew. The Israeli Companies Law requires us to issue a voting instrument in order to enable shareholders to vote through a voting instrument, if certain matters are on the agenda of the meeting. No business may be commenced until a quorum of two or more shareholders holding at least one-third of the voting rights are present in person or by proxy. The Israeli Companies Regulations provides that the record date for the participation of shareholders of a company, such as us, whose shares are traded or registered outside of Israel may be no more than 40, but no less than 4, days prior to the meeting, provided that notice for the meeting is given prior to the record date. Resolutions regarding the following matters must be passed at a general meeting of shareholders:

- amendments to our Articles of Association and our Memorandum of Association;
- appointment or termination of our auditors;
- appointment and dismissal of directors (in addition to the board of directors' authority to appoint directors in certain circumstances);
- approval of interested party actions and transactions requiring general meeting approval as provided in sections 255 and 268 to 275 of the Israeli Companies Law due to a personal interest of a controlling shareholder or a director or on certain matters related to compensation of our officers, directors and our controlling shareholders;
- increase or reduction of our authorized share capital and alterations of our share capital;
- a merger as provided in section 320(a) of the Israeli Companies Law;
- the exercise of the board of directors' powers by a general meeting, if the board of directors is unable to exercise its powers and the exercise of any of its powers is vital for our proper management, as provided in the Israeli Companies Law; and
- any matter that is required to be adopted by resolution of a general meeting pursuant to the law or in accordance with our Articles of Association.

An extraordinary meeting of our shareholders will be convened by the decision of the board of directors, or at the request of any two directors or one-quarter of the officiating directors, or by request of one or more shareholders holding at least 5% of the issued capital and at least 1% of the voting rights in our Company, or one or more shareholders holding at least 5% of the voting rights in our Company. Shareholders requesting an extraordinary meeting must submit their proposed resolution with their request. Within 21 days of receipt of the request, the board of directors must convene an extraordinary meeting and send out notices setting forth the date, time and place of the meeting.

The Israeli Companies Law codifies the fiduciary duties and duty of care that office holders owe to a company. An office holder under the Israeli Companies Law includes the positions of director, general manager, chief business manager, deputy general manager, vice general manager, executive vice president, vice president, any other person assuming the responsibilities of any of the forgoing positions without regard to such person's title, and manager directly subordinate to the general manager. Each person listed in the table in "Item 6—Directors, Senior Management and Employees—Directors and Senior Management" above is an office holder.

The Israeli Companies Law requires that a controlling shareholder and an office holder of a company promptly disclose, and no later than the first board meeting in which such transaction is discussed, any personal interest that he or she may have, and all related material information or document known to him or her, in connection with any existing or proposed transaction by the company. The duty to disclose shall not apply if the personal interest derives solely from a personal interest of a relative in an ordinary transaction. An extraordinary transaction is defined as a transaction not in the ordinary course of business, not on market terms, or that is likely to have a material impact on the company's profitability, assets or liabilities. Under the Israeli Companies Law, the audit committee shall determine if a transaction with a controlling shareholder or with an office holder or in which one of them has a personal interest, is an extraordinary transaction or is an ordinary transaction. The audit committee may determine criteria for transactions of this type once a year.

In the case of a transaction with an office holder or a transaction with another person in which an office holder has a personal interest, that is not an extraordinary transaction, after the office holder complies with the above disclosure requirement, board of directors' approval is required unless the Articles of Association of the company provide otherwise. Our Articles of Association provide that a transaction with one of our office holders or a transaction, in which an office holder has a personal interest which, in each case, is not regarded as an extraordinary transaction, requires the approval of our board of directors or our audit committee or such other body or person empowered by our board of directors for such purpose. Our policy, as approved by our board of directors, is that any such transaction with a value of less than \$1 million requires approval by our audit committee, and any such transaction with a value in excess of \$1 million requires the additional approval of our board of directors. If the transaction with the office holder or in which an office holder has a personal interest is an extraordinary transaction, then, that transaction must be approved by our audit committee and by the board of directors.

In all matters in which a person has a personal interest, including matters of his/her terms of employment, he/she will not be permitted to vote on the matter or be present in the audit committee or board of directors meeting in which the matter is considered. An office holder, who has a personal interest, may attend the abovementioned meetings in order to present the transaction, if the chairman of the audit committee or the chairman of the board of directors, as applicable, determined that the office holder is essential for the presentation. However, should a majority of the members of the audit committee or of the board of directors have a personal interest in the matter, then:

- (a) all of the directors are permitted to vote on the matter and attend the meeting in which the matter is considered; and
- (b) approval of the shareholders at a general meeting is required if the majority of the board of directors have a personal interest in the matter.

The term "controlling shareholder" for these purposes, however, also includes shareholders that hold 25% or more of the voting rights if no other shareholder owns more than 50% of the voting rights in the company.

In general, extraordinary transactions with a controlling shareholder or in which a controlling shareholder has a personal interest, and the terms of engagement of the company, directly or indirectly, with a controlling shareholder or his or her relative (including through a corporation controlled by a controlling shareholder), regarding the company's receipt of services from the controlling shareholder, and if such controlling shareholder is also an office holder of the company or an employee, regarding his or her terms of employment, require the approval of the company's audit committee (and on matters relating to terms of tenure and employment – the compensation committee), board of directors and shareholders. In addition, under a recent amendment to the Companies Law, the company must conduct a competitive procedure or other procedure, subject to the audit committee discretion, before any engagement in a transaction with controlling shareholders or in which a controlling shareholder has a personal interest.

Such shareholder approval must either include at least a majority of the shares held by disinterested shareholders who participate in the vote (without taking abstaining votes into account), or, alternatively, the total shareholdings of the disinterested shareholders who vote against the transaction must not represent more than 2% of the voting rights in the company. Under specified circumstances, such shareholder approval is not required.

In addition, any such extraordinary transaction whose term is more than three years, requires the abovementioned approval every three years, unless (with respect to transactions not involving receipt of services or compensation) the audit committee approves that a longer term is reasonable under the circumstances.

Under the Israeli Companies Law, procedures relating to the approval of executive compensation and the formulation of compensation policies were adopted. See "Item 6B – Compensation" for more information.

Under the Israeli Companies Law, if a private placement: (i) entails 20% or more of the voting rights of a company prior to the placement, and all or part of the private placement consideration is not in cash or in public traded securities or is not upon market terms and if as a result of the private placement the holdings of substantial shareholder will increase or result in a person becoming a substantial shareholder; or (ii) results in a person becoming a controlling shareholder, then the allotment must be approved by the board of directors and by the shareholders of the company. A "substantial shareholder" is defined as a shareholder that holds 5% or more of the company's voting rights or outstanding share capital, assuming the exercise of all of the securities convertible into shares held by that person. In order for the private placement to be on "market terms," the board of directors has to determine, on the basis of a detailed examination, that the private placement is on market terms, unless proved otherwise. Any placement of securities that does not fall within the above description may be issued at the discretion of the board of directors.

Under the Israeli Companies Law, a shareholder has a duty to act in good faith towards the company and other shareholders when exercising his rights and duties and refrain from abusing his power in the company, including, among other things, voting in the general meeting of shareholders and class meetings on the following matters:

- any amendment to the Articles of Association;

- an increase of the company's authorized share capital;
- a merger; or
- approval of interested party acts and transactions that require general meeting approval as provided in sections 255 and 268 to 275 of the Israeli Companies Law due to a personal interest of a controlling shareholder or a director or an executive officer of ours.

In addition, any controlling shareholder, any shareholder who knows that it possesses power to determine the outcome of a shareholder vote and any shareholder who has the power to appoint or prevent the appointment of an office holder in the company or who has any other power with respect to the company, is under a duty to act with fairness towards the company. The Israeli Companies Law does not describe the substance of this duty. The Israeli Companies Law requires that specified types of transactions, actions and arrangements be approved as provided for in a company's articles of association and in some circumstances by the audit committee, by the board of directors and by the general meeting of the shareholders. The vote required by the audit committee and the board of directors for approval of these matters, in each case, is a majority of the directors participating in a duly convened meeting.

### **C. Material Contracts**

#### ***Policy on determining materiality with respect to whether we are required to file an immediate report in the case of an event or matter not within our ordinary course of business***

In January 2010, we announced our policy to determine whether a specific event or matter affecting us and/or a company held by us is material to us in terms of the requirement to file an immediate report thereon pursuant to the applicable Israeli Securities Regulations.

These guidelines and rules were determined according to our characteristics as a holding company. The rules are set out below:

#### ***Quantitative examination***

The materiality of each such event or matter shall be calculated using the relevant criteria from the following, measured with reference to our latest consolidated financial statements.

- Percentage of assets – the assets purchased or sold divided by our total assets presented in our most recent financial reports published by us;
- Percentage of gain – the actual or forecasted gain or loss related to such event or matter divided by the average annual amount calculated according to the statement of income (in absolute terms) for the preceding 12 quarters as presented in our reviewed or audited financial statements that were published by us;
- Percentage of equity – increase or decrease in our equity due to such event or matter divided by our equity presented in our most recent financial reports published by us prior to that event or matter;

D. Percentage of liability – the liability being the subject of such event or matter divided by our total equity presented in our most recent financial reports published by us prior to that event or matter.

- Without derogating from the need to decide for each such event or matter, the materiality of which is being evaluated, which of the criteria stipulated in Section A above, are relevant, the following criteria will be considered relevant for the transactions identified: A. Purchase of assets – percentage of total assets; B. Sale of assets – percentage of gain, percentage of total assets; C. Taking a loan – percentage of liability.
- In the absence of special qualitative considerations as discussed below, an event or matter shall be considered to be material if one of the relevant criteria exceeds 10%.
- In the absence of qualitative considerations, an event or matter will be deemed not material if all the relevant criteria are less than 5%.
- Events or matters that are not classified under Sections C or D may be considered material and must be reviewed in qualitative terms with all of the relevant information and circumstances.
- In examining the materiality of an event or matter that is supposed to take place in the future, the probability of that event or matter materializing is to be determined as well as its expected importance and impact should it materialize.
- If dealing with an event or matter relating to a subsidiary or associate company of ours, our relative share of the impact of that event or matter is to be examined, in other words, relative to our percentage holding in that subsidiary or associate company, using the aforementioned materiality tests.
- If the event or matter is not an investment in securities, such as an engagement through financing agreements, engagement through agreements for the receipt of services and the like, the impacts of that event or matter on us must also be examined in terms of other relevant accounting items related to the nature of the subject event or matter.

#### *Qualitative examination*

The materiality of each event or matter will be examined in qualitative terms as well. The qualitative examination may differ from the findings of the quantitative examination of whether or not that event or matter is material. As part of the qualitative examination of the materiality of an event or matter, meaning and impacts for us may be considered with respect to one or more of the following:

- The event or matter involves material opportunities or risks and exposures. When examining this aspect, it is important to consider whether and to what extent the risk involved in that event or matter was not reflected in risk factors included in our previous public reports. The question of whether the event or matter is the realization of a risk factor reported to the public of investors prior to the occurrence of that event or matter is to be considered as well;

- As part of the event or matter, we enter a new and important area of activity or exit an existing important area of activity;
- The disclosure of the event or matter may bring about, with reasonable certainty and based on past experience, and evaluation models generally used by investors and analysts, a significant change in the price of our ordinary shares;
- The event or matter may have a special impact on our financial statements such as the reclassification of specific items, etc.;
- The event or matter may impact on our compliance with significant regulatory requirements, significant financial standards that may cause significant difficulty for us, or other significant contractual requirements;
- The event or matter may significantly influence analysts and/or investors when they analyze our activity and results;
- The event or matter is perceived as a significant event by our management and used as the basis for making management decisions.

Without derogating from the generality of the foregoing:

- If our controlling shareholder is required to file an immediate report on an event or matter concerning us or a subsidiary or associate company of ours, we shall also file an immediate report on the same event or matter, even if the aforementioned quantitative rules do not require us to do so.
- With respect to lawsuits (including class action suits) – in an event regarding the filing of a lawsuit, including a class action, against us or any subsidiary or associate company of ours, the materiality of the event shall be examined as follows: A. Quantitative review – will be conducted according to the amount of the claim or class action, multiplied by our percentage holding in the company being sued, if this relates to subsidiary or associate company. If there is an assessment as to the chances of success when materiality is being examined, these chances shall be considered and the expectancy of the claim from our perspective will be calculated. The relevant quantitative criterion to examine the materiality of the lawsuits will be the percentage of gain. The percentage received after performing the calculation will be examined in light of the regular quantitative review procedures specified in above. B. Qualitative examination – the question of whether the filing of the claim or the threat of a lawsuit has a significant impact on all the information used in investment decisions by the public of investors for our ordinary shares will be examined. In this criteria, our relevant considerations such as the following will be taken into account: the identity of the plaintiff; group of plaintiffs; the anticipated effects should the claim be certified as a class action and if it is accepted by court; the existence of similar lawsuits against the company being sued about similar material and the extent of the impact of the additional claim on all the information in the possession of investors; the reference to the class action in our financial statements.

- With respect to administrative or criminal proceedings – in an event relating to a criminal investigation conducted by enforcement agencies, the Israeli Securities Authority or other regulatory authority, against us and/or any of our officers about a matter significant to us, and with respect to events regarding a criminal and/or administrative proceeding against us and/or our officers on a matter significant to us, the qualitative examination of materiality will be given additional weight, and specifically, the manner in which the Event may impact investors and/or analysts when they analyze our activities and results and how investors relate to the manner in which we and/or our officers conduct our business.

#### ***Credit Line Agreement with Silicon Valley Bank***

In November 2011, we entered into a binding agreement with Silicon Valley Bank (the "Bank") to receive a credit line in the amount of \$30 million for a period of up to 18 months (the "Credit Period"). During the Credit Period, we were entitled to draw down loans for periods of up to 3 years from the date of each respective drawdown, at the Wall Street Journal prime rate of interest plus 0.75% per annum. According to the terms of the credit line, we were able to make early repayment of all the loans without any cost. At the time the credit line is actually utilized, we pledged shares of Given Imaging directly held by us in an amount equal to maintain a 3.25 ratio of the market value of the pledged shares (based on their trailing 5-day average closing price prior to the computation date) to the amount of credit utilized. Pursuant to the credit agreement, should the ratio of the market value of the pledged shares to the credit amount utilized decrease below 3, then we would be required either to pledge additional Given Imaging shares or repay a portion of the credit utilized in order to maintain a coverage ratio of 3.25, or provide alternative collateral acceptable to the Bank. On April 24, 2012, we drew down \$5 million of the facility against a pledge of 1,130,000 shares of Given Imaging, then representing approximately 3.6% of Given Imaging. In August 2012, we prepaid an amount of \$1 million to the bank in order to maintain the 3.25 coverage ratio. The agreement with the Bank is incorporated by reference as Exhibit 4.4 hereto.

In April 2013, we entered into an agreement with the Bank to extend the credit line in the amount of \$25 million (the "Credit Line Extension Agreement"). Of this amount, \$10 million was available until December 31, 2013 and was not utilized and \$15 million was available until October 30, 2014. The credit line was extended in order to ensure that we had diverse possible capital sources available for the purposes of continued investments in group companies and new companies and to finance current activities. In January 2014, we repaid the total loan outstanding in the amount of \$4 million to the Bank and in February 2014, further to the Given Merger, the credit line was terminated.

#### ***Services Agreement with DIC***

In April 2009, we entered into the Services Agreement with DIC which was renewed for an additional three years with effect from May 1, 2012. For more information see "Item 7—Major Shareholders and Related Party Transactions – Related Party Transactions." and the amendment to Services Agreement listed as Exhibit 4.2 to this Annual Report.



#### ***Agreement with Rafael***

In December 2007, we, DEP, RDC and Rafael signed an addendum agreement, or the Addendum, effective as of January 1, 2008 which amended the existing agreement between the parties pertaining to the first exclusive rights granted to RDC to commercialize certain technologies of Rafael. RDC's rights to commercialize certain technologies of Rafael will continue without time restrictions. Rafael undertook not to establish an entity similar to or competitive with RDC and we (together with DEP) undertook not to establish a similar or competing entity to RDC inasmuch as such entity is an Israeli entity engaged in the military-security field and is a competitor of Rafael. We (together with DEP) are committed to make further investments of \$0.75 million in RDC for each company that will be established by RDC based on Rafael's technologies. In addition, RDC granted Rafael an option to receive from RDC 3% of the shares of each new company that would be established by RDC based on Raphael's technologies. DEP will be entitled to receive certain management fees from RDC in respect of each new company that shall be established, insofar as it shall be sold, merged or its securities offered to the public, and upon the fulfillment of certain conditions. Raphael may cooperate with a third party for the purpose of commercialization of military products with an operating partner (which is not a financial body) and for the purpose of commercialization of "mature" products, as defined in the Addendum, outside of the military segment, a significant part of the development of which has been completed by Rafael. Insofar as Rafael shall seek to cooperate with a financial body with respect to "mature" products, it is required to also approach us, together with DEP at the same time. In cases in which Rafael shall cooperate with a third party in connection with the sale or marketing of products in the fields of business of RDC and in respect of which RDC has no rights, we will be able, and alternatively RDC will be able, to participate in approximately 10% of the said cooperation (subject to the third party's consent. In the event that Rafael is approached by a third party financial partner with a proposal for a new project, RDC will be entitled to cooperate with Rafael instead of such third party and will pay Rafael the consideration offered by such third party. If such third party is not a financial partner, RDC will be entitled to cooperate with such third party instead of Rafael and Rafael will be entitled to receive 3% of the shares of the company established. DEP is entitled to assign its rights and obligations in the agreement to any company, which controls, controlled by or in under the common control with DEP as long as we remain liable for our obligations thereunder. This Addendum is incorporated as Exhibit 4.4 hereto by reference to the Annual Report year ended December 31, 2007 filed with the SEC on June 30, 2008

#### ***Application of Variable Provisions of the Compensation Policy to our CEO***

On February 12, 2014, following approval of our audit committee and Board of Directors, our shareholders approved that the provisions of our compensation policy be applied to the residing CEO, Mr. Ari Bronshtein with regard to a bonus plan, in accordance with the conditions set forth in Sections 7-10 and 21 and to any other provision relevant to the variable compensation in our compensation policy. For further information, see Item 6B.

#### **D. Exchange Controls**

The Israeli Currency Control Law of 1978 imposes certain limitations on foreign currency transactions and transactions between Israeli and non-Israeli residents, which limitations may be regulated or waived by the Controller of Foreign Exchange at the Bank of Israel, through "general" and "special" permits. In May 1998, a "general permit" was issued pursuant to which substantially all transactions in foreign currency are permitted. Any dividends or other distributions paid in respect of ordinary shares and any amounts payable upon our dissolution, liquidation or winding up, as well as the proceeds of any sale in Israel of our securities to an Israeli resident are freely repatriable into non-Israeli currencies at the rate of exchange prevailing at the time of conversion, provided that Israeli income tax has been paid on (or withheld from) such payments.

#### **E. Taxation**

##### *General*

The following is a summary of the material provisions of the current tax law applicable to companies in Israel, with special reference to its effect on us and our group companies. The following also contains a discussion of material Israeli tax consequences to our shareholders and government programs from which we and some of our group companies benefit. To the extent that the discussion is based on tax legislation that has not been subject to judicial or administrative interpretation, we cannot assure you that the views expressed in the discussion will be accepted by the tax authorities in question.

The discussion is not intended, and should not be construed, as legal or professional tax advice and is not exhaustive of all possible tax considerations.

In light of the social protest in Israel, in particular with regard to housing prices and the cost of living, in August 2011, the Israeli prime minister appointed a committee for socio-economic change, headed by Prof. Trajtenberg (the "Trajtenberg Committee"). In September 2011, the Trajtenberg Committee submitted to the government its recommendations which include, inter alia: Putting a hold on a previously planned decrease in corporate tax, increasing corporate tax to 25% from 2012, and recommending that an increase in the tax rate will be considered in 2013; increasing the tax on capital gains (including the tax on interest and dividends) from 2012; removing and reducing customs duties; and strengthening the regulatory tools available to the government authorities in connection with supervision over monopolies and market power holders in certain sectors.

In October 2011, the government adopted the main recommendations in the committee's report, and decided to act to implement such recommendations.

Following the recommendations, in December 2011, the Law for Tax Burden Reform (Legislative Amendments) 2011 was passed. (See below for further details). Amongst other things, under this law, commencing from January 2012, the tax rate on capital gains, interest and dividends by individuals was increased by 5% (for example, the tax rate on capital gains from the sale of shares was increased from 20% or 25%, to 25% or 30%, respectively), and furthermore the scheduled progressive reduction in the corporate tax rate, which was expected to decrease by 2016 to a rate of 18%, was cancelled, and was increased to 25%.

### ***Israeli Tax Reform***

In July 2002, Israel's tax law has been extensively amended, generally effective January 1, 2003. Among the key amendments were (i) changes which may result in the imposition of taxes on dividends received by an Israeli company from its foreign subsidiaries; and (ii) the introduction of the "controlled foreign corporation" concept according to which an Israeli company may become subject to Israeli taxes on certain income of a non-Israeli subsidiary if the subsidiary's primary source of income is passive income (such as interest, dividends, royalties, rental income or capital gains). An Israeli company that is subject to Israeli taxes on the income of its non-Israeli subsidiaries will receive a credit for income taxes paid/withheld or that will be paid/withheld by the subsidiary in its country of residence, according to the terms and conditions determined in the Israeli Tax Ordinance.

In July 2005, Israel' tax law was significantly amended effective January 1, 2006. This amendment includes, among others, changes in the capital markets tax rate.

### ***General Corporate Tax Structure***

The Israeli corporate tax rate was 26% in 2009, 25% in 2010 and 24% in 2011. However, the effective tax rate payable by a company that derives income from an Approved Enterprise (as further discussed below) may be considerably less.

On December 5, 2011, the Israeli Parliament (the Knesset) passed the Law for Tax Burden Reform (Legislative Amendments), 2011 (the "Tax Burden Law") which, among others, cancels effective from 2012, the scheduled progressive reduction in the corporate tax rate. The Tax Burden Law also increases the corporate tax rate to 25% in 2012. In view of this increase in the corporate tax rate to 25% in 2012, the real capital gains tax rate and the real betterment tax rate were also increased accordingly. On July 30, 2013 the Knesset approved a new Tax Legislation which, among others, increases the Corporate Tax Rate from 2014 from 25% to 26.5%.

### ***Law for the Encouragement of Capital Investments, 1959***

From time to time, certain operations of our group companies have been granted Approved Enterprise and/or "beneficiary enterprise" status under the Law for the Encouragement of Capital Investments, 1959, as amended, or the Investment Law.

The Investment Law provides that a capital investment in eligible facilities may, upon application to the Investment Center of the Ministry of Industry and Trade of the State of Israel, or the Investment Center, be designated as an Approved Enterprise. Each certificate of approval for an Approved Enterprise relates to a specific investment program delineated both by its financial scope, including its capital sources, and by its physical characteristics, e.g., the equipment to be purchased and utilized pursuant to the program. The tax benefits derived from any such certificate of approval relate only to taxable income attributable to the specific Approved Enterprise.

Taxable income of a company derived from an Approved Enterprise is subject to company tax at the rate of up to 25% for a period of time termed the benefit period. The benefit period is a period of seven years commencing with the year in which the Approved Enterprise first generated taxable income. The benefits may be shorter as it is limited to 12 years from the commencement of production of the Approved Enterprise or 14 years from the date of approval, whichever is earlier. Under certain circumstances (as further detailed below), the benefit period may extend to a maximum of ten years from the commencement of the benefit period. A company which operates under more than one approval or that has capital investments which are only partly approved (such a company being designated as a Mixed Enterprise), may have an effective company tax rate that is the result of a weighted combination of the various applicable rates.

A company owning an Approved Enterprise may elect to forego certain government grants extended to Approved Enterprises in return for what is termed an alternative package of tax benefits (referred to as the Alternative Package). Under the Alternative Package, a company's undistributed income derived from an Approved Enterprise will be exempt from company tax for a period of between two and ten years, depending on the geographic location of the Approved Enterprise within Israel. Such company will be eligible for the tax benefits under the Investment Law for the remainder of the benefit period.

Should the percentage of share capital of the companies having Approved Enterprises held by foreign shareholders exceed 25%, future Approved Enterprises of such companies would qualify for reduced tax rates for an additional three years, after the seven years mentioned above.

The company tax rate applicable to income earned from Approved Enterprise programs (currently, for programs on which an application for an approved enterprise status was submitted before December 31, 2004) in the benefit period by a company meeting these qualifications is as follows:

<u>% of Foreign Ownership</u>	<u>Tax Rate</u>
Over 25% but less than 49%	25%
49% or more but less than 74%	20%
74% or more but less than 90%	15%
90% or more	10%

The above benefits are conditional upon the fulfillment of the conditions stipulated by the Tax Burden Law, regulations published there under and the letters of approval for the investments in the approved enterprises, as above. Non-compliance with the conditions may cancel all or part of the benefits and refund of the amount of the benefits, including interest. The managements believe that the companies are meeting the aforementioned conditions.

However, there can be no assurance that our group companies which enjoy Approved Enterprise benefits will obtain approval for additional Approved Enterprises, or that the provisions of the Investment Law will not change with respect to future approvals, or that the above-mentioned shareholding portion will be reached for each subsequent year.

A company that pays a dividend out of income derived from the Approved Enterprise(s) during the tax exemption period will be subject to deferred company tax in respect of the amount distributed (including the recipient's tax thereon) at the rate which would have been applicable had such company not elected the Alternative Package. This rate is generally 10% to 25%, depending on the extent to which non-Israeli shareholders hold such company's shares.

The dividend recipient is taxed at the reduced rate applicable to dividends from Approved Enterprises (generally 15% as compared to 30% (or compared to 25% from January 1, 2006 if the dividend recipient is not a substantial shareholder – shareholders owning, directly or indirectly, 10% or more of our outstanding voting capital) for individuals or an exemption for companies), if the dividend is distributed during the tax benefit period or within 12 years after this period. However, the limitation does not apply if the company qualifies as a foreign investors' company. This tax must be withheld by such company at the source, regardless of whether the dividend is converted into foreign currency.

Subject to certain provisions concerning income subject to Mixed Enterprises, all dividends are considered to be attributable to the entire enterprise and the effective tax rate on the dividend is the result of a weighted combination of the various applicable tax rates. However, such company is not obliged to distribute exempt retained profits under the Alternative Package, and such company may generally decide from which year's profits to declare dividends.

Each application to the Investment Center with regard to approved enterprise status (governmental grant route) is reviewed separately, and a decision as to whether or not to approve such application is based, among other things, on the then prevailing criteria set forth in the Investment Law, on the specific objectives of the applicant company set forth in such application and on certain financial criteria of the applicant company. Accordingly, there can be no assurance that any such application by any of our group companies will be approved. In addition, the benefits available to an Approved Enterprise are conditional upon the fulfillment of certain conditions stipulated in the Investment Law and its regulations and the criteria set forth in the certificate of approval, as described above. In the event that these conditions are violated, in whole or in part, a company with an Approved Enterprise would be required to refund the amount of tax benefits, with the addition of the Israeli consumer price index linkage differences and interest.

***Reform (Amendment) of the Encouragement of Capital Investment Law***

In April 2005, an amendment to the Investment Law came into force that revamps the Israeli tax incentives for future industrial and hotel investments. A tax "holiday" package can now be elected for up to 15 years for a "Privileged Enterprise" as defined in this amendment, if certain conditions are met, without needing to obtain approval. The extent of the tax benefits available depends mainly upon the level of foreign investment and the geographical location of the "Privileged Enterprise".

Tax payers may, under certain conditions, claim Privileged Enterprise status for new and expanded enterprises with respect to 2004 or subsequent years, unless the Investment Center granted such taxpayer Approved Enterprise status prior to December 31, 2004.

Subject to certain conditions, various alternative tax-only benefit packages can now be elected with respect to investments in a "Privileged Enterprise." Companies in industry or tourism in Israel may elect between:

- Tax "holiday" package for a "Privileged Enterprise": a tax exemption applies to undistributed profits for two to fifteen years depending on geographical location of the "Privileged Enterprise" and the level of foreign ownership. Company tax rates of between 10% and 25% apply to the distributed exempt profits or profits derived subsequent to the exempt period. The total period of tax benefits is seven to fifteen years; or
- Grant / Reduced tax package for an "Approved Enterprise": Fixed asset grants up to 24% for enterprises in a development area and reduced company tax rates between 0% and 25% for seven to 15 years.

In December 2010, the "Knesset" (Israeli Parliament) passed the Law for Economic Policy for 2011 and 2012 (Amended Legislation), 2011, which prescribes, among others, an amendment to the Investment Law effective January 1, 2011. According to this amendment ("**the preferred track**"), the benefit tracks in the Investment Law were modified and a flat tax rate applies to the eligible company's entire preferred income. The eligible company will be able to opt to apply the amendment and from then on it will be subject to the amended tax rates that are: 2011 and 2012 - 15% (in development area A - 10%), 2013 and 2014 - 12.5% (in development area A - 7%) and in 2015 and thereafter - 12% (in development area A - 6%). Dividend recipient from gains under the preferred track by an Israeli Company is exempt and subject to 15% by an individual.

On July 30, 2013 an amendment to the reduced tax rate was approved by the Knesset. Accordingly the reduced tax rate increased to 16% (in development area A - 9%). In addition a dividend attributed from gains under the preferred track by an individual is subject to 20% instead of 15%.

Our group companies are examining the possible effect of this amendment on their financial statements, if at all, and at this time have not yet decided whether to opt to apply the amendment.

#### ***Taxation under Inflationary Conditions***

The Income Tax Law (Inflationary Adjustments), 1985 (referred to as 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 normal taxable profits computed under regular historical cost principles. We and our group companies operating in Israel are taxed under this law.

Under the Inflationary Adjustments Law, results for tax purposes are measured in real terms, in accordance with the changes in the consumer price index. 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 consumer price index.

According to an amendment of the Inflationary Adjustments Law most of the provisions of the law are not valid starting tax year 2008. Pursuant to this amendment, the above mentioned "special tax adjustment" is canceled, depreciation deductions on Fixed Assets (that were classified as fixed assets from 2002-2007) are adjusted for inflation based on the increase in the consumer price index from their original purchase date but not before the beginning of the 1982 fiscal year up to December 31, 2007. Losses carried forward will be adjusted for inflation based on the increase in the consumer price index up to December 31, 2007.

#### ***Law for the Encouragement of Industry (Taxes), 1969***

Certain of our group companies currently qualify as Industrial Companies within the definition of the Law for the Encouragement of Industry (Taxes), 1969 (referred to as the Industry Encouragement Law). According to the Industry Encouragement Law, an Industrial Company is a company resident in Israel, at least 90% of the income of which in any tax year (exclusive of income from defense loans, capital gains, interest and dividends) is derived from an Industrial Enterprise owned by it. An Industrial Enterprise is defined as an enterprise whose major activity in a given tax year is industrial production activity.

The following preferred corporate tax benefits are available to Industrial Companies: (a) deduction of purchases of know-how and patents over an eight-year period for tax purposes; (b) under certain interpretations, deduction of expenses incurred in connection with a public issuance of securities over a three-year period; and (c) an election under certain conditions to file a consolidated tax return with additional related Israeli Industrial Companies and/or with a company that controls an Industrial Company and a specified percentage of its assets are invested in industrial companies; and (d) accelerated depreciation rates on equipment and buildings. In addition, new regulations which apply mainly to Industrial Companies, allow the depreciation of industrial equipment purchased prior to May 31, 2009 over a period of two tax years.

Eligibility for the benefits under the Industry Encouragement Law is not subject to receipt of prior approval from any governmental authority. No assurance can be given that any of our group companies will qualify and/or continue to qualify as an Industrial Company or that the benefits described above will be available in the future.

#### ***Capital Gains Tax***

Israeli law imposes a capital gains tax on the sale of capital assets. The law distinguishes between the Real Gain and the Inflationary Surplus. The Real Gain is the excess of the total capital gain over the Inflationary Surplus, computed on the basis of the increase of the consumer price index between the date of purchase and date of sale. The Inflationary Surplus accumulated until December 31, 1993 is taxed at a rate of 10% for residents of Israel (reduced to no tax for non-residents if calculated according to the exchange rate of the foreign currency lawfully invested in shares of an Israeli resident company, instead of the consumer price index). Inflationary Surplus accumulated from and after December 31, 1993 is exempt from any capital gains tax, while the Real Gain is added to ordinary income, which effective until December 31, 2002 is taxed at the marginal rate of up to 48% for individuals (in 2012 and 2013) and to corporate tax rate (25%) for corporations in 2012 and 2013. Effective January 1, 2003, the capital gains tax rate imposed upon sale of capital assets (including non traded shares) acquired after that date has been reduced to 25% with respect to individuals in 2012 and 2013; capital gains accrued from assets acquired before that date are subject to a blended tax rate based on the relative periods of time before and after the date that the asset was held. In addition to the above since 2013 individuals that their over-all income exceeds the NIS800 thousands threshold are subject to surtax of 2% ("surtax").

Under current law, as of January 1, 2006, the Israeli tax rate applicable to capital gains derived from the sale of shares, whether listed on a stock market or not, is 25% in 2012 and 2013 for Israeli individuals, unless such shareholder claims a deduction for financing expenses in connection with such shares, in which case the gain will generally be taxed at a rate of 25%.

Additionally, if such individual shareholder is considered a "Significant Shareholder" at any time during the 12-month period preceding such sale, i.e. such shareholder holds directly or indirectly, including with others, at least 10% of any means of control in the company, the tax rate shall be 30% in 2012 and 2013. However, the foregoing tax rates will not apply to: (i) dealers in securities; and (ii) shareholders who acquired their shares prior to an initial public offering (that may be subject to a different tax arrangement). In such case the taxable real gain will be based on the difference between the adjusted average value of the shares during the last three trading days before January 1, 2003 (or the adjusted original cost if it is higher than the adjusted average value) and the value of the shares at the date of sale. In the event the above mentioned calculation creates a loss, such loss can only be offset against a capital gain from other traded securities according to the provisions of the Israeli law. The amount of the loss is limited to the difference between the adjusted average value and the value of the shares at the date of sale.

#### ***Employee Stock Options***

Effective from January 1, 2003, the Israeli tax law enables a company to grant options through one of three tax tracks:

(a) the income tax track through a trustee pursuant to which the optionee pays income tax rate (according to the marginal tax rate of the optionee- up to 48% in 2012 and 2013 and surtax since 2013 plus payments to the National Insurance Institute and health tax on the profit gained upon the earlier to occur of the transfer of the options or the underlying shares from the trustee to the optionee or the sale of the options or the underlying shares by the trustee, and the company may recognize expenses pertaining to the options for tax purposes. The options (or upon their exercise, the underlying shares), must be held by a trustee for a period of 12 months commencing from the date of which the options were granted; or

(b) the capital gains tax track through a trustee pursuant to which the optionee pays capital gains tax at a rate of 25% on the capital profit portion and marginal tax rate (including payments to the National Insurance Institute and health tax) on the income portion (in general, the income portion is the profit derived from the difference between the average market value of the share 30 days before the allotment date and the exercise price of the option) upon, the earlier to occur of the transfer of the options or the underlying shares from the trustee to the optionee or the sale of the options or the underlying shares by the trustee. (On the capital profit the optionee is not required to make payments to the National Insurance Institute and health tax.) In this track, on the capital profit, the Company may not recognize expenses pertaining to the options for tax purposes but may do so on the income portion. The options (or upon their exercise, the underlying shares), must be held by a trustee for a period of 24 months commencing from the date of which the options were granted; or



(c) the income tax track without a trustee pursuant to which the optionee pays income tax rate (according to the marginal tax rate of the optionee up to 48% in 2012 and 2013 and surtax since 2013) plus payments to the National Insurance Institute and health tax on the profit at the allotment date, and pays capital gains tax at a rate of 25% on the capital profit upon the sale of the underlying shares, and the company may not recognize expenses pertaining to the capital gain for tax purposes but may recognize expenses pertaining to the profit at the allotment date.

In accordance with the provisions of the Tax Reform Legislation, if a company has selected the capital gains track, the company must continue granting options under the selected capital gains track until the end of the year following the year in which the first grant of options under that trustee track will be made. Notwithstanding the above, the company may at any time also grant options under the provisions of the income tax track without a trustee.

The above rules apply only to employees, including office holders but excluding controlling shareholders.

Controlling shareholders optionees are subject to income tax rate (according to the marginal tax rate of the optionee- up to 48% in 2012 and 2013 and surtax since 2013) on the profit upon the sale of the underlying shares.

#### ***U.S.-Israel Tax Treaty***

Pursuant to the Convention Between the Government of the United States of America and the Government of Israel with Respect to Taxes on Income (the "U.S.-Israel Tax Treaty"), 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 and who is entitled to claim the benefits afforded to such resident by the U.S.-Israel Tax Treaty (a "Treaty U.S. Resident") will not be subject to Israeli capital gains tax unless (a) such Treaty U.S. Resident is an individual and was present in Israel for more than 183 days during the relevant taxable year or (b) such Treaty U.S. Resident holds, directly or indirectly, shares representing 10% or more of the voting power of a company during any part of the 12-month period preceding such sale, exchange or disposition. A sale, exchange or disposition of shares by a Treaty U.S. Resident who is an individual and was present in Israel for more than 183 days during the relevant taxable year or who holds, directly or indirectly, shares representing 10% or more of the voting power of a company at any time during such preceding 12-month period would be subject to such Israeli tax, to the extent applicable, unless the following mentioned exemption from capital gain tax for shares listed on the Tel Aviv Stock Exchange applies; however, in case under the U.S.-Israel Tax Treaty and the Israeli tax law a Treaty U.S. Resident will be subject to capital gain tax in Israel, such Treaty U.S. Resident would be permitted to claim a credit for such taxes against the U.S. income tax imposed with respect to such sale, exchange or disposition, subject to the limitations in U.S. laws applicable to foreign tax credits.

### ***Taxation of Non-Residents***

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 and capital gain as mentioned above. On distributions of dividends other than bonus shares (stock dividends), income tax at the rate of 25% in 2012 and 2013 (30% in 2012 and 2013 in case of, the seller holds directly or indirectly, shares representing 10% or more of the voting power of a company during any part of the 12-month period preceding such sale) is withheld at source, unless a different rate is provided in a treaty between Israel and the shareholder's country of residence. For example, the tax rate would be 12.5% if the non-resident is a company which holds 10% or more of our voting power (during the part of our tax year which precedes the date of payment of the dividend and during the entire prior tax year) pursuant to the U.S.-Israel Tax Treaty. Under the U.S.-Israel Tax Treaty, the maximum tax on dividends paid to a holder of ordinary shares who is a resident of the United States will be 25%. However, under the Investment Law, dividends generated by an Approved Enterprise in any case are taxed at the rate of 15%. In addition, if our ordinary shares are traded on the TASE (or listed on a recognized stock exchange outside of Israel), gains on the sale of ordinary shares held by non-Israeli tax resident investors will generally be exempt from Israeli capital gains tax.

### ***U.S. Federal Income Tax Considerations***

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

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

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

This discussion is based on current provisions of the Internal Revenue Code of 1986, as amended, or the Code, current and proposed Treasury Regulations promulgated under the Code and administrative and judicial interpretations of the Code, all as currently in effect and all of which are subject to change, possibly with retroactive effect. This discussion does not address all aspects of U.S. federal income taxation that may be relevant to any particular U.S. holder based on the U.S. holder's particular circumstances. In particular, this discussion does not address the U.S. federal income tax consequences to U.S. holders who are broker-dealers or who own directly, indirectly or constructively, 10% or more of our outstanding voting shares, U.S. holders holding our ordinary shares as part of a hedging, straddle or conversion transaction, U.S. holders that acquired our ordinary shares upon the exercise of employee stock options or otherwise as compensation, U.S. holders whose functional currency is not the U.S. Dollar, insurance companies, tax-exempt organizations, financial institutions, grantor trusts, certain former citizens or long-term residents of the United States, real estate investment trusts, regulated investment companies, persons who have elected mark to mark accounting and persons subject to the alternative minimum tax, who may be subject to special rules not discussed below.

Additionally, the tax treatment of persons who are, or hold our ordinary shares through, a partnership or other pass-through entity is not discussed, and such persons should consult their advisor as to their tax consequences. The possible application of U.S. federal estate or gift taxes or any aspect of state, local or non-U.S. tax laws are also not considered in this discussion.

**You are advised to consult your tax advisor with respect to the specific U.S. federal, state, local and foreign tax consequences to you of purchasing, holding or disposing of our ordinary shares.**

#### *Taxation of Distributions on Ordinary Shares*

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

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

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

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

### ***Taxation of the Disposition of Ordinary Shares***

Subject to the discussion below under "Tax Consequences If We Are a Passive Foreign Investment Company," upon the sale, exchange or other disposition of our ordinary shares, a U.S. holder will recognize capital gain or loss in an amount equal to the difference between the amount realized on the disposition and the U.S. holder's tax basis in the ordinary shares. The gain or loss recognized on the disposition of the ordinary shares will be long-term capital gain or loss if the U.S. holder held the ordinary shares for more than one year at the time of the disposition. Long-term capital gains are currently taxable to certain non-corporate taxpayers at a maximum rate of 15% for taxable years beginning on or before December 31, 2013. Capital gain from the sale, exchange or other disposition of ordinary shares held for one year or less is short-term capital gain and taxed as ordinary income (currently up to a maximum rate of 39.6%). The deductibility of capital losses recognized on the sale, exchange or other distribution of our ordinary shares is subject to certain limitations. Gain or loss recognized by a U.S. holder on a sale, exchange or other disposition of ordinary shares generally will be treated as U.S. source income or loss for U.S. foreign tax credit purposes.

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

### ***Medicare Tax***

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

### ***Tax Consequences If We Are a Passive Foreign Investment Company ("PFIC")***

We will be a PFIC if either (i) 75% or more of our gross income in a taxable year is passive income or (ii) the average percentage (by value) in a taxable year of our assets that produce, or are held for the production of, passive income, is at least 50%. If we own (directly or indirectly) at least 25% by value of the stock of another corporation, we will be treated for purposes of the foregoing tests as owning our proportionate share of the other corporation's assets and as directly earning our proportionate share of the other corporation's income. If we are a PFIC, a U.S. holder must determine under which of three alternative taxing regimes it wishes to be taxed. In addition, if we are a PFIC, each U.S. holder will generally be required to file an annual report with the IRS.

The "QEF" regime applies (to the exclusion of the "excess distribution" regime, described below) if the U.S. holder elects to treat us as a "qualified electing fund", or QEF, for the first taxable year in which the U.S. holder owns our ordinary shares during which we are a PFIC, and if we comply with certain reporting requirements. If the QEF regime applies, then in each taxable year that we are a PFIC, such U.S. holder will include in its gross income a proportionate share of our ordinary earnings (which is taxed as ordinary income) and net capital gain (which is taxed as long-term capital gain), subject to a separate election to defer payment of taxes, in which such deferral is subject to an interest charge. These amounts would be included in income by an electing U.S. holder for its taxable year in which our taxable year ends, whether or not such amounts are actually distributed to the U.S. holder. A U.S. holder's basis in our ordinary shares for which a QEF election has been made would be increased to reflect the amount of any taxed but undistributed income and decreased by any amounts not included in income when distributed because such amounts were previously taxed under the QEF rules. Generally, a QEF election allows electing U.S. holders to treat gain or loss realized on the disposition of their ordinary shares as capital gain or loss. If a QEF election is made by the U.S. holder after the first taxable year in which the U.S. holder holds our ordinary shares during which we are a PFIC, then special rules would apply.

Once made, the QEF election applies to all subsequent taxable years of the U.S. holder in which it holds our ordinary shares and for which we are a PFIC and can be revoked only with the consent of the IRS. A shareholder makes a QEF election by attaching a completed IRS Form 8621, including the PFIC annual information statement, to a timely filed United States federal income tax return.

A second regime, the "mark-to-market" regime, may be elected so long as our ordinary shares are "marketable stock" (e.g., "regularly traded" on a "qualified exchange" or other market). Pursuant to this regime, an electing U.S. holder's ordinary shares are marked-to-market each taxable year in which we are a PFIC, and the U.S. holder recognizes as ordinary income or loss an amount equal to the difference as of the close of the taxable year between the fair market value of our ordinary shares and the U.S. holder's adjusted tax basis in our ordinary shares. Losses are allowed only to the extent of net mark-to-market gain previously included by the U.S. holder under the election for prior taxable years. An electing U.S. holder's adjusted basis in our ordinary shares is increased by income recognized under the mark-to-market election and decreased by the deductions allowed under the election.

Under the mark-to-market election, in a taxable year in which we are a PFIC, gain on the sale of our ordinary shares is treated as ordinary income, and loss on the sale of our ordinary shares, to the extent the amount of loss does not exceed the net mark-to-market gain previously included, is treated as ordinary loss. Any loss on the disposition of our ordinary shares in excess of previous net mark-to-market gains is generally considered a capital loss. The mark-to-market election applies to the taxable year for which the election is made and all later taxable years in which we are a PFIC, unless the ordinary shares cease to be marketable stock or the IRS consents to the revocation of the election. If the mark-to-market election is made by a U.S. holder after the first taxable year in which a U.S. holder holds our ordinary shares and we are a PFIC, then special rules would apply.

A U.S. holder making neither the QEF election nor the mark-to-market election is subject to the "excess distribution" regime. Under this regime, "excess distributions" are subject to special tax rules. An excess distribution is either (i) a distribution with respect to shares that is greater than 125% of the average distributions received by the U.S. holder from us over the shorter of either the preceding three taxable years or such U.S. holder's holding period for our shares or (ii) gain from the disposition of our PFIC shares (including gain deemed recognized if the PFIC shares are used as security for a loan).

Excess distributions must be allocated ratably to each day that a U.S. holder has held our ordinary shares if we are a PFIC. A U.S. holder must include amounts allocated to the current taxable year, as well as amounts allocated to taxable years prior to the first taxable year in which we were a PFIC, in its gross income as ordinary income for that year. All amounts allocated to each of the other taxable years would be taxed at the highest tax rate applicable to ordinary income for that taxable year and the U.S. holder also would be liable for interest on the deferred tax liability for such taxable year calculated as if such liability had been due with respect to such taxable year. The portions of gains and distributions that are not characterized as "excess distributions" are treated as ordinary income subject to tax in the current taxable year under the normal tax rules of the Code. A U.S. person who inherits shares in a non-U.S. corporation that was a PFIC in the hands of the decedent (who was not a nonresident alien) is denied the otherwise available step-up in the tax basis of such shares to fair market value at the date of death. Such U.S. holder's basis in such shares is generally equal to the lower of the decedent's basis or the fair market value of such shares on the decedent's date of death.

We believe that in 2013 we were not a PFIC. However, since the determination of whether we are a PFIC is based upon such factual matters as the valuation of our assets and, in certain cases, the assets of companies held by us, there can be no assurance with respect to the position of the IRS or a court of law as to our status as a PFIC. Our analysis is based, among other things, upon certain assumptions and methodologies with respect to the values that we have used, our percentage ownership (by value), and the appropriate value of our ownership interest, in companies we hold, and the manner in which we have allocated the aggregate value of our assets among our active assets and passive assets.

We cannot assure you that the IRS will not challenge our assumptions and methodologies. If the IRS were to successfully challenge such assumptions or methodologies, we could potentially be classified as a PFIC for 2013 or prior taxable years. The tests for determining PFIC status are applied annually and it is difficult to make accurate predictions of future income and assets, which are relevant to this determination. As described above, the tests are impacted, by, among other factors, changes in value of our group companies which are difficult to predict at this time and the appropriate value of our ownership interest in our group companies. Accordingly, there can be no assurance that we will not become a PFIC for the current fiscal taxable year ending December 31, 2014 or in any future taxable year. There exists the possibility that we could become a PFIC in 2014 as a result of the sale of our investment in Given Imaging in 2014. However, based on preliminary projections and analysis conducted by us and our advisors, we believe that it is possible that we may qualify for the "change in business exception" under Section 1298(b)(3) of the United States Internal Revenue Code and avoid being classified as a PFIC for 2014. The determination of whether the change in business exception applies to us will be affected by several factors, including the amount of our passive income in 2014, our deployment of the proceeds from the Given Imaging sale, and our PFIC status in 2015 and 2016, many of which will not be determinable until after 2014. If we ultimately conclude that the change in business exception applies and we are not classified as a PFIC for 2014, we cannot assure you that the United States Internal Revenue Service will not challenge our conclusion or our assumptions used in reaching such conclusion. If there were such a challenge by the IRS, we could be classified as a PFIC for 2014, even if we are not a PFIC in 2015 or 2016. In addition, if we otherwise satisfy the requirements for the change in business exception, but then become a PFIC in either 2015 or 2016, then we would retroactively be ineligible to apply the change in business exception for 2014.

We will notify U.S. holders in the event we conclude that we will be treated as a PFIC for any taxable year to enable U.S. holders to consider whether or not to elect to treat us as a QEF for U.S. federal income tax purposes or to "mark to market" the ordinary shares, or to become subject to the "excess distribution" regime.

**U.S. holders are urged to consult their tax advisors regarding the application of the PFIC rules, including eligibility for and the manner and advisability of making the QEF election or the mark-to-market election.**

***Non-U.S. Holders of Ordinary Shares***

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

***Information Reporting and Backup Withholding***

A U.S. holder generally is subject to information reporting and may be subject to backup withholding (currently at a rate of up to 28%) with respect to dividend payments and receipt of the proceeds from the disposition of the ordinary shares. Backup withholding will not apply with respect to payments made to exempt recipients, including corporations and tax-exempt organizations, or if a U.S. holder provides a correct taxpayer identification number certifying that such holder is not subject to backup withholding or otherwise establishes an exemption. Backup withholding is not an additional tax and may be claimed as a credit against the U.S. federal income tax liability of a U.S. holder, or alternatively, the U.S. holder may be eligible for a refund of any excess amounts withheld under the backup withholding rules, in either case, provided that the required information is furnished to the IRS. A U.S. holder of ordinary shares who does not provide a correct taxpayer identification number may be subject to penalties imposed by the IRS.



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

**F. Dividends and Paying Agents**

Not applicable.

**G. Statement by Experts**

Not applicable.

**H. Documents on Display**

We are required to file reports and other information with the SEC, under the Exchange Act and the regulations thereunder applicable to foreign private issuers. Reports and other information filed by us with the SEC may be inspected and copied at the SEC's public reference facilities described below. Although as a foreign private issuer we are not required to file periodic information as frequently or as promptly as U.S. companies, we generally do publicly announce our quarterly and year-end results promptly and file periodic information with the SEC on Form 6-K. As a foreign private issuer, we are also exempt from the rules under the Exchange Act prescribing the furnishing and content of proxy statements and our officers, directors and principal shareholders are exempt from the reporting and other provisions in Section 16 of the Exchange Act.

You may read and copy any document we file with the SEC without charge at the SEC's public reference room, located at 100 F Street, N.E., Washington, D.C. 20549. Copies of such material may be obtained by mail from the Public Reference Branch of the SEC at such address, at prescribed rates. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room. In addition, our filings are available to the public at the SEC's website at [www.sec.gov](http://www.sec.gov) and in Hebrew at the Israel Securities Authority website at [www.magna.isa.co.il](http://www.magna.isa.co.il). We also generally make available on our own web site ([www.elron.com](http://www.elron.com)) all our quarterly and year-end financial statements as well as other information. Our website is not part of this Annual Report.

Descriptions of contracts or other documents in this Annual Report are necessarily summaries. If the contract or document described is filed as an exhibit to this Annual Report, you should refer to the exhibit for the complete text of such contract or document.

## I. Subsidiary Information

Not applicable.

### Item 11. Quantitative and Qualitative Disclosures About Market Risk

For disclosures regarding our market risk exposures, see "Item 5 - Operating and Financial Review and Prospects – Liquidity and Capital Resources – Quantitative and Qualitative Disclosures about Market Risk" above, which is hereby incorporated herein by reference.

### Item 12. Descriptions of Securities Other Than Equity Securities

Not applicable.

## PART II

### Item 13. Defaults, Dividend Arrearages and Delinquencies

Not applicable.

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

Not applicable.

### Item 15. Controls and Procedures

#### a. Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures over financial reporting (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act), as of December 31, 2013. Based on this evaluation, our chief executive officer and chief financial officer concluded that, as of December 31, 2013, our disclosure controls and procedures were: (1) designed to ensure that material information relating to us, including our consolidated subsidiaries, is accumulated and communicated to our management, including our chief executive officers and chief financial officer, and by others within those entities, as appropriate to allow timely decisions regarding required disclosure, particularly during the period in which this report was being prepared; and (2) effective, in that they provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms.

#### b. Management's Annual Report on Internal Control over Financial Reporting

Our management, under the supervision of our chief executive officer and chief financial officer, is responsible for establishing and maintaining adequate internal controls over financial reporting for us and our subsidiaries. Based on the criteria for effective internal control over financial reporting established in *Internal Control — Original Framework*, which was issued by the Committee of Sponsoring Organizations of the Treadway Commission in 1992, management has assessed our internal control over financial reporting as effective as of December 31, 2013.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Our registered public accounting firm that audited our consolidated financial statements as set forth in "Item 18 – Financial Statements," has issued an attestation report on management's assessment of our internal control over financial reporting.

**c. Attestation Report of the Registered Public Accounting Firm**

The attestation report of our registered public accounting firm is included in page F-3 of our audited consolidated financial statements set forth in "Item 18 – Financial Statements."

**d. Changes in Internal Control Over Financial Reporting**

No change in our internal controls over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) occurred during the year ended December 31, 2013, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Item 16.** [Reserved]

**Item 16A.** Audit Committee Financial Expert

Our board of directors has determined that Arie Ovadia is the "audit committee financial expert" serving on its audit committee.

**Item 16B.** Code of Ethics

We have adopted a Code of Ethics and Business Conduct that is applicable to our officers and directors and those employees of DIC providing services to us under the Services Agreement. A copy of the Code of Ethics and Business Conduct was filed as an Exhibit 11.1 to our Annual Report on Form 20-F, filed with the SEC on June 29, 2004, and it is also available at our website at [www.elron.com](http://www.elron.com).

**Item 16C. Principal Accountant Fees and Services**

The following table sets forth the total remuneration that was paid by us and our subsidiaries to our principal accountants Kost Forer Gabbay & Kasierer (a member of Ernst & Young Global) in each of our previous two fiscal years:

	<u>2012</u>	<u>2013</u>
	(in thousands of U.S. \$)	
Audit Fees (1)	348	317
Tax Fees (2)	41	27
All Other Fees	5	14
Total	<u>394</u>	<u>358</u>

(1) Audit Fees consist of fees billed for the annual audit services engagement and other audit services, which are those services that only the external auditor can reasonably provide, and include statutory audits; consents; and assistance with and review of documents filed with the SEC.

(2) Tax Fees include fees billed for tax compliance services, including the audit of original and amended tax returns and claims for tax refund; tax consultations, such as assistance and representation in connection with tax audits and appeals requests for rulings or technical advice from taxing authority; and tax planning services.

Our audit committee's policy is to pre-approve each audit and non-audit service to be performed by our independent auditors for us and our subsidiaries.

**Item 16D. Exemptions from the Listing Standards for Audit Committees**

Not applicable.

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

During the last two years, there were no purchases of equity securities by us and affiliated purchasers other than shares purchased for members of the public through, among others, provident funds, mutual funds, pension funds, exchange traded funds and insurance policies, which are managed by subsidiaries of Clal Insurance, a subsidiary of IDBD.

During the last two years, other than option exercises by former employees, in immaterial amounts, there have not been any investments in our share capital. There are no outstanding obligations to make additional investments in our share capital.

**Item 16F. Change in Registrant's Certifying Accountant.**

Not Applicable.

**Item 16G. Corporate Governance**

Not Applicable.

**PART III****Item 17. Financial Statements**

Not applicable.

**Item 18. Financial Statements**

Our consolidated financial statements and the report of independent registered public accounting firm in connection therewith are filed as part of this Annual Report and follow the certifications following the signature page of this Annual Report.

**Item 19. Exhibits**

Exhibit No. Exhibit

- 1.1 Articles of Association (English translation), consolidated version including amendments approved by the Company's shareholders on February 1, 2012.
- 1.2 Memorandum of Association of Elron Electronic Industries Ltd., incorporated by reference to Exhibit 1.2 to the Company's Annual Report on Form 20-F for the year ended December 31, 2000, filed with the SEC on June 8, 2001.
- 4.1 Services Agreement dated as of March 19, 2009 by and between the registrant and Discount Investment Corporation Ltd. incorporated by reference to Exhibit 99.2 to Form 6-K, filed with the SEC on March 24, 2009.
- 4.2 Amendment to Services Agreement dated as of May 1, 2012 by and between the registrant and Discount Investment Corporation Ltd.
- 4.3 Joint Venture Agreement, dated as of April 1993, among Discount Investment Corporation Ltd., PEC Israel Economic Corporation, Rafael Armament Development Authority Ltd. and Galram Technology Industries Limited ("Joint Venture Agreement"), incorporated by reference to Exhibit 10.4 to Amendment No. 5 to the Company's Registration Statement on Form F-4, filed with the SEC on March 14, 2002.
- 4.4 Amendment to Joint Venture Agreement, dated December 30, 2007, incorporated by reference to Exhibit 4.2 to the Company's Annual Report on Form 20F for the year ended December 31, 2007 filed with the SEC on June 30, 2008.
- 4.5 Loan Agreement dated November 9, 2011 between the Company and Silicon Valley Bank incorporated by reference to Exhibit 2 to the Elron's Schedule 13D/A filed with the SEC on March 8, 2012
- 4.6 Amendment to Loan Agreement dated April 25, 2013 between the Company and Silicon Valley Bank
- 4.7 Agreement and Plan of Merger with Covidien Group S.a.r.l and Rioja Israel (2013) Ltd incorporated by reference to Exhibit 99.1 to the Form 6-K, filed with the SEC by Given Imaging Ltd on December 9, 2013.
- 8.1 List of subsidiaries.
- 11.1 Code of Ethics, incorporated by reference to Exhibit 11.1 to the Company's Annual Report on Form 20-F, filed with the SEC on June 29, 2004.
- 12.1 Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 12.2 Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 13.1 Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.\*
- 13.2 Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.\*
- 15.1 Consent of Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global, for Elron Electronic Industries Ltd., dated March 11, 2014.
- 15.2 Consent of Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global, for Pocared Diagnostics Ltd., dated March 11, 2014.
- 15.3 Consent of Somekh Chaikin, a member firm of KPMG International for Given Imaging Ltd., dated March 10, 2014.

\* This document is being furnished in accordance with SEC Release No. 33-8212 and 34-47551.

**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.

Dated: March 11, 2014

**ELRON ELECTRONIC INDUSTRIES LTD.**

By: /s/ Ari Bronshtein  
Name: Ari Bronshtein  
Title: Chief Executive Officer

By: /s/ Yaron Elad  
Name: Yaron Elad  
Title: Vice President & Chief Financial Officer

**Elron Electronic Industries Ltd.**  
**Consolidated Financial Statements**  
**For the Year Ended**  
**December 31, 2013**

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**Consolidated Financial Statements for the Year Ended December 31, 2013**

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**Contents**

	<u>Page</u>
<a href="#">Reports of Independent Registered Public Accounting Firm</a>	F - 2
<a href="#">Consolidated Statements of Financial Position</a>	F - 4
<a href="#">Consolidated Statements of Income</a>	F - 6
<a href="#">Consolidated Statements of Comprehensive Income</a>	F - 7
<a href="#">Consolidated Statements of Changes in Equity</a>	F - 8
<a href="#">Consolidated Statements of Cash Flows</a>	F - 11
<a href="#">Notes to the Consolidated Financial Statements</a>	F - 13
<a href="#">Annex to the Consolidated Financial Statements - Details Relating to Investments as of December 31, 2013</a>	F - 90

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**To the Board of Directors and Shareholders of**

**ELRON ELECTRONIC INDUSTRIES LTD.**

We have audited Elron Electronic Industries Ltd.'s (the "Company") internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework) (the "COSO criteria"). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit 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 effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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

In our opinion, the Company maintained in all material respects, effective internal control over financial reporting as of December 31, 2013, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial position of the Company and its subsidiaries as of December 31, 2013 and 2012, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2013 and our report dated March 11, 2014 expressed an unqualified opinion thereon.

Tel-Aviv, Israel  
March 11, 2014

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



**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**To the Board of Directors and Shareholders of**

**ELRON ELECTRONIC INDUSTRIES LTD.**

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

We did not audit the financial statements of a certain associate (as of December 31, 2013 - investment in associate classified as held for sale), the investment in which, at equity, amounted to \$ 66 million and \$ 57.3 million as of December 31, 2013 and 2012, respectively, and the Company's equity in their earnings amounted to \$ 2.9 million, \$ 4.4 million and \$ 2.2 million for the years ended December 31, 2013, 2012 and 2011, respectively. These financial statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for this company, is based solely on the reports of other the auditors.

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 management, as well as evaluating the overall financial statement presentation. We believe that our audits and the reports of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2013 and 2012, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2013, in conformity with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB"), and with the provisions of the Israeli Securities Regulations (Preparation of Annual Financial Statements), 2010.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework) and our report dated March 11, 2014 expressed an unqualified opinion thereon.

Tel-Aviv, Israel  
March 11, 2014

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

## Consolidated Statements of Financial Position as of

	Note	December 31	
		2013	2012
		\$ thousands	
<b>Current assets</b>			
Cash and cash equivalents	4	32,291	47,525
Other accounts receivable	5	3,479	3,834
Investment in associate classified as held for sale	3	108,735	-
		<u>144,505</u>	<u>51,359</u>
<b>Non-current assets</b>			
Investments in associates	3	8,541	113,217
Other investments measured at fair value	6	26,300	23,575
Other long-term receivables	8	29	3,832
Property, plant and equipment, net		75	177
Intangible assets, net	9	4,458	4,922
Deferred taxes	17	28,994	-
		<u>68,397</u>	<u>145,723</u>
<b>Total assets</b>		<u>212,902</u>	<u>197,082</u>

The notes to the consolidated financial statements constitute an integral part thereof.

## Consolidated Statements of Financial Position as of

	Note	December 31	
		2013	2012
		\$ thousands	
<b>Current liabilities</b>			
Loans from banks	11	4,000	-
Trade payables		176	237
Other accounts payable	10	3,525	2,605
		<u>7,701</u>	<u>2,842</u>
<b>Long-term liabilities</b>			
Long term loans from banks	11	-	4,000
Royalty bearing government grants	12	-	864
Long term taxes	17	5,386	4,457
		<u>5,386</u>	<u>9,321</u>
<b>Equity attributable to the Company's shareholders</b>	13		
Issued capital		9,573	9,573
Share premium		190,753	190,709
Capital reserves		(6,166)	(9,868)
Accumulated deficit		(13,377)	(28,374)
		<u>180,783</u>	<u>162,040</u>
<b>Non-controlling interests</b>		<u>19,032</u>	<u>22,879</u>
<b>Total equity</b>		<u>199,815</u>	<u>184,919</u>
<b>Total liabilities and equity</b>		<u>212,902</u>	<u>197,082</u>

Arie Mientkavich  
Chairman of the Board of Directors

Ari Bronshtein  
Chief Executive Officer

Yaron Elad  
Vice President &  
Chief Financial Officer

Approval date of the consolidated financial statements: March 11, 2014

The notes to the consolidated financial statements constitute an integral part thereof.

## Consolidated Statements of Income

	Note	For the year ended December 31		
		2013	2012	2011
		\$ thousands		
				(except for net income (loss) per share data)
<b>Income</b>				
Income from sales		97	-	14,103
Gain from disposal and revaluation of investee companies and changes in holdings, net	16.A	8,416	39,426	34,605
Financial income	16.F	684	1,241	1,758
		<u>9,197</u>	<u>40,667</u>	<u>50,466</u>
<b>Expenses</b>				
Cost of sales	16.B	59	-	5,823
Research and development expenses, net	16.C	3,929	6,869	18,184
Selling and marketing expenses	16.D	545	905	5,672
General and administrative expenses	16.E	7,193	7,190	10,474
Equity in losses of associates, net	16.G	11,868	8,357	10,374
Amortization of intangible assets		-	-	313
Financial expenses	16.F	561	2,052	4,173
Other expenses (income), net	16.H	(3,487)	(282)	9,560
		<u>20,668</u>	<u>25,091</u>	<u>64,573</u>
Income (loss) before taxes on income		(11,471)	15,576	(14,107)
Tax benefit (taxes on income)	17	28,401	262	(602)
<b>Net income (loss)</b>		<u>16,930</u>	<u>15,838</u>	<u>(14,709)</u>
<b>Attributable to:</b>				
The Company's shareholders		17,935	4,357	(8,417)
Non-controlling interests		(1,005)	11,481	(6,292)
		<u>16,930</u>	<u>15,838</u>	<u>(14,709)</u>
<b>Net income (loss) per share attributable to the Company's shareholders (in \$)</b>	18			
Basic and diluted net income (loss) per share		<u>0.54</u>	<u>0.09</u>	<u>(0.34)</u>

The notes to the consolidated financial statements constitute an integral part thereof.

## Consolidated Statements of Comprehensive Income

	For the year ended December 31		
	2013	2012	2011
	\$ thousands		
Net income (loss)	16,930	15,838	(14,709)
<b>Other comprehensive income (loss) (after tax)</b>			
<u>Amounts that would never be reclassified to profit or loss:</u>			
Loss from financial assets measured at fair value through other comprehensive income, net	(2,111)	(1,313)	(16,146)
Actuarial losses on defined benefit plan	-	-	(81)
Group's share of other comprehensive income (loss), net of companies accounted for under the equity method	(16)	164	237
<u>Total loss that would never be reclassified to profit or loss</u>	(2,127)	(1,149)	(15,990)
<u>Amounts that are classified or may be reclassified to profit or loss under certain conditions:</u>			
Available-for-sale financial assets classified to the statement of income (*)	-	-	782
Foreign currency translation differences for foreign operations	-	(54)	1,904
Foreign currency translation differences charged to the statement of income upon disposal of foreign operations	-	80	(1,200)
<u>Total gain that would be reclassified to profit or loss under certain conditions</u>	-	26	1,486
<b>Total other comprehensive loss</b>	(2,127)	(1,123)	(14,504)
<b>Total comprehensive income (loss)</b>	14,803	14,715	(29,213)
<b>Attributable to:</b>			
Company's shareholders	15,810	3,214	(23,433)
Non-controlling interests	(1,007)	11,501	(5,780)
	14,803	14,715	(29,213)

(\*) With respect to financial assets which were sold prior to the adoption of IFRS 9, Financial Assets, see also Note 2.G.

The notes to the consolidated financial statements constitute an integral part thereof.

## Consolidated Statements of Changes in Equity

	Attributable to the Company's shareholders									
	Issued capital	Share Premium	Capital reserve for transaction with controlling shareholders	Capital reserve for financial assets measured at fair value through other comprehensive income	Capital reserve from transactions with non-controlling interests	Accumulated deficit from share based payments	Accumulated deficit	Total	Non-controlling interests	Total equity
	\$ thousands									
<b>Balance at January 1, 2013</b>	9,573	190,709	351	(11,326)	1,107	391	(28,765)	162,040	22,879	184,919
Total comprehensive income (loss)	-	-	-	(2,111)	-	-	17,921	15,810	(1,007)	14,803
Share-based payments in respect of awards issued by subsidiaries	-	-	-	-	-	-	-	-	(38)	(38)
Change in non-controlling interests subsequent to the transfer of the investment in RDSeed to RDC (see Note 3.A.3.f))	-	-	-	-	2,172	-	-	2,172	(2,172)	-
Non-controlling interests created due to initially consolidated company	-	-	-	-	-	-	-	-	348	348
Change in non-controlling interests due to sale of a subsidiary	-	-	-	-	-	-	-	-	(261)	(261)
Change in non-controlling interests in consolidated company	-	-	-	-	717	-	-	717	(717)	-
Expiration of share-based payments	-	-	-	-	-	(379)	379	-	-	-
Exercise of options into shares of the Company	-*)	44	-	-	-	(12)	12	44	-	44
Sale of financial assets measured at fair value through other comprehensive income	-	-	-	2,924	-	-	(2,924)	-	-	-
<b>Balance at December 31, 2013</b>	<u>9,573</u>	<u>190,753</u>	<u>351</u>	<u>(10,513)</u>	<u>3,996</u>	<u>-</u>	<u>(13,377)</u>	<u>180,783</u>	<u>19,032</u>	<u>199,815</u>

\*) Amount less than \$1 thousand.

The notes to the consolidated financial statements constitute an integral part thereof.

## Consolidated Statements of Changes in Equity

	Attributable to the Company's shareholders										
	Issued capital	Share Premium	Capital reserve for transaction with controlling interests	Capital reserve for financial assets measured at fair value through other comprehensive income	Capital reserve from translation differences	Capital reserve from transactions with non-controlling interests	Accumulated deficit from share based payments	Accumulated deficit	Total	Non-controlling interests	Total Equity
	\$ thousands										
<b>Balance at January 1, 2012</b>	9,573	190,378	351	(10,013)	(29)	1,221	1,175	(19,047)	173,609	20,474	194,083
Total comprehensive income (loss)	-	-	-	(1,313)	29	-	-	4,498	3,214	11,501	14,715
Share-based payments in respect of awards issued by subsidiaries	-	-	-	-	-	-	-	-	-	492	492
Exercise of options into shares in a subsidiary	-	-	-	-	-	11	-	-	11	11	22
Expiration of share-based payments	-	-	-	-	-	-	(695)	695	-	-	-
Exercise of options into shares of the Company	*)-	331	-	-	-	-	(89)	89	331	-	331
Purchase of shares of subsidiary from non-controlling interests	-	-	-	-	-	(303)	-	-	(303)	(111)	(414)
Dividend to equity holders of the Company	-	-	-	-	-	-	-	(15,000)	(15,000)	-	(15,000)
Dividend paid by a subsidiary to non-controlling interests	-	-	-	-	-	-	-	-	-	(8,871)	(8,871)
Change in non-controlling interests due to sale of a subsidiary	-	-	-	-	-	-	-	-	-	(439)	(439)
Investment in subsidiary by RDC	-	-	-	-	-	178	-	-	178	(178)	-
<b>Balance at December 31, 2012</b>	<u>9,573</u>	<u>190,709</u>	<u>351</u>	<u>(11,326)</u>	<u>-</u>	<u>1,107</u>	<u>391</u>	<u>(28,765)</u>	<u>162,040</u>	<u>22,879</u>	<u>184,919</u>

\*) Amount less than \$1 thousand.

The notes to the consolidated financial statements constitute an integral part thereof.



## Consolidated Statements of Changes in Equity

	Attributable to the Company's shareholders											Non-controlling interests	Total equity
	Issued capital	Share premium	Capital reserve for transaction with controlling interests	Revaluation reserve from consolidation of subsidiaries	Capital reserve for financial assets measured at fair value through other comprehensive income	Capital reserve from translation differences	Capital reserve from transactions with non-controlling interests	Capital reserve for available for sale financial assets held for sale	Accumulated deficit from share based payments	Accumulated deficit	Total		
	\$ thousands												
<b>Balance at January 1, 2011</b>	9,573	190,378	351	150	1,398	(228)	80	3,960	1,194	(10,955)	195,901	23,569	219,470
Total comprehensive income (loss)	-	-	-	-	(1,537)	199	-	(13,834)	-	(8,261)	(23,433)	(5,780)	(29,213)
Share-based payments in respect of awards issued by subsidiaries	-	-	-	-	-	-	115	-	-	-	115	600	715
Expiration of share-based payments in respect of awards issued by subsidiaries	-	-	-	-	-	-	1,026	-	-	-	1,026	(1,026)	-
Expiration of share-based payment instruments	-	-	-	-	-	-	-	-	(19)	19	-	-	-
Reclassification of revaluation reserve in respect of acquisition of subsidiary achieved in stages	-	-	-	(150)	-	-	-	-	-	150	-	-	-
Increase in non-controlling interest due to additional investment in subsidiary	-	-	-	-	-	-	-	-	-	-	-	469	469
Change in non-controlling interests due to sale of a subsidiary	-	-	-	-	-	-	-	-	-	-	-	1,378	1,378
Classification of non-current assets as held for sale	-	-	-	-	(9,874)	-	-	9,874	-	-	-	-	-
Non-controlling interests created due to initially consolidated companies	-	-	-	-	-	-	-	-	-	-	-	1,264	1,264
<b>Balance at December 31, 2011</b>	<u>9,573</u>	<u>190,378</u>	<u>351</u>	<u>-</u>	<u>(10,013)</u>	<u>(29)</u>	<u>1,221</u>	<u>-</u>	<u>1,175</u>	<u>(19,047)</u>	<u>173,609</u>	<u>20,474</u>	<u>194,083</u>

The notes to the consolidated financial statements constitute an integral part thereof.

## Consolidated Statements of Cash Flows

	For the year ended December 31		
	2013	2012	2011
	\$ thousands		
<b>Cash flows from operating activities</b>			
Net income (loss)	16,930	15,838	(14,709)
<b>Adjustments to reconcile net income (loss) to net cash used in operating activities:</b>			
<b>Adjustment to the profit or loss items:</b>			
Depreciation and amortization	123	83	1,334
Financial income, net	(556)	(299)	(186)
Stock based compensation and changes in liability in respect of options	(84)	454	1,009
Gain from reversal of impairment of financial assets (see also Note 6)	(3,522)	-	-
Change in fair value of financial assets measured at fair value	-	1,407	60
Gain from sale of investments in available for sale financial assets	-	-	(543)
Loss from impairment of investments and financial assets	-	-	5,846
Loss from write down of inventory	-	-	3,953
Change in fair value of convertible debentures	-	-	669
Gain from disposal and revaluation of investee companies and changes in holdings, net	(8,416)	(39,426)	(34,605)
Equity in losses of associates, net	11,868	8,357	10,374
Taxes on income (tax benefit)	(28,401)	(262)	602
Other	(29)	(485)	850
	<u>(29,017)</u>	<u>(30,171)</u>	<u>(10,637)</u>
<b>Changes in Assets and Liabilities:</b>			
Increase in trade receivables	-	-	(699)
Decrease in other accounts receivable	340	449	2,058
Decrease (increase) in inventories	-	99	(1,310)
Increase (decrease) in liabilities in respect of government grants	42	(507)	89
Increase (decrease) in trade payables	(51)	(165)	217
Increase (decrease) in other accounts payable	978	(1,306)	(1,859)
	<u>1,309</u>	<u>(1,430)</u>	<u>(1,504)</u>
<b>Cash paid and received during the year for:</b>			
Taxes paid	-	(2,170)	-
Taxes received	-	1,734	-
Interest paid	(169)	(174)	(468)
Interest received	252	473	654
	<u>83</u>	<u>(137)</u>	<u>186</u>
<b>Net cash used in operating activities</b>	<u>(10,695)</u>	<u>(15,900)</u>	<u>(26,664)</u>

The notes to the consolidated financial statements constitute an integral part thereof.

## Consolidated Statements of Cash Flows

	For the year ended December 31		
	2013	2012	2011
	\$ thousands		
<b>Cash flows from investment activities</b>			
Purchase of property and equipment	(35)	(57)	(958)
Investment in associates and other companies	(10,239)	(12,230)	(12,899)
Purchase of intangible assets	-	-	(9)
Proceeds from sale of property and equipment	9	6	27
Proceeds from sale of investments in subsidiaries net of cash disposed of due to deconsolidation (see Note 3.A.3.h))	1,335	51,651	13,139
Proceeds from sale of Starling's operation (see also Note 3.A.3.c)	-	2,745	8,201
Proceeds from sale of associates and other companies	412	2,218	286
Proceeds from repayment of debentures (see also Note 6)	1,698	-	-
Dividend received from associates	-	-	230
Proceeds from sale of financial assets measured at fair value	115	1,748	1,562
Acquisition of investments in subsidiaries net of cash acquired	184	-	668
Long term deposits, net	912	(930)	372
<b>Net cash provided by (used in) investment activities</b>	<b>(5,609)</b>	<b>45,151</b>	<b>10,619</b>
<b>Cash flows from financing activities</b>			
Receipt of government grants	553	1,291	1,518
Repayment of government grants	-	-	(4,943)
Proceeds from exercise of options	44	331	-
Investment of non-controlling interests in subsidiaries	-	22	469
Dividend paid to the Company's shareholders	-	(15,000)	-
Dividend paid to non-controlling interests	-	(8,871)	-
Purchase of shares and options from non-controlling interests	-	(414)	-
Receipt of long-term loans from banks and others	-	5,000	3,250
Repayment of other long-term loans and liabilities	-	(4,339)	(224)
Repayment of convertible debentures	-	-	(3,877)
Short-term credit from banks and others, net	-	-	1,858
<b>Net cash provided by (used in) financing activities</b>	<b>597</b>	<b>(21,980)</b>	<b>(1,949)</b>
<b>Exchange rate differences in respect of cash and cash equivalents</b>	<b>473</b>	<b>192</b>	<b>1,517</b>
<b>Increase (decrease) in cash and cash equivalents</b>	<b>(15,234)</b>	<b>7,463</b>	<b>(16,477)</b>
<b>Cash and cash equivalents as of beginning of the year</b>	<b>47,525</b>	<b>40,062</b>	<b>56,539</b>
<b>Cash and cash equivalents as of end of the year</b>	<b>32,291</b>	<b>47,525</b>	<b>40,062</b>

The notes to the consolidated financial statements constitute an integral part thereof.

**Notes to the Consolidated Financial Statements**

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**(USD in thousands, except for price per share and number of shares)****Note 1- General**

Elron Electronic Industries Ltd. ("Elron" or "the Company") is a high technology operational holding company that focuses on building technology companies. Elron's group of companies includes companies at different stages of development operating in various technology fields such as medical devices and other fields. The Company is an Israeli-resident company incorporated in Israel, traded on the Tel-Aviv Stock Exchange and Over-The-Counter market in the United States. Its registered address is 3 Azrieli Center, Triangle Tower, 42nd floor, Tel Aviv, Israel.

The Company's parent company is Discount Investment Corporation Ltd. ("DIC"), an Israeli-resident company, traded on the Tel-Aviv Stock Exchange. DIC holds an approximately 50.32% interest in the Company as of December 31, 2013.

As aforementioned, Elron's ordinary shares are also registered in the U.S. under Securities and Exchange Commission (SEC) rules, and as such, in addition to the reporting requirements under Chapter F of the Israel Securities Law (1968) applicable to reporting companies in Israel, the Company continues to comply with reporting requirements in accordance with U.S. applicable securities laws and regulations, as long as those apply to Elron.

In December 2013, Given Imaging Ltd. ("Given", a company which was accounted for under the equity method of accounting until its classification in December 2013 as held for sale, see below) signed an agreement with an entity of the Covidien corporation (the "Purchaser") and a subsidiary fully owned by the Purchaser, according to which by way of merger between the Purchaser's subsidiary and Given, the entire share capital of Given will be transferred to the Purchaser for a cash consideration to Given's current shareholders of \$30 per share (the "Transaction" or the "Given Merger"). The share of Elron and RDC in the consideration, less tax payments and transactions costs, is approximately \$204,000 and \$61,000, respectively. In January 2014, subsequent to the reporting date, the general meeting of Given's shareholders approved the Transaction and the necessary regulatory approvals were received and in February 2014, subsequent to the reporting date, the Transaction was completed and the aforementioned consideration was received. See Note 3.B.4.a) for further details on the Transaction and its consequences.

These financial statements were approved by the Company's Board of Directors on March 11, 2014.

**Definitions**

In these financial statements:

IFRS - Standards and interpretations that were issued by the International Accounting Standards Board (IASB) and which include International Financial Reporting Standards (IFRS) and International Accounting Standards (IAS) along with the interpretations to these standards of the International Financial Reporting Interpretations Committee (IFRIC) and interpretations of the Standing Interpretations Committee (SIC), respectively.

Group companies/the Group - Elron and companies in which the Company has invested and in whose management the Company is involved, including through the appointment of directors.

Investee companies - Consolidated companies, associates and other investments held by the Company.

Subsidiaries/Consolidated Companies - Companies that are controlled by the Company (as defined in IFRS 10) and whose accounts are consolidated with those of the Company.

Associates - Companies over which the Company has significant influence and that are not subsidiaries and are accounted for in these consolidated financial statements in accordance with the equity method of accounting.

**Notes to the Consolidated Financial Statements**

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(USD in thousands, except for price per share and number of shares)

**Note 1- General (Cont.)**

Other investments/Other companies - Companies in which the Company has invested and that are neither subsidiaries nor associates.

RDC - RDC Rafael Development Corporation Ltd.

Related parties - As defined in IAS 24 (Revised) with respect to "Related Parties".

Principal shareholders and Controlling shareholders - As defined in the Israel Securities Regulations (Preparation of Annual Financial Statements), 2010.

Dollar - The US dollar.

CPI - The Israeli Consumer Price Index, as published by the Israeli Central Bureau of Statistics.

Government- Government of the state of Israel.

**Note 2- Significant Accounting Policies****A. Basis of presentation of the financial statements****1. Measurement basis**

The Company's consolidated financial statements have been prepared on a cost basis, except for the following: derivative financial instruments, financial instruments measured at fair value, investments in associates accounted for using the equity method of accounting, deferred tax assets and deferred tax liabilities, employee benefit liabilities, employee call options over shares of investee companies and government grant liabilities.

See below for additional information regarding the measurement of these assets and liabilities.

**2. The preparation format of the financial statements**

These financial statements have been prepared in accordance with IFRS and in conformity with the provisions of the Israel Securities Regulations (Annual Financial Statements), 2010.

**3. Consistent accounting policies**

The accounting policies adopted in the financial statements are consistent with those followed in all periods presented, except as noted in section 4 below with respect to changes in accounting policies in view of the adoption of new standards.

**4. Adoption of new standards****IAS 1 - Presentation of Financial Statements**

In June 2011, the IASB issued an amendment to IAS 1, regarding presentation of items of Other Comprehensive Income ("OCI"). According to the amendment items of OCI that may be reclassified to profit or loss in the future, would be presented separately from those that would never be reclassified to profit or loss.

The amendment was applied retrospectively commencing from the financial statements of 2013.

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**Notes to the Consolidated Financial Statements**


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(USD in thousands, except for price per share and number of shares)

**Note 2 – Significant Accounting Policies (Cont.)**4. **Adoption of new standards (Cont.)****A suite of new accounting standards regarding consolidation of financial statements and other issues**

The IASB issued a new suite of new accounting standards regarding consolidation of financial statements and related issues. The new suite of standards replaces existing standards regarding consolidation of financial statements and joint arrangements and includes a number of changes with respect to investments in associates. The new standards, and the amendments to these standards, as detailed below, are applicable retrospectively for annual periods beginning on or after January 1, 2013. The standards include easier transition guidance at the time of first time application.

Presented hereunder is a summary of the new standards that were issued and are relevant to the Company:

1. **IFRS 10 Consolidated Financial Statements ("IFRS 10")** - IFRS 10 replaces the requirements of IAS 27 *Consolidated and Separate Financial Statements* and the requirements of SIC-12 *Consolidation – Special Purpose Entities* with respect to the consolidation of financial statements, so that the requirements of IAS 27 will continue to be valid only for separate financial statements (IAS 27R (Revised 2011), *Separate Financial Statements*). IFRS 10 introduces a new single control model for determining whether an investor controls an investee and should therefore consolidate it. According to the model, an investor controls an investee when it is (1) exposed, or has rights, to variable returns from its involvement with that investee, (2) has the ability to affect those returns through its power over that investee and (3) the ability to use its power over the investee by affecting the investor's return. In addition, IFRS 10 states that 'De facto' power should be considered when assessing control and could require consolidation. When assessing control, all substantive potential voting rights will be taken into account. The structure, reasons for existence and conditions of potential voting rights should be considered.  
  
IAS 28R, *Investments in Associates and Joint Ventures ("IAS 28R")* - IAS 28R replaces the requirements of IAS 28 *Investments in Associates*. IAS 28R states, among other things, that IFRS 5 applies on an investment, or a portion of an investment, in an associate or a joint venture, that meets the criteria to be classified as held for sale. Until the disposal of the portion of the investment that has been classified as held for sale, as defined in IFRS 5, the equity method continues to be applied on the portion of the investment that has not been classified as held for sale.
2. **IFRS 12 Disclosure of Involvement with Other Entities ("IFRS 12")** - IFRS 12 contains extensive disclosure requirements for entities that have interests in subsidiaries, joint arrangements (i.e. joint operations or joint ventures), associates and unconsolidated structured entities.

**Amendments to IFRS 10 and IFRS 12 - Consolidated Financial Statements, Disclosure of Interests in Other Entities:**

In July 2012, the IASB issued amendments to IFRS 10 and IFRS 12 (collectively, "the amendments").

The amendments provide relief in the application of the transition guidance in IFRS 10 and IFRS 12 and permit adjustment of comparative data for only one year. The Company has adopted the relief, as provided by the amendments.

**Notes to the Consolidated Financial Statements**

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(USD in thousands, except for price per share and number of shares)

**Note 2 – Significant Accounting Policies (Cont.)****IFRS 13 - Fair Value Measurement ("IFRS 13")**

In May 2011 the IASB issued IFRS 13. IFRS 13 replaces the fair value measurement guidance contained in individual IFRSs with a single source of fair value measurement guidance. It defines fair value, establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements. IFRS 13 does not introduce new requirements to measure assets or liabilities at fair value. IFRS 13 is applicable prospectively for annual periods beginning on or after January 1, 2013. The disclosure requirements of IFRS 13 need not be applied in comparative information for periods before initial application.

**B. Significant accounting judgments, estimates and assumptions used in the preparation of the financial statements**

The preparation of the Group's consolidated financial statements in conformity with IFRS requires the managements of the Company and the investee companies to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income, expenses and disclosure of contingent liabilities. It is clarified that the actual results may differ from these estimates.

The preparation of accounting estimates used in the preparation of the Company's consolidated financial statements requires the managements of the Company and the investee companies to make assumptions regarding circumstances and events that involve considerable uncertainty. The managements prepare the estimates on the basis of past experience, various facts, external circumstances, and reasonable assumptions according to the pertinent circumstances of each estimate.

Presented below is a description of the critical accounting estimates that were used in preparing the consolidated financial statements of the Company:

**Legal claims**

When assessing the possible outcomes of legal claims that were filed against the Company and its investee companies, the companies relied on the opinions of their legal counsel. The opinions of their legal counsel are based on the best of their professional judgment, and take into consideration the current stage of the proceedings and the legal experience accumulated with respect to the various matters. The results of the claims may be different from such estimates. See additional information in Note 15.

**Determining the fair value of unquoted financial assets and non-controlling interests**

The fair value of unquoted financial assets in Level 3 of the fair value hierarchy and of non-controlling interests in a business combination is determined using valuation techniques including an option-pricing model. At times, the Company contracts independent valuation experts to assist in determining the fair value of such assets. The model's assumptions consist of the price of the underline asset, which is the value of the estimated company's equity, exercise price, expected volatility, expected life, expected dividend and risk-free interest rate. The price of the underline asset is determined based upon recent financing rounds, if any, or based upon projected future cash flows discounted at current discount rates applicable for items with similar terms and risk characteristics. The projected future cash flows and discount rates are subject to uncertainty and include consideration of inputs such as liquidity risk, credit risk and volatility. Further details are given in Note 6.

**Notes to the Consolidated Financial Statements**

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(USD in thousands, except for price per share and number of shares)

**Note 2 – Significant Accounting Policies (Cont.)****Impairment of non-financial assets**

The Company examines at each reporting date whether there have been any events or changes in circumstances which would indicate impairment of one or more of the non-financial assets. When indications of impairment exist, the Company examines whether the carrying amount of the asset can be recovered from the discounted cash flows anticipated to be derived from the asset, and if necessary, it records an impairment provision necessary to record the asset at the amount of the recoverable value. The cash flows are discounted using a discount rate before taxes that reflects current market assessments of the time value of money and the risks specific to the asset. The estimates regarding cash flows are based on past experience with respect to this asset or similar assets, and on the best possible assessments of the Group regarding the economic conditions that will exist during the remaining useful life of the asset, considering the market status at the area in which the asset is located. At times, these assessments are made by independent valuation experts.

**Valuation of intangible assets**

The Company is required to allocate the purchase price of investee companies (other than in the acquisition of non-controlling interests that do not confer control) to the assets and liabilities of such investee companies on the basis of their estimated fair value. At times, the Company contracts independent valuation experts to assist in determining the fair value of such assets and liabilities. Such valuations require management to make significant estimates and assumptions. The material intangible assets that were recognized with the assistance of evaluators include customer relations, know-how, technology and in process research and development. Critical estimates that were used to estimate the useful life of such intangible assets include, inter alia, the estimated life of the customer relations and of the other intangible assets as well as anticipated market developments. Management's estimates regarding the fair value and useful life are based on assumptions considered reasonable by management, but are uncertain, and therefore the actual results may be different than anticipated by management.

**Deferred tax assets**

Deferred tax assets are recognized for unused carryforward tax losses and temporary differences to the extent that it is probable that taxable profit will be available against which the losses can be utilized. Management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and level of future taxable profits together with future tax planning strategies. For additional information see Note 17.

**C. The operating cycle**

The Company's operating cycle is 12 months.

**D. Basis of consolidation**

The consolidated financial statements comprise the financial statements of companies that are controlled by the Company (subsidiaries). Control is achieved when the Company is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Potential voting rights are considered when assessing whether an entity has control, only when its substantive. The consolidation of the financial statements commences on the date on which control is obtained and ends when such control ceases.

Significant intercompany balances and transactions and gains or losses resulting from intercompany transactions are eliminated in full in the consolidated financial statements.



**Notes to the Consolidated Financial Statements**

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(USD in thousands, except for price per share and number of shares)

**Note 2 – Significant Accounting Policies (Cont.)**

The financial statements of the Company and of the subsidiaries are prepared as of the same dates and periods. The accounting policy in the financial statements of the subsidiaries was applied consistently and uniformly with the policy applied in the financial statements of the Company.

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

A transaction with non-controlling interests, whether a sale or an acquisition, is accounted for as an equity transaction. As such, further acquisitions of non-controlling interests by the Company are recognized directly in equity (the Company has elected to record at capital reserves in respect of transaction with non-controlling interests). Any difference between the amount of the adjustment to non-controlling interest (reflecting the change in relative interest in the subsidiary) and the consideration paid or received by the parent on the change in holding is recognized directly as an increase in equity. When this difference is negative, it presents a decrease in equity (the Company has elected to record at capital reserves in respect of transaction with non-controlling interests). In disposal of equity interests while control is retained, an increase or decrease in equity (the Company has elected to record at capital reserve from transactions with non-controlling interests) is recognized for the amount of the difference between the consideration received by the Company and the carrying amount of the non-controlling interests in the subsidiary which has been added to the Company's equity, taking into consideration realization of goodwill attributed to the subsidiary, if any, and capital reserves resulting from comprehensive income (loss), in accordance with the decrease in holdings in the subsidiary.

In a business combination achieved in stages, equity rights in the acquiree that had been previously held by the acquirer prior to obtaining control are measured at the acquisition date at fair value and included in the acquisition consideration by recognizing the gain or loss resulting from the fair value measurement, including amounts whose recognition in other comprehensive income was deferred.

For every business combination the Company examines whether to measure non-controlling interests and goodwill on the basis of full fair value or according to the proportionate part acquired of the fair value of the identifiable assets, net on the date of acquisition.

Contingent consideration in a business combination is measured at fair value and changes in the fair value of the contingent consideration, which do not represent adjustments to the acquisition cost in the measurement period, are not recognized as goodwill adjustments. If the contingent consideration is classified as a financial derivative, it will be measured at fair value through profit or loss.

Direct acquisition costs attributed to a business combination transaction are recognized in the statement of income as incurred rather than as part of the acquisition cost.

When the Group loses control over a company, it measures and recognizes its remaining investment at fair value. Any difference between the carrying amount of the former company under common control as of the date on which common control ceases and the fair value of any remaining investment and any consideration from disposal is recognized in profit or loss. If the remaining investment is subject to significant influence, it is treated as an investment in an associate.

**Notes to the Consolidated Financial Statements**

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(USD in thousands, except for price per share and number of shares)

**Note 2 – Significant Accounting Policies (Cont.)****E. Associates accounted for using the equity method of accounting**

Associates are those entities in which the Company has significant influence or the ability to significantly influence the financial and operating policies, but control was not achieved. In assessing whether or not the Company has significant influence over an entity, the Company takes into consideration ownership of potential voting rights that are immediately exercisable, directly or through subsidiaries, and their impact. Associates are accounted for using the equity method of accounting. The Company's consolidated financial statements include the Group's share of the income and expenses of equity accounted investees, after adjustments required to align the accounting policies with those of the Group for uniform accounting policies, from the date that significant influence commences until the date that significant influence ceases or until the date that the investment in these entities is classified as held for sale. In addition, the financial statements of the Company and of the associates are prepared as of the same dates and periods.

When the Group's share of losses exceeds its interest in an equity accounted investee, the carrying amount of that interest (including any long-term investments) is reduced to zero and the recognition of further losses is discontinued except to the extent that the Group has an obligation to support the investee or has made payments on behalf of the investee, or has granted it loans or guarantees.

In circumstances where the Company's ownership in an associate is in the form of a preferred security or other senior security, the Company recognizes losses based on the ownership level of the particular associate's security or loan held by the Company that grants it the preferred rights, and to which the equity method is being applied.

Excess cost of associates is presented as part of the investment. Goodwill relating to the acquisition of an associate is initially measured as the excess cost of an investment in an associate over the Company's proportional interest in the fair value of the identifiable assets and liabilities, net. Excess cost allocated in an associate to identifiable assets and identifiable liabilities having a finite useful life is amortized according to the said useful life. Goodwill is not systematically amortized, and evaluated for impairment as part of the investment in the associate as a whole.

The Group's share of the operating results of the associate is shown in the statement of comprehensive income as Group's share of earnings (losses) of associates, and other comprehensive income (loss) net of the associate attributable to the Group is presented in other comprehensive income (loss) in the relevant item in equity. Profits and losses resulting from transactions between the Group and the associate are eliminated to the extent of the interest in the associate.

When the Company loses its significant influence in an associate previously treated at equity, the remaining investment is revalued to its fair value on the date when significant influence is lost and is accounted for as an investment measured at fair value. The Company recognizes in profit or loss any difference between the fair value of any retained investment and any proceeds from disposing of the part interest in the associate, and the carrying amount of the investment at the date when significant influence is lost.

Upon purchase of shares of an associate while retaining significant influence in the associate, the Company applies the purchase method in respect of the interest acquired while the previous carrying amount of investment in the associate remains unchanged.

**Notes to the Consolidated Financial Statements**

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(USD in thousands, except for price per share and number of shares)

**Note 2 – Significant Accounting Policies (Cont.)****F. Functional currency and foreign currency****1. Functional currency and presentation currency**

The consolidated financial statements are presented in U.S. dollars, the Company's functional currency, and are rounded to the nearest thousand, unless stated otherwise.

The functional currency, which is the currency that best reflects the economic environment in which the Company operates and conducts its transactions, is separately determined for each Group entity. The functional currency of most of the investee companies is the U.S. dollar.

When a Group entity's functional currency differs from the Company's functional currency, that entity represents a foreign operation whose financial statements are translated so that they can be included in the consolidated financial statements.

All resulting translation differences are recognized in other comprehensive income (loss). Upon the disposal of a foreign operation, the relevant part of the other comprehensive income (loss) is recognized in the statement of income.

**2. Transactions in foreign currency**

Transactions denominated in foreign currency are recorded on initial recognition at the exchange rate at the date of the transaction. Monetary assets and liabilities denominated in foreign currency existing as of the reporting date are translated into the functional currency at the exchange rate at every reporting date.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated into the Company's functional currency using the exchange rate on the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are translated into the functional currency at the exchange rate on the date that the fair value was determined.

**3. Index-linked monetary items**

Monetary assets and liabilities linked to the changes in the CPI are adjusted at the relevant index at each reporting date according to the terms of the agreement. Linkage differences arising from the aforementioned adjustment are recognized in the statement of income.

**G. Financial instruments*****Financial assets:***

Until December 31, 2011 the Group has applied the provisions of IAS 39, Financial Instruments- Recognition and Measurement. Starting January 1, 2012, the Group has early adopted the first phase of IFRS 9, Financial Instruments, commencing January 1, 2012, without early adopting the second and third phases of IFRS 9, which are detailed in Note 2.W below.

**1. Initial recognition**

Financial instruments are recognized initially at fair value plus any directly attributable transaction costs, unless they are subsequently measured at fair value.

**Notes to the Consolidated Financial Statements**

(USD in thousands, except for price per share and number of shares)

**Note 2 – Significant Accounting Policies (Cont.)****2. Subsequent measurement**

After the initial recognition, the Company measures its financial assets at amortized cost or at fair value, as follows:

**a) Financial assets measured at amortized cost**

In subsequent periods, a financial asset is measured at amortized cost, using the effective interest method while deducting any impairment losses (see also Note 2.K below), if both of the following conditions are met:

- The asset is held within a business model whose objective is to hold assets in order to collect the contractual cash flows.
- The contractual terms of the financial asset give rise, on specified dates, to cash flows that are solely payments of principal and interest on the principal amount outstanding.

**b) Financial assets measured at fair value**

Financial assets that are equity instruments are measured in subsequent periods at fair value and the changes will be recognized in the statement of income or in other comprehensive income (loss), in accordance with the election of the Company on an instrument-by-instrument basis.

If the equity instruments are held for trading, they must be measured at fair value through profit or loss.

With regard to financial assets measured at fair value through other comprehensive income, gains, losses and impairment are not recognized in the statement of income, even upon disposal. Changes in fair value of these assets are recorded in "Reserve from financial assets measured at fair value through other comprehensive income". When the Company sells these assets, it transfers the gain or loss in respect with the asset sold from the capital reserve into accumulated deficit.

A financial asset is derecognized when the Group's contractual rights to the cash flows deriving from the financial asset expire.

**Cash and cash equivalents**

Cash includes cash balances available for immediate use. Cash equivalents include short-term highly liquid deposits in banks (with original maturities of three months or less) that are readily convertible into known amounts of cash and are part of the Group's cash management.

***Financial liabilities:***

Financial liabilities are recognized initially on the trade date. Financial liabilities are derecognized when the obligation of the Group, as specified in the agreement, expires or when it is discharged or cancelled.

Financial liabilities, other than financial liabilities designated at fair value through profit or loss, are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition these financial liabilities are measured at amortized cost using the effective interest method. Amortization of liabilities using the effective interest method is recognized in profit or loss under financial expenses.

**Notes to the Consolidated Financial Statements**

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(USD in thousands, except for price per share and number of shares)

**Note 2 – Significant Accounting Policies (Cont.)****Offset between financial assets and financial liabilities**

Financial assets and financial liabilities are offset and the net amount is presented in the statement of financial position if there is a legally enforceable right to set off the recognized amounts and there is an intention either to settle on a net basis or to realize the asset and settle the liability simultaneously.

**H. Fair value measurement**

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurement is based on the assumption that the transaction will take place in the asset's or the liability's principal market, or in the absence of a principal market, in the most advantageous market. The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

The Group uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

The fair value of financial assets measured at fair value is determined with reference to their quoted closing bid price as of the reporting date, and in the absence of such a quoted price, by other appropriate valuation methods (see also Note 2.B).

**I. Property, plant and equipment**

Items of property, plant and equipment are measured at cost less accumulated depreciation, less accumulated impairment losses, if any, and excluding day-to-day servicing expenses.

Depreciation is recognized in the statement of income on a straight-line basis over the estimated useful lives of the property, plant and equipment.

**J. Intangible assets****1. Research and development**

Research expenses undertaken with the goal of gaining new scientific or technical knowledge are recognized in the statement of income when incurred.

Development activities are activities relating to a plan for the creation of new products or processes or the significant improvement of existing products or processes. Expenditures in respect of development activities are recognized as an intangible asset only if all the following exist: the development costs can be reliably measured; the product or process is technically and commercially feasible; future economic benefits from the product are probable; and the Group intends to and has sufficient resources to complete the development and to use or sell the asset. The costs recognized as an intangible asset include the cost of the materials, direct labor and overhead costs that can be directly attributed to preparation of the asset for its intended use. Other development expenditures are recognized in the statement of income as incurred. This asset is measured at cost less any accumulated amortization and impairment.

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 2 – Significant Accounting Policies (Cont.)

## 2. Other intangible assets

- a. Intangible assets acquired in a business combination are included at the fair value at the acquisition date. After initial recognition, intangible assets are carried at their cost less any accumulated amortization (other than intangible assets having an indefinite useful life) and any accumulated impairment losses.
- b. Separately acquired intangible assets are measured on initial recognition at cost with the addition of costs directly attributable to the acquisition.
- c. Subsequent expenditures are capitalized as an intangible asset only when they increase the future economic benefits embodied in the specific asset for which they were expended. All other expenditures, including expenditures relating to goodwill and intangibles developed independently, are recognized in the statement of income as incurred (except for development costs which were capitalized).
- d. The amortization period of intangible assets having a finite useful life is determined according to the expected future economic benefits from the assets in each period, on the basis of estimated useful life of each group of assets. As for the testing of impairment, see Note 2.K below.

A summary of the policies applied to the Group's intangible assets is as follows:

	Technology and development in process *	Agreement with Rafael**
<b>Useful lives</b>	***	Indefinite
<b>Amortization period</b>	***	Not amortized
<b>Internally generated or acquired</b>	Acquired	Acquired

\* Mainly technology and development in process acquired in business combinations.

\*\* As a result of the agreement with Rafael Advanced Defense Systems Ltd. ("Rafael") - see Note 3.A.3.a).

\*\*\* Amortization of technology and development in process begins when sales are generated from the technology developed. The amortization period is set to reflect the future useful life, such as the estimated period in which future sales expected to be generated from the said technology developed. In 2013 the Company began the amortization of a technology and development in process asset in the amount of approximately \$650, over a period of 3 years. The useful life of the rest of the technology and development in process assets was not yet determined and its amortization has not begun.

The estimates regarding the amortization method and useful life of intangible assets having a finite useful life are reviewed at least at each year-end.

Intangible assets with indefinite useful lives are not systematically amortized and are tested for impairment annually or more if events or changes in circumstances indicate that the intangible asset may be impaired (see also Note 2.K). The useful life of these assets is reviewed annually to determine whether their life assessment continues to be supportable.

**Notes to the Consolidated Financial Statements**

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(USD in thousands, except for price per share and number of shares)

**Note 2 – Significant Accounting Policies (Cont.)****K. Impairment****1. Financial assets carried at amortized cost**

The Company assesses at each reporting period whether there is any objective evidence of impairment. There is objective evidence of impairment whenever one or more events has occurred after initial recognition that has a negative impact on the estimated future cash flows. Evidence of impairment may include indications that the debtor is experiencing financial difficulties, including liquidity difficulties and default on interest or principal payments. The amount of the impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. In subsequent periods, the previously recognized impairment loss is reversed when the increase in value can be related objectively to an event occurring after the impairment was recognized. The amount of the reversal is credited to the statement of income up to the amount of the previously recognized impairment loss.

**2. Non-financial assets**

The Company evaluates the need to record an impairment of the carrying amount of non-financial assets (other than deferred tax assets and employee-benefit-related assets) whenever events or changes in circumstances indicate that the carrying amount is not recoverable. If the carrying amount of non-financial assets exceeds their recoverable amount, the assets are reduced to their recoverable amount. The recoverable amount is the higher of fair value less costs of sale and value in use. In measuring value in use, the expected future cash flows are discounted using a pre-tax discount rate that reflects the risks specific to the asset. The recoverable amount of an asset that does not generate independent cash flows is determined for the cash-generating unit to which the asset belongs. Impairment losses are recognized in the statement of income.

An impairment loss of an asset, other than goodwill, is reversed only if there have been changes in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. Reversal of an impairment loss, as above, shall not be increased above the lower of the carrying amount that would have been determined (less depreciation or amortization) had no impairment loss been recognized for the asset in prior years and its recoverable amount. The reversal of the impairment loss is carried to profit or loss.

The following criteria are applied in assessing impairment of associate:

After application of the equity method, the Company examines whether it is necessary to recognize any additional impairment loss with respect to the investment in associates. The Company examines at each reporting period whether there is objective evidence that the value of the investment in the associate is impaired. Such evidence may include general market data, a decline in the stock market prices, recurring losses, the industry in which the investees operate, failure of research and development efforts, a significant deviation from the business plan, excess cost included in the investments, rounds of financing at an amount below the cost basis of the investment and other parameters. The test of impairment is carried out with reference to the entire investment, including the goodwill attributed to the associate. The loss, or its reversal, is recognized in the statement of income under line item other expenses (income), net.

**Notes to the Consolidated Financial Statements**

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(USD in thousands, except for price per share and number of shares)

**Note 2 – Significant Accounting Policies (Cont.)****L. Non-current assets held for sale**

A non-current asset or disposal group (a group for which settlement is planned, including assets and liabilities) is classified as held for sale if their carrying amount will be recovered principally through a sale transaction rather than through continuing use. For this to be the case, the assets must be available for immediate sale in their present condition, the Company must be committed to sell, there must be a program to locate a buyer and it is highly probable that a sale will be completed within one year from the date of classification. These assets are not depreciated and are presented separately as current assets in the statement of financial position, at the lower of their carrying amount and fair value less costs to sell. Simultaneously, liabilities associated with these assets are presented separately in the statement of financial position in a similar manner. Also, the related other comprehensive income (loss) is presented separately in the statement of changes in equity.

**M. Employee benefits****1. Post-employment benefits**

The Group has a number of post-employment benefit plans. The plans are usually financed by deposits with insurance companies or with funds managed by a trustee, and they are classified as defined contribution plans and defined benefit plans.

Remeasurements of the net liability in respect of defined benefit plan are recognized in other comprehensive income in the period in which they occur.

**2. Short-term benefits**

Short-term employee benefits are benefits that are expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related services. These benefits include salaries, paid annual leave, paid sick leave, recreation and social security contributions and are recognized as expenses as the services are rendered. A liability in respect of a cash bonus or a profit-sharing plan is recognized when the Group has a legal or constructive obligation to make such payment as a result of past service rendered by an employee and a reliable estimate of the amount can be made.

**N. Share-based payment transactions**

The cost of equity-settled transactions with employees and others is measured at the fair value of the equity instruments granted at grant date.

The fair value of share-based payments on the grant date is recognized as an expense, with a corresponding increase in retained earnings, over the period in which the relevant employees become fully entitled to the award. The amount recognized as an expense, taking the vesting terms into account, consisting of service terms and performance terms other than market terms, is adjusted to reflect the actual number of share options that are expected to vest.

Options granted to employees for the purchase of shares of investee companies are measured at each reporting period at fair value in accordance with the Black and Scholes model. The fair value of the options is recognized as a liability. Any changes in this liability are recognized as an expense or income under line item general and administrative expenses in profit or loss.



**Notes to the Consolidated Financial Statements**

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(USD in thousands, except for price per share and number of shares)

**Note 2 – Significant Accounting Policies (Cont.)****O. Provisions**

A provision is recognized when there is a present obligation, legal or constructive, as a result of a past event and a reliable estimate can be made of the amount of the obligation and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

**P. Revenues**

Revenue is recognized in profit or loss when the amount of revenue can be measured reliably, it is expected that the financial benefits will return to the company and the associated costs can be estimated reliably. Revenue is measured at the fair value of the consideration received, net of discounts. Revenue from services is recognized over the reporting period in which the service was provided.

**Q. Leases**

Lease agreements are classified as an operating lease if they do not transfer substantially all the risks and benefits incidental to ownership of the leased asset. Lease payments are recognized as an expense in the statement of income on a straight-line basis over the lease term, including the optional period, when on the date of the transaction it was reasonably certain that the option will be exercised.

**R. Taxes on income**

Taxes on income in the statement of income comprise current and deferred taxes. The tax results in respect of current or deferred taxes are carried to the statement of income except to the extent that the tax arises from items which are recognized directly in equity or in other comprehensive income.

**1. Current taxes**

The current tax liability is measured using the tax rates and tax laws that have been enacted or substantively enacted by the reporting date as well as adjustments required in connection with the tax liability in respect of previous years.

**2. Deferred taxes**

Deferred taxes are computed in respect of temporary differences between the carrying amounts in the financial statements and the amounts attributed for tax purposes.

Deferred tax balances are measured at the tax rates that are expected to apply to the period when the taxes are recorded in the statement of income or in equity, based on tax laws that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax assets are reviewed at each reporting date and reduced to the extent that it is not probable that they will be utilized. Simultaneously, temporary differences (such as carryforward losses) for which deferred tax assets have not been recognized are reassessed and deferred tax assets are recognized to the extent that their recoverability is probable.

**Notes to the Consolidated Financial Statements**

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(USD in thousands, except for price per share and number of shares)

**Note 2 – Significant Accounting Policies (Cont.)**

Taxes that would apply in the event of the sale of investments in investee companies have not been taken into account in computing the deferred taxes, as long as the sale of the investments in investee companies is not expected in the foreseeable future. Also, deferred taxes that would apply in the event of distribution of earnings by investee companies as dividend have not been taken into account in computing the deferred taxes, since the distribution of a dividend does not involve an additional tax liability or since it is the Company's policy not to initiate distribution of dividend that triggers an additional tax liability.

Deferred taxes are offset in the statement of financial position if there is a legally enforceable right to offset a current tax asset against a current tax liability and the deferred taxes relate to the same taxpayer and the same taxation authority.

**S. Government grants**

Government grants are recognized where there is reasonable assurance that the grant will be received and the Company will comply with the attached conditions.

Government grants from the Office of the Chief Scientist in Israel for supporting research and development activities that contain a liability to pay royalties to the State depending on future sales from development are recognized upon receipt as a liability, pursuant to IAS 39 Financial instruments: Recognition and Measurement, if future economic benefits are expected from the research activity that will result in royalties-bearing sales. When royalty payments in respect of the grant bear no market interest, the liability is measured at fair value discounted at market interest upon receipt of the grant. The difference between the amount of the grant received and the fair value of the liability will be accounted for as a Government grant with a corresponding decrease in research and development expenses. Amounts paid as royalties are recognized as settlement of the liability. When no economic benefits are probable, the receipts from the grant are deducted from the relevant research and development expenses. In such event, the royalty liability is accounted for as a contingent liability pursuant to IAS 37, until such liability is recognized upon fulfillment of the above expectation.

**T. Earnings (loss) per share**

Earnings (losses) per share are calculated by dividing the net income (loss) attributable to equity holders of the Company by the weighted number of ordinary shares outstanding during the period. Basic earnings (loss) per share only include shares that were actually outstanding during the period. Potential ordinary shares are only included in the computation of diluted earnings (loss) per share when their conversion has a dilutive effect on the earnings (loss) per share. Further, potential ordinary shares that are converted during the period are included in diluted earnings (loss) per share only until the conversion date and from that date in basic earnings (loss) per share. The Company's share of earnings (loss) of investee companies is included based on the earnings (loss) per share of the investee companies multiplied by the number of shares held by the Company.

**Notes to the Consolidated Financial Statements**

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(USD in thousands, except for price per share and number of shares)

**Note 2 – Significant Accounting Policies (Cont.)****U. Presentation of financial statements**

The Company has elected to present comprehensive income using two statements: a statement of income and a statement of comprehensive income, which presents, in addition to net income (loss) from the statement of income, all of the items recognized in other comprehensive income.

The Company has elected to present the statement of income using the nature of expense method. Furthermore, the Company presents a statement of changes in equity immediately after the statement of comprehensive income instead of in the notes. The statement includes changes in equity resulting from transactions with the parent company in its capacity as a controlling shareholder.

The Company presents the changes between the opening and the closing balances of each component of other comprehensive income in the notes accompanying the annual financial statements, see Note 13.F.

**V. Examination the significance of evaluations of assets and obligations for disclosure or inclusion**

The Company is reviewing the significance of the evaluations of assets and obligations, for the purposes of disclosing them or attaching them in the annual and interim financial statements, in accordance with Regulation 8b of the Securities Regulations (Periodic and Intermediate Reports), 1970 and according to the legal position number 105-23: parameters for fundamental valuations, as published by the Israeli Security Authority in December 2010 (the "ISA's Position").

In accordance with the ISA's Position, the Company applies also the "Representative Profit" test (i.e., profit for four quarters, calculated on the basis of average absolute values of the quarterly profit / loss attributable to shareholders of the Company for each of the 12 previous quarters) representing an accepted measurement tool for examining the results of holding companies of the Company's category. Representative Profit measurement assists the Company in examining significance and negligibility also in other contexts.

As permitted by the ISA's Position, when an evaluation complies with the quantitative conditions for enclosure but the Company is of the opinion that for qualitative reasons the evaluation does not qualify as very material, the Company examines the influence of the subject of the evaluation on the comprehensive income or on net gain in relation to the equity attributable to shareholders.

**W. Disclosure of new IFRS standards in the period prior to their adoption****Amendments to IAS 32 - Financial Instruments: Presentation, regarding the offsetting of financial assets and liabilities**

The IASB issued amendments to IAS 32 ("the amendments to IAS 32") regarding the offsetting of financial assets and liabilities. The amendments to IAS 32 clarify, among others, the meaning of "currently has a legally enforceable right of set-off" ("the right of set-off"). Among others, the amendments to IAS 32 prescribe that the right of set-off must be legally enforceable not only during the ordinary course of business of the parties to the contract but also in the event of bankruptcy or insolvency of one of the parties. The amendments to IAS 32 also state that in order for the right of set-off to be currently available, it must not be contingent on a future event, there may not be periods during which the right is not available, or there may not be any events that will cause the right to expire.

The amendments to IAS 32 are to be applied retrospectively commencing from the financial statements for periods beginning on January 1, 2014, or thereafter.

The Company estimates that the amendments to IAS 32 are not expected to have a material impact on its financial statements.

**Notes to the Consolidated Financial Statements**

(USD in thousands, except for price per share and number of shares)

**Note 2 – Significant Accounting Policies (Cont.)****IFRS 9 - Financial Instruments**

The IASB issued certain amendments to IFRS 9 regarding derecognition and financial liabilities. According to the provisions of these amendments, the provisions of IAS 39 will continue to apply to derecognition and financial liabilities for which the fair value option had not been chosen (designated at fair value through profit or loss). Namely, the classification and measurement provisions of IAS 39 will continue to apply to financial liabilities held for trading and financial liabilities measured at amortized cost.

The IASB did not set an effective date for the amendments. Earlier application is permitted provided that the Company also adopts the provisions of IFRS 9 regarding the classification and measurement of financial assets (the asset stage). First-time adoption of these amendments will be done retrospectively by giving necessary disclosure or restating comparative data, subject to the exemptions provided by the amendments.

In November 2013, the IASB issued Phase 3 of IFRS 9 ("Phase 3 of IFRS 9") as part of the complete version of IFRS 9. Phase 3 of IFRS 9 includes the new hedge accounting requirements and related amendments to IFRS 9, IFRS 7 and IAS 39.

The IASB did not set a mandatory effective date for Phase 3 of IFRS 9. Entities may apply Phase 3 of IFRS 9 early provided that they also adopt the other provisions of IFRS 9.

The Company has not yet evaluated the standard adoption's possible impact on its financial statements.

**Note 3- Investments in investees****A. Subsidiaries****1. Additional information about subsidiaries that are held by the Company****Material subsidiaries (including through fully owned corporate companies)**

	Principal place of business and country of incorporation	Equity interest and voting rights of the Group	Equity interest and voting rights of non- controlling interests	Amounts made available to the subsidiary		Carrying amount (\$)	Stock exchange
				Loans	Guarantees		
		%			\$ thousands		
<b>As of December 31, 2013:</b>							
RDC (1)	Israel	50.10	49.90	-	-	21,702	unquoted
<b>As of December 31, 2012:</b>							
RDC (1)	Israel	50.10	49.90	-	-	19,858	unquoted

(1) Held through fully owned corporate company, DEP Holding Technology Ltd ("DEP").

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 3- Investments in investees (Cont.)

## 2. Summarized financial information of a subsidiary with material non-controlling interests (\*)

Balances in the statement of financial position of RDC:

	<u>Current assets</u>	<u>Non-current assets</u>	<u>Current liabilities</u>	<u>Non-current liabilities</u>	<u>Equity attributable to shareholders of the company</u>	<u>Non-controlling interests</u>
<b>As of December 31, 2013</b>	32,726	10,054	576	5,391	18,650	18,163
<b>As of December 31, 2012</b>	20,327	22,013	232	4,461	16,807	20,840

(\*) The information presented does not include excess cost and goodwill.

Results of the operation in RDC's statements:

	<u>Revenues</u>	<u>Profit (loss) for the year</u>	<u>Profit (loss) attributable to non-controlling interests</u>	<u>Other comprehensive income (loss)</u>	<u>Total comprehensive income (loss)</u>
<b>For the year ended December 31, 2013</b>	-	(1,007)	(502)	(5)	(1,012)
<b>For the year ended December 31, 2012</b>	-	34,490	11,481	46	34,536

RDC's cash flows:

	<u>For the year ended December 31</u>	
	<u>2013</u>	<u>2012</u>
Operating activities	(556)	(1,642)
Investment activities	(8,676)	44,275
Financing activities	-	(24,275)
Increase (decrease) in cash and cash equivalents	(9,232)	18,357

## 3. Significant changes in investments in consolidated companies during the reporting period

## a) RDC

RDC is a holding company consolidated by Elron. Elron holds 50.1% of RDC's outstanding shares, through DEP, a subsidiary fully owned by Elron.

RDC has first rights to commercialize military technologies developed by Rafael – Advanced Defense Systems Ltd. ("Rafael"). RDC seeks to identify technology projects and invest in companies that will either commercialize Rafael's military technologies or which will benefit from Rafael's technology, know-how and expertise.

**Notes to the Consolidated Financial Statements**

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(USD in thousands, except for price per share and number of shares)

**Note 3- Investments in investees (Cont.)****3. Significant changes in investments in consolidated companies during the reporting period (Cont.)****a) RDC (Cont.)**

In December 2007, Elron, DEP, RDC and Rafael signed an agreement amending the existing agreement between the parties pertaining to the rights granted to RDC to commercialize certain technologies of Rafael (the "Addendum"). Pursuant to the Addendum, RDC's rights to commercialize certain technologies of Rafael will continue without time restrictions. Pursuant to the terms of the Addendum, Elron made a one-time investment in RDC of \$4,000 and is committed to make further investments of \$750 in RDC for each company established by RDC based on Rafael's technologies.

The excess invested in RDC in respect of Elron's investment in RDC's equity was allocated to the agreement with Rafael as an intangible asset with indefinite useful life, and accordingly is not subject to amortization, but rather is reviewed for impairment at least annually or more frequently if indicators of impairment are identified.

Intangible assets, net, include an amount of approximately \$3,051 in respect of this agreement (see Note 9).

During 2011, Elron and Rafael granted RDC a loan in the amount of \$6,500. Elron's share was \$3,250.

In June 2012, RDC's entire debt to its shareholders was prepaid. Elron's share in the principal and interest was approximately \$3,300, similar to Rafael's share.

In June 2012, RDC distributed a cash dividend in the aggregate amount of approximately \$17,800. Elron's share in such dividend, through DEP, amounted to approximately \$8,907. The balance in the amount of \$8,871 was distributed to Rafael and accordingly was recorded in the statement of changes in equity as a dividend paid by a subsidiary to non-controlling interests.

**b) Sync-Rx**

Sync-Rx Ltd. ("Sync-Rx") develops real-time image processing systems for cardiovascular catheterizations. Sync-Rx was a subsidiary of Elron whose outstanding shares, prior to its sale, were approximately 87% held by RDC.

In November 2012, an agreement was completed for the sale of all the shares of Sync-Rx to Volcano Corporation (the "Acquirer"). The sale agreement includes, among other things, the following conditions: a) The selling shareholders received cash proceeds in the amount of approximately \$17,250, of which an amount of approximately \$3,250 was deposited in escrow for a period of 18 months in order to secure certain indemnification obligations of the selling shareholders to the Acquirer; b) The Acquirer is entitled to certain indemnifications in connection with the transaction, as customary in transactions of this type, from the consideration recipients, in amounts not exceeding the consideration amount, except in the event of fraud, confidentiality commitments and claim waivers.

RDC's share in the aggregate proceeds was approximately \$15,800, of which an amount of approximately \$3,100 was deposited in escrow.

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 3- Investments in investees (Cont.)

## 3. Significant changes in investments in consolidated companies during the reporting period (Cont.)

## b) Sync-Rx (Cont.)

As a result of the transaction, Elron recognized in 2012 a gain, attributable to the Company's shareholders, in the amount of approximately \$8,600 (a consolidated net gain of approximately \$17,000, presented under line item gain from disposal and revaluation of investee companies and changes in holdings, net, in the statement of income). The said gain also includes the consideration held in escrow, as the Company was able to reliably estimate the fair value of this component.

Presented below is a breakdown of the consideration and cash flows resulting from the sale:

<u>Sale consideration:</u>	
Cash received	13,022
Long-term escrow deposit	3,061
	<u>16,083</u>
Less: transaction costs	<u>346</u>
	<u>15,737</u>
<u>Aggregate cash flows received by the Group as a result of the sale:</u>	
Cash received less transaction costs paid in cash	12,676
Less: cash and cash equivalents in subsidiary as of sale date	<u>423</u>
Net cash	<u>12,253</u>

## c) Starling

Starling Advanced Communications Ltd. ("Starling") provided mobile SATCOM broadband connectivity solutions for aircraft and ground vehicles prior to selling its assets and ceasing the remainder of its operations (see below). Prior to Starling's liquidation (see below), Elron directly held approximately 46% of Starling's outstanding shares, and RDC held approximately 54%.

In September 2011, an agreement for the sale of Starling's assets was completed and came into effect according to which Starling sold its entire business in the field of non-military satellite communication systems, to an international company in the communications market (the "Purchaser") (the "Transaction"). The first installment of approximately \$8,600 was received on the closing date. An additional payment in the amount of approximately \$2,700 was received in September 2012. Upon the Transaction closing, Starling commenced an orderly process of ceasing its remaining operations.

As part of the terms of the asset sale agreement, the Company and RDC, Starling's shareholders, undertook, severally, to guarantee to the Purchaser, Starling's intellectual property representations and certain additional undertakings, including non-competition, in an aggregate amount not to exceed \$2,700 for the duration of the periods set forth for Starling's undertakings on these matters.

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 3- Investments in investees (Cont.)

## 3. Significant changes in investments in consolidated companies during the reporting period (Cont.)

## c) Starling (Cont.)

Presented below is the breakdown of the assets and liabilities, capital reserves from translation differences in the consolidated statements of financial position as of the transaction date, and the consolidated gain accrued from the transaction:

	<u>Carrying amount as of transaction date</u>
Other accounts receivables	57
Inventories	1,147
Property, plant and equipment, net	548
Intangible assets	82
Other long-term receivables	77
	<u>1,911</u>
Capital reserves from translation differences	(1,200)
Decrease in net assets, as a result of the Transaction	(711)
Sale consideration (1)	<u>10,313</u>
Total consolidated gain from business sale before tax	<u>9,602</u>
 <u>(1) Sale Consideration</u>	
Cash received upon transaction closing	8,663
Consideration which was received in September 2012 (presented by its value at Transaction closing date)	2,566
Less: Transaction costs	<u>916</u>
	<u>10,313</u>
 <u>Aggregate cash flows received by the Group as a result of the sale at Transaction closing:</u>	
Cash received less Transaction costs paid in cash	8,201
Less: full repayment of Starling's debt to the Chief Scientist Officer, paid directly by the Purchaser	<u>4,435</u>
Net cash	<u>3,766</u>



**Notes to the Consolidated Financial Statements**

(USD in thousands, except for price per share and number of shares)

**Note 3- Investments in investees (Cont.)****3. Significant changes in investments in consolidated companies during the reporting period (Cont.)****c) Starling (Cont.)**

As a result of the Transaction, Elron recognized a net gain (attributable to the Company's shareholders) in 2011 in the amount of approximately \$7,351 (a consolidated net gain of approximately \$9,602, recorded under line item gain from disposal and revaluation of investee companies and changes in holdings, net in the statement of income). This gain was offset by an inventory write-down loss and expenses in respect of provisions for repairs and the termination of agreements with customers and suppliers following the decision of Starling's board of directors to cease Starling's operations, as aforementioned, so that the Transaction's impact on the net gain (attributable to the Company's shareholders) amounted to approximately \$4,700.

In order to enable Starling to execute the Transaction and to fully and timely settle all of its commitments, including its commitments to the holders of the Series A debentures it issued on the Tel Aviv Stock Exchange in June 2007 (the "Debentures"), on the closing date of the Transaction, the Company and RDC made available to Starling a credit facility in an aggregate amount of \$11,000 on the terms determined by the parties.

In 2011, Elron and RDC advanced to Starling \$5,400 out of the credit facility. Elron's share in this amount was approximately \$2,520.

Following the completion of the business sale transaction, in November 2011, Starling fully prepaid the Debentures (in the amount of approximately \$6,900), such that each holder was paid principal, accrued interest and linkage up to the prepayment date. Elron's and RDC's share in the prepayment was approximately \$2,750 and approximately \$1,550, respectively.

In May 2012, a merger transaction was completed whereby an Israeli private company, wholly owned by Elron and RDC, which was founded shortly before the merger agreement was signed and which had no business activity, was merged with and into Starling, in accordance with the eighth section of the Israeli Companies Law, 1999 (the "Companies Law"). The registered shareholders of Starling's shares on the record date, apart from Elron and RDC, transferred their Starling shares to Elron and RDC in consideration for NIS 0.87 (approximately \$0.23) per each ordinary share. Starling's shares were delisted from trading on the Tel Aviv Stock Exchange on May 15, 2012, on which date Starling became a private company. The aggregate merger consideration amounted to approximately NIS 1,600 thousand (approximately \$420) which was paid by Elron and RDC in proportion to each party's respective post-merger holdings in Starling.

In June 2012, it was decided to voluntarily liquidate Starling. Later that year a liquidator was appointed and Starling was liquidated.

**d) Medingo**

Medingo Ltd ("Medingo") was engaged in the development of an insulin micro-pump. Prior to its sale (see below) Elron held approximately 92% of Medingo's outstanding shares, including approximately 84% held by RDC.

**Notes to the Consolidated Financial Statements**

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(USD in thousands, except for price per share and number of shares)

**Note 3- Investments in investees (Cont.)****3. Significant changes in investments in consolidated companies during the reporting period (Cont.)****d) Medingo (Cont.)**

On April 13, 2010, a definitive sale agreement was executed for the acquisition of all of Medingo's shares by F. Hoffman-La Roche Ltd. (the "Acquirer"), the principal terms of which included, inter alia, the following terms: (i) Upon completion of the transaction, the selling shareholders received consideration in the aggregate amount of \$160,000, subject to certain adjustments, of which an amount of \$27,000 was deposited in escrow for a period of 24 months (the Escrow Deposit) to cover mainly potential indemnification payments which may be due from the selling shareholders in connection with breaches, if any, of the sale agreement and certain potential future claims relating to Medingo, if any; (ii) The selling shareholders will receive gradual payments of additional contingent consideration of up to \$40,000 conditional upon Medingo achieving, gradually, over a certain period, certain operational milestones including, inter alia, the establishment of a production line with certain operational characteristics, ("Contingent Consideration"). See below regarding the receipt of the Contingent Consideration; (iii) Elron's and RDC's maximum potential indemnification obligations under the sale agreement are limited to approximately 110% of their respective share of the total consideration amount, except - with respect to each of them separately - in case of fraud or willful misconduct by it.

On May 28, 2010, the sale was completed. As a result, in respect of the aforementioned sale:

1. In accordance with Medingo's capital structure and the shareholders' rights to Medingo's capital, Elron and RDC received approximately \$13,900 and approximately \$95,000, respectively, upon and near the date of completion of the transaction. In May 2012 Elron and RDC received additional amounts of approximately \$2,700 and approximately \$19,900, respectively, from the Escrow Deposit. See below regarding Elron's and RDC's share in the Contingent Consideration.
2. Elron recorded a net gain (attributable to the Company's shareholders) in the second quarter of 2010 of approximately \$70,800 (a consolidated net gain of approximately \$124,700). See below regarding the gain recognized in 2012 resulting from Elron's and RDC's share in the Contingent Consideration.

The net gain recorded in 2010 detailed above includes recognition of the gain in respect of the consideration received upon completion of the transaction and recognition of the gain in respect of the financial asset recognized in respect of the consideration held in escrow. The net gain recorded in 2010 does not include recognition of the contingent consideration element, as in management's estimation, in light of the significant uncertainty as to the achievement of the aforementioned milestones and the timing thereof, the fair value measurement of this element could not be reliably estimated, for the reason, among others, that the Company did not have control over Medingo's success in meeting the aforementioned milestones, which was under the control of the Acquirer and was dependent upon additional factors, and also for the reason that pursuant to the sale agreement, the Company did not have access in 2010 and 2011 to information which could enable it to establish a reliable range of reasonable fair value estimates.

**Notes to the Consolidated Financial Statements**

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(USD in thousands, except for price per share and number of shares)

**Note 3- Investments in investees (Cont.)****3. Significant changes in investments in consolidated companies during the reporting period (Cont.)****d) Medingo (Cont.)**

In May 2012, the parties to the sale agreement signed a supplement to the sale agreement (the "Supplement"), according to which, as final consideration in lieu of the selling shareholders' right under the original sale agreement to all the Contingent Consideration payments, the Acquirer agreed to pay the selling shareholders an aggregate lump sum of \$19,000 (the "Additional Consideration"), on May 29, 2012 (which immediately followed the original expiration date of the escrow deposit, as aforementioned).

On May 29, 2012, the entire Escrow Deposit was released to the selling shareholders, and the Additional Consideration in the amount of \$19,000 was paid to the selling shareholders. Elron's and RDC's share in the Additional Consideration was approximately \$1,400 and \$14,100, respectively. Elron recorded in the second quarter of 2012 a net gain (attributable to the Company's shareholders) from its share in the Additional Consideration of approximately \$8,500 (a consolidated net gain of approximately \$15,600), under line item gain from disposal and revaluation of investee companies, and changes in holdings, net in the statement of income.

**e) Kyma**

Kyma Medical Technologies Ltd. ("Kyma") is developing a remote patient monitoring (RPM) solution for Congestive Heart Failure (CHF) patients. As of the reporting date, RDC holds approximately 64% of Kyma's outstanding shares. Prior to the investment agreement in October 2013, as detailed below, Kyma was a subsidiary of RDC. As of the reporting date, the investment in Kyma is accounted for under the equity method.

In January 2011, Elron invested an amount of \$4,000 in Kyma, in addition to an amount of \$1,000 invested in Kyma in 2010, in consideration for Preferred B shares. Following this investment, Elron's holding in Kyma's outstanding shares increased to approximately 65%. As a result, Kyma became a consolidated company and the Company recognized in 2011 a \$407 gain resulting from the revaluation to fair value of the shares of Kyma held by it prior to obtaining control (a fair value of \$1,000 less the prior carrying value of \$593). This gain was recognized in line item gain from disposal and revaluation of investee companies and changes in holdings, net, in the statement of income.

The fair value of non-controlling interests was estimated at the date of initial consolidation at \$727. As a result, at the time of the business combination an intangible asset attributed to IPR&D in the amount of \$1,244 was recognized.

**Notes to the Consolidated Financial Statements**

(USD in thousands, except for price per share and number of shares)

**Note 3- Investments in investees (Cont.)****3. Significant changes in investments in consolidated companies during the reporting period (Cont.)****e) Kyma (Cont.)**

In March 2011, Elron transferred its investment in Kyma, including any rights and obligations in regards to this investment, to RDC in consideration for \$5,000. As a result, Kyma became a subsidiary of RDC.

In September 2011, RDC and Kyma signed an investment agreement, according to which RDC will invest \$2,500 in Kyma in three installments, which were advanced to Kyma during 2012.

In October 2013, Kyma, RDC and a new investor completed an investment agreement in the amount of \$6,000 to be advanced in two installments in consideration for Preferred C shares (RDC's share in this amount is approximately \$2,000). In addition, the new investor also received warrants for Preferred C shares (exercisable from the investment date), which will enable the new investor the option to invest in Kyma an additional amount of \$4,000. The first installment in respect of this investment in the amount of \$3,000 was advanced immediately. RDC's share in the first installment was \$1,000. Following the first installment, RDC's holding in Kyma's outstanding shares decreased from approximately 73% to approximately 64%.

In January 2014, subsequent to the reporting date, the second installment in respect of this investment was advanced, in the amount of \$3,000. RDC's share in the second installment was \$1,000. Should the new investor exercise the warrants, RDC's holding in Kyma's outstanding shares is expected to decrease to approximately 38%. After this investment, which also brought about a change in Kyma's board of directors, RDC lost control over Kyma and commencing from the fourth quarter of 2013, the investment in Kyma is accounted for under the equity method of accounting. As a result, and in accordance with IFRS 10's provisions, Elron recognized in the fourth quarter of 2013 a net gain attributable to Elron's shareholders in the amount of approximately \$1,700 (a consolidated net gain in the amount of approximately \$2,800), resulting mainly from the revaluation to fair value of RDC's investment in Kyma, under line item gain from disposal and revaluation of investee companies and changes in holdings, net, in the statement of income.

**f) RDSeed**

RDSeed Ltd. ("RDSeed"), formerly known as Navitrio Ltd., a subsidiary, was founded in 2011 in order to invest in the digital field. Until the date of transfer of the investment in RDSeed to RDC (as detailed below), Elron directly held 85% of RDSeed's outstanding shares.

From the date of inception of RDSeed until the date of transfer of the investment in RDSeed to RDC, Elron invested in RDSeed an amount of \$5,000.

In July 2013, Elron transferred its investment in RDSeed, including any rights and obligations in connection with this investment, to RDC in consideration for approximately \$5,000. As a result, RDSeed became an RDC subsidiary. Subsequent to this transaction, RDC held 85% of RDSeed's outstanding shares. As a result, the Company recognized in 2013 a capital reserve from transactions with non-controlling interests in the amount of approximately \$2,172.

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 3- Investments in investees (Cont.)

## 3. Significant changes in investments in consolidated companies during the reporting period (Cont.)

## f) RDSeed (Cont.)

In addition, in July 2013, RDSeed signed an investment agreement with RDC, in the amount of \$2,000 in consideration for Preferred A shares. An amount of \$1,000 was advanced immediately. The second installment in the amount of \$1,000 was advanced in December 2013. As of the reporting date, RDC holds approximately 89% of RDSeed's outstanding shares.

## g) Wavion

Prior to the sale of Wavion Inc. ("Wavion") Elron held approximately 67% of Wavion's outstanding shares.

In November 2011, an agreement to sell all of the shares of Wavion to Alvarion Ltd. ("Alvarion") was signed including, among others, the following terms: (i) The transaction was executed by way of merger, upon completion of which Wavion was sold to Alvarion in consideration of aggregate proceeds of approximately \$26,500, subject to certain adjustments, of which approximately \$3,000 was deposited in escrow for a period of 15 months, and in consideration of additional proceeds of up to approximately \$3,750, contingent upon Wavion achieving a certain revenue milestone in the fourth quarter of 2011 (the "Contingent Consideration"). (ii) Alvarion will be entitled to certain indemnities in connection with the transaction, as is customary in transactions of this type, from the recipients of the transaction proceeds (without joint liability among them) in amounts not exceeding in the aggregate the transaction proceeds, except in the case of fraud or willful misconduct.

Upon completion of the transaction, Elron received aggregate proceeds in the amount of approximately \$16,200, of which approximately \$1,900 was deposited in escrow. In April 2012, the Company received an additional consideration of approximately \$1,272 on account of the Contingent Consideration. In February 2013, the Company received the escrow deposit in the amount of approximately \$1,900.

In respect of the sale, the Company recorded in 2011 a net gain of approximately \$21,400, presented under line item gain from disposal and revaluation of investee companies and changes in holdings, net, in the statement of income. The gain recognized in 2011 includes, in addition to the cash received, the consideration held in escrow and the Contingent Consideration, as the Company was able to estimate the fair value of these components reliably.

Aggregate cash flows received by the Group at Transaction closing as a result of the sale:

Cash received less Transaction costs paid in cash (*)	14,275
Less: cash and cash equivalents in subsidiary as of sale date	1,136
Net cash	<u>13,139</u>

(\*) This amount does not include the Contingent Consideration of approximately \$1,272 received in April 2012, nor the escrow deposit of approximately \$1,900 received in February 2013.

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 3- Investments in investees (Cont.)

## 3. Significant changes in investments in consolidated companies during the reporting period (Cont.)

## h) Financial data of previously consolidated and initially consolidated companies

	Companies previously consolidated as of the date of deconsolidation		
	2013	2012	2011
Cash and cash equivalents	635	465	1,136
Current assets (excluding cash and cash equivalents)	99	108	5,938
Non-current assets	258	45	1,415
Current liabilities	(209)	(834)	(9,688)
Non-current liabilities	(1,272)	(913)	(4,406)
	Companies initially consolidated		
	2013	2012	2011
Cash and cash equivalents	184	-	5,158
Current assets (excluding cash and cash equivalents)	17	-	342
Non-current assets	9	-	67
Current liabilities	(185)	-	(260)
Non-current liabilities	-	-	(414)

## B. Investments in associates accounted for using the equity method of accounting:

## 1. Composition

	December 31	
	2013	2012
Carrying amount of the shares and loans in the statement of financial position (1)	9,584	114,260
Less - provision for impairment	1,043	1,043
<b>Total</b>	<b>8,541</b>	<b>113,217</b>
(1) The carrying amount of the shares and loans includes:		
Allocated excess of cost (*)	4,261	27,160
Goodwill (*)	-	20,151
	<b>4,261</b>	<b>47,311</b>

(\*) As of December 31, 2012 most of the allocated excess cost and all of the goodwill are a part of the investment in Given. No impairments were recorded in respect of this investment. As of December 31, 2013 the investment in Given is classified as held for sale, see also Note 3.B.4.a) below.

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 3- Investments in investees (Cont.)

## B. Investments in associates accounted for using the equity method of accounting (Cont.):

According to the Company's accounting policy as described in Note 2.E above, the aggregate equity in losses not recognized by the Company, amounted to a total of approximately \$1,232 from the date of acquisition until December 31, 2013 (not including companies that as of the reporting date were not held by the Company) and a total of approximately \$525 for the year ended December 31, 2013 (and as for companies held by the Company as of December 31, 2012- approximately \$707 from the date of acquisition through December 31, 2012).

See Note 16.G for further details with respect to losses in respect of associates for the years ended December 31, 2013, 2012 and 2011.

## 2. Summarized data of the financial statements of associates, unadjusted to the Group's percentage of holdings (\*)

	<u>Current assets</u>	<u>Non-current assets</u>	<u>Total assets</u>	<u>Current liabilities</u>	<u>Non-current liabilities</u>	<u>Total liabilities</u>	<u>Equity attributable to shareholders of the company</u>	<u>Equity attributable to non-controlling interests</u>	
<b>As of December 31, 2013</b>									
Given Imaging Ltd.	203,359	114,689	318,048	41,100	5,839	46,939	271,109	-	
BrainsGate Ltd.	9,293	163	9,456	2,580	1,212	3,792	5,664	-	
Pocared Diagnostics Ltd.	1,570	858	2,428	1,165	110	1,275	1,153	-	
<b>As of December 31, 2012</b>									
Given Imaging Ltd.	155,570	117,537	273,107	36,814	6,483	43,297	229,810	-	
BrainsGate Ltd.	15,503	164	15,667	2,337	1,262	3,599	12,068	-	
Pocared Diagnostics Ltd.	3,186	710	3,896	890	-	890	3,006	-	
	<u>Revenues</u>	<u>Gross profit</u>	<u>Operating profit (loss)</u>	<u>Profit (loss) from continuing operations</u>	<u>Profit (loss) for the year</u>	<u>Profit (loss) attributable to shareholders of the company</u>	<u>Profit (loss) attributable to non-controlling interests</u>	<u>Other comprehensive income (loss)</u>	<u>Total comprehensive income (loss)</u>
<b>2013</b>									
Given Imaging Ltd.	190,769	146,389	14,380	9,345	9,345	9,345	-	(54)	9,291
BrainsGate Ltd.	-	-	(6,533)	(6,416)	(6,416)	(6,416)	-	-	(6,416)
Pocared Diagnostics Ltd.	-	-	(10,572)	(10,697)	(10,697)	(10,697)	-	-	(10,697)
<b>2012</b>									
Given Imaging Ltd.	180,501	136,834	13,295	15,022	15,022	15,115	(93)	536	15,558
BrainsGate Ltd.	-	-	(6,207)	(6,067)	(6,067)	(6,067)	-	-	(6,067)
Pocared Diagnostics Ltd.	-	-	(7,069)	(7,076)	(7,076)	(7,076)	-	-	(7,076)
<b>2011</b>									
Given Imaging Ltd.	177,955	136,506	12,293	7,632	7,632	7,441	191	764	8,396
BrainsGate Ltd.	-	-	(7,536)	(7,605)	(7,605)	(7,605)	-	-	(7,605)
Pocared Diagnostics Ltd.	-	-	(5,566)	(5,556)	(5,556)	(5,556)	-	-	(5,556)

(\*) The information presented does not include excess cost and goodwill.

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 3- Investments in investees (Cont.)

## 3. Additional information about associates that are held by the Company in conformity with the Israeli Securities Regulations (Annual Financial Statements), 2010 and with the provisions of IFRS 12:

## a) General information

	Principal place of business and country of incorporation	Equity interest and voting rights (1)	Company's participating in gain (loss) rights (2)	Amounts made available to the associate		Carrying amount (3)	Stock exchange	Fair value
				Loans	Guarantees			
<b>As of December 31, 2013:</b>								
Given Imaging Ltd. (4)	Israel	20.57	20.57	-	-	108,735(5)	(6)	284,702(7)
BrainsGate Ltd.	Israel	29.87	35.3	-	-	957	unquoted	unquoted
Pocared Diagnostics Ltd.	Israel	41.35	48.59	897	-	551	unquoted	unquoted
				897	-	110,243		284,702
<b>As of December 31, 2012:</b>								
Given Imaging Ltd. (4)	Israel	21.89	21.89	-	-	105,714(5)	(6)	165,350(7)
BrainsGate Ltd.	Israel	29.90	35.3	-	-	2,958	unquoted	unquoted
Pocared Diagnostics Ltd.	Israel	40.84	44.7	-	-	1,830	unquoted	unquoted
				-	-	110,502		165,350

- (1) Reflects the Company's ownership interests in the ordinary shares and the preferred shares of the investee companies on an as-converted-basis, and does not take full dilution into account.
- (2) In most of the investees the Company invests in the form of a preferred security or other senior security, that grants it the preferred rights over regular shares. Therefore, the Company recognizes losses based on its share in the associate's security or loan held by the Company that grants it the preferred rights, and to which the equity method is being applied, and not based on the Company's equity interests. See also Note 2.E.
- (3) The Company's investment is calculated based on the consolidated financial statements as the net aggregate amount attributable to the Company's shareholders of total assets less total liabilities, including goodwill, excess cost allocated and loans.
- (4) Elron's direct holding. As of December 31, 2013, Elron additionally held 8.05% of Given through RDC, such that Elron's effective holding including RDC's holding was 24.60% (as of December 31, 2012, 26.18%). DIC together with the Company and RDC held approximately 43% of the issued and outstanding shares of Given as of December 31, 2013.
- (5) As of December 31, 2013 Given was held for sale and was not accounted for under the equity method of accounting. Represents the consolidated carrying amount of Elron and RDC. Elron's direct carrying amount in Given was \$89,175, and the investment in Given attributable to the Company's shareholders was \$99,471.
- (6) As of December 31, 2013, was publicly traded on the Tel Aviv Stock Exchange (TASE) in Israel and on the NASDAQ in the United States. See also Note 3.B.4.a) regarding Given Merger.
- (7) Represents the consolidated value of Elron and RDC's share in the fair value of Given. As of December 31, 2013, this amount represents a value of 30.08 dollars per Given share, in accordance with the traded share price as of the reporting date (in the Given Merger a consideration of 30 dollars per Given share was determined, see Note 3.B.4.a) below)



## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 3- Investments in investees (Cont.)

## b) Information about the convertible securities of associates that are held directly by the Company

Certain of the Company's associates have issued warrants and/or share options to employees and others. The following data details the warrants' and share options' possible impact on Elron's holdings in these companies as of December 31, 2013:

	<u>Vesting period</u>	<u>Elron's holding before exercise in share capital</u> %	<u>Elron's holding after exercise in share capital</u> %
Given Imaging Ltd. (1) (2)	2014-2016	20.57	18.87
BrainsGate Ltd. (3)	2014-2023	29.90	26.82
Pocared Diagnostics Ltd. (4)	2014-2020	41.35	36.35

- (1) Elron's direct holding. Elron's effective holding including RDC's holding after exercise is 22.57%.  
(2) Until the completion of the Given Merger (see Note 3.B.4.a) below), all of the options that were issued for Given shares were exercised or expired.  
(3) BrainsGate Ltd. ("BrainsGate") has issued to certain shareholders, including Elron, warrants for preferred shares, which are subject to immediate exercise, see also Note 3.B.4.c). Elron's holding, taking into account only the exercise of these warrants, is 30.44%.  
(4) Pocared Diagnostics Ltd. ("Pocared") has convertible loans, which may be repaid or converted into shares if certain conditions are met. Since the amount of the shares issuable upon conversion is determined only at the time of actual conversion, these convertible loans were not taken into account in determining the holding rate after exercise. See Note 3.B.4.b) below.

## c) Reconciliation to the carrying amount of the Company's interest in material associates:

	<u>BrainsGate</u>		<u>Pocared</u>		<u>Given</u>
	<u>2013</u>	<u>2012</u>	<u>As of December 31,</u>		<u>2012 (*)</u>
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>	<u>2012 (*)</u>
Total equity	5,664	12,068	1,153	3,006	229,810
Participating share in profit or loss of the associate (**)	35.3%	35.3%	48.59% (***)	44.7%	30.45% (****)
	1,999	4,260	560	1,343	69,977
Excess cost	10	10	896	896	48,367
Share in the equity attributable to employee options	(1,478)	(1,753)	(512)	(409)	(12,630)
Loans	-	-	975	-	-
Other adjustments	426	441	(1,368)	-	-
Balance of the investment in the associate	957	2,958	551	1,830	105,714

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 3- Investments in investees (Cont.)

## c) Reconciliation to the carrying amount of the Company's interest in material associates (Cont.):

	BrainsGate		Pocared		Given
	For the year ended December 31,				
	2013	2012	2013	2012	2012 (*)
<b>The results of operations of the associates</b>					
Total comprehensive income (loss)	(6,416)	(6,067)	(10,697)	(7,076)	15,651
Participating share in profit or loss of the associate (**)	35.3%	35.3%	48.59% (***)	44.7%	30.45% (***)
	(2,265)	(2,142)	(5,197)	(3,162)	4,766
Amortization of excess cost	-	-	-	-	(4,120)
Other adjustments	(15)	(41)	-	4	(116)
Company's share in profit (loss) of the associate	(2,280)	(2,183)	(5,197)	(3,158)	530

(\*) As of December 31, 2013, the investment in Given was classified as held for sale in accordance with IFRS 5. See also Note 3.B.4.a).

(\*\*) See details in Note 2.E above.

(\*\*\*) For details regarding the participating in Pocared's losses, see new investment agreement in Note 3.B.4.b) above.

(\*\*\*) Represents the consolidated holdings of Elron and RDC in Given.

## d) Other associates

The Company's share, in aggregate, in loss and in other comprehensive loss of other associates for the year ended December 31, 2013 is \$4,391 (for 2012- \$3,382).

## e) Inclusion of the financial statements of associates accounted for under the equity method of accounting

The Company is enclosing the financial statements of Pocared to these financial statements.

As aforementioned, in February 2014, subsequent to the reporting date, the Given Merger was completed, and as a result Given ceased being accounted for under the equity method of accounting. According to the Israeli Securities Regulations (Annual Financial Statements), 2010, the Company is not required to enclose Given's statements. Since the Company is enclosing Given's financial statements to its annual report for 2013 in the United States (20F), and for convenience, the Company is enclosing Given's statements for 2013 as an appendix to these financial statements, as it was enclosed in the United States.

## Notes to the Consolidated Financial Statements

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(USD in thousands, except for price per share and number of shares)

## Note 3- Investments in investees (Cont.)

**4. Significant changes in investments in associates during the reporting period****a) Given**

Given provides minimally invasive diagnostic products for visualization and detection of disorders of the gastrointestinal tract, and was traded on Nasdaq and the Tel-Aviv Stock Exchange (symbol: GIVN), until the completion of the merger, as detailed below. Given was accounted for under the equity method of accounting, until its classification as held for sale, see below. As of December 31, 2013, Elron directly held approximately 21% of Given (DIC and RDC held approximately 14% and 8% of Given, respectively). Therefore, as of December 31, 2013 the Company together with DIC and RDC held approximately 43% of the issued and outstanding shares of Given.

As aforementioned in Note 1, in December 2013, Given signed an agreement with an entity of the Covidien corporation (the "Purchaser") and a subsidiary fully owned by the Purchaser, according to which, by way of merger between the Purchaser's subsidiary and Given, the entire share capital of Given will be transferred to the Purchaser for a cash consideration to Given's current shareholders of \$30 per share (the "Transaction" or the "Given Merger"). The share of Elron and RDC in the consideration, less tax payments and transactions costs, is approximately \$204,000 and \$61,000, respectively. On December 8, 2013, Elron's and RDC's boards of directors decided to vote in favor of the Transaction at the general meeting of Given's shareholders. In January 2014, subsequent to the reporting date, the general meeting of Given's shareholders approved the Transaction and the necessary regulatory approvals were received, and in February 2014, subsequent to the reporting date, the Transaction was completed and the aforementioned consideration was received.

As a result, as of December 31, 2013, the investment in Given complied with the terms set in IFRS 5 for classification as a non-current asset held for sale, and accordingly, the investment was classified as an asset held for sale in the statement of financial position as of December 31, 2013. According to the provisions of IFRS 5, after the date of classification as held for sale, the investment is no longer accounted for under the equity method of accounting and the investment in Given is presented according to its carrying amount at the date of classification as held for sale.

In the first quarter of 2014, Elron is expected to recognize in respect with the Transaction a net gain, attributable to the Company's shareholders, which is estimated at this point in an amount of approximately \$107,000, including Elron's share in the gain expected to be recorded by RDC. The said gain is after tax expenses which are estimated at this point in approximately \$37,500 (the expected consolidated net gain, net of tax, is \$130,000).

In light of the aforementioned, the Company examined the expected utilization of carryforward losses and other temporary differences and recognized in 2013 a deferred tax asset of approximately \$29,000 (and a tax liability of approximately \$600 in respect of RDC's holdings in Given). See also Note 17.

**b) Pocared**

Pocared, an Israeli company, is developing a real-time and automated system for infectious diseases diagnosis using optical technology. As of the reporting date, Elron holds approximately 41% of Pocared's outstanding shares and Pocared is accounted for under the equity method of accounting.

**Notes to the Consolidated Financial Statements**

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(USD in thousands, except for price per share and number of shares)

**Note 3- Investments in investees (Cont.)****4. Significant changes in investments in associates during the reporting period (Cont.)****b) Pocared (Cont.)**

In May 2013, Pocared signed an investment agreement with its major shareholders, including Elron, whereby a total amount of up to \$10,000 will be advanced in two installments in consideration for additional Preferred F shares. The first installment in respect of this investment in the amount of approximately \$3,000 was advanced in the same month. Elron's share in this installment was approximately \$1,400. The second installment will be advanced conditionally upon Pocared achieving a certain milestone as stipulated in the agreement. This agreement was in addition to an investment agreement signed in 2011, whereby a total amount of \$26,000 was invested in Preferred F shares.

In October 2013, Pocared's major shareholders, including Elron, granted Pocared a loan in the amount of \$2,000. Elron's share in this loan was approximately \$900.

In February 2014, subsequent to the reporting date, some of Pocared's shareholders, including Elron, granted Pocared an additional loan in the amount of \$2,000. One of Pocared's major shareholders chose not to participate in this loan and therefore Elron's share in this loan was \$1,500.

In February 2012, the Company granted phantom options over Pocared shares to the chairman of the board of directors and to another employee, representing approximately 1.2% of Pocared's outstanding share capital. See also Note 19.D.1.

**b) BrainsGate**

BrainsGate is developing a minimally invasive treatment platform for patients suffering from Central Nervous System diseases. As of the reporting date, Elron holds approximately 30% of BrainsGate's outstanding shares. BrainsGate is accounted for under the equity method of accounting.

In July 2011, BrainsGate signed an investment agreement with its major shareholders, including Elron, whereby approximately \$20,000 was advanced in three installments in consideration for Preferred D shares and warrants for Preferred D shares. The first installment was advanced immediately and the additional two installments were advanced during 2012. Elron's share in this investment was approximately \$7,100. Following completion of the financing round Elron's holding in BrainsGate's outstanding share capital increased from approximately 26% to 30%.

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 3- Investments in investees (Cont.)

## 4. Significant changes in investments in associates during the reporting period (Cont.)

## d) CartiHeal

CartiHeal (2009) Ltd. ("CartiHeal") is developing an implant for repair of articular cartilage and osteochondral defects. As of the reporting date, Elron holds approximately 32% of CartiHeal's outstanding shares, and the investment in CartiHeal is accounted for under the equity method of accounting.

In January 2012, prior to Elron's initial investment in CartiHeal, CartiHeal signed an investment agreement with certain of its shareholders whereby approximately \$5,000 was advanced in two installments in consideration for Preferred D shares and warrants to Preferred D shares. The first installment in the amount of \$2,500 was advanced immediately. In July 2012, Elron joined the existing investment agreement between CartiHeal and its shareholders and invested the second installment in the amount of \$2,500 in CartiHeal, in lieu of such existing shareholders, in consideration for Preferred D shares and warrants for Preferred D shares.

In September 2013, CartiHeal's shareholders, including Elron, exercised the warrants for Preferred D shares, in consideration for \$5,000 (Elron's share was \$2,500). As a result, Elron's holding in CartiHeal's outstanding shares increased from approximately 24% to approximately 32%.

## Note 4- Cash and cash equivalents

	December 31	
	2013	2012
Cash	5,137	1,166
Cash equivalents - short-term deposits (*)	27,154	46,359
	<u>32,291</u>	<u>47,525</u>

(\*) The deposits bear variable interest rate, which is determined based on the deposit period and currency. The interest rate on deposits as of December 31, 2013, is 0.3%-0.7%.

## Note 5- Other accounts receivable

As of December 31, 2013, other accounts receivable mainly include a deposit held in escrow due to the sale of SyncRx in the amount of approximately \$3,100 (see also Note 3.A.3.b)). As of December 31, 2012, other accounts receivable mainly include a deposit held in escrow due to the sale of Wavion in the amount of approximately \$1,900, which was received in February 2013, and bank deposits in the amount of approximately \$930.

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 6- Other investments measured at fair value

	December 31, 2013			December 31, 2012		
	Quoted	Unquoted	Total	Quoted	Unquoted	Total
Investment in shares measured at fair value through profit or loss	-	25,453	25,453	-	22,325	22,325
Investment in shares measured at fair value through other comprehensive income	847	-	847	178	1,072	1,250
<b>Total</b>	<b>847</b>	<b>25,453</b>	<b>26,300</b>	<b>178</b>	<b>23,397</b>	<b>23,575</b>

(\*) For a list of investments, see Annex to the consolidated financial statements.

**Financial assets measured at fair value - unquoted shares**

The Company holds interests not entitling significant influence in several private companies. The fair value of these companies' shares has been estimated using:

1. Discounted Future Earnings Method - This methodology is used when the investees undergoing evaluation are able to provide projections for their future cash flows. In addition, it was deemed not unreasonable that market participants or other investors would use this methodology to determine the fair value of their rights in these companies.
2. Company Security Transaction Method ("CSTM") - According to the CSTM method, the value of each investee is estimated based upon recent transaction prices in the investee's securities. For these transactions to be relied upon to develop an estimate of fair value, they must be arm's length transactions. Additional factors considered in this analysis include: size, amount and type of shares sold; the timing of the transaction relative to the estimation date; differences in the rights, preferences, marketability, control of the transaction securities, participation of new investors, shareholders who don't participate, volatility in the investee's projections and the volatility of comparable firms.
3. Option Pricing Model ("OPM") - After deriving the investee's fair value, it is generally accepted for market participants to allocate the value of the investee to the different classes of equity. OPM is an option pricing model based on the Black and Scholes formula or based on the Binomial (lattice) model. This model is based upon the concept that the securities of a firm's capital structure can be considered as call options on the value of the firm. The model uses a Black and Scholes option model or a Binomial (lattice) model to estimate the value of the investee between value ranges.

The valuations require management to make certain assumptions about certain parameters, including projections, credit risk and volatility.

**Notal**

Notal Vision Inc. ("Notal") provides a system and services for remote monitoring from home of AMD patients at risk of vision loss, for the early detection of important visual changes. As of the reporting date, Elron holds approximately 22% of Notal's outstanding shares and approximately 18% on a fully diluted basis. The investment in Notal is accounted for as a financial asset measured at fair value through profit or loss.

**Notes to the Consolidated Financial Statements**

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(USD in thousands, except for price per share and number of shares)

**Note 6- Other Investments (accounted for as available for sale) (Cont.)****Notal (Cont.)**

In 2012, Notal signed an investment agreement with its major shareholders, including Elron, whereby approximately \$5,000 was advanced in two installments in consideration for Preferred C shares and warrants for Preferred C shares. Both installments were advanced during 2012. Elron's share in this investment was \$1,250.

In July 2013, Notal signed an investment agreement with its major shareholders, including Elron, in the amount of \$10,000 advanced in two equal installments (Elron's share in this amount was approximately \$1,940) and an option to participate in an additional installment in the amount of \$5,000, in consideration for Preferred C shares and warrants for Preferred C shares. The first installment was advanced in July 2013 and in January 2014, subsequent to the reporting date, the second installment was advanced.

Notal's fair value was derived from the value determined in a valuation carried out by an independent appraiser. The value of this investment as of December 31, 2013 was estimated at approximately \$11,009. The significant details included in this valuation pursuant to the requirements of the Israeli Securities Regulations (Periodic and Immediate Reports), 1970, with regards to an investment in unquoted shares are as follows:

1. **The subject of the valuation:** Elron's investment in Notal.
2. **The valuation's effective date:** As of December 31, 2013. The date of the engagement with the appraiser was December 24, 2013.
3. **The carrying amount of the investment in Notal in the Company's financial statements:** As of June 30, 2013 - \$6,937 (unaudited), as of December 31, 2012 - \$5,650.
4. **The value of Notal established by the Appraiser:** Approximately \$53,055. Accordingly, the value of Elron's interest was determined at \$11,009. As a result, in 2013 the Company recognized a gain of \$3,425 (a gain of \$1,287 recognized in the second quarter (unaudited) and a gain of \$2,137 recognized in the fourth quarter (unaudited)) under gain from disposal and revaluation of investee companies and changes in holdings, net in the statement of income.
5. **The valuation model used by the Appraiser:**
  - a. The DCF Method for determining Notal's value (enterprise value).
  - b. The Option Pricing Model (OPM), using the formulas of Black and Scholes model for allocating Notal's value to different classes of shares and for determining the value of Elron's interest accordingly.

**Notes to the Consolidated Financial Statements**

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**(USD in thousands, except for price per share and number of shares)****Note 6- Other Investments (accounted for as available for sale) (Cont.)****6. The assumptions used:**

- a. The discount rate (WACC): 17.5%.
- b. The long term growth rate/ terminal value: discounted cash flows were computed until the end of the patent's life. The valuation did not use "representative year".
- c. Probability for insurance reimbursement: 50%.
- d. The standard deviation: The volatility used in the Black and Scholes model was 72.8%.
- e. Comparable prices used/ comparative items used: The standard deviation is based on the data of Professor Demodaran, as applicable for Notal's activity.

**Aqwise**

Aqwise – Wise Water Technologies Ltd. ("Aqwise") provides biological water and wastewater treatment solutions for the industrial and municipal markets. As of the reporting date, Elron holds approximately 19.8% of Aqwise's outstanding shares.

In July 2012, Aqwise completed an investment and share sale transaction with its shareholders and a third party (the "Investor"), according to which an amount of \$4,500 was invested in Aqwise. In addition, as part of the transaction, the Investor purchased a portion of Aqwise's other shareholders' shares, including a portion of Elron's shares. Upon the completion of the transaction, Aqwise repaid the loan which was granted to it by its shareholders (of which Elron's share was approximately \$350). In addition, Elron received an amount of approximately \$1,550 in consideration for the sale of a portion of its holding in Aqwise to the Investor. Following the completion of the said transaction, Elron's holding in Aqwise's outstanding shares decreased from approximately 34% to approximately 19.8%, and approximately 18% on a fully diluted basis. Accordingly, since the Company no longer retains significant influence over Aqwise, the remaining investment is presented as an investment in a financial asset measured at fair value through profit or loss. Prior to the investment and share sale transaction the investment in Aqwise was accounted for under the equity method of accounting.



**Notes to the Consolidated Financial Statements**

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(USD in thousands, except for price per share and number of shares)

**Note 6- Other Investments (accounted for as available for sale) (Cont.)****Aqwise (Cont.)**

Following the completion of the transaction, Elron holds 10,291 ordinary shares of Aqwise. The value of the investment in these shares was determined at the date in which the Company lost significant influence by reference to Aqwise's share price in the transaction (approximately \$417 per share), and as of December 31, 2012 amounted to approximately \$4,300.

As a result of the aforementioned, in 2012, Elron recognized a gain in the amount of approximately \$3,900, under line item gain from disposal and revaluation of investee companies and changes in holdings, net, in the statement of income. This gain was comprised of the value of the remaining investment held by Elron (approximately \$4,300), plus the net cash consideration (approximately \$1,850), less the equity investment value prior to the transaction (approximately \$2,200), and a charge of foreign currency translation differences to the statement of income in a total amount of approximately \$50.

The fair value of the investment in Aqwise as of December 31, 2013 was determined with the assistance of an independent appraiser. The value of this investment as of December 31, 2013 was estimated at approximately \$3,800. Accordingly, the Company recognized a loss from change in the value of the investment in the amount of approximately \$500, under line item gain from disposal and revaluation of investee companies and changes in holdings, net, in the statement of income.

**Jordan Valley**

Jordan Valley Semiconductors Ltd. ("Jordan Valley") provides metrology solutions for manufacturing process control in the microelectronics industry. As of the reporting date, Elron holds approximately 19% of Jordan Valley's outstanding shares. The investment in Jordan Valley is accounted for as a financial asset measured at fair value through profit or loss.

Jordan Valley's fair value was derived from the value determined in a valuation carried out by an independent appraiser, Empire Valuation Consultants, LLC ("Empire" or the "Appraiser"). The value of this investment as of December 31, 2013 was estimated at approximately \$10,440. The significant details included in this valuation pursuant to the requirements of the Israeli Securities Regulations (Periodic and Immediate Reports), 1970, with regards to an investment in unquoted shares are as follows:

1. **The subject of the valuation:** Elron's investment in Jordan Valley.
2. **The valuation's effective date:** As of December 31, 2013. The date of the engagement between Empire and Elron was December 20, 2013.
3. **The carrying amount of the investment in Jordan Valley in the Company's financial statements:** As of June 30, 2013 - \$11,380 (unaudited), as of December 31, 2012 - \$12,190.
4. **The value of Jordan Valley established by the Appraiser:** Approximately \$37,537. Accordingly, the value of Elron's interest was determined at \$10,440. As a result, in 2013 the Company recognized a loss of approximately \$1,700 (a loss of approximately \$800 recognized in the second quarter (unaudited) and a loss of approximately \$900 in recognized in the fourth quarter (unaudited)) under gain from disposal and revaluation of investee companies and changes in holdings, net in the statement of income.

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**Notes to the Consolidated Financial Statements**


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(USD in thousands, except for price per share and number of shares)

**Note 6- Other Investments (accounted for as available for sale) (Cont.)**
**Jordan Valley (Cont.)**

5. **Details of the Appraiser:** Empire Valuation Consultants, LLC. The valuation was performed by a team led by Mr. Mark Shayne, a Managing Director with Empire. Mr. Shayne has an M.B.A. from the Stern Graduate School of Business at New York University, and is an Accredited Senior Appraiser (ASA) of the American Society of Appraisers, and Accredited in Business Valuation (ABV) by the American Institute of Certified Public Accountants. Mr. Shayne has experience providing financial consulting, appraisal, due diligence, and expert witness testimony on valuation matters. His areas of expertise include valuation of common and preferred stock, employee and incentive stock options, partnership interests, and intangible assets, among others. There is no dependency between the Appraiser and the Company, the party who ordered the valuation. The Appraiser is indemnified by the Company for expenses which may be incurred to the Appraiser in carrying out this valuation.
6. **The valuation model used by the Appraiser:**
  - a. The DCF Method for determining Jordan Valley's value (enterprise value).
  - b. The Black and Scholes model for allocating Jordan Valley's value to different classes of shares and for determining the value of Elron's interest accordingly.
7. **The assumptions used:**
  - a. The discount rate (WACC): 19%.
  - b. The long term growth rate: 3% per year.
  - c. The terminal value as a percentage of the value determined in the valuation: 35%.
  - d. The standard deviation: The volatility used in the Black and Scholes model was 40%.
  - e. Comparable prices used: The volatility was estimated based on the following data sets: (1) the volatilities of six publicly listed comparable companies using their historical equity prices; and (2) the implied forward-looking volatilities, which were calculated based on the market prices of the publicly traded options for certain of these comparable companies.
  - f. The number of comparable items used: Six publicly listed companies, as mentioned above. Up to six matrices per company were used as a basis for comparison between Jordan Valley's overall value and the value of comparable publicly listed companies.

**Enablence**

In 2010, Elron received shares and debentures of Enablence Technologies Inc. ("Enablence"), due to the sale of Teledata Networks Ltd.. Enablence is a foreign company publicly traded on the TSX Venture Exchange.

**Debentures:**

As of the date the debentures were recorded, its par value was approximately \$3,779 and the investment in these debentures was treated in the financial statements as a financial asset measured at amortized cost. In 2011, due to substantial doubt in Enablence's ability to repay its debt, Elron recognized an impairment of the entire debentures' balance. In 2012, Enablence paid a negligible portion of its debt to the holders of the debentures (Elron's share was approximately \$283). As a result, the Company recognized a partial cancellation of the impairment charge recognized in 2011.

In August 2013, Enablence completed a financing round with a new investor in the amount \$15,000 thousand CAD. Simultaneously, a settlement agreement between Enablence and its debenture-holders, including Elron, for the partial repayment of the debt was also completed.

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 6- Other Investments (accounted for as available for sale) (Cont.)

## Enablence (Cont.)

According to the settlement agreement, out of the consideration Enablence paid to the debenture-holders, Elron received the following consideration: approximately \$1,700 in cash, of which an amount of \$400 was paid in Enablence shares which were purchased for cash by an Enablence shareholder as part of the settlement agreement; and 5,880,104 Enablence shares (constituting approximately 4% of Enablence's outstanding shares), which were subject to a four month lockup period in accordance with Canadian securities legislation. The value of the shares received, as of the transaction date (less a discount in respect of the lockup period, see Note 20.F) is approximately \$1,800. In addition, pursuant to the settlement agreement, the debenture-holders, including Elron, waived the outstanding debt and released Enablence from any claims in connection with the debentures.

As a result of the settlement agreement, Elron recorded in 2013 a net gain in the amount of approximately \$3,500 in respect of a partial cancellation of the impairment recognized in 2011. The above-mentioned gain is presented under line item other expenses (income), net in the statement of income.

Shares:

The investment in Enablence shares is accounted for as a financial asset measured at fair value through other comprehensive income. As of December 31, 2013, the investment in shares which are not restricted, is measured according to the shares' quoted market price. The fair value of the investment in Enablence's restricted shares, received in the settlement agreement, was determined by reference to their quoted market price less a discount in respect of the lockup period. As of the date of approval of these statements, the lockup was removed from the shares received in the settlement agreement.

## Note 7- Assets held for sale

## Given

In light of the Given Merger, see Note 3.B.4.a) above, as of December 31, 2013, the investment in Given was classified as an asset held for sale in the statement of financial position.

## Note 8-Other long-term receivables

	December 31	
	2013	2012
Escrow deposits (1)	-	3,061
Other	29	771
	29	3,832

(1) The balance as of December 31, 2012, is comprised of a deposit held in escrow due to the sale of Sync-Rx, see Note 3.A.3.b) above. As of December 31, 2013, this balance is included in line item other accounts receivable.

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 9- Intangible Assets

	Technology and in-process Development (1)	Agreement with Rafael (2)	Total
<b>Cost</b>			
Balance at January 1, 2012 and December 31, 2012	1,871	3,051	4,922
Additions due to business combinations	814	-	814
Decrease due to sale of consolidated company	(1,224)	-	(1,224)
<b>Balance at December 31, 2013</b>	<b>1,461</b>	<b>3,051</b>	<b>4,512</b>
<b>Amortization</b>			
Balance at January 1, 2012 and December 31, 2012	-	-	-
Amortization recognized during the year	54	-	54
<b>Balance at December 31, 2013</b>	<b>54</b>	<b>-</b>	<b>54</b>
<b>Amortized cost</b>			
Balance at December 31, 2013	1,407	3,051	4,458
Balance at December 31, 2012	1,871	3,051	4,922

- (1) The Company examines the need for impairment in regards with these assets at least once a year.
- (2) Not systematically amortized – indefinite useful life (see Note 3.A.3.a). The Company estimated the recoverable amount of the agreement with Rafael as part of RDC as a whole. In accordance with this examination, it was concluded that there was no need to depreciate the carrying amount of the asset in the financial statements. The assets and liabilities of RDC were included in the recoverable amount estimate.

## Note 10- Other accounts payable

	December 31	
	2013	2012
Accrued expenses	1,238	1,255
Liabilities to employees	1,727	706
Governmental institutions	96	118
Employees call options (*)	246	293
Other payables	218	233
	<b>3,525</b>	<b>2,605</b>

- (\*) With regard to phantom options over shares of Pocared granted to the chairman of the board of directors and another employee, see Note 19.D.1.

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 11- Financial liabilities

	December 31	
	2013	2012
<b>Short-term liabilities:</b>		
Loans from banks (1)	4,000	-
<b>Long-term liabilities:</b>		
Loans from banks (1)	-	4,000
	<u>4,000</u>	<u>4,000</u>

- (1) In November 2011, Elron entered into a binding agreement with Silicon Valley Bank (the "Bank") to receive a credit line in the amount of \$30,000 for a period of up to 18 months (the "Period"), which was afterwards extended until October 2014. The credit line was obtained in order to diversify and ensure additional sources of financing for the Company towards continued investing in companies held by the Company and new companies and to finance its ongoing operations. During the Period, the Company was entitled to draw down loans for periods of up to 3 years from the date of each respective draw down, at the Wall Street Journal prime rate of interest plus 0.75% per annum. According to the terms of the credit line, the Company was able to make early repayment of all the loans without any cost. At the time the credit line is actually utilized, the Company pledged shares of Given directly held by it in an amount equal to maintain a 3.25 ratio of the market value of the pledged shares (based on their trailing 5-day average closing price prior to the computation date) to the amount of credit utilized. Pursuant to the agreement with the Bank, should the ratio of the market value of the pledged shares to the credit amount utilized decrease below 3, then the Company would be required either to pledge additional Given shares or repay a portion of the credit utilized in order to maintain a coverage ratio of 3.25, or provide alternative collateral acceptable to the Bank. Subsequent to the Given Merger (see also Note 3.B.4.a) above), the credit line expired.

In April 2012, the Company drew down a loan in the amount of \$5,000 from the aforementioned credit line. To secure the loan, and in accordance with the credit agreement, a pledge was placed on 1,130,000 Given shares held by the Company in favor of the Bank, which then represented approximately 3.7% of Given's outstanding shares.

In August 2012, Elron prepaid an amount of \$1,000 out of the loan balance, and in January 2014, subsequent to the reporting date, Elron prepaid the rest of the loan balance, in the amount of \$4,000.

The coverage ratio as of December 31, 2013 was 8.5.

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 12- Royalty bearing government grants

## Government grants

	2013	2012
	\$ thousands	
Balance as of January 1	864	958
Grants received during the year	553	1,291
Deconsolidation of a subsidiary (2013- Note 3.A.3.e), 2012-Note 3.A.3.b))	(1,272)	(910)
Amounts charged to the statement of income	(145)	(475)
Balance as of December 31 (*)	-	864

(\*) As of December 31, 2012 the balance is presented in the statement of financial position under line item royalty bearing government grants.

## Note 13- Equity

## A. Composition of share capital:

	December 31,			
	2013		2012	
	Registered	Issued and outstanding	Registered	Issued and outstanding
	Number of shares			
Ordinary shares of NIS 0.003 par value each	35,000,000	29,743,767	35,000,000	29,733,767

## B. Rights attached to shares

1. Voting rights at the general meeting, right to dividend, rights upon liquidation of the Company and right to nominate the directors in the Company.
2. Quoted on the Tel Aviv Stock Exchange and the over-the-counter market in the United States (see also Note 1.A).

**Notes to the Consolidated Financial Statements**

(USD in thousands, except for price per share and number of shares)

**Note 13- Equity (Cont.)****C. Changes in issued and outstanding share capital**

	<u>Number of Shares</u>	<u>\$ thousands par value</u>
Balance at January 1, 2012	29,660,017	9,573
Exercise of employees' options into shares	<u>73,750</u>	<u>*)</u>
Balance at December 31, 2012	29,733,767	9,573
Exercise of employees' options into shares	<u>10,000</u>	<u>*)</u>
Balance at December 31, 2013	<u><u>29,743,767</u></u>	<u><u>9,573</u></u>

(\*) Amount less than \$1.

**D. Capital management in the Company**

The Company's and its subsidiaries' capital management policy is to maintain a strong equity base in order to preserve their ability to ensure business continuity thereby creating a return for the shareholders, to uphold their commitments to other interested parties such as credit givers and employees, and in order to support future development activity.

The Company is not under any minimal equity requirements nor is it required to attain a certain level of capital return.

**E. Dividend Distribution**

In 2012, the Company declared and paid a dividend in an amount of \$15,000 (approximately \$0.51 per share).

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 13- Equity (Cont.)

## F. Comprehensive income (loss)

Year ended December 31, 2013

	Attributable to the Company's shareholders				Non-controlling interests	Total
	Accumulated deficit	Reserve for financial assets measured at fair value through other comprehensive income	Total			
Net gain (loss)	17,935	-	17,935	(1,005)	16,930	
Loss from financial assets measured at fair value through other comprehensive income	-	(2,111)	(2,111)	-	(2,111)	
Group's share of net other comprehensive loss of companies accounted for under the equity method	(14)	-	(14)	(2)	(16)	
Total other comprehensive loss	(14)	(2,111)	(2,125)	(2)	(2,127)	
Total comprehensive income (loss)	17,921	(2,111)	15,810	(1,007)	14,803	



## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 13- Equity (Cont.)

## F. Comprehensive income (loss)

Year ended December 31, 2012

	Attributable to the Company's shareholders			Total	Non-controlling interests	Total
	Accumulated deficit	Reserve for financial assets measured at fair value through other comprehensive income	Adjustments arising from translating financial statements of foreign operations			
Net gain	4,357	-	-	4,357	11,481	15,838
Loss from financial assets measured at fair value through other comprehensive income	-	(1,313)	-	(1,313)	-	(1,313)
Adjustments arising from translating financial statements of foreign operations	-	-	(51)	(51)	(3)	(54)
Foreign currency translation differences charged to the statement of income upon disposal of foreign operations	-	-	80	80	-	80
Group's share of net other comprehensive income of companies accounted for under the equity method	141	-	-	141	23	164
Total other comprehensive income (loss)	141	(1,313)	29	(1,143)	20	(1,123)
Total comprehensive income (loss)	4,498	(1,313)	29	3,214	11,501	14,715

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 13- Equity (Cont.)

## F. Comprehensive income (loss)

Year ended December 31, 2011

	Attributable to the Company's shareholders				Total	Non-controlling interests	Total
	Accumulated deficit	Reserve for financial assets measured at fair value through other comprehensive income held for sale	Reserve for financial assets measured at fair value through other comprehensive income	Adjustments arising from translating financial statements of foreign operations			
Loss	(8,417)	-	-	-	(8,417)	(6,292)	(14,709)
Loss from financial assets measured at fair value through other comprehensive income	-	(16,068)	(78)	-	(16,146)	-	(16,146)
Available-for-sale financial assets classified to the statement of income	-	2,234	(1,452)	-	782	-	782
Adjustments arising from translating financial statements of foreign operations	-	-	-	1,399	1,399	505	1,904
Foreign currency translation differences charged to the statement of income upon disposal of foreign operations	-	-	-	(1,200)	(1,200)	-	(1,200)
Actuarial loss from defined benefit plans	(54)	-	-	-	(54)	(27)	(81)
Group's share of net other comprehensive income (loss) of companies accounted for under the equity method	210	-	(7)	-	203	34	237
Total other comprehensive income (loss)	156	(13,834)	(1,537)	199	(15,016)	512	(14,504)
Total comprehensive income (loss)	(8,261)	(13,834)	(1,537)	199	(23,433)	(5,780)	(29,213)

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 13- Equity (Cont.)

## G. Share-based payments

## 1. Company option plans

During May 2003, the Company's Board of Directors adopted an option plan under which an aggregate of up to 500,000 options to purchase up to 500,000 ordinary shares may be granted to officers and employees (the "2003 Option Plan"). In March 2007, the 2003 Option Plan was increased by an additional 500,000 options to purchase 500,000 ordinary shares of the Company. The 2003 Option Plan provides that the exercise price shall be reduced by an amount equal to the amount of any dividend per share distributed. The board of directors has the discretion to extend vesting and the period within which to exercise options.

As of December 31, 2013, 567,000 options were granted under the 2003 Option Plan at an average exercise price of \$8.03 per share. The exercise price is adjusted to reflect a dividend distributed following the option grant. The options vest over a period of four years in four equal annual portions and expire after 5 years from date of grant. All of the options granted by the Company have expired or exercised.

## 2. Changes during 2013, 2012 and 2011

The following table lists the number of share options, the weighted average exercise prices of share options and modifications to employee option plans during 2013, 2012 and 2011:

	2013		2012		2011	
	Number of options	Weighted average exercise price \$	Number of options	Weighted average exercise price \$	Number of options	Weighted average exercise price \$
Share options outstanding at beginning of the year	38,750	7.93	232,500	11.01	237,500	10.96
Share options forfeited during the year	(28,750)	9.11	(120,000)	15.53	(5,000)	9.05
Share options exercised during the year (1)	(10,000)	4.49	(73,750)	4.49	-	-
Share options outstanding at end of the year	-	-	38,750	7.93	232,500	11.01
Share options exercisable at end of the year	-	-	38,750	7.93	232,500	11.01

(1) The weighted average price per share of shares exercised in 2013 and 2012 at the date of exercise was approximately \$5.

No expense was recognized in respect of share-based payment in 2013, 2012 and 2011, and no new options were granted in these years.

**Notes to the Consolidated Financial Statements**

(USD in thousands, except for price per share and number of shares)

**Note 14- Operating Segment**

- A. The Company operates in one segment, namely "Holdings and Corporate Operations". This segment includes corporate headquarters and reflects the operations of the investments in investee companies and their sale.
- B. Revenues based on the location of customers, are as follows:

	December 31,		
	2013	2012	2011(*)
Israel	3	-	1,682
USA & North America	70	-	1,110
Europe	9	-	747
Asia	-	-	5,803
South America	-	-	1,282
Other	15	-	3,479
	<u>97</u>	<u>-</u>	<u>14,103</u>

(\*) Represents income recognized until November 23, 2011, the date of Wavion's sale, see also Note 3.A.3.g) above.

**Note 15- Contingent liabilities, pledges and commitments****A. Legal claims**

The amounts of the claims described below are true for the dates on which they were filed, unless otherwise indicated. Details on claims against the Company and its investee companies are included hereunder to the extent that the possible impact of each one of them on the financial results of the Company is significant.

- In November 1999, a number of institutional shareholders of Elscint filed a claim in the District Court of Haifa, together with a request to approve certain causes of action set out in the claim, as a class action on behalf of the public shareholders of Elscint, and a request for certain causes of action to be treated as a derivative action against various defendants, including Elscint, Elbit Imaging, Elron, companies to which Elron sold its holdings in Elbit Imaging in May 1999, and certain officers in the defendant companies. The claim alleges, mainly, that Elbit Imaging is duty bound to make a tender offer for the shares of Elscint held by the public and that it unlawfully refuses to do so and, in addition, it raises allegations of preference of the interests of the defendants over those of Elscint and its public shareholders with respect to a number of transactions involving Elscint that the plaintiffs allege discriminated against Elscint's public shareholders. In June 2007 the plaintiffs submitted to the Haifa District Court an updated statement of claim and request to approve the claim as a class action. The updated claim claims compensation for damages sustained due to the alleged failure to effect the tender offer, but no longer seeks an order compelling the tender offer. The updated statement of claim does not specify the monetary amount claimed, but does include various allegations relating to the manner of determining the damages claimed.

**Notes to the Consolidated Financial Statements**

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(USD in thousands, except for price per share and number of shares)

**Note 15- Contingent liabilities, pledges and commitments (Cont.)****A. Legal claims (Cont.)**

The Court dismissed the plaintiffs' request to approve the claim as a class action, but the plaintiffs appealed, and in May 2012, the Supreme Court handed down a judgment in which it partially accepted the appeal filed by the plaintiffs regarding the District Court's rejection of the motion to approve their claim as a "class action". In the said judgment, it was determined, inter alia, that the motion for approval of the claim as a "class action" was accepted with some modifications and directions as to the conduct of the proceeding and that the case is being returned to the District Court to conduct the claim as a "class action" against all of the defendants, including the Company and its former officers as detailed in the said judgment. The cause of action alleged against the Company is minority oppression of the minority shareholders of Elscint, such that control of Elscint was sold to someone who is anticipated to exploit the assets of the company in an unequal manner ("Sabotage Sale"). The Company denies the allegations against it in the action.

The Company has provided a provision in its financial statements of an immaterial amount, which according to the estimation of the Company's management, based, inter alia, on the opinion of its legal advisors, is sufficient to cover the financial resources that may be required of it in order to expunge the claim, if any.

2. In September 2006 two additional claims were filed in the Haifa District Court against the same defendants and based substantially on the same facts of the claim detailed in section 1 above, along with requests to recognize the claims as class actions. The claims are for an undisclosed amount. The court has determined that at this stage the defendants do not yet have to file statements of defense. The Company rejects all the allegations described above, and management is of the opinion, based on the legal advice received, that it has good defense arguments against these claims, to the extent they are directed against it, which, more likely than not, will cause dismissal of the claims. Therefore, no provision in connection with the claims described above has been included in Elron's financial statements.
3. Sometimes the Company is involved in claims, in addition to those described above, in the ordinary course of business. The costs that may result from these claims are recognized as provisions only when it is more likely than not that an obligation originating from past events will arise, and the amount of that obligation can be quantified or estimated within a reliable range. The amount of the provisions is based on the estimated risk factor in every claim. Events occurring during legal deliberations may require a renewed valuation of that estimation. The Company's estimation of the risk is based on the legal opinion of its legal consultants as well as the Company's estimation of probable settlement amounts that the Company may pay, providing both parties agree to the settlement's conditions. The aggregate amount of these claims, if accepted, is estimated by the plaintiffs at an immaterial amount. No provision was included in the financial statements in respect of these additional claims.

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 15- Contingent liabilities, pledges and commitments (Cont.)

## B. Commitments

## 1. Operating lease commitments

The Company and the subsidiaries have operating leases in respect of their premises and motor vehicles with an average useful life of 3 years. The future minimum non-cancellable rental payments under these agreements as of December 31, 2013, are as follows:

First year	407
Second year	407
Third year	101
Total	915

2. For details about the Services Agreement with DIC, see Note 19.B.

3. For details about other commitments with related parties, see Note 19.

## Note 16- Supplementary statement of income data

## A. Gain from disposal and revaluation of investee companies and changes in holdings, net

	For the year ended December 31		
	2013	2012	2011
Medingo (see Note 3.A.3.d))	-	15,558	-
SyncRx (see Note 3.A.3.b))	-	17,016	-
Wavion (see Note 3.A.3.g))	-	-	21,436
Starling's business (see Note 3.A.3.c))	-	-	9,602
Jordan Valley (see Note 6)	(1,750)	(110)	(1,210)
Notal (see Note 6)	3,425	1,803	-
Aqwise (see Note 6)	(481)	3,929	-
Safend (1)	-	-	2,286
Change in holdings in Given (2)	4,149	829	2,084
Kyma (see Note 3.A.3.e))	2,770	-	407
Other	303	401	-
	8,416	39,426	34,605

(1) In September 2011, all the shares of Safend Ltd were sold to Wave Systems Corp (the "Acquirer"), in consideration for approximately \$12,800, consisting mostly of shares of the Acquirer.

(2) As a result from exercised and expired options and restricted share units of Given's employees and services providers.

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 16- Supplementary statement of income data (Cont.)

## B. Cost of sales

	For the year ended December 31		
	2013	2012	2011 (*)
Materials	-	-	1,659
Depreciation and amortization	-	-	81
Salaries, wages and related expenses	56	-	316
Changes in inventories and other	3	-	3,767
	<u>59</u>	<u>-</u>	<u>5,823</u>

(\*) Until November 23, 2011, the date of Wavion's sale, see also Note 3.A.3.g) above.

## C. Research and development expenses, net

	For the year ended December 31		
	2013	2012	2011
Cost of research and development	4,154	7,238	19,731
Less: government grants	225	369	1,547
	<u>3,929</u>	<u>6,869</u>	<u>18,184</u>

## D. Selling and marketing expenses

	For the year ended December 31		
	2013	2012	2011
Salaries, wages and related expenses	250	367	3,254
Advertising and public relations	110	13	171
Commissions and royalties	-	-	882
Other	185	525	1,365
	<u>545</u>	<u>905</u>	<u>5,672</u>

## E. General and administrative expenses

	For the year ended December 31		
	2013	2012	2011
Salaries, wages and related expenses	2,527	2,224	3,808
Services agreement with DIC (*)	1,682	1,465	1,423
Rent and building maintenance	649	686	905
Professional services	1,244	1,332	2,094
Other	1,091	1,483	2,244
	<u>7,193</u>	<u>7,190</u>	<u>10,474</u>

(\*) For further information, see Note 19.B.

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 16- Supplementary statement of income data (Cont.)

## F. Financial income and expenses

## 1. Financial income

	For the year ended December 31		
	2013	2012	2011
Interest income from loans, deposits and other receivables	64	315	258
Interest income from bank deposits	239	397	601
Income from exchange rate differences, net	152	-	-
Gain from revaluation of financial assets at fair value through profit or loss	-	248	254
Other	229	281	645
<b>Total financial income</b>	<b>684</b>	<b>1,241</b>	<b>1,758</b>

## 2. Financial expenses

	For the year ended December 31		
	2013	2012	2011
Interest expenses on financial liabilities measured at amortized cost	162	175	426
Loss from revaluation of financial assets at fair value through profit or loss	-	1,655	314
Negative change in fair value of financial liabilities measured through profit and loss, net	-	-	714
Loss from change in exchange rate of foreign currency, net	-	119	1,822
Commissions	251	21	209
Other financial expenses	148	82	688
<b>Total financial expenses</b>	<b>561</b>	<b>2,052</b>	<b>4,173</b>



## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 16- Supplementary statement of income data (Cont.)

## F. Financial income and expenses (Cont.)

## 3. Financial income (expenses), net, by components

	For the year ended December 31		
	2013	2012	2011
<u>Deposits and receivables</u>			
Bank deposits	239	396	611
Other deposits and other receivables	445	478	(929)
<u>Financial assets at fair value through profit or loss</u>	-	(1,407)	(60)
<u>Financial liabilities</u>			
Convertible debentures	-	-	(714)
Loans from banks	(561)	(278)	(1,323)
<u>Total financial income (expenses), net</u>	<u>123</u>	<u>(811)</u>	<u>(2,415)</u>

## G. Equity in losses of associates, net

	For the year ended December 31		
	2013	2012	2011
Company's share in net losses of associates (1) (2)	7,838	3,943	5,810
Amortization of excess cost in respect of associates	4,030	4,414	4,564
<u>Total loss on equity basis, net</u>	<u>11,868</u>	<u>8,357</u>	<u>10,374</u>

(1) Including also the Company's share in the losses of former associates until the date they ceased being associates.

(2) See also Note 3.B above.

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 16- Supplementary statement of income data (Cont.)

## H. Other expenses (income), net

	For the year ended December 31		
	2013	2012	2011
Impairment losses from investments, financial assets and intangible assets (1)	-	-	5,846
Gain from cancellation of impairment (2)	(3,522)	(283)	-
Equity in gains (losses) of partnerships - Innomed	-	-	1,065
Impairment charge in respect of inventory of Starling (3)	-	-	3,233
Other	35	1	(584)
<b>Total other expenses (income), net</b>	<b>(3,487)</b>	<b>(282)</b>	<b>9,560</b>

- (1) Impairment losses in 2011 are primarily due to an impairment charge in respect of Enablence's debentures (see Note 6) and an impairment charge in respect of B.P.T. Bio Pure Technology Ltd.
- (2) Gain from cancellation of the impairment charge in respect of Enablence's debentures, see Note 6 above.
- (3) Write-down of inventories in 2011 in respect of Starling, is included under other expenses (income), net since Starling did not recognize revenue from sales.

## Note 17- Taxes on Income

## A. Tax laws applicable to the Group companies

*Income Tax (Inflationary Adjustments) Law, 1985:*

Since 2008, the results for tax purposes are measured in nominal values, excluding certain adjustments for changes in the Israeli CPI carried out in the period up to December 31, 2007. Adjustments relating to capital gains such as for sale of property (betterment) and securities continue to apply until disposal. Since 2008, the amendment to the law includes, among others, the cancellation of the inflationary additions and deductions and the additional deduction for depreciation (in respect of depreciable assets purchased after the 2007 tax year).

*The Law for the Encouragement of Capital Investments, 1959:*

Some of the group companies have requested to be entitled to various tax benefits by virtue of the "beneficiary enterprise" status granted to part of their enterprises, as implied by this Law. The principal benefits by virtue of the Law are:

**Notes to the Consolidated Financial Statements**

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**(USD in thousands, except for price per share and number of shares)****Note 17- Taxes on Income (Cont.)**

Alternative track:

Under this track, a company is tax exempt in the first ten years of the benefit period (dependent on the development area).

In respect of expansion programs pursuant to Amendment No. 60 to the Law, the benefit period starts at the later of the year elected and the first year the Company earns taxable income provided that 12 years have not passed since the beginning of the year of election and for companies in development area A - 14 years since the beginning of the year of election.

The income qualifying for tax benefits under the alternative track is the taxable income of a company that has met certain conditions as determined by the Law ("a beneficiary enterprise"), and which is derived from an industrial enterprise or a hotel.

A company that pays a dividend out of income derived from the approved enterprise or beneficiary enterprise during the tax exemption period will be subject tax in respect of the said income, at the year in which the income was earned. When a dividend from approved enterprise and beneficiary enterprise is distributed, it is taxed at a tax rate of 15%.

*Amendments to the Law for the Encouragement of Capital Investments, 1959:*

In December 2010, the "Knesset" (Israeli Parliament) passed the Law for Economic Policy for 2011 and 2012 (Amended Legislation), 2011, which prescribes, among others, amendments in the Law for the Encouragement of Capital Investments, 1959 ("the Amendment"). The amendment became effective as of January 1, 2011. According to the amendment, the benefit tracks in the Law were modified and a flat tax rate applies to the Company's entire privileged income. The Company can elect (without possibility of reversal) to apply the Amendment and from then on it will be subject to the amended tax rates that are: 2011 and 2012 - 15% (in development area A - 10%), 2013 and 2014 - 12.5% (in development area A - 7%) and in 2015 and thereafter - 12% (in development area A - 6%).

The amendments to the law had no influence over the deferred tax balance of the Company as of December 31, 2013.

*Conditions for benefits*

The above benefits are conditional upon the fulfillment of the conditions stipulated by the Law, regulations published thereunder and the letters of approval for the investments in the approved enterprises, as above. Non-compliance with the conditions may cancel all or part of the benefits and refund of the amount of the benefits, including interest.

*The Law for the Encouragement of Industry (Taxation), 1969:*

Certain of the Company's subsidiaries are "Industrial Companies", as defined by the Law for the Encouragement of Industry (Taxation), 1969, and as such, are entitled to certain benefits, mainly: (1) accelerated depreciation; (2) deduction of expenses incurred in connection with a public issuance of securities over a three-year period; (3) deduction of purchases of know-how and patents over an eight-year period for tax purposes ; and (4) an election to file a consolidated tax return with additional Israeli Industrial Companies.

No assurance can be given that these companies will continue to qualify as an Industrial Company or that the benefits described above will be available in the future.

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 17- Taxes on Income (Cont.)

**B. Tax rates applicable to the Group**

The rate of the Israeli corporate tax is as follows: 2011 - 24%, 2012 and 2013 -25%. Corporate tax applies on capital gains from the year of sale. On December 5, 2011, the Israeli Parliament (the Knesset) passed the Law for Tax Burden Reform (Legislative Amendments), 2011 ("the Law") which, among others, cancels effective from 2012, the scheduled progressive reduction in the corporate tax rate. The Law also increases the corporate tax rate to 25% in 2012. In view of this increase in the corporate tax rate to 25% in 2012, the real capital gains tax rate and the real betterment tax rate were also increased accordingly. The mentioned change does not carry any material influence over the financial statements.

On July 30, 2013, the "Knesset" issued the Law for Changing National Priorities (Legislative Amendments for Achieving Budget Targets for 2013 and 2014), 2013 ("the Budget Law"), which consists, among others, of fiscal changes whose main aim is to enhance the collection of taxes in those years. These changes include, among others, increasing the corporate tax rate from 25% to 26.5%, cancelling the reduction in the tax rates applicable to privileged enterprises (9% in development area A and 16% elsewhere) and, in certain cases, increasing the rate of dividend withholding tax within the scope of the Law for the Encouragement of Capital Investments to 20% effective from January 1, 2014. There are also other changes such as taxation of revaluation gains effective from August 1, 2013. The provisions regarding revaluation gains will become effective only after the publication of regulations defining what should be considered as "retained earnings not subject to corporate tax" and regulations that set forth provisions for avoiding double taxation of overseas assets. As of the date of approval of these financial statements, these regulations have not been issued.

The deferred tax balances included in the financial statements as of December 31, 2013 are calculated according to the new tax rates that were substantially enacted as of the reporting date and, therefore, comply with the above changes, as applicable to the Company.

C. The Company and the subsidiaries received final tax assessments through 2009.

**D. Taxes on income (tax benefit) included in the statements of income**

	Year ended December 31,		
	2013	2012	2011
Current taxes	-	-	-
Deferred taxes	(28,362)	(279)	400
Net taxes in respect of previous years	(39)	17	202
	<u>(28,401)</u>	<u>(262)</u>	<u>602</u>

**E. Long term taxes**

As of December 31, 2013, the Company and consolidated companies had tax liabilities in the amount of \$5,386 (\$4,457 as of December 31, 2012) which are presented under non-current liabilities, and deferred tax assets in the amount of \$28,994 under non-current assets.

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 17- Taxes on Income (Cont.)

## E. Long term taxes (Cont.)

As a result from the Given Merger, see also Note 3.B.4.a) above, the Company recognized a deferred tax asset in the amount of approximately \$11,250 in respect of the temporary difference between the cost of its investment in Given for tax purposes and its carrying value, and deferred tax asset in the amount of approximately \$17,750 in respect of carryforward losses that are expected to be utilized in 2014, due to the expected gain from this transaction (as of December 31, 2012 no deferred tax assets were recorded). In addition, the Group recorded a tax liability in the amount of approximately \$4,100 in respect of the temporary difference from RDC's investment in Given. This liability was partially set off by a deferred tax asset in the amount of approximately \$3,500 in respect of RDC's carryforward losses that are expected to be utilized in 2014, due to the Given Merger. The deferred taxes are calculated using a tax rate of 26.5%, based on the expected applicable tax rate at the date of utilization.

Carryforward operating tax losses and capital losses of the Company and consolidated companies total approximately \$328,000 as of December 31, 2013. Carryforward tax losses in Israel may be set against future taxable income. Deferred tax assets relating to carryforward losses in the amount of approximately \$65,000 were not recognized because their utilization in the foreseeable future is not probable. In addition, the Company does not have tax results carried to other comprehensive income.

Tax assets in the amount of approximately \$21,000 (approximately \$18,000 as of December 31, 2012) have not been recognized in respect of temporary differences associated with investments in investees in the amount of approximately \$81,000 (approximately \$72,000 as of December 31, 2012), because the realization of these investments in the foreseeable future is not expected (which realization is at the Company's discretion), and because the distribution of dividends by these companies is not liable for tax.

## F. Theoretical tax:

	Year ended December 31,		
	2013	2012	2011
Income (loss) before taxes on income	(11,471)	15,576	(14,107)
Statutory tax rate	25%	25%	24%
Tax (tax benefit ) computed at the statutory tax rate	(2,868)	3,894	(3,386)
Increase (decrease) in taxes on income (tax benefit) resulting from the following factors:			
Company's share of losses of associates, net	2,967	2,089	2,490
Changes in temporary differences with respect to which deferred taxes were not recognized	(341)	(17,503)	(8,414)
Increase in unrecognized tax losses for which deferred taxes were not recognized	279	10,825	9,693
Deferred taxes recorded in respect of temporary difference in the investment in Given, for which deferred taxes were not recognized in the past	(7,155)	-	-
Deferred taxes recorded in respect of prior periods losses and benefits, for which deferred taxes were not recognized in the past	(21,285)	-	-
Utilization of previously unrecognized tax losses for which deferred taxes were not recognized in the past	-	-	(37)
Non-deductible expenses for tax purposes	41	416	413
Income in a special tax rate	-	-	(359)
Taxes in respect of previous years	(39)	17	202
Taxes on income (tax benefit)	(28,401)	(262)	602

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 18- Net earnings (loss) per share

## A. Basic net earnings (loss) per share

1. Details of the income (loss) used in the computation of basic net earnings (loss) per share

	Year ended December 31,		
	2013	2012	2011
Net earnings (loss) attributable to ordinary shareholders	17,935	4,357	(8,417)
Adjustment for Company's share in the basic loss per share of associates (*)	(1,939)	(1,751)	(1,745)
Income (loss) used in computation of basic net earnings (loss) per share	15,996	2,606	(10,162)

- \*) Represents adjustments for differences between the Company's share in the income or losses of associates, and the associate's earnings or loss per share multiplied by the number of shares held by the Company.

2. Details of the number of shares used in the computation of basic net earnings (loss) per share

	Year ended December 31,		
	2013	2012	2011
Balance as of January 1	29,733,767	29,660,017	29,660,017
Effect of options converted into shares	8,860	3,760	-
Weighted average number of ordinary shares used in the computation of basic net earnings (loss) per share	29,742,627	29,663,777	29,660,017

## B. Diluted net earnings (loss) per share

To compute diluted net earnings (loss) per share for 2013, 2012 and 2011, options to employees under share-based payment plans have not been taken into account since their conversion had anti-dilutive effect.

(USD in thousands, except for price per share and number of shares)

**Note 19- Balances and transactions with related and interested parties**

**A. Related parties**

The related parties of the Company are DIC, IDB Development Corporation Ltd. ("IDB"), related parties of DIC and IDB, associates and subsidiaries, directors and key management personnel of the Company, DIC or IDB, and a close member of the family of any of the persons mentioned above. For details regarding holdings in investee companies – see Note 3.

For details in respect of Elron's, RDC's and DIC's holdings in Given, prior to its sale, see Note 3.B.4.a).

**B. Details of transactions with related and interested parties**

**Classification of transactions as negligible transactions**

The Board of Directors of the Company adopted a policy determining guidelines and rules for the classification of a transaction by the Company or by a consolidated company with a related party in which the controlling shareholder in the Company has a personal interest as a negligible transaction (Negligible Transaction Policy). The following is a summary of these guidelines.

In the absence of any special qualitative considerations given the specific circumstances, a transaction that is not extraordinary (in other words - it is conducted in the ordinary course of its business, under market conditions, and does not have a material impact on the Company), it will be considered a negligible transaction, if the relevant criteria calculated for the transaction (one or more, as set out below) is less than one percent (1%) of the Company's equity according to the Company's last consolidated financial statements, and if the transaction amount does not exceed \$1,200.

In any related party transaction involved with a personal interest of the Company's controlling shareholder that is evaluated and classified as to whether is a negligible transaction, the relevant criteria shall be calculated as follows: (A) In the purchase of a fixed asset ("asset that is not a current asset") - the size of the transaction; (B) In the sale of a fixed asset ("asset that is not a current asset") - the profit/loss from the transaction; (C) In the incurrence of a monetary liability - the size of the transaction; (D) In the purchase/sale of products (with the exception of a fixed asset) or services - the size of the transaction.

**Services agreement with DIC**

On March 19, 2009, the Company entered into a Services Agreement with DIC, effective from May 1, 2009, ("the Services Agreement" or "the Agreement"), which was approved by the Company's audit committee and board of directors, and subsequently, by a special meeting of the Company's shareholders. In February 2012, the Services Agreement was amended and extended for a further three year period commencing from May 1, 2012 (the "Revised Agreement"). The agreement's amendment and extension was approved by the Company's audit committee and board of directors, and subsequently, by a special meeting of its shareholders.

**Notes to the Consolidated Financial Statements**

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(USD in thousands, except for price per share and number of shares)

**Note 19- Balances and transactions with related and interested parties (Cont.)****Services agreement with DIC (Cont.)**

According to the agreement, each party has the right to terminate it on at least 120 days prior notice if DIC is no longer the Company's largest shareholder. Pursuant to the agreement, the Company receives managerial and administrative services from DIC that include CEO, CFO, comptroller, general counsel, corporate secretary, junior employee and administration employee services. Pursuant to the agreement, during its first three year period, Elron paid DIC an annual fee equivalent to NIS 4,700,000, CPI-linked. Pursuant to the Revised Agreement, the Company pays DIC an annual fee equivalent to NIS 5,900,000, CPI-linked (approximately \$1,764 as of December 31, 2013). Under the agreement, the services are provided by persons designated by DIC, subject to the Company's approval (other than the CEO and CFO who are appointed by the Company following its proposal of such officers and approval by DIC and the Company's board of directors, and other than the comptroller, general counsel and corporate secretary, who are appointed by the Company following its proposal of such officers and approval by DIC) and are employed or otherwise engaged by DIC, at its expense ("Staff Persons"). The services do not include chairman of the board services and other headquarter services (such as offices, professional services of third parties etc.). In connection with the Services Agreement, all the Company's employees, except its Chairman, were terminated in May 2009, some of whom joined DIC.

The Company, at its sole discretion and at its expense, and subject to the approvals required by law, may pay Staff Persons special bonuses for their special contribution to the Company. According to the Services Agreement, DIC is obligated to provide the services through a sufficient number of people with the appropriate experience and capabilities. In addition, DIC may designate Staff Persons or other persons to serve on the boards of directors of companies in which the Company has invested, after receipt of the approval of the Company's CEO.

Pursuant to the terms of the agreement, the Company has agreed to indemnify DIC for any amounts DIC will be required to pay as a result of any legal or administrative proceedings initiated by any third party (other than Staff Persons), seeking to impose liability on DIC arising from any act of omission in performing the services, unless such act or omission amounted to gross negligence or was done other than in good faith. Moreover, DIC will not be responsible for any act of omission of any Staff Person performing the services unless such act or omission was made pursuant to the express instructions of DIC. In addition, the Company provides to Staff Persons performing functions of officers, indemnification letters with respect to liabilities to which they will become exposed by virtue of performing such functions.



**Notes to the Consolidated Financial Statements**

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(USD in thousands, except for price per share and number of shares)

**Note 19- Balances and transactions with related and interested parties (Cont.)****Services agreement with DIC (Cont.)**

The payments made to DIC under the service agreement in 2013 are: management fees in the amount of \$1,682. This amount does not include regular payments made to DIC in immaterial amounts, which are detailed in Note 19.D

**Loans to subsidiaries**

- a) For details on loans granted by the Company to Starling see Note 3.A.3.c).
- b) For details on loans granted by the Company to Pocared, see Note 3.B.4.b).

**The Company's engagement with IDB in an arrangement providing for the use of space in the Company's offices**

On July 21, 2010, following approval by the Company's audit committee and board of directors, the Company's shareholders approved an agreement between the Company and IDB pursuant to which the Company would agree to make available to IDB, to the extent that it is interested, from time to time, available office space in its offices at 3 Azrieli Center, 42<sup>nd</sup> floor, Tel Aviv, Israel, which space is not used by the Company, in accordance with the terms of its lease agreement. In consideration for the use of available office rooms which IDB shall wish to use, IDB shall pay the Company an amount per square meter equal to the amount per square meter according to the rental fees (including management fees to the management company of the building in which the Company's offices are located) and the municipality taxes which the Company pays for its offices. The calculation of the amount per such square meter shall be according to the total net area (in square meters) of the Company's offices and office rooms which shall be used by IDB without taking into account a pro rata share of the public areas located outside the Company's offices. As of the reporting date, the consideration for such use amounts to approximately NIS 179 (approximately \$0.052) per square meter per month, CPI-linked plus VAT as required by law. Following the approval of this arrangement, IDB notified the Company that it intended to use one of the available rooms based on the above conditions. On August 8, 2011, the Company's audit committee resolved to limit the Company's agreement with IDB providing for the use of the Company's office space to a three-year period commencing on the date of such resolution, until August 8, 2014. In addition, in March 8, 2011, the Company's audit committee approved the use of one of the available rooms by DIC. This arrangement with DIC is a negligible transaction for the Company.

**The Company's engagement with IDB in an arrangement to receive support center services**

On July 21, 2010, following approval by the Company's audit committee and board of directors, the Company's shareholders approved an agreement between the Company and IDB pursuant to which the Company would receive IT support services from IDB's IT support center in consideration for the Company's pro rata portion of the support center's costs in connection therewith, calculated pro rata to the number of users receiving IT support from the IDB support center. On August 8, 2011, the Company's Audit Committee resolved to limit the Company's agreement with IDB providing for the receipt of IT support services to a three-year period commencing on the date of such resolution, until August 8, 2014.

**Directors' compensation in connection with service provided by officers as directors of Given**

The Company received directors' remuneration of approximately \$67 in 2013 in connection with the service provided by its officers on the board of directors of Given.

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 19- Balances and transactions with related and interested parties (Cont.)

## C. Composition of balances with interested and related parties

As of December 31, 2013

	Controlling shareholder (parent company)	Other related parties and interested parties	Ultimate parent company	Associates	Key management personnel
Other accounts receivable	-	-	-	35	-
Trade and other accounts payable	-	(11)	(21)	-	(141)
Highest balance during the year of loans and current debts	-	-	-	64	-

As of December 31, 2012

	Controlling shareholder (parent company)	Other related parties and interested parties	Ultimate parent company	Associates	Key management personnel
Other accounts receivable	-	-	-	44	-
Trade and other accounts payable	(8)	(1)	(20)	(25)	(94)
Highest balance during the year of loans and current debts	-	-	-	24	-

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 19-Balances and transactions with related and interested parties (Cont.)

## D. Transactions with related and interested parties

Year ended December 31, 2013

	For terms see Note	Controlling shareholder (parent company)	Sister companies	Ultimate parent company	Associates	Key management personnel	Other related parties and interested party
<b>Income (*)</b>		8	-	5	143	-	-
<b>Expenses</b>							
Services Agreement- related expenses	19.B	(1,682)	-	-	-	-	-
Directors' remuneration	19.D.2	(13)	-	(28)	-	(362)	-
Insurance-related expenses		-	-	-	-	-	(117)
Salaries, wages and related expenses		-	-	-	-	(742)	-
Other		-	(18)	(59)	-	-	(74)
		<u>(1,687)</u>	<u>(18)</u>	<u>(82)</u>	<u>143</u>	<u>(1,104)</u>	<u>(191)</u>

(\*) Mainly interest and participation in directors' remuneration.

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 19-Balances and transactions with related and interested parties (Cont.)

## D. Transactions with related and interested parties (Cont.)

Year ended December 31, 2012

	For terms see Note	Controlling shareholder (parent company)	Sister companies	Ultimate parent company	Associates	Key management personnel	Other related parties and interested party
<b>Income (*)</b>		6	-	4	214	-	-
<b>Expenses</b>							
Services Agreement- related expenses	19.B	(1,465)	-	-	-	-	-
Directors' remuneration	19.D.2	(38)	-	(31)	-	(351)	-
Insurance-related expenses		-	-	-	-	-	(120)
Salaries, wages and related expenses		-	-	-	-	(513)	-
Other		-	(44)	(58)	-	-	(119)
		<u>(1,497)</u>	<u>(44)</u>	<u>(85)</u>	<u>214</u>	<u>(864)</u>	<u>(239)</u>

(\*) Mainly interest and participation in directors' remuneration.

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 19-Balances and transactions with related and interested parties (Cont.)

## D. Transactions with related and interested parties (Cont.)

Year ended December 31, 2011

	For terms see Note	Controlling shareholder (parent company)	Sister companies	Ultimate parent company	Associates	Key management personnel	Other related parties and interested party
<b>Income (*)</b>		11	-	3	121	-	-
<b>Expenses</b>							
Services Agreement- related expenses	19.B	(1,423)	-	-	-	-	-
Directors' remuneration	19.D.2	(48)	-	(9)	-	(372)	-
Insurance-related expenses		-	-	-	-	-	(123)
Salaries, wages and related expenses		-	-	-	-	(697)	-
Other		-	(145)	(49)	-	-	(68)
		<u>(1,460)</u>	<u>(145)</u>	<u>(55)</u>	<u>121</u>	<u>(1,069)</u>	<u>(191)</u>

(\*) Mainly interest and participation in directors' remuneration.

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 19-Balances and transactions with related and interested parties (Cont.)

## D. Transactions with related and interested parties (Cont.)

## Compensation of key management personnel employed by the Company (including directors)

	No. of personnel in 2013	For the year ended December 31, 2013 \$ thousands	No. of personnel in 2012	For the year ended December 31, 2012 \$ thousands	No. of personnel in 2011	For the year ended December 31, 2011 \$ thousands
Short-term employee benefits	1	702	1	474	1	509
Termination benefits	1	58	1	53	1	56
Share-based payment transactions	1	(18)	1	(14)	1	132
Total		742		513		697

## Compensation of key management personnel not employed by the Company (including directors)

	No. of personnel in 2013	For the year ended December 31, 2013 \$ thousands	No. of personnel in 2012	For the year ended December 31, 2012 \$ thousands	No. of personnel in 2011	For the year ended December 31, 2011 \$ thousands
Short-term employee benefits	8	403	10	420	10	429

The amounts disclosed in the table above are the amounts recognized as an expense during the reporting period relating to key management personnel.

The amounts disclosed in the table do not include compensation paid to key management personnel of the Company by DIC according to the Services Agreement (see Note 19.B above).

## 1. Grants:

On March 10, 2011, the Company's board of directors approved (following approval by the Company's audit committee) a payment of a bonus to Mr. Mientkavich of NIS 1,200 thousand (approximately \$334) for the year 2010. This bonus was not presented to the general meeting of the shareholders for approval, and has not yet been paid. Due to the fact that the bonus was not yet ultimately paid, despite having been approved, in 2011 the Chairman approached the Company and proposed that the bonus will be a performance bonus in lieu of the cash bonus, such that the value of the performance bonus will be only approximately 45% of the value of the cash bonus that was previously approved but not yet paid, and will include an option component that is directly linked to the Company's performance or to significant challenges facing it. Due to the importance of Pocared to the Company and to its holdings, it was proposed that in lieu of the aforementioned cash bonus, the Company will approve the grant of (phantom) options of Pocared to the Chairman from Pocared shares held by Elron, which shall only be cash exercisable. On February 1, 2012, the Company's shareholders (following approval of the Company's audit committee and board of directors), approved the granting of phantom options over 375,722 Preferred F Shares of Pocared to the Chairman, representing 2% of the Company's holdings in Pocared's Preferred F Shares (approximately 0.5% of Pocared's share capital). The exercise price per share of each option shall be \$0.605.

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(USD in thousands, except for price per share and number of shares)

**Note 19-Balances and transactions with related and interested parties (Cont.)**

**D. Transactions with related and interested parties (Cont.)**

The options are exercisable until the fourth anniversary of the date of approval by the shareholders of the Company. The options shall be automatically exercisable upon an exit event (as defined below) during the four year period. If an exit event does not occur by the fourth anniversary of the date of approval by the shareholders of the Company, then the value of the options will be determined on the date of their expiry based on a valuation to be performed by a valuator chosen by the Company's audit committee. The options will be exercised into cash, in an amount equal to the difference between the exercise price and the price at which they are either sold or valued. For this purpose, an exit event shall be deemed to have occurred in the event of a sale of the majority of the shares or assets of Pocared or in the event of an initial public offering of the securities of Pocared or in the event of the sale of more than 50% of the holdings of the Company in Pocared. If the proceeds in respect of the Pocared shares, in the case of an exit event, received by the Company are in the form of securities, then the Company shall pay the Chairman in cash an amount equal to the fair value of the said securities as determined by an external independent valuator appointed by the Company's Audit Committee.

In respect of this grant the Company recognized an income in the amount of approximately \$18 in 2013 due to a decrease in these options' fair value (and in 2012 and 2011 an income in the amount of approximately \$14 and an expense in the amount of approximately \$132, respectively).

In addition, an employee (who provides services to Elron under the Services Agreement with DIC) was granted phantom options for shares of Pocared on similar terms. In respect of this grant the Company recognized in 2013 an income in the amount of approximately \$29 due to a decrease in these options' fair value (and in 2012 and 2011 an income in the amount of approximately \$24 and an expense in the amount of approximately \$200, respectively).

According to the provisions of the Company's compensation policy and since the Company met the threshold conditions set forth in the policy, Mr. Mientkavich is entitled to an annual bonus for 2013 in the amount of NIS 739 thousand. A part of the bonus in the amount of NIS 116 thousand (in addition to index-linkage from December 31, 2013) shall be paid to Mr. Mientkavich shortly after the date of approval of the financial statements for 2014, subject to meeting threshold conditions set forth in the compensation policy.

According to the provisions of the Company's compensation policy and since the Company met the threshold conditions set forth in the policy, Mr. Ari Bronshtein, the CEO of the Company, is entitled to an annual bonus for 2013 in the amount of NIS 1,691 thousand. This bonus reflects 11.8 times his monthly compensation cost. A part of the bonus in the amount of NIS 143 thousand (in addition to index-linkage from December 31, 2013) shall be paid to Mr. Bronshtein shortly after the date of approval of the financial statements for 2014, subject to meeting threshold conditions set forth in the compensation policy.

**2. Directors' compensation**

Compensation to directors who are controlling persons or their family members, for their employment as directors of the Company and their participation in its meetings and committees was approved by the Company's shareholders on October 18, 2007 (following approval by the Company's audit committee and board of directors), in the maximum amounts stated in regulations 4 and 5 of the Israel Companies Regulations (Rules Regarding Remuneration and Expenses for an Outside Director), 2000. Directors' compensation or any other compensation shall not be paid to directors who are paid employees of the Company or of a company under its control, or who are eligible to compensation therefrom in a capacity other than director of the Company.

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 19-Balances and transactions with related and interested parties (Cont.)

## 2. Directors' compensation (Cont.)

Due to Amendment No. 16 to the Israel Companies Law, 1999, in December 2011, the Company's audit committee and board of directors approved to continue to grant compensation to those of the Company's directors who are controlling shareholders and/or affiliates thereof, or to those of the Company's directors whose compensation for holding office is paid to a controlling shareholder of the Company, who at the resolution date held office and who may hold office from time to time, for a three-year period until October 24, 2014. The audit committee's and board of directors' approval was given pursuant to the Israeli Companies Regulations (Reliefs in Related Parties Transactions), 5760-2000.

Directors' fees which do not exceed the customary remuneration that was paid by the Company for the year 2013 to the directors of the Company during this period, 8 directors in total, amounted to approximately \$403 (see section D above). Of such amount, a sum of approximately \$28 was paid to IDB for the service of a former officer thereof as director of the Company, a sum of approximately \$13 was paid to DIC for the service of a former officer thereof as director of the Company, and a sum of approximately \$26 was paid to Dori Manor, a controlling shareholder of the Company (at the date of payment), for his office as a director of the Company, in 2013. Since September 2010, Ms. Rona Dankner, a former director of the Company and the daughter of the former ultimate controlling shareholder of the Company, Mr. Nochi Dankner, waived the entire director's remuneration that she is entitled to receive from the Company (which amounted to immaterial yearly amount).

## 3. Share based payments

The chairman of the board of directors, Mr. Mientkavich, in his capacity as a director of Given, held the following options to purchase ordinary shares and restricted share units of Given. These options and share units were exercised when the Given Merger was completed, in February 2014, subsequent to the reporting date.

Date	Number	Exercise price (\$)	Exercise period	Fair value (\$)
July 2007	Options for the purchase of 35,000 shares	29.42	4 equal shares until July 2014	413
June 2008	Options for the purchase of 10,000 shares	16	From the first anniversary of the grant date until June 2015	55
August 2009	Options for the purchase of 10,000 shares	11.55	From the first anniversary of the grant date until August 2014	44
June 2010	4,545 share units	-	Commencing May 2011	80
May 2011	4,545 share units	-	Commencing May 2012	92
May 2012	4,545 restricted share units	-	Commencing 2013 shareholders meeting	81
October 2013	5,233 restricted share units	-	4 equal shares until October 2016	100



## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 20- Financial instruments

## A. Classification of financial assets and financial liabilities

The financial assets and financial liabilities in the statement of financial position are classified by groups of financial instruments pursuant to IAS 39 and IFRS 9:

	December 31,	
	2013	2012
<b>Financial assets:</b>		
Financial assets measured at amortized cost:		
Other accounts receivable	3,269	3,559
Other long-term receivables	-	3,693
<u>Financial assets measured at fair value through profit or loss</u>	<u>25,453</u>	<u>22,325</u>
<u>Financial assets measured at fair value through other comprehensive income</u>	<u>847</u>	<u>1,250</u>
<b>Financial liabilities:</b>		
Financial liabilities measured at amortized cost:		
Loans from bank and others	4,000	4,000
Trade payables and other current liabilities	3,683	2,830
Royalty bearing government grants	-	864

## B. Management of financial risks

The Group is exposed to various risks resulting from the use of financial instruments, such as:

- Market risk (including currency risk, CPI risk, interest rate risk and other price risk).
- Credit risk.
- Liquidity risk.

The officer responsible for management of the Company's risks is Mr. Yaron Elad, the Company's CFO.

The handling of financial exposures, formulation of hedging strategy, supervision over, execution and provision of an immediate response to extraordinary developments in the various markets, is under the responsibility of the officer responsible for the Company's risk management, who acts in consultation with the Company's CEO, audit committee members and investment committee members. The audit committee is updated as to the implementation of the Company's policy at least on a quarterly basis.

The main purpose of the financial liabilities is to finance the Company's and group companies' operations. The Group's financial assets include other receivables (current and non-current), and cash and short-term deposits that derive directly from its operations. The Company also holds investments measured at fair value.

**Notes to the Consolidated Financial Statements**

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(USD in thousands, except for price per share and number of shares)

**Note 20- Financial instruments (Cont.)****B. Management of financial risks (Cont.)****Market risk**

Market risk is the risk that the fair value of the future cash flows from a financial instrument will fluctuate because of changes in market prices. Market prices comprise four types of risk: currency risk, CPI risk, other price risk and interest rate risk. Financial instruments affected by market risk include loans and credit, deposits and investments measured at fair value.

**1. Currency risk**

Since most of the investee companies operate in Israel, the Group's main exposure results from changes in the exchange rate between the New Israeli Shekel ("NIS") and the dollar. Elron's functional currency, as well as that of most of its investee companies, is the dollar. Elron's policy is to reduce exposure to exchange rate fluctuations by having, to the extent possible, most of its and its investee companies' assets and liabilities, as well as most of their revenues and expenditures in dollars, or dollar linked. However, salaries and related expenses, as well as expenses related to the DIC Services Agreement (see Note 19.B) and other operating expenses are denominated in NIS. It is the Company's and its investee companies' policy to use derivative financial instruments to protect from changes in the exchange rate between the NIS and the dollar and to keep a portion of the Company's and its investee companies' resources in NIS against a portion of their future NIS expenses and against liabilities denominated in NIS. If the NIS should strengthen against the dollar, it may harm the Company's and its investee companies' results of operations.

The Company holds a material portion of its cash balances in dollars, however, in the future, changes may take place from time to time in the amounts of these balances, in how the Company maintains its cash, and the portion of cash it holds in each currency, based on business developments and future decisions.

**2. CPI risk**

The Company is engaged in a services agreement with DIC (see Note 19.B). In addition, the Company and several group companies are engaged in a number of lease agreements that are linked to the CPI for various time periods, which are also impacted by changes in the CPI.

**3. Other price risk**

The Company has investments in unquoted financial instruments and in quoted financial instruments that are classified as financial assets measured at fair value, which expose the Company to risk stemming from fluctuations in the security price determined based, among other things, on the stock market prices.

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 20- Financial instruments (Cont.)

## B. Management of financial risks (Cont.)

## 4. Interest risk

The Group is exposed to market risks resulting from changes in interest rates, relating primarily to Elron's and RDC's obligations to banks and interest bearing deposits in banks. As of the approval date of the financial statements, Elron and RDC do not use derivative financial instruments to limit exposure to interest rate risk. In addition, as of December 31, 2013 the Company has received a variable interest loan from Silicon Valley Bank in the amount of \$4,000 (which was prepaid subsequent to the reporting date, see Note 11 above). In addition, certain of the investee companies have variable interest loans. Therefore, an increase in interest rates would result in an increase in their and the Company's financial expenses.

The following table details the interest of the Group's interest-bearing financial instruments:

	<u>December 31,</u>	
	<u>2013</u>	<u>2012</u>
Fixed rate instruments:		
Financial assets	30,707	49,550
	<u>30,707</u>	<u>49,550</u>
Floating rate instruments:		
Financial assets	-	2,902
Financial liabilities	(4,000)	(4,864)
	<u>(4,000)</u>	<u>(1,962)</u>

## Credit risk

Credit risk is the risk that a counterparty will not meet its obligations under a financial instrument, leading to a financial loss. The Group is exposed to credit risk from its operating activities and from its financing activities, including deposits with banks and financial institutions, foreign exchange transactions and other financial instruments.

As the Group holds most of its cash and cash equivalents, short-term and long-term investments, escrow deposits and other financial instruments in various financial institutions with high credit ratings, the Group does not have significant concentrations of credit risk. The Company's policy is spreading out its cash investments among the various institutions. As of December 31, 2013, cash and cash equivalents amounted to \$32,291. In addition, other accounts receivable include \$3,073 in escrow from the sale of SyncRx (see Note 3.A.3.b)).

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 20- Financial instruments (Cont.)

**B. Management of financial risks (Cont.)****Liquidity risks**

The Group's policy for managing its liquidity is to assure, to the extent possible, that it will have sufficient liquidity to settle its liabilities in a timely manner and to ascertain the existence of the cash balances it requires to meet its financial obligations.

**C. Sensitivity tests relating to changes in market factors**

A change in the interest rate, exchange rate or CPI as of December 31, 2013 and 2012 would not have changed the Company's equity and income or loss in material amounts.

**D. Sensitivity tests relating to price risk**

A change in the fair value of financial assets measured at fair value through profit or loss would increase (decrease) the Company's equity and income (loss) in the theoretical amounts presented below.

	<u>2013</u>	<u>2012</u>	<u>2011</u>
5% increase	1,273	1,116	748
10% increase	2,545	2,233	1,496
5% decrease	(1,273)	(1,116)	(748)
10% decrease	(2,545)	(2,233)	(1,496)

A change in the fair value of financial assets measured at fair value through other comprehensive income would not have changed the Company's equity in material amounts.

**E. Fair value of financial instruments**

The carrying amount of all of the Company's financial assets and liabilities, including cash and cash equivalents, other accounts receivable, other investments measured at fair value, other long term receivables, other accounts payable, trade payables, royalty bearing government grants and loans from banks, conform to or approximate their fair values.

**F. Classification of financial instruments by fair value hierarchy**

The financial instruments presented in the statement of financial position at fair value are grouped into classes with similar characteristics using the following fair value hierarchy which is determined based on the source of input used in measuring fair value:

- Level 1 - quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 - inputs other than quoted prices included within Level 1 that are observable either directly or indirectly.
- Level 3 - inputs that are not based on observable market data (valuation techniques which use inputs that are not based on observable market data).

According to the Company's policy, transfers between the fair value hierarchy are considered to have occurred in the date of the event or change in circumstances that caused the transfer.

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 20- Financial instruments (Cont.)

## F. Classification of financial instruments by fair value hierarchy (Cont.)

*Financial assets measured at fair value:*

December 31, 2013:

	<u>Level 1</u>	<u>Level 2 (*)</u>	<u>Level 3</u>
Other investments measured at fair value	144	703	25,453

December 31, 2012:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Other investments measured at fair value	178	-	23,397

\*) As noted above in Note 6, shares of Enableness received under the settlement agreement are subject to a four month lockup period. As of December 31, 2013, the fair value of the investment in Enableness's restricted shares was determined by reference to their quoted market price less a discount in respect of the lockup period. The discount was estimated based on the Option Pricing Model method and amounted to approximately \$40 as of December 31, 2013. The discount alone was measured according to level 2, and deducted from the quoted market price of the shares according to level 1.

*Changes in financial assets classified in Level 3:*

	<u>Financial assets measured at fair value</u>
<b>Balance as of January 1, 2012</b>	16,014
Total recognized income:	
In profit or loss	1,813
In other comprehensive income	19
Transfer into level 3 due to a decrease in holdings in companies measured according to the equity method of accounting prior to their classification as financial assets (see Note 6)	4,301
Investment	1,250
<b>Balance as of December 31, 2012</b>	23,397
Total recognized income (loss):	
In profit or loss	1,193
In other comprehensive income (loss)	(1,071)
Investment	1,934
<b>Balance as of December 31, 2013</b>	25,453
Total gain for 2013 included in profit or loss relating to assets held at the end of the reporting year	1,193
Total gain for 2012 included in profit or loss relating to assets held at the end of the reporting year	1,813

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 20- Financial instruments (Cont.)

## G. Liquidity risk

1. Set forth below are the contractual repayment dates of financial liabilities, including an estimate of the interest payments, without amounts with respect to which there are offset agreements:

As of December 31, 2013 the contractual repayment date of all financial liabilities is in 2014, as following: trade payables- \$176, other accounts payable- \$3,507, loans from banks- \$4,011, including interest payment (the loan was prepaid subsequent to the reporting date, see also Note 11)

	December 31, 2012							No specific repayment date
	Total projected cash flows*	First year	Second year	Third year	Fourth year	Fifth year	More than 5 years	
Trade payables	237	237	-	-	-	-	-	-
Other current financial liabilities	2,601	2,601	-	-	-	-	-	-
Loans from banks	4,375	160	160	4,055	-	-	-	-
Royalty bearing government grants	864	-	-	-	-	-	-	864
	<u>8,077</u>	<u>2,998</u>	<u>160</u>	<u>4,055</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>864</u>

\*) The anticipated cash flows were calculated on the basis of the exchange rates that prevailed on December 31, 2012.

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 20- Financial instruments (Cont.)

## G. Liquidity risk (Cont.)

2. The expected maturity profile of financial assets according to their contractual terms in non-capitalized amounts (including an estimate of interest to be received):

December 31, 2013:

	Less than one year	1 to 2 years	2 to 3 years	3 to 4 years	4 to 5 years	> 5 years	Un- determined	Total
<b>Financial assets measured at amortized cost:</b>								
Deposits and receivables	3,269	-	-	-	-	-	-	3,269
<b>Financial assets measured at fair value through profit or loss:</b>								
Shares	-	-	-	-	-	-	25,453	25,453
<b>Financial assets measured at fair value through other comprehensive income:</b>								
Shares	-	-	-	-	-	-	847	847
	<u>3,269</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>26,300</u>	<u>29,569</u>

December 31, 2012:

	Less than one year	1 to 2 years	2 to 3 years	3 to 4 years	4 to 5 years	> 5 years	Un- determined	Total
<b>Financial assets measured at amortized cost:</b>								
Deposits and receivables	3,558	3,061	-	-	-	-	632	7,251
<b>Financial assets measured at fair value through profit or loss:</b>								
Shares	-	-	-	-	-	-	22,325	22,325
<b>Financial assets measured at fair value through other comprehensive income:</b>								
Shares	-	-	-	-	-	-	1,250	1,250
	<u>3,558</u>	<u>3,061</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>24,207</u>	<u>30,826</u>

## Notes to the Consolidated Financial Statements

(USD in thousands, except for price per share and number of shares)

## Note 20- Financial instruments (Cont.)

## H. Linkage terms of assets and liabilities on a consolidated basis

December 31, 2013:

	NIS (CPI linked)	USD (or USD linked)	NIS (not linked)	Non- monetary item**	Total
<b>Assets *</b>					
Cash and cash equivalents	-	28,567	3,724	-	32,291
Other accounts receivable	16	59	166	165	406
Assets held for sale	-	-	-	108,735	108,735
Investments in associates	-	-	-	8,541	8,541
Other investments measured at fair value	-	-	-	26,300	26,300
Property, plant and equipment, net	-	-	-	75	75
Deferred tax assets	-	-	-	28,994	28,994
Intangible assets, net	-	-	-	4,458	4,458
Other long-term receivables	-	3,073	29	-	3,102
	<u>16</u>	<u>31,699</u>	<u>3,919</u>	<u>177,268</u>	<u>212,902</u>
<b>Liabilities *</b>					
Trade payables	-	25	151	-	176
Other accounts payable	-	885	2,373	267	3,525
Long term loans from banks	-	4,000	-	-	4,000
Long term taxes	-	-	-	5,386	5,386
	<u>-</u>	<u>4,910</u>	<u>2,524</u>	<u>5,653</u>	<u>13,087</u>

\*) Non-current assets and liabilities in this table include their current maturities.

\*\*) Including non-financial items.

December 31, 2012:

	NIS (CPI linked)	USD (or USD linked)	NIS (not linked)	Non- monetary item**	Total
<b>Assets *</b>					
Cash and cash equivalents	-	44,766	2,759	-	47,525
Other accounts receivable	34	1,443	91	296	1,864
Investments in associates	-	-	-	113,217	113,217
Other investments measured at fair value	-	-	-	23,575	23,575
Property, plant and equipment, net	-	-	-	177	177
Intangible assets, net	-	-	-	4,922	4,922
Other long-term receivables	-	5,663	64	75	5,802
	<u>34</u>	<u>51,872</u>	<u>2,914</u>	<u>142,262</u>	<u>197,082</u>
<b>Liabilities *</b>					
Trade payables	11	49	177	-	237
Other accounts payable	-	944	1,348	313	2,605
Long term loans from banks	-	4,000	-	-	4,000
Royalty bearing government grants	-	864	-	-	864
Long term taxes	-	-	-	4,457	4,457
	<u>11</u>	<u>5,857</u>	<u>1,525</u>	<u>4,770</u>	<u>12,163</u>

\*) Non-current assets and liabilities in this table include their current maturities.

\*\*) Including non-financial items.



## ANNEX TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

## A. Details Relating to Investments in the consolidated financial statements as of December 31, 2013

	<u>Rate of holdings in equity</u>		<u>Consolidated rate of holdings in equity</u>	<u>Elron's effective rate of holdings in equity (3)</u>	<u>Fully diluted consolidated rate of holdings</u>	<u>Elron's fully diluted effective holdings (3)</u>	<u>Consolidated carrying value of investment December 31, 2013</u>	<u>Market value of investment</u>	
	<u>Elron (1)</u>	<u>RDC(2)</u>						<u>December 31, 2013</u>	<u>March 10, 2014</u>
				%					\$ thousands
<u>Investments in investee companies</u>									
<u>Subsidiaries:</u>									
Cloudyn Software Ltd.	-	45.94	45.94	20.43	43.33	19.27	399	-	-
Pose POS Ltd. (formerly Blitz Branding Ltd.)	-	43.30	43.30	19.25	45.16	20.08	437	-	-
<u>Associates:</u>									
Given Imaging Ltd. (4)	20.57	8.05	28.61	24.60	26.26	22.57	108,735	284,702	N/A
NuLens Ltd.	34.72	-	34.72	34.72	29.84	29.84	(100)	-	-
BrainsGate Ltd.	29.87	-	29.87	29.87	26.82	26.82	957	-	-
Pocared Diagnostics Ltd.	41.35	-	41.35	41.35	36.35	36.35	551	-	-
Cartiheal (2009) Ltd.	32.31	-	32.31	32.31	27.27	27.27	2,726	-	-
Kyma Medical Technologies Ltd.	-	64.41	64.41	32.27	45.80	22.95	3,863	-	-
DES Dry Eye Solutions Ltd.	17.00	-	17.00	17.00	30.00	30.00	500	-	-
Numbeez Ltd.	-	37.85	37.85	16.83	34.29	15.25	47	-	-
Plymedia Inc.	26.74	-	26.74	26.74	19.25	19.25	-	-	-
<u>Other investments:</u>									
Notal Vision Inc.	22.34	-	22.34	22.34	18.07	18.07	11,009	-	-
Jordan Valley Semiconductors Ltd.	18.83	-	18.83	18.83	16.95	16.95	10,440	-	-
Atlantium Technologies Inc.	7.77	-	7.77	7.77	6.60	6.60	130	-	-
Aqwise – Wise Water Technologies Ltd.	19.81	-	19.81	19.81	17.94	17.94	3,809	-	-
Enableness Technologies Inc.	4.45	-	4.45	4.45	N/A	N/A	847	847(5)	767

(1) Including holding through Elron's fully-owned subsidiaries.

(2) Including holding through RDSSeed.

(3) Elron's effective holdings include holdings by RDC multiplied by 50.10% and holdings by RDSSeed multiplied by 89% (RDC's holding rate in RDSSeed) and by 50.10% (Elron's holding rate in RDC).

(4) For details regarding the Given Merger subsequent to the reporting date and its classification as held for sale as of December 31, 2013, see Note 3.B.4.a).

(5) The value of the Enableness shares was determined based on their quoted price on the TSX Venture Exchange and less a discount in respect of the lockup period (see also Note 6 above).

**Given Imaging Ltd.  
and its Subsidiaries**

**Consolidated  
Financial Statements**

**As of and for the  
Year Ended December 31, 2013**

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**Given Imaging Ltd. and its subsidiaries**  
**Index to Consolidated Financial Statements**

	<b>Page</b>
<a href="#"><u>Report of Independent Registered Public Accounting Firm</u></a>	G - 2
<a href="#"><u>Consolidated Balance Sheets</u></a>	G - 3
<a href="#"><u>Consolidated Statements of Income and Comprehensive Income</u></a>	G - 5
<a href="#"><u>Consolidated Statements of Changes in Stockholders' Equity</u></a>	G - 6
<a href="#"><u>Consolidated Statements of Cash Flows</u></a>	G - 7
<a href="#"><u>Notes to the Consolidated Financial Statements</u></a>	G - 9

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**Report of Independent Registered Public Accounting Firm**

**The Board of Directors and Shareholders  
Given Imaging Ltd.**

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

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company and subsidiaries as of December 31, 2013 and 2012, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2013, in conformity with U.S. generally accepted accounting principles.

**Somekh Chaikin  
Certified Public Accountants (Israel)  
Member Firm of KPMG International**

Haifa, Israel,  
February 27, 2014

**Given Imaging Ltd. and its Subsidiaries**  
**Consolidated Balance Sheets**  
(In thousands except share data)

	Note	December 31,	
		2013	2012
<b>Assets</b>			
<b>Current assets</b>			
Cash and cash equivalents	1D; 2	\$ 44,136	\$ 35,442
Short-term investments	1H; 5	90,315	58,446
Accounts receivable:			
Trade	1E	33,064	31,279
Other	3	6,817	4,654
Inventories	1F; 4	26,451	22,591
Advances to suppliers		847	1,349
Deferred tax assets	1P; 14D	3,879	2,646
Other current assets		3,199	2,689
<b>Total current assets</b>		<b>208,708</b>	159,096
<b>Other long term assets</b>		<b>1,048</b>	924
<b>Assets held for employees' severance payments</b>	1G; 10	<b>9,967</b>	7,974
<b>Long-term investments</b>	1H; 5	<b>33,029</b>	30,188
<b>Non-current inventory</b>	1F; 4	<b>4,478</b>	6,150
<b>Fixed assets, less accumulated depreciation</b>	1I; 6	<b>10,772</b>	12,335
<b>Intangible assets, less accumulated amortization</b>	1J; 7; 16	<b>26,904</b>	30,705
<b>Goodwill</b>	1K; 16; 17	<b>26,942</b>	26,942
<b>Total Assets</b>		<b>\$ 321,848</b>	<b>\$ 274,314</b>

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

**Given Imaging Ltd. and its Subsidiaries**  
**Consolidated Balance Sheets**  
(In thousands except share data)

	Note	December 31,	
		2013	2012
<b>Liabilities and equity</b>			
<b>Current liabilities</b>			
Current installments of obligation under capital lease	8A	\$ -	\$ 38
Accounts payable:			
Trade		10,754	8,756
Other	9	28,943	27,091
Deferred income		1,403	929
<b>Total current liabilities</b>		<b>41,100</b>	<b>36,814</b>
<b>Long-term liabilities</b>			
Liability in respect of employees' severance payments	10	10,828	8,761
Contingent consideration in respect of business combination	1V, 16C	1,239	1,038
Deferred tax liabilities	14D	3,669	4,675
Other long-term liabilities	8A	105	78
<b>Total long-term liabilities</b>		<b>15,841</b>	<b>14,552</b>
<b>Total liabilities</b>		<b>56,941</b>	<b>51,366</b>
<b>Commitments and contingencies</b>	8		
<b>Equity</b>			
Equity	11		
Ordinary Shares, NIS 0.05 par value each (90,000,000 shares authorized as of December 31, 2013 and 2012, 33,078,646 and 31,080,876 shares issued and fully paid as of December 31, 2013 and 2012, respectively)		393	367
Additional paid-in capital		251,771	219,103
Capital reserve		1,591	1,591
Accumulated other comprehensive income		15	266
Retained earnings		11,137	1,621
<b>Total equity</b>		<b>264,907</b>	<b>222,948</b>
<b>Total liabilities and equity</b>		<b>\$ 321,848</b>	<b>\$ 274,314</b>

\_\_\_\_\_  
President and CEO

\_\_\_\_\_  
CFO

Date of approval of the financial statements: 27 February, 2014

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

Given Imaging Ltd. and its Subsidiaries  
Consolidated Statements of Income and Comprehensive Income  
(In thousands except share and per share data)

	Note	Year ended December 31,		
		2013	2012	2011
<b>Revenues</b>				
Cost of revenues	1N; 12	\$ 190,769	\$ 180,501	\$ 177,955
		<u>(43,784)</u>	<u>(42,971)</u>	<u>(41,466)</u>
<b>Gross profit</b>		<b>146,985</b>	137,530	136,489
<b>Operating expenses</b>				
Research and development, gross	1Q	(25,703)	(25,627)	(26,129)
Government grants	1O; 8C	1,115	1,439	1,113
Research and development, net		<u>(24,588)</u>	<u>(24,188)</u>	<u>(25,016)</u>
Sales and marketing		(82,164)	(76,272)	(75,014)
General and administrative		(25,415)	(22,746)	(23,078)
Other, net	6; 7	(498)	(455)	(397)
<b>Total operating expenses</b>		<b>(132,665)</b>	(123,661)	(123,505)
<b>Operating profit</b>		<b>14,320</b>	13,869	12,984
Financial income, net	13	91	847	1,343
<b>Profit before taxes on income</b>		<b>14,411</b>	14,716	14,327
Income tax expense	1P; 14	(4,895)	(459)	(2,158)
<b>Net profit</b>		<b>9,516</b>	14,257	12,169
Net loss (profit) attributable to non-controlling interest	16A	-	93	(191)
<b>Net profit attributable to shareholders</b>		<b>9,516</b>	14,350	11,978
Net change in respect of available-for-sale securities		(251)	1,151	(980)
<b>Total comprehensive profit attributable to shareholders</b>		<b>9,265</b>	15,501	10,998
Total comprehensive profit (loss) attributable to non-controlling interest		-	(93)	191
<b>Total comprehensive profit</b>		<b>\$ 9,265</b>	<b>\$ 15,408</b>	<b>\$ 11,189</b>

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

**Given Imaging Ltd. and its Subsidiaries**  
**Consolidated Statements of Changes in Stockholders' Equity**  
(In thousands except share data)

	Shareholders of the Company							Non- controlling interests	Total
	Ordinary Shares		Additional Paid-In Capital	Capital Reserve	Accumulated Other Comprehensive Income (loss)	Retained Earnings (Accumulated Deficit)			
	Shares	Amount							
<b>Balance as of January 1, 2011</b>	29,829,277	\$ 350	\$ 194,899	\$ 2,051	\$ 95	\$ (24,707)	\$ 100	\$ 172,788	
<b>Change during the year 2011:</b>									
Net profit	-	-	-	-	-	11,978	191	12,169	
Net change in respect of available-for-sale securities	-	-	-	-	(980)	-	-	(980)	
Exercise of equity awards	619,561	9	6,576	-	-	-	-	6,585	
Stock based compensation	-	-	7,363	-	-	-	-	7,363	
<b>Balance as of December 31, 2011</b>	30,448,838	359	208,838	2,051	(885)	(12,729)	291	197,925	
<b>Change during the year 2012:</b>									
Net profit (loss)	-	-	-	-	-	14,350	(93)	14,257	
Net change in respect of available-for-sale securities	-	-	-	-	1,151	-	-	1,151	
Exercise of equity awards	632,038	8	4,107	-	-	-	-	4,115	
Stock based compensation	-	-	6,158	-	-	-	-	6,158	
Change in non-controlling interest	-	-	-	(460)	-	-	(198)	(658)	
<b>Balance as of December 31, 2012</b>	31,080,876	367	219,103	1,591	266	1,621	-	222,948	
<b>Change during the year 2013:</b>									
Net profit	-	-	-	-	-	9,516	-	9,516	
Net change in respect of available-for-sale securities	-	-	-	-	(251)	-	-	(251)	
Exercise of equity awards	1,997,770	26	27,070	-	-	-	-	27,096	
Stock based compensation	-	-	5,598	-	-	-	-	5,598	
<b>Balance as of December 31, 2013</b>	<u>33,078,646</u>	<u>\$ 393</u>	<u>\$ 251,771</u>	<u>\$ 1,591</u>	<u>\$ 15</u>	<u>\$ 11,137</u>	<u>\$ -</u>	<u>\$ 264,907</u>	

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



Given Imaging Ltd. and its Subsidiaries  
Consolidated Statements of Cash Flows  
(In thousands)

	Year ended December 31,		
	2013	2012	2011
<b>Cash flows from operating activities:</b>			
Net profit	\$ 9,516	\$ 14,257	\$ 12,169
<b>Adjustments required to reconcile net profit to net cash provided by operating activities:</b>			
Depreciation and amortization	8,818	8,597	8,296
Losses from available-for-sale marketable securities	635	8	47
Change in deferred taxes	(2,441)	(1,795)	(409)
Stock based compensation	5,598	6,158	7,363
Loss from disposal of fixed assets and intangible assets	575	484	397
Revaluation of contingent consideration	201	-	-
Decrease (increase) in accounts receivable – trade	(1,785)	977	(4,544)
Decrease (increase) in other accounts receivable – other	639	1,252	(968)
Decrease (increase) in other current assets	(510)	(1,316)	212
Decrease (increase) in advances to suppliers	502	(142)	(766)
Increase in inventories	(2,188)	(299)	(3,145)
Increase (decrease) in accounts payable	3,587	(691)	1,433
Increase (decrease) in deferred revenue	474	408	(267)
Other	82	54	111
<b>Net cash provided by operating activities</b>	<b>23,703</b>	<b>27,828</b>	<b>19,929</b>
<b>Cash flows from investing activities:</b>			
Purchase of fixed assets and intangible assets	(4,029)	(7,005)	(10,551)
Other long-term assets	49	(538)	(39)
Acquisition of a business, net of cash acquired (1)	-	(6,000)	-
Change in short-term deposits, net	(20,155)	4,968	(20,176)
Proceeds from sales and maturity of marketable securities	14,057	13,343	11,141
Investments in marketable securities	(29,498)	(24,827)	(16,910)
<b>Net cash used in investing activities</b>	<b>(39,576)</b>	<b>(20,059)</b>	<b>(36,535)</b>
<b>Cash flows from financing activities:</b>			
Principal payments on capital lease obligation	(38)	(129)	(168)
Proceeds from exercise of equity awards	24,342	4,115	6,585
Purchase of shares from a non-controlling shareholder in a subsidiary	-	(658)	-
<b>Net cash provided by financing activities</b>	<b>24,304</b>	<b>3,328</b>	<b>6,417</b>
<b>Effect of exchange rate changes on cash and cash equivalents</b>	<b>263</b>	<b>60</b>	<b>(145)</b>
<b>Increase (decrease) in cash and cash equivalents</b>	<b>8,694</b>	<b>11,157</b>	<b>(10,334)</b>
<b>Cash and cash equivalents at beginning of year</b>	<b>35,442</b>	<b>24,285</b>	<b>34,619</b>
<b>Cash and cash equivalents at end of year</b>	<b>\$ 44,136</b>	<b>\$ 35,442</b>	<b>\$ 24,285</b>
<b>Supplementary cash flow information:</b>			
Income taxes paid	\$ 9,161	\$ 2,883	\$ 2,179

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

**Given Imaging Ltd. and its Subsidiaries**  
**Consolidated Statements of Cash Flows**  
**(In thousands)**

**(1) Acquisition of a business, net of cash acquired:**

	<b>Year ended December 31, 2012</b>
Working capital (excluding cash and cash equivalents)	\$ (595)
Fixed assets, net	(183)
Intangible assets (including Goodwill)	(6,260)
Other long-term liabilities	1,038
	<u>\$ (6,000)</u>

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

**Given Imaging Ltd. and its Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
**(In thousands)**

**Note 1 - Organization and Summary of Significant Accounting Policies**

**A. General**

Given Imaging Ltd. (the "Company") was incorporated in Israel in January 1998.

The Company has developed the Given System, a proprietary wireless imaging system for visual examination of the gastrointestinal ("GI") tract. The system uses a miniaturized video camera contained in a capsule, referred to as the PillCam™ capsule, which is ingested by the patient and delivers high quality color images in a painless and noninvasive manner.

The Given System consists of three principal components:

- a single-use, disposable PillCam color-imaging capsule that is ingested by the patient;
- a portable data recorder and sensors that are worn by the patient; and
- a proprietary software, known as RAPID, for downloading, processing and analyzing recorded data.

In 2001, the Company commenced marketing the Given System with the PillCam SB capsule for visualizing and detecting disorders of the small bowel. PillCam SB is cleared for marketing in the United States, the European Union and Japan, which are the Company's principal markets. In November 2004, the Company began marketing and sale of the PillCam ESO capsule for visualization of the esophagus. This capsule is cleared for marketing in all principal markets, except Japan. In the second half of 2007, the Company began selling the first generation of its PillCam COLON capsule in Europe. The Company received the CE mark for this capsule in late 2009, the clearance by Japan's Pharmaceuticals & Medical Devices Agency (PMDA) in July 2013 and the FDA approval in February 2014. The clearance of PillCam COLON is limited in each country to specific approved indications.

The Company has direct or indirect wholly-owned subsidiaries in the United States, Brazil, the Netherlands, Germany, France, Australia, Hong Kong, Vietnam, Japan and Singapore.

On December 8, 2013, the Company entered into an Agreement and Plan of Merger with Covidien Group S.a.r.l. ("Covidien S.a.r.l."), a Luxembourg company and an indirect, wholly-owned subsidiary of Covidien plc ("Covidien"), and Rioja Israel (2013) Ltd., an Israeli company and a wholly-owned subsidiary of Covidien S.a.r.l. On January 23, 2014, the shareholders of the Company approved the proposed merger. The merger was subject to certain other conditions, including the expiration of a statutory waiting period under Israeli law. On February 27, 2014 the merger was completed and the Company's shares were delisted from any stock exchange on which they were traded, the Company ceased to be a publicly-traded company and became a privately-held company that is a wholly-owned subsidiary of Covidien.

*Businesses acquired*

In December 2008, the Company acquired the Bravo pH monitoring business from Medtronic, Inc. The Bravo pH monitoring system is the only wireless, catheter-free pH test for Gastro Esophageal Reflux Disease, or GERD, and uses a disposable capsule temporarily placed in the esophagus that measures pH levels and transmits the data to an external receiver. pH testing is considered the standard test for diagnosing GERD.

In April 2010, the Company acquired privately-held Sierra Scientific Instruments ("Sierra"), now known as Given Imaging (Los Angeles) ("GILA"), for approximately \$35 million in cash. GILA is a leading provider of specialty diagnostic devices for the gastrointestinal tract. GILA's primary business is the development, manufacture and sale of high-resolution pressure systems, also known as high resolution manometry, for the diagnosis of motility disorders within the GI tract. GILA's high resolution manometry systems are sold under the name ManoScan. Since sales began in 2004, GILA has produced and installed ManoScan™ systems world-wide and supported numerous clinical procedures. GILA also markets and sells catheter-based pH and impedance monitoring systems. As part of the acquisition, the Company acquired 100% of the shares of GILA's subsidiary, a Vietnamese company, which manufactures catheters.

**Given Imaging Ltd. and its Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
**(In thousands)**

**Note 1 - Organization and Summary of Significant Accounting Policies (cont'd)**

**A. General (cont'd)**

In October 2012, the Company acquired from The SmartPill Corporation ("SmartPill"), a U.S. based-company, assets related to the SmartPill® GI Monitoring System for \$6 million plus an earn-out component. The SmartPill® is an ingestible capsule that uses sensor technology to measure pH, pressure and temperature in the gastrointestinal tract. The SmartPill System measures gastric emptying and the transit time of solid and liquid content through the entire gastrointestinal tract and is used to evaluate motility disorders such as gastroparesis and constipation.

The Company operates in the medical device industry and its business is subject to numerous risks, including, without limitations, (1) the Company's ability to develop and bring to market new products, (2) the Company's ability to receive regulatory clearance or approval to market its products or changes in regulatory environment, (3) the Company's success in implementing its sales, marketing and manufacturing plans, (4) continuous supply of certain components from third-party suppliers, (5) protection and validity of patents and other intellectual property rights, (6) the impact of currency exchange rates, (7) the effect of competition by other companies, (8) the outcome of significant litigation, and (9) the existence of favorable reimbursement for its product from government and commercial payors, (10) changes and reforms in applicable healthcare laws and regulations, (11) quarterly variations in operating results, (12) the possibility of armed conflicts or civil or military unrest in Israel, (13) risks associated with the acquisition and integration of other businesses, and (14) the impact of macro-economic and market conditions in the Company's main markets.

**B. Basis of presentation**

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and include the accounts of the Company and its wholly-owned subsidiaries in the United States, Germany, France, the Netherlands, Hong-Kong, Singapore, Vietnam, Japan, Brazil and Australia. All intercompany balances and transactions have been eliminated in consolidation. As of December 31, 2013, the Company considers itself operating in only one segment.

**C. Functional and reporting currency**

The functional and reporting currency of the Company and all its subsidiaries is the U.S. dollar. Transactions denominated in foreign currencies other than the U.S. dollar are translated into the functional currency using the prevailing exchange rates at the date of the transactions. Monetary accounts maintained in currencies other than the U.S. dollar are re-measured using the representative foreign exchange rate at the balance sheet date. Gains and losses from the translation of foreign currency balances are recorded in financial income, net.

**D. Cash and cash equivalents**

All highly-liquid investments with original maturity of three months or less from the date of deposit are considered to be cash equivalents.

**E. Allowance for doubtful accounts receivable - trade**

The allowance for doubtful accounts receivable is calculated on the basis of specific identification of balances, the collection of which, in management's opinion, is doubtful. In determining the adequacy of the allowance, management bases its opinion on the estimated risk, in reliance on available information with respect to the debtor's financial position and an evaluation of the collateral received.

**Given Imaging Ltd. and its Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
(In thousands)

**Note 1 - Organization and Summary of Significant Accounting Policies (cont'd)**

**E. Allowance for doubtful accounts receivable - trade (cont'd)**

The activity in the allowance for doubtful accounts for the three years ended December 31, 2013 is as follows:

	Year ended December 31,		
	2013	2012	2011
<b>Opening balance</b>	\$ 343	\$ 311	\$ 295
<b>Additional provision</b>	243	261	150
<b>Write-offs</b>	(45)	(229)	(134)
<b>Closing balance</b>	<u>\$ 541</u>	<u>\$ 343</u>	<u>\$ 311</u>

**F. Inventories**

Inventories are stated at lower of cost or market. Cost is determined using the average cost method for raw materials, components and finished goods and on the basis of actual manufacturing costs for work in progress.

Inventory that is not expected to be consumed in the next operating cycle, based upon sales forecast, is classified as non-current (for more details see Note 4).

**G. Assets held for employees' severance payments**

Assets held for employees' severance payments represent contributions to insurance policies that are recorded at their current redemption value.

**H. Marketable securities**

The Company accounts for marketable securities under Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 320-10 "Accounting for Certain Investments in Debt and Equity Securities".

Available-for-sale securities are recorded at fair value. Changes in fair value based on closing market prices of the securities at balance sheet date are recorded directly to equity as accumulated other comprehensive income (loss). A decline in market value of available-for-sale security below cost deemed "other than temporary" will be charged to the statement of income when it occurs.

As of December 31, 2013, marketable securities consist of corporate bonds, which the Company classified as "available-for-sale".

**Given Imaging Ltd. and its Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
**(In thousands)**

**Note 1 - Organization and Summary of Significant Accounting Policies (cont'd)**

**I. Fixed assets**

Fixed assets are stated at cost. Depreciation is computed by the straight-line method over the estimated useful lives of the assets at the following annual rates:

	%
Computers and software	33
Instruments and laboratory equipment	15
Leasehold improvements	10
Motor vehicles	15
Machinery and equipment	15
Communication equipment	15
Office furniture and equipment	10-15

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

The Company evaluates fixed assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable, in accordance with the provisions of ASC 360-10, "Accounting for the Impairment of or Disposal of Long-Lived Assets" ("ASC 360-10"). Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to undiscounted future net cash flows expected to be generated by the asset. If the carrying amount of the assets is less than the undiscounted future net cash flows, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets.

**J. Definite-life intangible assets**

Definite-life intangible assets acquired in business combinations consist mainly of acquired technology (including in-process research and development expenditures), trademarks, patents and customer relationships, and are amortized using the straight-line method over their estimated period of useful life, mainly 8 to 20 years (for more details see Note 16C).

Legal expenses related to patents and trademarks registration have been capitalized and amortized over the expected useful life of the assets, which is mainly 8 years.

Technology and content costs are generally expensed as incurred, except for certain costs relating to the development of the Company's website that are capitalized and amortized over their estimated useful life which is generally 3 years.

Amortization charges are classified according to the expense category that benefits from the related intangible asset.

Definite-life intangible assets are evaluated for recoverability whenever events or changes in circumstances indicate that the carrying amount may not be recoverable, in accordance with ASC 360-10 (see Note II above).

**Given Imaging Ltd. and its Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
(In thousands)

**Note 1 - Organization and Summary of Significant Accounting Policies (cont'd)**

**K. Goodwill**

Pursuant to ASC 350-20, "Goodwill and Other Intangible Assets," goodwill and indefinite life intangible assets are not amortized but rather tested for impairment at least annually.

Goodwill is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized. Goodwill is reviewed for impairment at least annually in accordance with the provisions of FASB ASC Topic 350, Intangibles - Goodwill and Other. An entity has the option to perform a qualitative assessment to determine whether it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount prior to performing the two-step goodwill impairment test. If this is the case, the two-step goodwill impairment test is required. If it is more-likely-than-not that the fair value of a reporting unit is greater than its carrying amount, the two-step goodwill impairment test is not required. When performing the two-step test, under the first step, the fair value of the reporting unit is compared with its carrying value (including goodwill). If the fair value of the reporting unit exceeds its carrying value, step two does not need to be performed. If the fair value of the reporting unit is less than its carrying value, an indication of goodwill impairment exists for the reporting unit and the enterprise must perform step two of the impairment test (measurement). Under step two, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation and the residual fair value after this allocation is the implied fair value of the reporting unit goodwill. Fair value of the reporting unit is determined using a discounted cash flow analysis.

The Company performs its annual impairment review of goodwill at December 31, and when a triggering event occurs between annual impairment tests. (See also Note 17 for details.)

**L. Stock compensation plans**

Stock-based compensation is accounted for based on the provisions of ASC 718-20, "Share-Based Payment" ("ASC 718-20"). ASC 718-20 requires compensation expense relating to share-based payments to be recognized in income using a fair-value measurement method. Under the fair value method, the estimated fair value of awards at the grant date is charged to income on a straight-line basis over the requisite service period, which is generally the vesting period.

Stock-based compensation recognized in the consolidated statements of income is based on awards ultimately expected to vest. As a result, the expense has been reduced for estimated forfeitures. ASC 718-20 requires forfeitures to be estimated at the time of grant and revised in subsequent periods if actual forfeitures differ from those estimates.

**M. Use of estimates**

The preparation of the consolidated financial statements, in accordance with generally accepted accounting principles in the United States of America, requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Significant items subject to such estimates and assumptions include the useful lives of fixed assets, allowances for doubtful accounts, the valuation of deferred tax assets, intangible assets, goodwill, inventory, derivatives, share-based compensation, reserves for income tax uncertainties, contingent consideration in respect of business combination and other contingencies. Actual results could differ from those estimates.

**Given Imaging Ltd. and its Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
(In thousands)

**Note 1 - Organization and Summary of Significant Accounting Policies (cont'd)**

**N. Revenue recognition**

Revenues from sales of products are recognized upon delivery provided that the collection of the resulting receivable is reasonably assured, persuasive evidence of an arrangement exists, no significant obligations in respect of installation remain and the sales price is fixed or determinable.

The Company accrues estimated warranty costs at time of shipment based on contractual rights and historical experience. The Company's policy is not to grant return rights.

Taxes collected from customers and remitted to governmental authorities are presented in the financial statements on a net basis.

For sales contracts, which include a Post Contract Customer Support ("PCS") component, revenues allocated to PCS in accordance with ASC Subtopic 605-25, "Revenue Recognition - Multiple Element Arrangements", are deferred and recognized ratably over the term of the support period. For multi-element arrangements that include tangible products that contain software that is essential to the tangible product's functionality and undelivered software elements that relate to the tangible product's essential software, the Company allocates revenue to all deliverables based on their relative selling prices, in accordance with ASU 2009-13, Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements. In such circumstances, the Company uses a hierarchy to determine the selling price to be used for allocating revenue to deliverables: (i) vendor-specific objective evidence of fair value ("VSOE"), (ii) third-party evidence of selling price ("TPE"), and (iii) best estimate of the selling price ("ESP").

The Company accounts for multiple element arrangements that consist only of software or software-related products, including PCS, in accordance with ASC Subtopic 985-605 "Software Revenue Recognition". For such arrangements, revenue that includes multiple elements is allocated to each element based on the relative fair value of each element, and fair value is determined by VSOE. If the Company cannot objectively determine the fair value of any undelivered element included in such multiple-element arrangements, the Company defers revenue until all elements are delivered and services have been performed, or until fair value can objectively be determined for any remaining undelivered elements.

**O. Government - sponsored research and development**

The Company participates in various programs of the Office of the Chief Scientist of the Israeli Ministry of Economy (the "OCS"), some of which are royalty bearing. Grants received from the OCS are recorded as a reduction of research and development expenses at the time the related expense is incurred and subject to grant approval. Royalties payable to OCS are classified as cost of revenues.



**Given Imaging Ltd. and its Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
(In thousands)

**Note 1 - Organization and Summary of Significant Accounting Policies (cont'd)**

**P. Taxes on income**

The Company accounts for income taxes under ASC 740, "Income Taxes" ("ASC 740"). Under ASC 740, deferred tax assets or liabilities are recognized in respect of temporary differences between the tax bases of assets and liabilities and their financial reporting amounts as well as in respect of tax loss and credit carry forwards, based on enacted statutory tax rates applicable to the periods in which such deferred taxes will be realized. The tax effect resulting from a change in tax rates is recognized in the period that includes the enactment date. Valuation allowances are established when necessary to reduce deferred tax assets to the amount that is more likely than not to be realized.

The Company may incur additional tax liability in the event of intercompany dividend distributions by some of its subsidiaries. Those subsidiaries have, at December 31, 2013, accumulated retained earnings of approximately \$ 13 million which may be distributed as dividends. Such additional tax liability in respect of these non-Israeli subsidiaries has not been provided for in these financial statements as the Company does not expect these subsidiaries to distribute dividends in the foreseeable future.

The Company accounts for uncertainty in income taxes, under ASC 740-10 which prescribe a recognition threshold and measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. ASC 740-10 also provides guidance on de-recognition of tax benefits, classification on the balance sheet, interest and penalties, accounting in interim periods, disclosure and transition. The Company follows a two-step approach to recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon settlement.

The Company's accounting policy is to accrue interest and penalties related to unrecognized tax benefits as a component of income tax expense in the consolidated statements of income and comprehensive income.

**Q. Research and development costs**

Research and development costs, net of grants received, are charged to the statement of income as incurred (excluding in-process research and development expenditures acquired in business combinations). ASC 985-20, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed", requires capitalization of certain software development costs subsequent to the establishment of technological feasibility. Technological feasibility is established upon completion of a working model and success in clinical trials. Costs, incurred by the Company between completion of the working models and success in clinical trials and the point at which the products are ready for general release, have been insignificant. Therefore, research and development costs are charged to the statement of income and comprehensive income, as incurred.

**R. Allowance for product warranty**

It is the Company's policy to grant a warranty for certain products. The balance sheet provision for warranties is determined based upon the Company's experience regarding the relationship between sales and warranty costs.

**Given Imaging Ltd. and its Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
(In thousands)

**Note 1 - Organization and Summary of Significant Accounting Policies (cont'd)**

**S. Concentration of credit risk**

Financial instruments that may subject the Company to significant concentrations of credit risk consist principally of cash and cash equivalents, trade accounts receivable and marketable securities.

Cash and cash equivalents are deposited with major financial institutions in Europe, the United States, Japan, Australia, Singapore, Hong Kong, Brazil, Vietnam and Israel.

The Company performs ongoing credit evaluations of the financial condition of its customers. The risk of collection associated with trade receivables is reduced by the large number and geographical dispersion of the Company's customer base and the Company's policy of requiring collateral or security with respect to receivables due from distributors.

The marketable securities held by the Company are highly rated corporate bonds, see also Note 5B.

**T. Comprehensive income**

In addition to net profit, comprehensive income includes unrealized gains or losses arising from marketable securities classified as available-for-sale.

**U. Fair value measurements**

The Company's financial instruments include mainly cash and cash equivalents, accounts receivable, short and long term investments, contingent consideration in respect of business combination, marketable securities, derivative financial instruments and accounts payable. The carrying amounts of these financial instruments approximate their fair value.

The Company implements ASC Topic 820 "Fair Value Measurements and Disclosures" ("ASC 820") for fair value measurements of financial assets and financial liabilities and for fair value measurements of nonfinancial items that are recognized or disclosed at fair value in the financial statements. ASC 820 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.

Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 inputs are unobservable inputs for the asset or liability. (For details see Note 15).

*Derivative financial instruments*

The Company enters into forward exchange contracts to hedge certain anticipated transactions which are expected to be denominated in non-dollar currencies. These derivatives are not designated as hedging instruments for accounting purposes. The derivatives are recognized on the balance sheet at their fair value. Changes in the fair value are recognized in the consolidated statement of income as 'financial income – net'.

**Given Imaging Ltd. and its Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
(In thousands)

**Note 1 - Organization and Summary of Significant Accounting Policies (cont'd)**

**V. Business combinations**

The Company accounts for business combinations under the revised principles of ASC Topic 805 ("ASC 805"), Business Combinations, related to business combinations and non-controlling interests. ASC 805 requires recognition of assets acquired, liabilities assumed, and non-controlling interest in the acquiree at the acquisition date, measured at their fair values as of that date. ASC 805 also requires the fair value of acquired in-process research and development ("IPR&D") to be recorded as intangibles with indefinite lives, contingent consideration to be recorded on the acquisition date (with subsequent adjustments recognized in the consolidated statement of income), and restructuring and acquisition-related deal costs to be expensed as incurred. In addition, changes in valuation allowance related to acquired deferred tax assets and changes in acquired income tax positions are to be recognized in earnings.

The Company applied the revised principles to the acquisition of SmartPill in 2012 (see Note 16C, for details).

**W. Recently issued accounting standards**

In July 2013, the FASB issued ASU No. 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. ASU No. 2013-11 requires an entity to present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except to the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. No new recurring disclosures are required. The amendments are effective for annual and interim reporting periods beginning on or after December 15, 2013 and are to be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. The adoption of ASU No. 2013-11 is not expected to have a material impact on the Company's consolidated financial statements.

**Note 2 - Cash and Cash Equivalents**

	<b>December 31,</b>	
	<b>2013</b>	<b>2012</b>
Cash and cash equivalents consist of balances denominated in the following currencies:		
U.S. Dollars	\$ 28,925	\$ 23,846
New Israeli Shekels	3,822	3,424
Euros	5,501	3,968
Japanese Yen	3,561	3,050
Other	2,327	1,154
	<b>\$ 44,136</b>	<b>\$ 35,442</b>

**Given Imaging Ltd. and its Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
(In thousands)

**Note 3 - Accounts Receivable - Other**

	December 31,	
	2013	2012
Government institutions	\$ 2,291	\$ 2,662
Receivables for issuance of equity	2,754	-
Other	1,772	1,992
	<u>\$ 6,817</u>	<u>\$ 4,654</u>

**Note 4 - Inventories**

	December 31,	
	2013	2012
Raw materials and components	\$ 12,738	\$ 12,744
Work-in-progress	6,790	5,846
Finished goods	11,401	10,151
	<u>\$ 30,929</u>	<u>\$ 28,741</u>

Inventories are presented among:

	December 31,	
	2013	2012
Current assets	\$ 26,451	\$ 22,591
Non-current assets	4,478	6,150
	<u>\$ 30,929</u>	<u>\$ 28,741</u>

*Non-current Inventory:*

At December 31, 2013, \$4,478 of the Company's components inventory is in excess of requirements for the year 2013 based on management's estimate of sales. This long term components inventory is mainly comprised of imaging sensor and transmitter of its PillCam capsules and raw material used for the production of new products. Management believes that this amount will be utilized according to its forecasted sales.

**Given Imaging Ltd. and its Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
(In thousands)

**Note 5 - Short-term Investments and Marketable Securities**

**A. Short-term investments and marketable securities**

As of December 31, 2013 and 2012, short-term investments consist of:

	<b>December 31,</b>	
	<b>2013</b>	<b>2012</b>
Available-for-sale securities	\$ 14,160	\$ 2,446
Bank deposits	76,155	56,000
<b>Total</b>	<b>\$ 90,315</b>	<b>\$ 58,446</b>

**B. Available-for-sale marketable securities**

As of December 31, 2013 and 2012, marketable securities consist of corporate bonds only.

During 2013, the Company recorded \$251 of realization and adjustments of unrealized losses from corporate bonds. Proceeds from the sale and maturity of available-for-sale securities were \$14,057 in 2013; net realized losses included in finance income in 2013 were \$180 (net realized gains included in finance income in 2012 - \$191; in 2011 - \$76).

The carrying amount, gross unrealized holding gains, gross unrealized holding losses, and fair value marketable securities classified as available-for-sale at December 31, 2013 and 2012 are as follows:

	<b>Carrying amount</b>	<b>Gross unrealized holding gains</b>	<b>Gross unrealized holding (losses)</b>	<b>Fair value</b>
At December 31, 2013	\$ 47,174	\$ 123	\$ (108)	\$ 47,189
At December 31, 2012	\$ 32,368	\$ 295	\$ (29)	\$ 32,634

Maturities of debt securities classified as available-for-sale at December 31, 2013 were as follows:

	<b>Carrying amount</b>	<b>Fair value</b>
Current maturities	\$ 14,129	\$ 14,160
Due after one year through three years	33,045	33,029
	\$ 47,174	\$ 47,189

At December 31, 2013, all marketable securities which were in an unrealized loss position, had been in such a position for less than 12 months.

**Given Imaging Ltd. and its Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
(In thousands)

**Note 6 - Fixed Assets, Less Accumulated Depreciation**

	December 31,	
	2013	2012
Computers and software	\$ 14,513	\$ 13,633
Instruments and laboratory equipment	1,591	1,494
Leasehold improvements	6,526	6,338
Motor vehicles	31	140
Machinery and equipment	19,855	20,035
Communication equipment	649	558
Office furniture and equipment	2,654	2,550
<b>Fixed assets, at cost</b>	<b>45,819</b>	<b>44,748</b>
<b>Accumulated depreciation</b>	<b>(35,047)</b>	<b>(32,413)</b>
<b>Fixed assets at cost, less accumulated depreciation</b>	<b>\$ 10,772</b>	<b>\$ 12,335</b>

Depreciation expenses for the years ended December 31, 2013, 2012 and 2011 were \$4,093, \$4,213 and \$4,550, respectively. During 2013, the Company wrote off fixed assets which were no longer in use. This resulted in a charge of \$277 recorded in 'operating expenses – other' in the consolidated statement of income.

As of December 31, 2013 and 2012, the cost of fixed assets under capital lease was \$498 and \$607, and the accumulated depreciation for year ended December 31, 2013 and 2012 was \$466 and \$484, respectively.

**Note 7 - Intangible Assets, Less Accumulated Amortization**

	December 31,	
	2013	2012
Patents and trademarks	\$ 16,630	\$ 16,222
Web site development	2,107	1,821
Software development	647	647
IPR&D acquired in a business combination	5,306	5,306
Patents and technology acquired in business combinations	15,667	15,667
Trademarks and trade names acquired in business combinations	4,020	4,020
Customer relationships acquired in business combinations	3,616	3,556
<b>Intangible assets, at cost</b>	<b>47,993</b>	<b>47,239</b>
<b>Accumulated amortization</b>	<b>(21,089)</b>	<b>(16,534)</b>
<b>Intangible assets, less accumulated amortization</b>	<b>\$ 26,904</b>	<b>\$ 30,705</b>

Amortization expenses for the years ended December 31, 2013, 2012 and 2011 were \$ 4,725, \$4,384 and \$3,746, respectively. Estimated amortization expenses for the next five years are: \$4,633 in 2014, \$4,477 in 2015, \$4,355 in 2016, \$3,431 in 2017 and \$2,547 in 2018. During 2013, the Company wrote off patents, trademarks and software development which are no longer expected to be used. This resulted in a charge of \$298 recorded in 'operating expenses – other' in the consolidated statements of income.

**Given Imaging Ltd. and its Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
(In thousands)

**Note 8 - Commitments and Contingencies**

**A. Leases**

The Company and its subsidiaries lease office space and manufacturing space for periods of up to 11 years (including options to extend the terms of the leases). The current lease for the Company's headquarters is in Yoqneam, Israel. This facility houses the Company's corporate headquarters, research and development and manufacturing facilities. Under this lease agreement, the Company will pay approximately \$1,775 a year in rent and management fees. These payments are linked to the NIS and subject to adjustments based on changes in the Israeli Consumer Price Index. In addition, to secure its obligations under the lease, the Company provided bank guarantees in the amount of approximately \$788 in favor of the lessor. The lease expires on December 31, 2015. The Company has an option to extend the lease until December 31, 2020.

Rental expenses under the lease agreements for the years ended December 31, 2013, 2012 and 2011 was \$ 5,876, \$4,976 and \$5,311, respectively.

**B. Agreements with key single - source suppliers and commitments to suppliers**

(1) The Company has agreements with a number of single source suppliers for some of the components necessary for the production of its products. For example, the Company has sole suppliers for the imaging sensor and transmitter of its PillCam capsules and the data recorder unit of the Bravo system.

The Company relies on other single source suppliers with whom it does not have long term contracts for some other components necessary for the production of its products, such as the electrical circuit boards used in the PillCam and Bravo capsules and for computer workstations.

Purchases under such agreements with the suppliers for the years ended December 31, 2013, 2012 and 2011 were \$16,169, \$15,690 and \$8,376, respectively.

(2) The Company's annual commitments under agreements with single source and other suppliers for the next 5 years are as follows:

2014	\$ 10,203
2015	2,398
2016	3,295
2017	3,624
2018 and beyond	-
	<u>\$ 19,520</u>

**C. Office of the Chief Scientist Grants**

The Company's research and development efforts have been partially financed through royalty-bearing grants from OCS. In return for the OCS's participation, the Company is committed to pay royalties to the Israeli Government at the rate of 3%-5% of the sales of its product, up to 100% of the amount of the grants received plus LIBOR interest. The Company is entitled to the grants only upon incurring research and development expenditures. There are no future performance obligations related to the grants received from the OCS. However, under certain limited circumstances, the OCS may withdraw its approval of a research program or amend the terms of its approval. Upon withdrawal of approval, the grant recipient may be required to refund the grant, in whole or in part, with or without interest, as the OCS determines. The Company received from the OCS a total cumulative amount of \$1,528 which is the total outstanding obligation for royalty-bearing grants as of December 31, 2013.

**Given Imaging Ltd. and its Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
(In thousands)

**Note 8 - Commitments and Contingencies (cont'd)**

**D. Non-Exclusive Patent License Agreement**

In August 2012, the Company entered into a non-exclusive patent license agreement with a third party. Under this license agreement, the Company licensed on a non-exclusive basis a portfolio of patents related to research and development activity of the Company. In consideration for this license, the Company paid EURO 1 million upon signing the agreement and may be obligated to pay royalties of up to EURO 8 million if the Company commercializes products in the field covered by the licensed patents. The Company does not anticipate royalty payments in the foreseeable future.

**E. Litigation**

- (1) From time to time, as a result of the nature of its business, the Company is subject to actual or threatened litigation. Based on consultation with counsel, management believes that the potential exposure to the Company from such actual or threatened litigation as of December 31, 2013 is remote or immaterial. Accordingly, no provision has been made in the Company's financial statements for any of such claims.
- (2) The Company has an outstanding loan to a U.S. corporation in an amount of approximately \$700 (including accrued and unpaid interest) as of December 31, 2013. The loan was provided in connection with a business relationship with the U.S. corporation that the Company has terminated in July 2012. The U.S. corporation has disputed the right of the Company to terminate the relationship and has asserted claims for damages of at least \$200 million against the Company in connection therewith. As of the date of these financial statements, no law suit has been filed against the Company with respect to this matter. Management believes that these claims are baseless and that the potential exposure to the Company from the asserted claims is remote. Accordingly, no provision has been made in the Company's financial statements.

**F. Registration Rights Agreement**

In November 2011, an Amended and Restated Registration Rights Agreement among the Company, Elron Electronic Industries ("Elron"), Discount Investment Corporation ("DIC") and Rafael Development Corporation ("RDC") was approved at a special meeting of the Company's Shareholders. As of December 31, 2013, Elron, DIC and RDC collectively owned an aggregate of 45.6% of the Company's ordinary shares and are collectively referred to as the "affiliated shareholders." This Amended and Restated Registration Rights Agreement has amended and restated a similar agreement among us and the affiliated shareholders that had been entered into in 2007. The 2007 agreement replaced earlier registration rights granted by the Company to Elron, DIC, RDC, entities affiliated with OrbiMed Capital LLC and other shareholders in connection with a private placement of our ordinary shares completed in September 2000, before our initial public offering. These earlier registration rights expired in October 2006.

Under this agreement, at the request of one or more of the affiliated shareholders holding at least 5% of the Company's then outstanding ordinary shares, the Company must use its best efforts to register any or all of these shareholders' ordinary shares to the extent that the aggregate offering price of the shares to be registered is at least \$15 million. In addition, the affiliated shareholders also have the right to request that the Company include their ordinary shares in any registration statements filed by the Company in the future for the purpose of a public offering, subject to specified limitations. With respect to any shareholder, registration rights will expire if that shareholder can sell all of its ordinary shares within a 90 day period under Rule 144 under the United States Securities Act of 1933, as amended. Generally, the Company is obligated to pay all expenses incurred in carrying out the above registrations, as well as the fees and expenses of one legal counsel for the selling shareholders in each registration.

The 2011 Amended and Restated Registration Rights Agreement extended the affiliated shareholders' registration rights until July 18, 2017 and provides relief from certain requirements and financial thresholds necessary to trigger registration rights to the benefit of lending institution to which any of the affiliated shareholders pledge its respective shares in the Company in connection with any credit line or loan provided to the affiliated shareholders. Finally, the Company has agreed that each of the affiliated shareholders could require that any registration be a shelf registration under Rule 415 under the United States Securities Act of 1933, and to maintain such a shelf registration for the maximum possible time.



**Given Imaging Ltd. and its Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
(In thousands)

**Note 9 - Accounts Payable – Other**

	December 31,	
	2013	2012
Government institutions	\$ 4,883	\$ 5,782
Liabilities relating to employees	18,068	15,665
Advances from customers	50	196
Warranty	709	573
Commissions	1,063	1,291
Accrued expenses	4,170	3,584
	\$ 28,943	\$ 27,091

**Note 10 - Liability in Respect of Employee Severance Payments**

Under Israeli law and labor agreements the Company is required to pay severance payments to each employee who was employed by the Company for over one year and has been terminated by the Company or resigned under certain specified circumstances. The Company's liability for these severance payments is covered mainly by deposits with insurance companies in the name of the employee and/or by purchase of insurance policies. The liability related to these severance payments is calculated on the basis of the latest salary of the employee multiplied by the number of years of employment as of the balance sheet date. The liability for employee severance payments included in the balance sheet represents the total amount due for such severance payment, while the assets held for severance benefits included in the balance sheet represents the Company's contributions to insurance policies. The Company may make withdrawals from the funds only upon complying with the Israeli severance pay law or labor agreements. In respect of certain Israeli employees, the Company obtained 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 with the insurance companies exempt the Company from any additional obligation to these employees for whom the said depository payments are made.

Expenses recorded in respect of employees' severance payments for the years ended December 31, 2013, 2012 and 2011 are \$1,399, \$1,125 and \$1,471, respectively.

The U.S. subsidiaries have a defined contribution retirement plan for their employees. Employees are allowed to contribute up to 18% of their salary in any one year, subject to a regulatory limit. The Company contributes 3% of an employee's salary subject to regulatory limits. Employees are vested in the Company's contributions after 30 days of employment. Expenses recorded in respect of the defined contribution retirement plan in the U.S for the years ended December 31, 2013, 2012 and 2011 are \$1,111, \$1,089 and \$1,157, respectively.

**Given Imaging Ltd. and its Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
(In thousands)

**Note 11 - Equity**

**A. Ordinary shares**

All of the issued and outstanding Ordinary Shares of the Company are authorized and fully paid. The Ordinary Shares of the Company are not redeemable and have no preemptive rights. The ownership or voting of Ordinary Shares by non-residents of Israel is not restricted in any way by the Company's memorandum or articles of association or the laws of the State of Israel, except that citizens of countries (including corporations incorporated in countries) which are considered under the applicable law as "enemy states" of Israel may not be recognized as owners of Ordinary Shares.

**B. Employees' and non employees' stock options**

The Company has three active equity plans:

The newest plan is the 2009 Equity Incentive Plan. The 2009 equity plan permits the Company to grant a number of equity instruments, such as options, restricted stock, restricted stock units and stock appreciation rights to eligible employees, directors and consultants. Stock option awards under this plan must be granted at no less than the fair market value of our ordinary shares on the date of the grant and the term of the awards may not exceed ten years. Shares underlying equity awards that have been cancelled or forfeited return to the pool of equity units are also available for grant under the plan. As of December 31, 2013, there were outstanding under this plan 337,533 restricted share units, or RSUs. No other types of equity units are outstanding under the 2009 plan.

Generally, awards vest over a four-year period beginning with the first or second anniversary of the grant. The Company's Compensation and Nominating Committee has the authority to grant awards with different vesting terms and to accelerate the time periods for the vesting of awards. To the extent the awards have vested, they may be exercised in whole or in part from time to time until their expiration.

Upon the termination of employment or service of participating employees and consultants, all unvested awards are cancelled. All vested awards may be exercised within 180 days following termination, except if termination of employment is due to specified circumstances such as death or disability of a plan participant, in which case vested awards may be exercised within one year following termination. All vested awards not exercised within this period are automatically cancelled. Unvested awards to non-employee directors whose service is terminated or discontinued for any reason other than for cause and who have been members of our board of directors for more than five years, will automatically vest and become exercisable immediately prior to termination or discontinuation of service. These vested awards may be exercised within 180 days following termination of service, except in cases of where termination or discontinuation of service is a result of statutory requirements, death, disability or other circumstances of forced cessation of service, in which case awards may be exercised at any time until their expiration date. In a case of termination for cause of a plan participant, all awards, whether vested or unvested, are automatically cancelled or forfeited, respectively.

Under the 2009 equity plan, in the event of an acquisition, merger or other share exchange in which the Company is not the surviving entity and the acquiring entity does not agree to assume the awards, all outstanding, but unvested, awards of each plan participant having been employed by the Company at least one year, will be accelerated and exercisable, ten days prior to the completion of the acquisition, merger or share exchange. In addition, if the employment of a particular holder of outstanding awards is terminated by the Company as of or during the 12-month period following a change in control (as defined in the 2009 equity plan), all unvested awards of such holder will be automatically accelerated and exercisable, subject to certain adjustments and exceptions. Upon the completion of the acquisition by Covidien described in Note 1A above, this mechanism was carried out.

Awards granted under the 2009 equity plan to Israeli residents may be granted under Section 102 of the Israeli Income Tax Ordinance pursuant to which the awards or the ordinary shares issued upon their exercise must be deposited with a trustee for at least two years following the date of the grant. Under Section 102, any tax payable by an employee from the grant or exercise of the awards is deferred until the transfer of the awards or ordinary shares by the trustee to the employee or upon the sale of the awards or ordinary shares.

**Given Imaging Ltd. and its Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
(In thousands)

**Note 11 - Equity (cont'd)**

**B. Employees' and non employees' stock options (cont'd)**

Awards granted under Section 102 may qualify for certain tax benefits under the Israeli Tax Ordinance.

Stock options granted under the plan to U.S. residents may also qualify as incentive stock options within the meaning of Section 422 of the U.S. Internal Revenue Code of 1986, as amended. The exercise price for incentive stock options must not be less than the fair market value on the date the option is granted, or 110% of the fair market value if the option holder holds more than 10% of our share capital.

The Company also has an equity plan entitled the 2006 Equity Incentive Plan. The terms of the 2006 plan are identical to the terms of the 2009 equity plan. The Company has reserved for issuance a total of 4,000,000 Ordinary Shares under the 2006 Plan.

As of December 31, 2013 there were 1,322,027 options outstanding under the 2006 Plan.

The Company's 2003 stock option plan was materially amended in February 2012 and renamed the Amended and Restated 2003 Equity Incentive Plan, and is currently identical to the 2009 plan. Previously, the 2003 stock option plan only permitted the grant of stock options. The Company has reserved for issuance a total of 2,500,000 Ordinary Shares under the 2003 Plan. As of December 31, 2013, there were outstanding options to purchase 854,240 ordinary shares and 449,682 RSUs under the 2003 stock option plan. Stock option awards under this plan had been granted at no less than the fair market value of the Company's ordinary shares on the date of the grant and the term of the awards does not exceed ten years. The 2003 stock option plan has expired on February 12, 2013 and no equity grants will be made under this plan after this date. However, outstanding awards may be exercised until their expiration date.

Options

The following table summarizes information relating to stock options for Ordinary Shares outstanding, as of December 31, 2013 and 2012:

<b>Exercise prices</b>	<b>Options outstanding as of December 31, 2013</b>	
	<b>Number outstanding</b>	<b>Weighted average remaining contractual life (in years)</b>
\$1 - \$10	296,426	1.29
\$10.01-\$20	350,950	1.17
\$20.01-\$30	1,029,451	0.95
\$30.01-\$40	499,440	0.79
	<b>2,176,267</b>	

<b>Exercise prices</b>	<b>Options outstanding as of December 31, 2012</b>	
	<b>Number outstanding</b>	<b>Weighted average Remaining contractual life (in years)</b>
\$1 - \$10	704,792	1.93
\$10.01-\$20	1,714,775	1.45
\$20.01-\$30	1,822,472	1.50
\$30.01-\$40	499,440	1.90
	<b>4,741,479</b>	

**Given Imaging Ltd. and its Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
(In thousands)

**Note 11 - Equity (cont'd)**

**B. Employees' and non employees' stock options (cont'd)**

The stock option activity under the Plans is as follows:

	<u>Number of shares</u>	<u>Weighted average exercise price</u>	<u>Weighted average grant date fair value</u>
<b>Balance at January 1, 2013</b>	4,741,479	\$ 21.16	\$ 9.70
Exercised	(1,699,722)	\$ 15.94	\$ 7.70
Forfeited	(865,490)	\$ 22.44	\$ 9.08
<b>Balance at December 31, 2013</b>	<u>2,176,267</u>	\$ 24.73	\$ 11.51
<b>Exercisable at December 31, 2013</b>	<u>2,176,267</u>	\$ 24.73	\$ 11.51

As of December 31, 2013, all options are vested

The aggregate intrinsic value of options outstanding as of December 31, 2013, 2012 and 2011 is \$14,741, \$8,878 and \$10,944, respectively. The aggregate intrinsic value of options exercisable as of December 31, 2013, 2012 and 2011 is \$14,741, \$7,116 and \$6,946, respectively.

The total intrinsic value of options exercised during the year ended December 31, 2013 and 2012, is \$ 14,877 and \$2,079, respectively.

*RSUs*

The following table summarizes information relating to RSUs as of December 31, 2013 and related changes during the year ended December 31, 2013:

	<u>Number of shares</u>	<u>Weighted average grant date fair value</u>
<b>Non-vested RSUs</b>		
<b>Balance at January 1, 2013</b>	811,041	\$ 18.30
Granted	<b>306,922</b>	<b>\$ 16.68</b>
Vested	<b>(298,048)</b>	<b>\$ 18.13</b>
Forfeited	<b>(32,700)</b>	<b>\$ 18.29</b>
<b>Balance at December 31, 2013</b>	<u><b>787,215</b></u>	<u><b>\$ 17.73</b></u>

The aggregate intrinsic value of RSUs granted during 2013, 2012 and 2011 is \$5,120, \$6,004 and \$6,600, respectively.

During 2013 the Company granted 252,909 RSUs to employees and non-employees. 50% of the RSUs vest on the second anniversary of the date of grant, and 25% vest on each of the third and fourth anniversaries of the date of the grant. 23,548 RSUs were granted to the Company's two external directors, which will be fully vested on the first anniversary of the grant date, and 30,465 RSUs were granted to other non-employee directors vesting one-third on each of the first three anniversaries of the grant date. The fair value of the RSUs as of the date of grant is amortized over the vesting period. Unrecognized compensation costs related to the RSUs as of December 31, 2013, to be recognized over a weighted average period of 1.17 years, were \$8.7 million, and compensation expenses of \$5.4 and \$5.3 million were recognized in the years ended December 31, 2013 and 2012, respectively.

*Total compensation costs*

The following table summarizes the allocation of the stock-based compensation charge for both employee and non-employee stock option grants:

	<u>Year ended December 31,</u>		
	<u>2013</u>	<u>2012</u>	<u>2011</u>
Selling and marketing expenses	<u>1,931</u>	1,985	2,175
General and administrative expenses	<u>2,870</u>	3,449	4,480
	<u>\$ 5,598</u>	\$ 6,158	\$ 7,363

**Given Imaging Ltd. and its Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
(In thousands)

**Note 12 - Revenues**

**A. Revenues by product lines**

	Year ended December 31,		
	2013	2012	2011
Workstations, recorders and software	\$ 10,347	\$ 7,533	\$ 9,060
PillCam SB capsule	120,453	116,618	117,561
PillCam ESO capsule	296	269	425
PillCam Colon capsule	2,664	1,981	1,798
Patency capsules and scanners	926	906	792
Bravo pH monitoring products	18,090	17,677	19,746
GIL A manometry and catheters	35,074	34,704	28,460
SmartPill systems and capsules	2,672	594	-
Services	247	219	113
	<u>\$ 190,769</u>	<u>\$ 180,501</u>	<u>\$ 177,955</u>

**B. Revenues by geographic areas**

	Year ended December 31,		
	2013	2012	2011
Americas	\$ 117,354	\$ 115,168	\$ 108,745
Europe, Middle East and Africa (mainly Europe)	48,757	42,911	45,122
Asia Pacific	24,658	22,422	24,088
	<u>\$ 190,769</u>	<u>\$ 180,501</u>	<u>\$ 177,955</u>

Most of the Company's long-lived assets are located in Israel.

**Note 13 - Financial Income, net**

	Year ended December 31,		
	2013	2012	2011
Currency gains, net	\$ 5	\$ 61	\$ 650
Income from marketable securities and deposits	705	1,599	1,347
Bank charges and other	(619)	(813)	(654)
	<u>\$ 91</u>	<u>\$ 847</u>	<u>\$ 1,343</u>

The Company uses forward contracts and option strategies to manage its foreign exchange rate exposures. Contracts with notional amounts of \$20.3 million, \$37.7 million and \$64.7 million and with estimated fair values that totaled \$ 300, \$212 and \$1,431 as of December 31, 2013, 2012 and 2011, respectively, were not designated as hedging instruments for accounting purposes. The changes in fair value of these contracts of \$ 88, \$(1,219) and \$(1,563) for the years ended December 31, 2013, 2012 and 2011 have been recognized as finance income (loss) in those years among "currency gains, net". The periodic net cash settlements totaled \$1,203, \$1,995 and \$1,617 for the years ended December 31, 2013, 2012 and 2011, respectively.

**Given Imaging Ltd. and its Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
**(In thousands)**

**Note 14 - Taxes on Income**

**A. Israeli Taxation**

- (1) Israeli income tax is computed on the basis of the Company's results in New Israeli Shekels ("NIS") determined for statutory purposes.

Pursuant to the Encouragement Capital Investments Law -1959 (the "Law"), the Company was awarded "Approved Enterprise" status under the government alternative benefits path ("Alternative Path") beginning in 1999, upon completion of the project as approved by the Investment Center. The program is for investments in the development of infrastructure and for investments in locally produced and imported equipment. The main benefits to which the Company will be entitled, if it implements all the terms of an approved program, are the exemption from tax on income deriving from an Approved Enterprise, and reduced tax rates on dividends originating from this income (if distributed within a certain time limit).

Under the Alternative Path, the income derived from an Approved Enterprise will be exempt from tax for a ten-year period, commencing on the date that taxable income is first generated by the Approved Enterprise (limited to the earlier of a maximum period of 12 years from the year of commencement of operations or 14 years from the year the approval letter was received).

Dividend distributions originating from income of an Approved Enterprise will be subject to a withholding tax at the shareholders level at the rate of 15%, provided that the dividend is distributed during the period stipulated under Israeli law.

In the event of a dividend distribution (including withdrawals and charges that are deemed to be dividends) out of the income originating from the Approved Enterprise, and on which the Company received a tax exemption, the distribution is subject to corporate taxes at rates varying from 10% - 25% (currently 25%) depending on the percentage of foreign investment holding in the Company as defined by the Law.

If the Company derives income from sources other than the Approved Enterprise during the relevant period of benefits, such income will be taxable at regular corporate tax rates (see (4) below).

In 2005, an amendment to the Law was enacted (the "2005 Amendment"). Provisions of the 2005 Amendment which apply to the Company are as follows:

- a. Companies that meet the criteria of the Alternative Path of tax benefits will receive those benefits (now called "Beneficiating Enterprise" benefits) without prior approval. In addition, there will be no requirement to file reports with the Investment Center. Companies will be required to notify the Israeli Income Tax Authorities regarding the implementation of the Alternative Path. Audit will take place via the Income Tax Authorities as part of the tax audits. Request for pre-ruling is possible.
- b. Tax benefits of the Alternative Path include lower tax rates or zero tax depending on the investment zone and the path chosen, lower tax rates on dividends and accelerated depreciation.
- c. In order to receive benefits in the Grant Path or the Alternative Path, the Industrial Enterprise must contribute to the economic independence of Israel's economy in one of the following ways:
  1. Its primary activity is in the Biotechnology or Nanotechnology fields and pre-approval is received from the head of research and development at the Office of the Chief Scientist;
  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 foreign market of at least 12 million residents.

**Given Imaging Ltd. and its Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
(In thousands)

**Note 14 - Taxes on Income (cont'd)**

**A. Israeli Taxation (cont'd)**

The 2005 Amendment does not apply retroactively for investment programs having an Approved Enterprise approval certificate from the Investment Center issued up to December 31, 2004 (even when investments under these programs are conducted after January 1, 2005). Consequently, the amendments should not impact an existing Approved Enterprise, which received prior 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 may be as early as 2004. The Company has notified the Israeli Income Tax Authorities as to the expansion of its Approved Enterprise status based on the 2005 Amendment.

(2) The 2010 Amendment to the Law for the Encouragement of Capital Investments – 1959

On December 29, 2010 an amendment to the Law for the Encouragement of Capital Investments – 1959 was approved (hereinafter – “the 2010 Amendment”). The 2010 Amendment was published in the Official Gazette on January 6, 2011. The 2010 Amendment is effective from January 1, 2011 and its provisions will apply to preferred income derived or accrued in 2011 and thereafter by a preferred company, per the definition of these terms in the 2010 Amendment. Companies can choose to not be included in the scope of the 2010 Amendment and to stay in the scope of the Law before its amendment until the end of the benefits period. The 2012 tax year is the last year companies can choose as the year of election, providing that the minimum qualifying investment began in 2010. Accordingly, in 2013 the Company submitted request that 2012 will be a year of election.

The 2010 Amendment also provides that no tax will apply to a dividend distributed out of preferred income to a shareholder that is a company, for both the distributing company and the shareholder. A tax rate of 15% shall continue to apply to a dividend distributed out of preferred income to an individual shareholder or foreign resident, subject to double taxation prevention treaties, similar to the provisions of the existing law. Furthermore, the 2010 Amendment provides relief with respect to tax paid on a dividend received by an Israeli company from profits of an approved/alternative/ beneficiary enterprise that accrued in the benefits period according to the version of the law before its amendment, if the company distributing the dividend elects to notify the tax authorities by June 30, 2015 that it is applying the provisions of the 2010 Amendment and the dividend is distributed after the date of the notice.

As of the December 31, 2012, the Company has not chosen the election of the Amendment to the law, and therefore is currently not entitled to the available relief described above.

(3) An amendment to the Law, which was enacted on November 12, 2012 (the “Trapped Profits Law”) offered reduced corporate income tax rates for a limited period of one year, intended to encourage the distribution of profits derived from tax-exempt income accumulated up to December 31, 2011. The Trapped Profits Law provides a formula, pursuant to which the higher the amount of income a company would be willing to release, the lower would the applicable corporate income tax rate be for that company with respect to such income. In 2013, the Company released Trapped Profits in the amount of \$ 55 million and accordingly paid corporate tax in the amount of \$5.5 million. These profits could be distributed in the future without subjecting the Company to additional corporate tax. In addition according to the Trapped Profits Law the Company would be required to invest \$14.5 million in the Industrial Enterprise over the next five years.

**Given Imaging Ltd. and its Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
(In thousands)

**Note 14 - Taxes on Income (cont'd)**

**A. Israeli Taxation (cont'd)**

- (4) As of December 31, 2013, out of the Company's retained earnings, after the release of the Trapped Profits abovementioned, approximately \$25 million are tax-exempt earnings attributable to its approved and Beneficiating Enterprise. The tax-exempt income attributable to the Approved and Beneficiating Enterprises cannot be distributed to shareholders without subjecting the Company to taxes. If these retained tax-exempt profits are distributed, the Company would be taxed at the reduced corporate tax rate applicable to such profits (currently- 25% pursuant to the implementation of the Investment Law).
- (5) On July 14, 2009, the Knesset (the Israeli parliament) passed the Economic Efficiency Law (Legislation Amendments for Implementation of the 2009 and 2010 Economic Plan) - 2009, which provided, inter-alia, an additional gradual reduction in the regular company tax rate to 18% as from the 2016 tax year. In accordance with the aforementioned amendments, the regular company tax rates applicable as from the 2009 tax year are as follows: in the 2009 tax year- 26%, in the 2010 tax year - 25%, in the 2011 tax year - 24%, in the 2012 tax year - 23%, in the 2013 tax year - 22%, in the 2014 tax year - 21%, in the 2015 tax year - 20% and as from the 2016 tax year the regular company tax rate will be 18%. The aforementioned change in the tax rates had no material impact on the Company's financial position or results of operations, since the Israeli company is currently tax exempt as explained above.
- On December 5, 2011 the Knesset approved the Law to Change the Tax Burden (Legislative Amendments) – 2011. According to the law, the tax reduction that was provided in the Economic Efficiency Law, as aforementioned, will be cancelled and the regular company statutory tax rate will be 25% as from 2012. On August 5, 2013 the Knesset passed the Law for Changes in National Priorities (Legislative Amendments for Achieving Budget Objectives in the Years 2013 and 2014) – 2013, by which, inter alia, the corporate tax rate would be raised by 1.5% to a rate of 26.5% as from 2014.
- (6) In 2013 and 2012, the Company signed settlement agreements with the Israeli Tax Authorities (ITA) for fiscal years 2008 through 2011 (see also Note 14F below).
- (7) As of December 31, 2013, the Company has no tax loss carryforwards in Israel except for capital losses of approximately \$41 million which are available to offset future taxable capital gains for indefinite period. The Company has not recorded deferred tax assets on behalf of these capital losses, since management believes it is more likely than not that these deferred tax assets will not be realized.

**B. Foreign subsidiaries**

As of December 31, 2013, the Company's subsidiaries had accumulated net operating loss carryforwards totaling approximately \$19,651. Operating loss carryforwards in the Japanese subsidiary, totaling approximately \$4,023, will expire between 2014-2020. Operating loss carryforwards in the German, French and Brazilian subsidiaries amounted to approximately \$11,641, \$2,870 and \$1,117, respectively, and can be carried forward indefinitely.



**Given Imaging Ltd. and its Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
(In thousands)

**Note 14 - Taxes on Income (cont'd)**

**C. Profit before tax and income tax benefit (expense) included in the consolidated statements of income**

	Year ended December 31,		
	2013	2012	2011
<u>Profit before taxes on income and non controlling interest:</u>			
Israel	\$ 7,691	\$ 9,231	\$ 6,598
Foreign jurisdiction	6,720	5,485	7,729
	<u>14,411</u>	<u>14,716</u>	<u>14,327</u>
<u>Current tax benefit (expense):</u>			
Israel	(4,161)	84	(1,002)
Foreign jurisdiction	(3,175)	(2,338)	(1,565)
	<u>(7,336)</u>	<u>(2,254)</u>	<u>(2,567)</u>
<u>Deferred taxes (see Note 14D):</u>			
Israel	-	-	-
Foreign jurisdiction	2,441	1,795	409
	<u>2,441</u>	<u>1,795</u>	<u>409</u>
Income tax expense	<u>\$ (4,895)</u>	<u>\$ (459)</u>	<u>\$ (2,158)</u>

**D. Deferred taxes**

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers projected future taxable income and tax planning strategies in making this assessment.

Based upon projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not that the Company will realize the benefits of these deductible differences, net of the existing valuation allowances at December 31, 2013. The amount of the deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carryforward period are reduced.

The tax effects of significant items comprising the Company's deferred taxes:

	December 31,	
	2013	2012
<u>Deferred tax assets:</u>		
Tax loss carryforwards of subsidiaries	\$ 10,921	\$ 12,120
Other timing differences	3,498	2,643
Total gross deferred tax assets	14,419	14,763
Valuation allowance	(10,338)	(12,117)
Net deferred tax assets	<u>\$ 4,081</u>	<u>\$ 2,646</u>
Long term deferred tax liabilities - intangible assets acquired in business combination	<u>\$ (3,669)</u>	<u>\$ (4,675)</u>

**Given Imaging Ltd. and its Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
(In thousands)

**Note 14 - Taxes on Income (cont'd)**

**D. Deferred taxes (cont'd)**

Deferred tax assets are presented among:

	December 31,	
	2013	2012
Current assets	\$ 3,879	\$ 2,646
Other long term assets	202	-
	<u>\$ 4,081</u>	<u>\$ 2,646</u>

The changes in the valuation allowance are comprised as follows:

	Year ended December 31,		
	2013	2012	2011
Balance at beginning of year	\$ 12,117	\$ 13,135	\$ 15,111
Adjustments to the beginning-of-the- year balance resulting from a change in circumstances that causes a change in judgment about the realizability of the related deferred tax asset in future years	(640)	(239)	-
Utilization of tax losses for which deferred taxes were not created in prior years and additions of losses during the year	(164)	(779)	(1,976)
Changes due to tax assessments and statute of limitations	(975)	-	-
Balance at end of year	<u>\$ 10,338</u>	<u>\$ 12,117</u>	<u>\$ 13,135</u>

**E. Reconciliation of statutory tax expense to actual income tax expense**

	Year ended December 31,		
	2013	2012	2011
Profit before taxes on income	\$ 14,411	\$ 14,716	\$ 14,327
Tax rate	25%	25%	24%
Computed expected tax expense	(3,603)	(3,679)	(3,438)
Tax benefits arising from Approved Enterprises	2,765	2,717	1,584
Changes in unrecognized tax benefits	1,447	48	(1,471)
Permanent differences and other	(350)	(77)	(311)
Change in valuation allowance	804	1,018	1,976
Foreign tax rate differential	(499)	(486)	(498)
Tax in respect of release of Trapped Profits (see Note 14A(3))	(5,459)	-	-
Income tax expense	<u>\$ (4,895)</u>	<u>\$ (459)</u>	<u>\$ (2,158)</u>

**Given Imaging Ltd. and its Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
(In thousands)

**Note 14 - Taxes on Income (cont'd)**

**F. Accounting for income tax uncertainties**

The Company and its subsidiaries file income tax returns in Israel, the U.S and other foreign jurisdictions. The U.S. subsidiary files income tax returns in federal jurisdictions, and various states within the U.S. The Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2008.

A reconciliation of the beginning and ending amount of unrecognized tax benefits based on the provisions of FASB ASC Subtopic 740-10, is as follows:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Balance at January 1	\$ 3,793	\$ 5,301	\$ 3,991
Additions based on tax positions related to the current year	12	236	1,479
Reductions for tax positions of prior years	(1,258)	(204)	(169)
Settlements	(211)	(1,540)	-
Balance at December 31	<u>\$ 2,336</u>	<u>\$ 3,793</u>	<u>\$ 5,301</u>

Unrecognized tax benefits in the amount of \$2,336 if recognized, would affect the effective tax rate of the Company. The Company does not expect unrecognized tax benefits to change significantly over the next 12 months.

During the years ended December 31, 2013, 2012 and 2011 the Company recorded approximately \$(201) \$(80) and \$161, respectively in interest relating to unrecognized tax benefits in the consolidated statements of income and accrued \$33 and \$405 in the balance sheets as of December 31, 2013 and 2012, respectively.

**Given Imaging Ltd. and its Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
(In thousands)

**Note 15 - Fair Value of Financial Instruments**

The level in the fair value hierarchy within which a fair measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

The following table presents the placement in the fair value hierarchy of assets and liabilities that are measured at fair value on a recurring basis (including items that are required to be measured at fair value and items for which the fair value option has been elected) at December 31, 2013 and 2012:

	December 31, 2013	In active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
<b>Assets:</b>				
Short-term investments	\$ 14,160	\$ 14,160	\$ -	\$ -
Long-term marketable securities	33,029	33,029	-	-
Derivatives	300	-	300	-
<b>Total At December 31, 2013</b>	<b>47,489</b>	<b>47,189</b>	<b>300</b>	<b>-</b>
<b>Liabilities –</b>				
contingent consideration	(1,239)			(1,239)
<b>Total At December 31, 2013</b>	<b>\$ 46,250</b>	<b>\$ 47,189</b>	<b>\$ 300</b>	<b>\$ (1,239)</b>
	December 31, 2012	In active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
<b>Assets:</b>				
Short-term investments	\$ 2,446	\$ 2,446	\$ -	\$ -
Long-term marketable securities	30,188	30,188	-	-
Derivatives	212	-	212	-
<b>Total At December 31, 2012</b>	<b>32,846</b>	<b>32,634</b>	<b>212</b>	<b>-</b>
<b>Liabilities –</b>				
contingent consideration	(1,038)			(1,038)
<b>Total At December 31, 2012</b>	<b>\$ 31,808</b>	<b>\$ 32,634</b>	<b>\$ 212</b>	<b>\$ (1,038)</b>

**Foreign Exchange Contracts**

The Company and its subsidiaries complete transactions in currencies other than their functional currencies. The Company's primary objective with respect to currency risk is to reduce net income volatility that would otherwise occur due to exchange-rate fluctuations. In order to minimize the risk of gain or loss due to exchange rates, the Company uses foreign currency derivatives. As of December 31, 2013, the Company held foreign currency forward contracts aggregating \$1,710 hedging Australian dollar, \$14,071 hedging Euro and \$4,556 hedging Yen. Such instruments had a combined fair value gain of \$300 and \$212 as of December 31, 2013 and 2012, respectively, based on quotations from financial institutions. The Company does not apply hedge accounting. Gains /losses on these instruments are recognized in the consolidated statement of income as 'financial income – net'.

**Given Imaging Ltd. and its Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
(In thousands)

**Note 16 - Acquisitions and Investment**

**A. Investment in the Japanese Subsidiary**

On January 1, 2011, the Company's share in Given Imaging K.K. ("GIKK") was 93% of the total issued and outstanding shares of GIKK.

In March 2012, the Company purchased all of the remaining shares held by the non-controlling shareholders in GIKK for a total consideration of \$658. As a result of this share purchase the Company holds 100% of GIKK.

**B. Marketing Subsidiary in Brazil**

In January 2012, the Company paid \$390 in a combination of cash and cancellation of a credit line in connection with setting up a sales and marketing subsidiary in Brazil. Under the terms of the agreement, the Company paid additional \$210 in January 2013 and \$150 in January 2014. The Company may be obligated to pay up to an additional \$390 if certain conditions and performance milestones are achieved between January 2014 and December 31, 2015.

**C. Acquisition of SmartPill Corporation**

In October 2012, as part of the Company's strategy of expanding its product offerings, the Company acquired from the SmartPill Corporation, a U.S. based-company, the assets related to the SmartPill® GI Monitoring Systems for \$6 million. The purchase agreement also includes an earn-out component, based on sales of the SmartPill product between 2013 and 2016.

The fair value of the contingent consideration arrangement of \$1,038 was estimated based on future earn-out payments discounted to the valuation date using the weighted average cost of capital of 15.2%. That measure is based on significant inputs that are not observable in the market, which ASC Section 820-10-35 refers to as Level 3 inputs. Key assumptions include management's estimation about future sales. As of December 31, 2013 and 2012, only the time-factor had affected the remaining contingent consideration; the range of outcomes and the assumptions used to develop the estimates had not changed.

The Company accounted for the transaction as a business combination. The following table represents the final allocation of the purchase price:

	<b>\$ in thousands</b>
<b>Current assets</b>	<b>\$ 595</b>
Property, plant and equipment	183
<b>Identifiable intangible assets:</b>	
Technological intellectual property (1)	3,105
Business-related intellectual property (2)	302
Goodwill(3)	2,853
<b>Total assets acquired</b>	<b>7,038</b>
<b>Non-current liabilities</b>	<b>(1,038)</b>
<b>Net assets acquired</b>	<b>\$ 6,000</b>

(1) Amortized over a period of 15 years.

(2) Amortized over a period of 7 years.

(3) The goodwill arising from the acquisition represents, inter alia, the synergies between the technology acquired and the Company's existing operational, R&D and sales and marketing infrastructure. The goodwill recognized is expected to be deductible for income tax purposes.

In the fourth quarter of 2012, the Company recorded revenues of \$594 related to SmartPill.

Pro-forma financial statements for SmartPill acquisition have not been furnished as they are immaterial to the understanding of future operations.

**Given Imaging Ltd. and its Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
(In thousands)

**Note 17 - Goodwill**

Goodwill reflects the excess of the purchase price of Smart Pill, GILA and Bravo pH monitoring business acquired in December 2012, April 2010 and December 2008, respectively, over the fair value of net assets.

The Company has set its annual impairment testing date for Given Imaging Functional Diagnostics at December 31, 2013 and 2012 and no impairment charge was recognized.

The changes in the carrying amount of goodwill for the years ended December 31, 2013 and 2012 are as follows:

	<u>December 31,</u>	
	<u>2013</u>	<u>2012</u>
Balance as of January 1		
Goodwill	\$ 26,942	\$ 24,089
Goodwill acquired during the year	-	2,853
Balance as of December 31	<u>\$ 26,942</u>	<u>\$ 26,942</u>

**Note 18 – Subsequent Event**

On February 27, 2014 Covidien announced that it has completed the acquisition of Given Imaging Ltd. Pursuant to the terms of the acquisition agreement, Covidien acquired all of the outstanding shares of Given Imaging, which will now be an indirect wholly-owned subsidiary of Covidien. As a result of the completion, certain executive employees were entitled to a special bonus in the aggregate amount of approximately \$3.5 million and certain advisors were entitled to a success fee in the aggregate amount of approximately \$12 million. These success fees and bonuses were subject to the completion of the merger and accordingly were not provided in the financial statements as of December 31, 2013.

POCARED DIAGNOSTICS LTD.  
(A development stage company)

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2013

U.S. DOLLARS IN THOUSANDS

INDEX

	<u>Page</u>
<a href="#"><u>Report of Independent Auditors</u></a>	P-2
<a href="#"><u>Consolidated Balance Sheets</u></a>	P-3 - P-4
<a href="#"><u>Consolidated Statements of Operations</u></a>	P-5
<a href="#"><u>Statements of Changes in Shareholders' Equity (Deficiency)</u></a>	P-6 - P-8
<a href="#"><u>Consolidated Statements of Cash Flows</u></a>	P-9
<a href="#"><u>Notes to Consolidated Financial Statements</u></a>	P-10 - P-33

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## REPORT OF INDEPENDENT AUDITORS

To the Board of Directors and Shareholders of

### POCARED DIAGNOSTICS LTD. (A development stage company)

We have audited the accompanying consolidated financial statements of Pocared Diagnostics Ltd. (a development stage company) and its subsidiary ("the Company"), which comprise the consolidated balance sheets as of December 31, 2013 and 2012, and the related consolidated statements of operation, changes in share's equity (deficiency) and cash flows for the years then ended, and for the period from January 1, 2005 (inception) through December 31, 2013, and the related notes to the consolidated financial statements.

#### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

#### Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the 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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

#### Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiary as of December 31, 2013 and 2012 and the consolidated results of their operations and their cash flows for the years then ended and for the period from January 1, 2005 (inception) through December 31, 2013, in conformity with United States generally accepted accounting principles.

#### The Company's ability to continue as a Going Concern

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1c to the consolidated financial statements, the Company has recurring losses from operations totaling \$ 10,620 thousand and has a net capital deficiency of \$ 64,815 thousand that raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 1c. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

Tel-Aviv, Israel  
February 25, 2014

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



CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	December 31,	
	2013	2012
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 803	\$ 2,047
Restricted cash	150	99
Inventory	206	802
Accounts receivable	411	222
<b>Total current assets</b>	<b>1,570</b>	<b>3,170</b>
<b>PROPERTY AND EQUIPMENT, NET</b>	<b>837</b>	<b>710</b>
<b>LONG-TERM DEPOSIT</b>	<b>21</b>	<b>16</b>
<b>Total assets</b>	<b>\$ 2,428</b>	<b>\$ 3,896</b>

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

CONSOLIDATED BALANCE SHEETS

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

	December 31,	
	2013	2012
<b>LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIENCY)</b>		
<b>CURRENT LIABILITIES:</b>		
Trade payables	\$ 458	\$ 168
Employees and payroll accruals	308	304
Accrued expenses	399	418
<b>Total current liabilities</b>	<b>1,165</b>	<b>890</b>
<b>LONG-TERM LIABILITIES:</b>		
Convertible loan	1,833	-
<b>CONVERTIBLE PREFERRED SHARES (Note 4)</b>		
Preferred A shares, NIS 0.01 par value; Authorized: 1,500,000 shares at December 31, 2013 and 2012; Issued and outstanding: 1,333,333 shares at December 31, 2013 and 2012	300	300
Preferred B shares, NIS 0.01 par value; Authorized: 1,550,000 shares at December 31, 2013 and 2012; Issued and outstanding: 1,507,341 shares at December 31, 2013 and 2012	1,634	1,634
Preferred C shares, NIS 0.01 par value; Authorized: 1,000,000 shares at December 31, 2013 and 2012; Issued and outstanding: 760,501 shares at December 31, 2013 and 2012	1,280	1,280
Preferred D, D-1, and D-2 shares, NIS 0.01 par value; Authorized: 9,660,000 shares at December 31, 2013 and 2012; Issued and outstanding: 9,573,601 shares at December 31, 2013 and 2012	25,288	25,288
Preferred E shares, NIS 0.01 par value; Authorized: 11,000,000 shares at December 31, 2013 and 2012; Issued and outstanding: 10,413,052 shares at December 31, 2013 and 2012	6,548	6,548
Preferred F shares, NIS 0.01 par value; Authorized: 66,000,000 shares at December 31, 2013 and 44,000,000 at December 31, 2012; Issued and outstanding: 48,302,205 and 37,172,831 shares at December 31, 2013 and 2012, respectively	29,195	22,462
Liquidation preference of Preferred shares at December 31, 2013 amounted to \$ 113,334		
	<b>64,245</b>	<b>57,512</b>
<b>SHAREHOLDERS' EQUITY (DEFICIENCY):</b>		
Ordinary shares, NIS 0.01 par value; Authorized: 113,000,000 shares at December 31, 2013 and 100,000,000 as of December 31, 2012; Issued and outstanding: 2,000,000 shares at December 31, 2013 and 2012	4	4
Additional paid-in capital	1,254	943
Deficit accumulated during the development stage	(66,073)	(55,453)
<b>Total shareholders' deficiency</b>	<b>(64,815)</b>	<b>(54,506)</b>
<b>Total liabilities and shareholders' deficiency</b>	<b>\$ 2,428</b>	<b>\$ 3,896</b>

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

25/2/14 Date of approval of the financial statements	Avi Ludomirski Chairman of the Board	Jonathan Gurfinkel Chief Executive Officer	Michal Mendelevich Levy - Finance Manager
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CONSOLIDATED STATEMENTS OF OPERATIONS

U.S. dollars in thousands

	Year ended December 31,		Period from January 1, 2005 (inception date) through December 31,
	2013	2012	2013
Operating expenses:			
Research and development	\$ 7,601	\$ 4,964	\$ 53,576
Marketing	239	253	736
General and administrative	2,732	1,852	11,060
Operating loss	10,572	7,069	65,352
Financial expenses (income), net	26	(26)	590
Loss before income taxes	10,598	7,043	65,942
Income taxes	22	33	131
Net loss	\$ 10,620	\$ 7,076	\$ 66,073

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

STATEMENTS OF CHANGES IN CONVERTIBLE PREFERRED SHARES AND SHAREHOLDERS' EQUITY (DEFICIENCY)

U.S. dollars in thousands, except share data

	Convertible Preferred shares		Ordinary shares		Additional paid-in capital	Deficit accumulated during the development stage	Total shareholders' equity (deficiency)
	Number	Amount	Number	Amount			
Balance as of January 1, 2005 (inception date)	-	\$ -	-	\$ -	\$ -	\$ -	\$ -
Issuance of Ordinary shares, net in January 1, 2005	-	-	2,000,000	4	-	-	4
Issuance of Preferred A shares (at \$0.22), net	1,333,333	300	-	-	-	-	-
Stock-based compensation related to options granted to service providers	-	-	-	-	6	-	6
Net loss	-	-	-	-	-	(669)	(669)
Balance as of December 31, 2005 (unaudited)	1,333,333	300	2,000,000	4	6	(669)	(659)
Issuance of Preferred B shares (at \$1.08), net	1,507,341	1,634	-	-	-	-	-
Issuance of preferred C shares (at \$1.68)	760,501	1,280	-	-	-	-	-
Stock based compensation related to options granted to service providers	-	-	-	-	45	-	45
Net loss	-	-	-	-	-	(1,918)	(1,918)
Balance as of December 31, 2006	3,601,175	3,214	2,000,000	4	51	(2,587)	(2,532)
Issuance of Preferred D shares (at \$2.29)	2,982,896	6,832	-	-	-	-	-
Stock based compensation related to options granted to service providers and employees	-	-	-	-	107	-	107
Net loss	-	-	-	-	-	(7,558)	(7,558)
Balance as of December 31, 2007	6,584,071	10,046	2,000,000	4	158	(10,145)	(9,983)
Issuance of Preferred D shares (at \$2.32)	1,606,176	3,735	-	-	-	-	-
Stock based compensation related to options granted to service providers and employees	-	-	-	-	118	-	118
Net loss	-	-	-	-	-	(18,070)	(18,070)
Balance as of December 31, 2008	8,190,247	\$ 13,781	2,000,000	\$ 4	\$ 276	\$ (28,215)	\$ (27,935)

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

STATEMENTS OF CHANGES IN CONVERTIBLE PREFERRED SHARES AND SHAREHOLDERS' EQUITY (DEFICIENCY)

U.S. dollars in thousands, except share data

	Convertible Preferred shares		Ordinary shares		Additional paid-in capital	Deficit accumulated during the development stage	Total shareholders' equity (deficiency)
	Number	Amount	Number	Amount			
Balance as of December 31, 2008	8,190,247	\$ 13,781	2,000,000	\$ 4	\$ 276	\$ (28,215)	\$ (27,935)
Conversion of convertible loan to Preferred D-1 shares	4,924,722	14,700	-	-	-	-	-
Exercise of option granted to service provider	59,807	21	-	-	-	-	-
Issuance of Preferred E shares (at \$0.63)	10,413,052	6,548	-	-	-	-	-
Stock based compensation related to options granted to service providers and employees	-	-	-	-	143	-	143
Net loss	-	-	-	-	-	(10,653)	(10,653)
Balance as of December 31, 2009	23,587,828	35,050	2,000,000	4	419	(38,868)	(38,445)
Stock based compensation related to options granted to service providers and employees	-	-	-	-	174	-	174
Net loss	-	-	-	-	-	(3,953)	(3,953)
Balance as of December 31, 2010	23,587,828	35,050	2,000,000	4	593	(42,821)	(42,224)
Issuance of Preferred F shares (at \$0.605)	21,928,376	13,250	-	-	-	-	-
Conversion of convertible loan into Preferred F shares (at \$0.605)	15,244,456	9,212	-	-	-	-	-
Stock based compensation related to options granted to service providers and employees	-	-	-	-	224	-	224
Net loss	-	-	-	-	-	(5,556)	(5,556)
Balance as of December 31, 2011	60,760,660	57,512	2,000,000	4	817	(48,377)	(47,556)
Stock based compensation related to options granted to service providers and employees	-	-	-	-	126	-	126
Net loss	-	-	-	-	-	(7,076)	(7,076)
Balance as of December 31, 2012	60,760,660	\$ 57,512	2,000,000	\$ 4	\$ 943	\$ (55,453)	\$ (54,506)

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

STATEMENTS OF CHANGES IN CONVERTIBLE PREFERRED SHARES AND SHAREHOLDERS' EQUITY (DEFICIENCY)

U.S. dollars in thousands, except share data

	Convertible Preferred shares		Ordinary shares		Additional paid-in capital	Deficit accumulated during the development stage	Total shareholders' equity (deficiency)
	Number	Amount	Number	Amount			
Balance as of December 31, 2012	60,760,660	\$ 57,512	2,000,000	\$ 4	\$ 943	\$ (55,453)	\$ (54,506)
Issuance of Preferred F shares (at \$0.605)	11,129,374	6,733					
Stock based compensation related to options granted to service providers and employees	-	-	-	-	111		111
Beneficial conversion feature on convertible loan					200		200
Net loss	-	-	-	-	-	(10,620)	(10,620)
Balance as of December 31, 2013	<u>71,890,034</u>	<u>\$ 64,245</u>	<u>2,000,000</u>	<u>\$ 4</u>	<u>\$ 1,254</u>	<u>\$ (66,073)</u>	<u>\$ (64,815)</u>

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		Period from January 1, 2005 (inception date) through December 31,
	2013	2012	2013
<b>Cash flows from operating activities:</b>			
Net loss	\$ (10,620)	\$ (7,076)	\$ (66,073)
Adjustments required to reconcile net loss to net cash used in operating activities:			
Depreciation	223	213	695
Increase in accrued interest on convertible loan	24	-	965
Revaluation of restricted cash	7	(3)	10
Stock-based compensation related to employees and service providers	111	126	1,054
Decrease (increase) in inventory	596	451	(206)
Increase in accounts receivable	(189)	(38)	(411)
Decrease (increase) in long-term deposit	(5)	2	(21)
Increase (decrease) in trade payables	290	(40)	458
Increase (decrease) in accrued expenses	(19)	135	399
Amortization of beneficial conversion feature in convertible loan	9	-	9
Increase in employees and payroll accruals	4	70	308
Net cash used in operating activities	(9,569)	(6,160)	(62,813)
<b>Cash flows from investing activities:</b>			
Investment in restricted cash	(58)	(20)	(160)
Proceeds from short term time deposit	-	2,011	2,011
Investment in short-term time deposit	-	-	(2,011)
Purchase of property and equipment	(350)	(121)	(1,532)
Net cash provided by (used in) investing activities	(408)	1,870	(1,692)
<b>Cash flows from financing activities:</b>			
Proceeds from convertible loan	2,000	-	24,982
Proceeds from issuance of Preferred shares, net	6,733	-	40,326
Net cash provided by financing activities	8,733	-	65,308
Increase (decrease) in cash and cash equivalents	(1,244)	(4,290)	803
Cash and cash equivalents at beginning of period	2,047	6,337	-
Cash and cash equivalents at end of period	\$ 803	\$ 2,047	\$ 803
<b>Non-cash financing information:</b>			
Beneficial conversion feature in convertible loan	200	-	-

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1- GENERAL

- a. Pocared Diagnostics Ltd. ("the Company") was founded in 2004 and began its operation in January 2005. The Company has developed an innovative technological platform for fully automated, real-time diagnosis of contaminants suspended in liquids. The Company develops a real-time, fully automated laboratory based system for the in-vitro diagnostics (IVD) industry, and specifically for the microbiology market.

The Company's technology and System address the demands for greater throughput and test accuracy. The Company's testing platform can analyze different types of specimens, including urine, swabs, sputum, blood, CSF and feces. The first application to be released is for diagnosis of Urinary Tract Infection. The Company's system is at development stage and it is not available for use at the US.

- b. On January 1, 2008, the Company's wholly-owned subsidiary, Pocared Diagnostics, Inc. ("the Subsidiary"), commenced operations in the USA. Accordingly, Pocared Diagnostics, Inc. is consolidated from the date mentioned above in the Company's financial statements.

The Company and its Subsidiary are parties to a service agreement under which all research and development expenditures incurred by the Subsidiary are reimbursed by the Company on a cost-plus basis.

- c. Since its inception, the Company has devoted substantially most of its efforts to business planning, research and development. In addition, the Company has not generated revenues. Accordingly, the Company is considered to be in the development stage, as defined in ASC 915 "Development Stage Entities".

The Company has incurred loss in the amount of \$ 10,620 during the year ended December 31, 2013, has an accumulated deficit during the development stage of \$ 66,073 as of December 31, 2013 and has accumulated negative cash flow from operating activities.

The Company plans to continue to finance its operations, as it has in the past, through private placements. The Company cannot, however, give any assurance that it will in the future continue to be successful in obtaining such additional necessary financing. (See Note 11)

These factors raise substantial doubt about the Company's ability to continue as a going concern. The consolidated financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that might be necessary if the Company be unable to continue as a going concern. (See Note 11)



NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

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

a. Use of estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. The Company's management believes that the estimates, judgments and assumptions used are reasonable based upon information available at the time they are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amount of expenses during the reporting period. Actual results could differ from those estimates.

b. Financial statements in U.S. dollars:

The Company's financing activities including previous years loans and equity transactions are incurred in U.S. dollars. The majority of the Company's expenses are currently paid in dollars. The Company's management believes that the U.S. dollar is the currency of the primary economic environment in which the Company operates. Thus, the functional and reporting currency of the Company is the U.S. dollar.

The Company's transactions and balances denominated in U.S. dollars are presented at their original amounts. Transactions and balances denominated in a currency other than U.S. dollars have been remeasured to U.S. dollars in accordance with ASC 830. All transaction gains and losses from re measurement of monetary balance sheet items denominated in currencies other than U.S. dollars are reflected in the statements of operations as financial income or expenses as appropriate.

c. Principles of consolidation:

The consolidated financial statements include the accounts of the Company and its subsidiary. Inter-company balances and transactions including profits from inter-company sales not yet realized have been eliminated upon consolidation.

d. Cash equivalents:

Cash equivalents are short-term highly liquid investments that are readily convertible to cash with maturities of three months or less as of the date acquired.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

e. Restricted cash:

Restricted cash is primarily invested in highly liquid deposits, which mature within one year. These deposits are used as security for credit cards and rented premises.

f. Inventories:

The Company manages its inventory according to the FIFO method.

Inventories are stated at the lower of cost or market value. Cost is determined as follows:

Raw materials are based on cost of purchase.

Work in progress is based on the cost of raw materials and components used, costs of production including labor are calculated on a periodic basis.

Inventory write-offs have been provided to cover risks arising from dead and slow moving items, technological obsolescence and excess inventories according to revenue forecasts. During the year ended December 31, 2012, the Company recorded a \$ 547 write offs of inventory under research and development cost.

g. Property and equipment:

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

	<u>%</u>	<u>Mainly</u>
Computers, peripheral equipment and software	33	33%
Lab equipment	15 - 50	15%
Leasehold improvements	20	20%
Office furniture and equipment	7 - 15	7%
Communication equipment	15	15%

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

h. Impairment for long-lived assets:

The Company's long-lived assets are reviewed for impairment in accordance with ASC 360, whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset (or an asset group) to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. As of December 31, 2013, and December 31, 2012 no impairment losses have been identified.

i. Research and development costs:

Research and development costs are charged to expenses as incurred.

j. Severance pay:

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

Pursuant to Section 14 of the Severance Compensation Law, 1963 ("Section 14"), all employees of the Company are entitled only to monthly deposits, at a rate of 8.33% of their monthly salary, made on their behalf with insurance companies. Upon release of the policy to the employee, no additional liability exists between the parties regarding the matter of severance pay and no additional payments shall be made by the Company to the employee.

k. Fair value of financial instruments:

The carrying amount reported in the balance sheet for cash and cash equivalents, restricted cash, short-term deposits, accounts receivable, trade payables, accrued expenses and employees and payroll accruals approximate their fair value due to the short-term maturities of such instruments.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

The Company adopted ASC 820 which clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability.

As a basis for considering such assumptions, ASC 820 establishes a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

- Level 1 - Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 - Include other inputs that are directly or indirectly observable in the marketplace.
- Level 3 - Unobservable inputs which are supported by little or no market activity.

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

l. Accounting for share-based compensation:

The Company accounts for options granted to employees under the fair value recognition provision of ASC 718, "Stock Compensation" which requires the use of an option valuation model to measure the fair value of options at the date of grant, in order to recognize it as an expense over the requisite service period. ASC 718 requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent period if actual forfeitures differ from those estimates (see note 6(c)).

The fair value of each options award is estimated on the grant date using the Black-Scholes-Merton model noted in the following table:

	2013	2012
Dividend yield	0%	0%
Expected volatility	84-105%	80%
Risk-free interest	1.51%-1.63%	0.63%-0.95%
Expected life	4.75 years	3.75 years

Expected volatility was calculated based upon the industry volatility of high-tech companies.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The expected option term represents the period during which the Company's stock options are expected to be outstanding and was determined based on the simplified method permitted by Staff Accounting Bulletin No. 110 ("SAB 110") as the average of the vesting period and the contractual term. The risk-free interest rate is based on the yield from U.S. Federal Reserve rates. The Company has historically not paid dividends and has no foreseeable plans to pay dividends.

In accordance with ASC 505-50, "Equity-Based Payments to Non-Employees", the Company records compensation expenses equal to the fair value of options granted to non-employees over the period of service, which is generally the vesting period.

m. Convertible Preferred shares:

Since the Company board of directors has the exclusive right to approve a redemption event, and since the Company board of directors controlled by preferred shareholders, all of the preferred shares have been presented outside of permanent equity in accordance of the ASC 480-10-S99-3A, "Classification and Measurement of Redeemable Securities" since it is uncertain whether or when a redemption event will occur. Subsequent adjustment to increase the carrying value to redemption values will be made when it became probable that such redemption will occur.

n. Income taxes:

The Company and its subsidiary account for income taxes in accordance with ASC 740, "Income Taxes" ("ASC 740"). This Statement prescribes the use of the liability method whereby deferred tax assets and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company provides a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value (see note 8(c)).

The Company recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

o. Concentrations of credit risks:

Financial instruments that potentially subject the Company and its subsidiary to concentrations of credit risk consist principally of cash and cash equivalents and restricted cash.

Cash and cash equivalents and restricted cash are invested in major banks in Israel and the U.S management believes that the financial institutions that hold the Company's investments are institutions with a high credit standing and, accordingly, minimal credit risk exists with respect to these investments.

p. Concentrations of credit risks:

The Company evaluated all events or transactions that occurred subsequent to December 31, 2013 through, the date of approval of these consolidated financial statements and has determined that there are no subsequent events that require disclosure or recognition in the consolidated financial statement, except as noted in note 11.

NOTE 3:- INVENTORIES

	December 31,	
	2013	2012
Raw materials and components	\$ 206	\$ 696
Work in progress	-	106
	<u>\$ 206</u>	<u>\$ 802</u>

\*) In 2013 the company reclassified \$ 621 amount from inventory to research and development expenses as the Company used the materials and components as part of its research and development activity. During the year ended December 31, 2012, the Company recorded a \$ 547 write offs of inventory under research and development cost.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 4:- PROPERTY AND EQUIPMENT

	December 31,	
	2013	2012
Cost:		
Computers, peripheral equipment and software	\$ 331	\$ 257
Lab equipment	907	784
Office furniture and equipment	57	38
Leasehold improvements	215	81
Communication equipment	22	22
	1,532	1,182
Accumulated depreciation	695	472
Depreciated cost	<u>\$ 837</u>	<u>\$ 710</u>

Depreciation expenses amounted to \$ 223 and \$ 213 for the years ended December 31, 2013 and 2012, respectively.

NOTE 5:- CONVERTIBLE LOAN

- a. During the period between August and November 2009, the Company entered into several convertible loan agreements, according to which certain lenders provided the Company with convertible loans in an aggregate amount of \$ 5,832. The loans bear annual interest at the rate of 3% and the convertible to preferred shares of the Company in accordance with the agreements. The Company accounted for the above convertibles loans according to ASC 470-20 "Debt with Conversion". No beneficial conversion feature was recorded as the effective conversion price of the convertibles loans was higher than the fair market value of the share on the date of issuance.
- b. In June 2010, the Company entered into several convertible loan agreements, according to which certain lenders provided the Company with convertible loans in an aggregate amount of \$ 3,150. The convertible loan agreements were signed under the same terms as indicated above. The Company accounted for above convertibles loans according to ASC 470-20, "Debt with Conversion". No beneficial conversion feature was recorded, as the effective conversion price of the convertibles loans was higher than the fair market value of the share on the date of issuance.
- c. In January 2011, the Company signed a Preferred F shares purchase agreement for the issuance of 43,343,631 Preferred F shares in four installments, for the total consideration of \$ 17,000 and the conversion of the convertible loans.

Subject to the agreement dated August 31, 2009, September 30, 2009, November 29, 2009 and June 10, 2010, the convertible loans shall be converted at the first installment to 15,244,457 Preferred F shares. (Refer to Note 6(b2)).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 5:- CONVERTIBLE LOAN (Cont.)

- d. During October 2013, the Company entered into a convertible loan agreement, according to which certain lenders provided the Company with convertible loan in an aggregate amount of \$ 2,000. The loan bears annual interest at the rate of 8%, compounded annually. The loan shall be converted or repaid as follows: a) upon the achievement of the Milestone (as defined in the Loan Agreement), the loans shall be automatically converted together with the accrued interest into Series F Preferred Shares of the Company, at the original issue price for such shares (\$0.605) less a discount of 15%. If such automatic conversion takes place before the expiration of 6 months from the closing of such loans, such discount to increase by 4% per month but no more than 30%; b) in the event of an equity investment which is unrelated to the Milestone, each lender may convert its portion of the total loan, into Series F Preferred Shares, or into the shares issued at such equity investment based on their terms, at the price per share paid therefor, with a discount as described in (a) above; c) each lender may convert its portion of the loan together with accrued interest, into Series F Preferred Shares, at the discounted price per share as describe in (a) above; d) in the event of an M&A Transaction (as defined in the Loan Agreement), an amount equal to 200% of the outstanding loans together with accrued interest shall be repaid to the lenders, prior and in preference to the liquidation preference on, or any dividend, distribution or other payment made with respect to, the Company's equity; e) in the event that the loans were not converted pursuant to the foregoing options within 48 months from the date of the Loan Agreement closing, then loans together with accrued interest shall be due and payable to the lenders, provided that no Lender shall enforce rights to repayment without the consent of the Major Lenders (as defined in the Loan Agreement). The Company accounted for above convertibles loans according to ASC 470-20 "Debt with Conversion". Beneficial conversion feature was recorded as the effective conversion price of the convertibles loans was lower than the fair market value of the share on the date of issuance. The beneficial conversion feature amounted to \$ 200 on the issuance date and will be amortized over a period of 48 months from that date. In 2013 the amortization expenses of the beneficial conversion feature were 9\$.

As of December 31, 2013 discount on account of convertible loan amounted to 191\$.

NOTE 6:- SHARE CAPITAL

- a. Share rights:

1. Ordinary shares:

The holders of Ordinary shares have the right to receive notices to attend and vote in general meetings; the right to share in dividends and a residual right upon liquidation after all preferred shareholders have received their preference allocation.



NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 6- SHARE CAPITAL (Cont.)

2. Preferred shares:

Preferred shares confer to their holders certain right to receive dividends and the right to vote. The Preferred shares are convertible into Ordinary shares on a one-for-one basis at any time except the Preferred F shares that are convertible into Ordinary shares on a two-for-one basis at any time, at the holder's discretion. The Preferred share will be automatically converted into Ordinary share upon certain events, all as set forth in the Company Amended Articles of Association. The Preferred shares confer upon the holders certain liquidation preference, depending on the ratio between the assets available from distribution and the original purchase price, all as set forth in the Company's Amended Articles of Association.

b. Share capital:

1. On January 10, 2011, the Company effected a private placement and issued 9,586,777 Preferred F shares in consideration of \$ 5,800. According to the share purchase agreement, the Company will issue up to an additional 18,512,397 Preferred F shares in consideration of up to \$ 11,200 in three equal quarterly installments starting April 1, 2011. On March 21, 2011, the Company's board of directors resolved to postpone the quarterly installments by 8 weeks. On March 31, 2011, the Company's shareholders approved the above mentioned postponement. On December 5, 2011, the Company's shareholders resolved to postpone the fourth installment to March 30, 2012. On March 22 the company shareholders resolved to postpone the fourth installment to November 30, 2012 and then postpone again to January 2013. The Company's shareholders approved on January 9, 2013 the fourth installment. See Note 11.
2. On January 10, 2011, the convertible loan and accrued interest were converted into 15,244,456 Preferred F shares.
3. On May 27, 2011 the Company received the second installment (see b(1) above) and issued 6,170,799 shares in consideration of \$ 3,733.
4. On September 8, 2011 the Company received the third installment (see b(1) above) and issued 6,170,799 shares in consideration of \$ 3,733.
5. On February 18, 2013 the Company received the fourth installment and issued 6,170,696 shares in consideration of \$ 3,733.
6. In May 13, 2013 the Company effected a private placement and on June 12, 2013 issued 4,958,678 Preferred F shares in consideration of the first installment of \$ 3,000. Under this private placement the Company will issue up to an additional 11,570,925 Preferred F shares in consideration of up to \$ 7,000 based on completion of the stipulated milestone.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 6- SHARE CAPITAL (Cont.)

7. Liquidation preference of Preferred shares as of December 31, 2013 amounted to \$ 113,334.

c. Stock Option Plan:

Under the Company's 2007 Share Option Plan ("the Plan"), options may be granted to officers, directors, employees and consultants of the Company.

Pursuant to the Plan, the Company reserved for issuance 12,387,689 Ordinary shares. As of December 31, 2013, an aggregate of 1,260,873 stock options of the Company are still available for future grant. Each option granted under those Plans is exercisable until the earlier of seven years from the date of the grant of the option or the expiration dates of the respective option plans. The options vest primarily over a service period of four years. For each grant, 25% of the option vest on the option vest on the first anniversary of the grant and 6.25% at the end of each subsequent quarter over the course of the following three years. Any options canceled or forfeited before expiration, become available for future grants. All as set forth in the Plan, or otherwise approved by Board of Directors.

A summary of the Company's stock option plan activity is as follows:

	Year ended December 31, 2013			
	Number of options	Weighted average exercise price	Weighted average remaining contractual term (in years)	Aggregate intrinsic value
Outstanding at beginning of year	5,955,620	\$ 0.17	4.96	-
Granted	4,133,930	0.31	6.55	-
Outstanding at end of year	10,089,550	\$ 0.23	5.61	-
Exercisable at end of year	4,095,709	\$ 0.21	3.85	-

The weighted average grant date fair values of options granted as of December 31, 2013 and 2012 was \$ 0.05 and \$ 0.11, respectively.

The weighted average fair values of the outstanding options as of December 31, 2013 and 2012 were \$ 0.09 and \$ 0.12, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 6:- SHARE CAPITAL (Cont.)

- d. Options granted to non-employees:

The Company's outstanding options that were granted to service providers as of December 31, 2013 are as follows:

Issuance date	Number of options	Exercise price	Options exercisable	Exercisable through
April 2005	9,877	\$ 0.18	9,877	April 2015
July 2005	9,877	\$ 0.18	9,877	July 2015
December 2005	8,438	\$ 0.65	8,438	December 2015
May 2006	19,936	\$ 1.14	19,936	December 2016
November 2007	21,460	\$ 2.23	21,460	November 2014
August 2009	23,666	\$ 0.63	23,666	August 2016
January 2011	611,920	\$ 0.09	420,695	January 2018
June 2011	50,306	\$ 0.09	31,225	June 2018
September 2011	50,306	\$ 0.09	28,102	September 2018
January 2013	50,306	\$ 0.09	-	January 2020
May 2013	46,466	\$ 0.09	-	May 2020
	<u>902,558</u>		<u>598,256</u>	

The Company accounts for its options to consultants under the fair value method of ASC 505-50. The fair value for these options was estimated using a Black-Scholes option-pricing model with the following weighted-average assumptions for the years ended December 31, 2013 and 2012:

	2013	2012
Dividend yield	0%	0%
Expected volatility	105%	80%
Risk-free interest	1.55%	0.6%
Expected life	6.5 years	2.78 years

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 6:- SHARE CAPITAL (Cont.)

- e. Stock-based compensation expenses:

The following table sets forth the total stock-based compensation expense resulting from stock options granted to employees, directors and service providers included in the Company's consolidated statement of operations:

	Year ended December 31,	
	2013	2012
Research and development cost	\$ 44	\$ 42
General and administrative expenses	67	84
Total stock-based compensation expense	<u>\$ 111</u>	<u>\$ 126</u>

As of December 31, 2013, there was \$ 175 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted to employees and service providers under the Company's stock option plans. That cost is expected to be recognized over a weighted-average period of 4 years.

NOTE 7:- CONVERTIBLE PREFERRED SHARES

- a. The Company's Amended and Restated Articles of Association authorize the issuance of shares of series A, B, C, D, E and F convertible preferred shares. The Article of Association ("AOA") states that the convertible preferred shares are not redeemable, they include certain contingent provisions (deemed liquidation events) that may trigger distribution of cash upon events that are not in the Company's control and that do not result in final liquidation of the Company (e.g., change in control). Based on ASC 480-10-S99, as redemption of the Company's convertible preferred shares is considered outside of the Company's control (since the board of directors is controlled by the preferred shareholders), all the convertible preferred shares have been classified outside of shareholders deficit in the Company's consolidated balance sheets and consolidated statements of changes in convertible preferred shares and shareholders' deficit.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 7:- CONVERTIBLE PREFERRED SHARES (Cont.)

- b. Significant terms of convertible preferred share are as follows:

*Voting rights*

The preferred shares shall have the same voting rights as Ordinary shares. The holders are entitled to one vote for each share of ordinary share for which the share be converted. The holders of the convertible share and ordinary share vote together and not as separate classes.

*Dividends*

In the event of any declaration of a Dividend by the Company, and provided that, immediately after such declaration and distribution of such Dividend the net cash balance of the Company shall be at least \$15,000, then the cash or property available for distribution to the Shareholders shall be distributed or allocated among the Shareholders according to the order of preference:

- (i) The holders of Preferred F Shares shall be entitled to receive an amount equal to 200% of the Original Issue Price per Preferred F Share plus interest on the Original Issue Price at the rate of 8% per annum.
- (ii) after the Preferred F Dividend Preference has been paid in full the holders of Preferred E Shares shall be entitled to receive an amount equal to the Original Issue Price per Preferred E Share plus interest at the rate of 5% per annum.
- (iii) after the Preferred F and E Dividend Preference has been paid in full the holders of Preferred D, D-1 and D-2 Shares shall be entitled to receive an amount equal to the Original Issue Price per Preferred D, D-1 and D-2 Share plus interest at the rate of 5% per annum.
- (iv) after the Preferred F, E, D, D-1 and D-2 Dividend Preference has been paid in full the holders of Preferred A, B and C Shares shall be entitled to receive an amount equal to the Original Issue Price per Preferred A, B and C Share plus interest at the rate of 5% per annum.
- (v) after payment in full of the all the Preferred Dividend Preference (F, E, D, D-1, D-2, C, B and A), the remaining Dividend Distribution available for distribution, if any, shall be distributed pro rata among all the holders of Ordinary Shares and Preferred Shares of the Company, on an as converted basis.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 7:- CONVERTIBLE PREFERRED SHARES (Cont.)

*Liquidation*

Until a Qualified IPO, in the event of any sale, liquidation, dissolution or winding up, either voluntary or involuntary bankruptcy, or reorganization of the Company (collectively, a "Liquidation Event"), or a Deemed Liquidation Event, then the assets or proceeds available for distribution to the Shareholders or otherwise payable to them in their capacity as such (the "Distributable Proceeds") shall be distributed or allocated among the Shareholders according to the following order of preference:

- (i) the holders of Preferred F Shares shall be entitled to receive, from the Distributable Proceeds, on a pro rata basis amongst themselves, prior and in preference to any other securities of the Company, an amount equal to 200% of the Original Issue Price per Preferred F Share plus interest on the Original Issue Price at the rate of 8% per annum, compounded annually, from the Original Issue Date of such Preferred F Share and until the date of the Liquidation Event or Deemed Liquidation Event, plus an amount equal to all declared but unpaid dividends on each Preferred F Share but less any dividends previously received on such Preferred F Shares (collectively, the "Preferred F Preference Amount"). In the event that the Distributable Proceeds shall be insufficient for the distribution of the Preferred F Preference Amount in full to all of the holders of Preferred F Shares, then the Distributable Proceeds shall be distributed or allocated among the holders of Preferred F Shares on a pro rata pari passu basis in proportion to the amounts such holders would have received had the Distributable Proceeds been sufficient for the distribution in full of the Preferred F Preference Amount
- (ii) after the Preferred F Preference Amount has been paid in full and prior to any payments to other holders of Preferred Shares, the holders of Preferred E Shares shall be entitled to receive, from the remaining Distributable Proceeds, , for each Preferred E Share held by them, the Original Issue Price per Preferred E Share plus interest at the rate of 5% per annum, compounded annually, from the Original Issue Date of such Preferred E Share and until the date of the Liquidation Event or Deemed Liquidation Event, plus an amount equal to all declared but unpaid dividends on each Preferred E Share but less any dividends previously received on such Preferred E Shares (collectively, the "Preferred E Preference Amount").

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 7:- CONVERTIBLE PREFERRED SHARES (Cont.)

- (iii) after the Preferred F Preference Amount and the Preferred E Preference Amount have been paid in full the holders of Preferred D Shares, Preferred D-1 Shares and Preferred D-2 Shares as a group shall be entitled to receive, from the remaining Distributable Proceeds, for each Preferred D Share, Preferred D-1 Share and/or Preferred D-2 Share held by them, the Original Issue Price per Preferred D Share, Preferred D-1 Share or Preferred D-2 Share, as applicable, plus interest at the rate of 5% per annum, compounded annually, from the Original Issue Date of such Preferred D Share, Preferred D-1 Share and/or Preferred D-2 Share and until the date of the Liquidation Event or Deemed Liquidation Event, plus an amount equal to all declared but unpaid dividends on each Preferred D Share, Preferred D-1 Share and/or Preferred D-2 Share but less any dividends previously received on such Preferred D Shares Preferred D-1 Share and Preferred D-2 Share (collectively, the "Preferred D,D-1,D-2 Preference Amount").
- (iv) after the Preferred F Preference Amount, the Preferred E Preference Amount and the Preferred D,D-1,D-2 Preference Amount have been paid in full the holders of Preferred A, B, C Shares as a group, shall be entitled to receive, from the remaining Distributable Proceeds, on a pro rata basis amongst themselves, for each Preferred A, B, C Share held by them, the Original Issue Price per Preferred A, B, C share as applicable, plus interest at the rate of 5% per annum, compounded annually, from the Original Issue Date of such shares and until the date of the Liquidation Event or Deemed Liquidation Event, plus an amount equal to all declared but unpaid dividends on each Preferred A Shares, Preferred B Shares and Preferred C Shares, as applicable, but less any dividends previously received on such shares (collectively, the "Preferred A,B,C Preference Amount").
- (v) after payment in full of the Preferred F Preference Amount, the Preferred E Preference Amount, the Preferred D,D-1,D-2 Preference Amount and the Preferred A,B,C Preference Amount, the remaining Distributable Proceeds available for distribution, if any, shall be distributed or allocated pro rata among all the holders of Ordinary Shares and Preferred Shares of the Company, on an as converted basis.

*Conversion*

The Preferred Shareholders shall have conversion rights as follows:

Each Preferred Share shall be convertible, at the option of the holder of such share, at any time after the Original Issue Date of such share, into such number of fully paid and non-assessable Ordinary Shares of the Company as is determined by dividing the applicable Original Issue Price for such share by the Conversion Price at the time in effect for such share. The Conversion Price for each Preferred Share shall be subject to adjustment in accordance with any Recapitalization Event and pursuant to the anti-dilution provisions set forth herein.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 7:- CONVERTIBLE PREFERRED SHARES (Cont.)

Each Preferred Share shall automatically be converted into fully paid and non-assessable Ordinary Shares by dividing the applicable Original Issue Price by the Conversion Price at the time in effect for such Preferred Share, immediately upon: (i) a Qualified IPO, or (ii) the consent in writing of the Majority Preferred Shareholders. In the event that prior to the Qualified IPO, the Company issues any Additional Securities (as defined below) at a price per share lower than the Conversion Price of any of the Preferred Shares in effect immediately prior to such issuance, then upon each such issuance, the Conversion Price of the relevant Preferred Shares shall be reduced, for no additional consideration, in accordance with Conversion Price Adjustments of Preferred Shares formula as defined in the Article Of Association of the Company.

c. Share issuance:

1. On January 10, 2011, the Company effected a private placement and issued 9,586,777 Preferred F shares in consideration of \$ 5,800. According to the share purchase agreement ("SPA"), the Company will issue up to an additional 18,512,397 Preferred F shares in consideration of up to \$ 11,200 in three equal quarterly installments starting April 1, 2011. On March 21, 2011, the Company's board of directors resolved to postpone the quarterly installments by 8 weeks. On March 31, 2011, the Company's shareholders approved the above mentioned postponement.
2. On January 10, 2011, the convertible loan and accrued interest were converted into 15,244,456 Preferred F shares.
3. On May 27, 2011 the Company received the second installment (see c(1) above) and issued 6,170,799 shares in consideration of \$ 3,733.
4. On September 8, 2011 the Company received the third installment (see c(1) above) and issued 6,170,799 shares in consideration of \$ 3,733.
5. On February 18, 2013 the Company received the fourth installment and issued 6,170,799 shares in consideration of \$ 3,733.
6. In May 13, 2013 the Company effected a private placement. On June 9, 2013 the Company issued 4,958,678 Preferred F shares in consideration of the first installment of \$ 3,000. Under this private placement the Company will issue up to an additional 11,570,925 Preferred F shares in consideration of up to \$ 7,000 based on completion stipulated milestone



NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 8:- TAXES ON INCOME

- a. Tax rates applicable to the income of the Israeli company:

Taxable income of Israeli companies is subject to tax rate of 25% in 2013 and 24% in 2012 .On July 30, 2013, the Israeli Parliament (the Knesset) approved the second and third readings of the Economic Plan for 2013-2014 ("Amended Budget Law") which consists, among others, of fiscal changes whose main aim is to enhance the collection of taxes in those years.

These changes include, among others, raising the Israeli corporate tax rate from 25% to 26.5%, effective from January 1, 2014.

- b. Non-Israeli subsidiary:

The tax rates of the subsidiary are compounded from a progressive federal tax of 35% in addition to a state and local tax.

- c. Deferred income taxes:

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

	December 31	
	2013	2012
Operating loss and deductions carry forwards	\$ 17,209	\$ 13,048
Reserves and allowances	37	42
Research and development tax credit	1,924	1,100
Depreciation of fixed assets	15	12
Net deferred tax asset before valuation allowance	19,185	14,202
Valuation allowance	(19,185)	(14,202)
Net deferred tax asset	\$ -	\$ -

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 8:- TAXES ON INCOME (Cont.)

As of December 31, 2013, the Company has provided a full valuation allowance of approximately \$ 19,185 in respect of deferred tax assets resulting from tax loss carry forwards and other temporary differences. Management currently believes that since the Company and its subsidiary have a history of losses it is more likely than not that the deferred tax regarding the loss carry forward and other temporary differences will not be realized in the foreseeable future.

- d. Loss before taxes on income consists of the following:

	Year ended December 31	
	2013	2012
Domestic	\$ (10,697)	\$ (7,139)
Foreign	99	96
	<u>\$ (10,598)</u>	<u>\$ (7,043)</u>

The provision for income tax derives from reimbursement of the U.S. subsidiary's expenses by the parent company, which is taxable in the U.S.

- e. Net operating losses carry forward:

The Israeli Company has accumulated losses and deductions for tax purposes as of December 31, 2013, in the amount of approximately \$ 64,940, which may be carried forward and offset against taxable income in the future for an indefinite period.

- f. Final tax assessments:

The Company's tax assessments through the 2008 tax year are considered final.

- g. No liability for unrecognized tax benefits was recorded as a result of implementation of ASC 740.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 9:- FINANCIAL INCOME (EXPENSES), NET

	Year ended December 31	
	2013	2012
Financial income:		
Interest on bank deposits	\$ (8)	\$ (43)
Foreign currency translation differences	(15)	-
	(23)	(43)
Financial expenses:		
Interest and bank charges	40	12
Beneficial conversion feature	9	-
Foreign currency translation differences	-	5
	49	17
	\$ 26	\$ (26)

NOTE 10:- COMMITMENTS

- a. The facilities and motor vehicles of the Company are rented under operating leases that expire on various dates. Aggregate minimum rental commitments under cancelable and non-cancelable leases as of December 31, 2013, are as follows:

Year	
2014	\$ 439
2015	418
	\$ 857

Facilities and motor vehicles rent expenses for the years ended December 31, 2013 and 2012, were \$ 467 and \$ 280, respectively.

- b. During the year 2013, the Company entered into several purchase orders with several suppliers. As of December 31, 2013, the Company has open purchase orders in the amount of \$ 608.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 11:- SUBSEQUENT EVENTS**

In February 4, 2014, the Company entered into a convertible loan agreement, according to which certain lenders provided the Company with convertible loan in an aggregate amount of \$ 2,038. The loan bears annual interest at the rate of 8%, compounded annually. The loan shall be converted or repaid in accordance with the terms in the agreement which are the same as the terms in the convertible loan received during 2013.

**NOTE 12:- RECONCILIATION TO "INTERNATIONAL FINANCIAL REPORTING STANDARDS"**

- a. According to International Financial Reporting Standards ("IFRS"), a convertible loan has a convertible element which should be bifurcated and recorded in equity. The financial liability is presented at fair value through profit and loss. According to U.S. GAAP, a convertible loan is presented at its nominal value with a beneficial conversion feature recorded net from the loan and in equity (see Note 5 (d)). The Company's convertible loan had been accounted accordingly.
- b. According to International Financial Reporting Standards ("IFRS"), the redemption convertible preferred shares should be presented as equity since the event may trigger the redemption are in the control of the entity as the board approval is required and the board represents the Company according to IFRS. According to U.S. GAAP in accordance with ASC 480-10-S99-3A the redeemable convertible preferred shares are presented outside of permanent equity, as further explain in Note 7a and Note 2m.

Based on this, the following adjustments are required to the financial statements:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 12:- RECONCILIATION TO "INTERNATIONAL FINANCIAL REPORTING STANDARDS" (Cont.)

c. Reconciliations to balance sheets:

	December 31, 2013			December 31, 2012		
	U.S GAAP	Effect of transition to IFRS	IFRS	U.S GAAP	Effect of transition to IFRS	IFRS
<b>ASSETS</b>						
Total current assets	\$ 1,570	-	\$ 1,570	\$ 3,186	-	\$ 3,186
Total non-current assets	858	-	858	710	-	710
Total assets	\$ 2,428	\$ -	\$ 2,428	\$ 3,896	\$ -	\$ 3,896
<b>LIABILITIES AND EQUITY</b>						
Total current liabilities	\$ 1,165	\$ -	\$ 1,165	\$ 890	\$ -	\$ 890
Convertible loan	1,833	(1,723)	110	-	-	-
Convertible Preferred shares	64,245	(64,245)	-	57,512	(57,512)	-
Total shareholders' equity	(64,815)	65,968	1,153	(54,506)	57,512	3,006
Total liabilities and shareholders' equity	\$ 2,428	\$ -	\$ 2,428	\$ 3,896	\$ -	\$ 3,896

d. Reconciliations to the statement of income:

	December 31, 2013			December 31, 2012		
	U.S GAAP	Effect of transition to IFRS	IFRS	U.S GAAP	Effect of transition to IFRS	IFRS
Operating expenses	\$ 10,572	\$ -	\$ 10,572	\$ 7,069	\$ -	\$ 7,069
Financial expenses (income)	\$ 26	\$ 77	\$ 103	\$ (26)	\$ -	\$ (26)
Loss before income taxes	10,598	-	10,675	7,043	-	7,043
Income taxes	22	-	22	33	-	33
Net loss	\$ 10,620	\$ 77	\$ 10,697	\$ 7,076	\$ -	\$ 7,076

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 13:- STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY (DEFICIENCY) ACCORDING TO IFRS

Shareholders' deficiency attributable to equity holders of the parent																	
	Ordinary shares		Preferred A shares		Preferred B shares		Preferred C shares		Preferred D, D-1 and D-2 shares		Preferred E shares		Preferred F shares		Additional paid-in capital	Deficit accumulated during the development stage	Total shareholders' equity (deficiency)
	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount			
Balance at January 1, 2005 (inception date)	-	\$ -	-	\$ -	-	\$ -	-	\$ -	-	\$ -	-	\$ -	-	\$ -	-	\$ -	\$ -
Issuance of Ordinary shares, net in January 1, 2005	2,000,000	4	-	-	-	-	-	-	-	-	-	-	-	-	-	-	4
Issuance of Preferred A shares (at \$0.22), net	-	-	1,333,333	3	-	-	-	-	-	-	-	-	-	-	297	-	300
Stock-based compensat related to options granted to service providers	-	-	-	-	-	-	-	-	-	-	-	-	-	-	6	-	6
Net loss	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(669)	(669)
Balance at December 2005 (unaudited)	2,000,000	4	1,333,333	3	-	-	-	-	-	-	-	-	-	303	-	(669)	(359)
Issuance of Preferred B shares (at \$1.08), net	-	-	-	-	1,507,341	3	-	-	-	-	-	-	-	1,631	-	-	1,634
Issuance of preferred C shares (at \$1.68)	-	-	-	-	-	-	760,501	2	-	-	-	-	-	1,278	-	-	1,280
Stock based compensat related to options granted to service providers	-	-	-	-	-	-	-	-	-	-	-	-	-	45	-	-	45
Net loss	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(1,918)	(1,918)
Balance at December 2006	2,000,000	4	1,333,333	3	1,507,341	3	760,501	2	-	-	-	-	-	3,257	-	(2,587)	682
Issuance of Preferred D shares (at \$2.29)	-	-	-	-	-	-	-	-	2,982,896	7	-	-	-	6,825	-	-	6,832
Stock based compensat related to options granted to service providers and employees	-	-	-	-	-	-	-	-	-	-	-	-	-	107	-	-	107
Net loss	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(7,558)	(7,558)
Balance at December 2007	2,000,000	4	1,333,333	3	1,507,341	3	760,501	2	2,982,896	7	-	-	-	10,189	-	(10,145)	63
Issuance of Preferred D shares (at \$2.32),	-	-	-	-	-	-	-	-	1,606,176	4	-	-	-	3,731	-	-	3,735
Stock based compensat related to options granted to service providers and employees	-	-	-	-	-	-	-	-	-	-	-	-	-	118	-	-	118
Net loss	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(18,070)	(18,070)
Balance at December 31, 2008	2,000,000	\$ 4	1,333,333	\$ 3	1,507,341	\$ 3	760,501	\$ 2	4,589,072	\$ 11	\$ -	\$ -	\$ -	\$ 14,038	\$ -	\$(28,215)	\$(14,154)



providers and employees	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	111	-	111
Net loss																			(10,697)	(10,697)
Balance at December 31, 2013	2,000,000	4	1,333,333	3	1,507,341	3	760,501	2	9,573,601	61	10,413,052	25	48,302,206	136	69,675	(68,756)	1,153			



**FIRST LOAN MODIFICATION AGREEMENT**

This First Loan Modification Agreement (this "Loan Modification Agreement") is entered into as of April 25, 2013, by and between **SILICON VALLEY BANK**, a California corporation, with its principal place of business at 3003 Tasman Drive, Santa Clara, California 95054 and with a loan production office located at 275 Grove Street, Suite 2-200, Newton, Massachusetts 02466 ("Bank") and **ELRON ELECTRONIC INDUSTRIES LTD.**, a company organized under the laws of the State of Israel, with its principal place of business at Triangle Building, Azrieli Center, 42nd Floor, Tel Aviv, Israel 67023 ("Borrower").

1. **DESCRIPTION OF EXISTING INDEBTEDNESS AND OBLIGATIONS.** Borrower is indebted to Bank pursuant to a loan arrangement dated as of November 9, 2011, evidenced by, among other documents, a certain Loan Agreement dated as of November 9, 2011, between Borrower and Bank (the "Loan Agreement"). Capitalized terms used but not otherwise defined herein shall have the same meaning as in the Loan Agreement (as amended by this Loan Modification Agreement).
2. **DESCRIPTION OF COLLATERAL.** Repayment of the Obligations is secured by, among other property, (a) the Collateral, and (b) the Pledged Assets as defined in a certain Debenture Fixed Charge Agreement dated as of March 21, 2012, between Borrower and Bank, as amended by a certain Amendment to the Debenture Fixed Charge Agreement dated as of April 25, 2013 (as amended, the "Debenture") (together with any other collateral security granted to Bank, the "Security Documents"). Hereinafter, the Security Documents, together with all other documents evidencing or securing the Obligations shall be referred to as the "Existing Loan Documents".
3. **DESCRIPTION OF CHANGE IN TERMS.**
  - A. **Modifications to Loan Agreement.**
    1. Borrower acknowledges and agrees that a Term Loan Advance in the principal amount of Four Million Dollars (\$4,000,000.00) is outstanding as of the First LMA Closing Date, and that Borrower has not requested, and will not request, and Bank shall have no obligation to make, any other Term Loan Advance. Borrower and Bank acknowledge and agree that, except to the extent expressly provided herein, the terms and provisions of this Loan Modification Agreement will not modify the terms of the Loan Agreement applicable to such outstanding Term Loan Advance.
    2. Borrower acknowledges and agrees that, in addition to and without limiting any provisions of the Loan Agreement (as amended hereby), as a condition precedent to Bank's obligation to make the initial 2013 Term Loan Advance, Borrower shall deliver to Bank a legal opinion of Borrower's counsel (authority/enforceability), in the same form and substance required in connection with the Loan Agreement (updated as appropriate to reflect this Loan Modification Agreement and the amendments to the Debenture).
    3. The Loan Agreement shall be amended by deleting the following text, appearing in Section 2.1.1 thereof:  

“ (b) **Interest Period.** Commencing on the first Payment Date of the calendar quarter following the month in which the Funding Date of such Term Loan Advance occurs, Borrower shall make quarterly payments of interest, in arrears, on the principal amount of each Term Loan Advance at the rate set forth in Section 2.2(a).”

and inserting in lieu thereof the following:

“ (b) Interest Period. Commencing on the first Payment Date of the calendar quarter following the month in which the Funding Date of such Term Loan Advance occurs, Borrower shall make quarterly payments of interest, in arrears, on the principal amount of each Term Loan Advance at the rate set forth in Section 2.2(a)(i).”

4 The Loan Agreement shall be amended by adding the following, to appear as Section 2.1.2 thereof:

“ **2.1.2 2013 Term Loan Advances.**

(a) Availability. Subject to the terms and conditions of this Agreement, during the 2013 Draw Period, Bank agrees to make advances (each a “**2013 Term Loan Advance**” and collectively, “**2013 Term Loan Advances**”) available to Borrower in an aggregate amount of up to the 2013 Term Loan Advance Amount. Each 2013 Term Loan Advance must be in an amount at least equal to Five Million Dollars (\$5,000,000.00). After repayment, no 2013 Term Loan Advance (or any portion thereof) may be reborrowed.

(b) Interest Period. Commencing on the first Payment Date of the calendar quarter following the month in which the Funding Date of such 2013 Term Loan Advance occurs, Borrower shall make quarterly payments of interest, in arrears, on the principal amount of each 2013 Term Loan Advance at the rate set forth in Section 2.2(a)(ii).

(c) Repayment. All outstanding principal and accrued interest under each 2013 Term Loan Advance, and all other outstanding Obligations with respect to each 2013 Term Loan Advance, are due and payable in full on the applicable 2013 Term Loan Maturity Date.

(d) Permitted Prepayment. Borrower shall have the option to prepay any 2013 Term Loan Advance (or portion thereof), provided Borrower (i) provides written notice to Bank of its election to prepay such 2013 Term Loan Advance (or portion thereof) at least fourteen (14) days prior to such prepayment, and (ii) pays, on the date of such prepayment (A) all outstanding principal plus accrued interest under such 2013 Term Loan Advance (or portion thereof), and (B) all other sums, that shall have become due and payable, including interest at the Default Rate with respect to any past due amounts.

(e) Permitted Termination. In no way derogating from Section 2.1.2(d) above, Borrower shall be entitled to terminate this Agreement, without any liability, penalty, fees or costs to Borrower solely on account of such termination, upon Borrower (i) providing at least fourteen (14) days prior written notice to Bank (upon the provision of such notice, Borrower shall no longer be entitled to request any further 2013 Term Loan Advances) and (ii) paying, on the effective date of such termination (A) all outstanding principal plus accrued interest under all Credit Extensions and (B) all other sums that shall have become due and payable under the Loan Documents (including, without limitation, any outstanding Unused Commitment Fees), including interest at the Default Rate with respect to any past due amounts.

(f) Mandatory Prepayment.

(i) In the event of a Qualifying Transaction occurring after the First LMA Closing Date, Bank shall be entitled to request that Borrower prepay, on account of the outstanding principal amount of 2013 Term Loan Advances (plus all interest accrued thereon), an amount equal to fifty percent (50.0%) of the Qualifying Proceeds in connection with such Qualifying Transaction. Borrower shall give Bank prior written notice of the Qualifying Transaction or of the potential occurrence of a Qualifying Transaction (it being understood that such notice shall not constitute any assurance that the potential Qualifying Transaction will in fact occur and Borrower shall not be deemed to be in default of this Agreement should such potential Qualifying Transaction not occur), in any event, no later than the date of Borrower's receipt of any portion of such Qualifying Proceeds. Borrower shall, within five (5) Business Days if requested by Bank by notice to Borrower given within sixty (60) days of Bank's receipt of the above-referenced notice from Borrower, make such prepayment. For the sake of clarity, if, from time to time, Borrower receives an additional portion from such Qualifying Proceeds, then the above notice requirement and other provisions apply equally to such additional Qualifying Proceeds.

(ii) In the event that, after the First LMA Closing Date, Borrower makes a distribution to all of its shareholders (by way of dividend or otherwise) (without limiting any provisions of this Agreement, including, without limitation, Section 7.6, provided however that no such distribution shall be made unless and until Borrower receives notice from Bank as provided below (or Bank fails to give such notice within the fourteen (14) day period for Bank to give notice as provided below)), whether with respect to Qualifying Proceeds or otherwise, Borrower shall notify Bank thereof simultaneously with its notice to the public declaring the distribution (and in any case, at least fourteen (14) days prior to the date of the proposed distribution), and Borrower shall, simultaneously with the making of the distribution if requested by Bank by notice to Borrower given within fourteen (14) days of Bank's receipt of the above-referenced notice from Borrower, repay the outstanding principal amount of 2013 Term Loan Advances (plus all interest accrued thereon) in an amount equal to one hundred percent (100.0%) of such distribution.

(iii) In the event of an early prepayment whether at the request of Bank pursuant to Section 2.1.2(f)(i) above or at the request of Borrower pursuant to Section 2.1.2(d) above (the amount of principal and interest actually repaid in each such event, the "**Early Prepayment Amount**"), then Borrower shall be entitled to make a distribution to its shareholders in the aggregate amount up to the Early Prepayment Amount without the obligation to make any payment to Bank pursuant to Section 2.1.2(f)(ii) above (for the avoidance of doubt, Borrower would still be required to give Bank notice of such distribution in accordance with Section 2.1.2(f)(ii)).

(iv) Notwithstanding the aforesaid, in no event shall any amount repaid by Borrower to Bank pursuant to the mandatory prepayment under this Section 2.1.2(f) exceed the then existing outstanding principal amount of 2013 Term Loan Advances (plus all interest accrued thereon)."

5 The Loan Agreement shall be amended by deleting the following text, appearing in Section 2.2 thereof:

“ (a) Interest Rate. Subject to Section 2.2(b), the principal amount outstanding under each Term Loan Advance shall accrue interest at a floating per annum rate equal to three-quarters of one percentage point (0.75%) above the Prime Rate, which interest shall be payable quarterly.”

and inserting in lieu thereof the following:

“ (a) Interest Rate.

(i) Term Loan Advances. Subject to Section 2.2(b), the principal amount outstanding under each Term Loan Advance shall accrue interest at a floating per annum rate equal to three-quarters of one percentage point (0.75%) above the Prime Rate, which interest shall be payable quarterly.

(ii) 2013 Term Loan Advances. Subject to Section 2.2(b), the principal amount outstanding under each 2013 Term Loan Advance shall accrue interest at a floating per annum rate equal to one and three-quarters of one percentage points (1.75%) above the Prime Rate, which interest shall be payable quarterly.”

6 The Loan Agreement shall be amended by deleting the following text, appearing in Section 2.3 thereof:

“ (b) Term Loan Advance Fees. In addition to the commitment fee provided in Section 2.3(a), in respect of (and as a condition precedent to) each Term Loan Advance, a fully earned, non-refundable fee of one-quarter of one percent (0.25%) of the principal amount of such Term Loan Advance, on the Funding Date of such Term Loan Advance (collectively, “**Term Loan Advance Fees**”); and

(c) Bank Expenses. All Bank Expenses (including reasonable attorneys’ fees and expenses for documentation and negotiation of this Agreement) incurred through and after the Effective Date, when due.”

and inserting in lieu thereof the following:

“ (b) Term Loan Advance Fees. In addition to the commitment fee provided in Section 2.3(a), in respect of (and as a condition precedent to) (i) each Term Loan Advance, a fully earned, non-refundable fee of one-quarter of one percent (0.25%) of the principal amount of such Term Loan Advance, on the Funding Date of such Term Loan Advance, and (ii) each 2013 Term Loan Advance, a fully earned, non-refundable fee of one-half of one percent (0.50%) of the principal amount of such 2013 Term Loan Advance, on the Funding Date of such 2013 Term Loan Advance (collectively, “**Term Loan Advance Fees**”);

(c) Unused Commitment Fee. Borrower shall pay to Bank a fee (the “**Unused Commitment Fee**”), payable quarterly, in arrears, on a calendar year basis, on the first (1<sup>st</sup>) calendar day of each calendar quarter, in an amount equal to one-half of one percent (0.50%) per annum of the average unused portion of the 2013 Term Loan Advance Amount, as determined by Bank. The unused portion of the 2013 Term Loan Advance Amount, for purpose of this calculation, shall equal the difference between (i) the 2013 Term Loan Advance Amount and (ii) the average for the period of the daily closing balance of the aggregate original principal amount of all 2013 Term Loan Advances made by Bank through and including the time of determination. Borrower shall not be entitled to any credit, rebate or repayment of any Unused Commitment Fee previously earned by Bank pursuant to this Section 2.3(c) notwithstanding any termination of this Agreement or the suspension or termination of Bank’s obligation to make Credit Extensions hereunder; and

(d) Bank Expenses. All Bank Expenses (including reasonable attorneys’ fees and expenses for documentation and negotiation of this Agreement) incurred through and after the Effective Date, when due.”

7 The Loan Agreement shall be amended by deleting the following text, appearing in Section 3.2 thereof:

“ (g) delivery to Bank of the following, each in form and substance satisfactory to Bank: (i) a certificate of the secretary of Borrower with respect to Borrower’s articles, by-laws, incumbency and resolutions authorizing and approving the Term Loan Advance being requested and all related actions, transactions and documents, including, without limitation, the documentation delivered pursuant to Section 3.2(e), and (ii) completed and executed resolutions adopted by Borrower’s board of directors (and, if required, stockholders) authorizing and approving the Term Loan Advance being requested and all related actions, transactions and documents, including, without limitation, the documentation delivered pursuant to Section 3.2(e); and”

and inserting in lieu thereof the following:

“ (g) delivery to Bank of the following, each in form and substance satisfactory to Bank: (i) a certificate of the secretary of Borrower with respect to Borrower’s articles, by-laws, incumbency and resolutions authorizing and approving the Term Loan Advance or 2013 Term Loan Advance, as applicable, being requested and all related actions, transactions and documents, including, without limitation, the documentation delivered pursuant to Section 3.2(e), and (ii) completed and executed resolutions adopted by Borrower’s board of directors (and, if required, stockholders) authorizing and approving the Term Loan Advance or 2013 Term Loan Advance, as applicable, being requested and all related actions, transactions and documents, including, without limitation, the documentation delivered pursuant to Section 3.2(e); and”

The Loan Agreement shall be amended by deleting the following text, appearing in Section 4.1 thereof:

“Borrower undertakes to create in favor of Bank, prior to and as a condition precedent to requesting and receiving any Term Loan Advance, a first priority security interest and a first ranking fixed pledge and charge over the Collateral, which shall be such shares of stock in Given owned by Borrower as have an aggregate value (as reasonably determined by Bank) at least equal to three hundred twenty-five percent (325.0%) of the amount (as reasonably determined by Bank) of all outstanding Obligations (plus the amount of the Term Loan Advance requested), and such other shares of stock in Given owned by Borrower and other assets over which Borrower grants a first priority security interest and a first ranking fixed pledge and charge to Bank (if and to the extent provided in this Agreement and/or the Debenture), all in accordance with the Debenture Fixed Charge Agreement attached hereto as **Exhibit C** (as amended, modified or restated from time to time, the “**Debenture**”). In addition, prior to and as a condition precedent to requesting and receiving any Term Loan Advance, Borrower shall (a) execute and deliver to Bank such additional debentures, or amendments to the Debenture, as requested by Bank, to give Bank a first priority security interest and a first ranking fixed pledge and charge over the Collateral (each such new and/or amended debenture shall be included in the definition of the term “**Debenture**” herein), and (b) deliver to Bank (at Bank’s Israeli office) the certificates evidencing the shares of stock in Given owned by Borrower that constitute, or will constitute, Collateral.”

and inserting in lieu thereof the following:

“Borrower undertakes to create in favor of Bank, prior to and as a condition precedent to requesting and receiving any Term Loan Advance or 2013 Term Loan Advance, a first priority security interest and a first ranking fixed pledge and charge over the Collateral, which shall be such shares of stock in Given owned by Borrower as have an aggregate value (as reasonably determined by Bank) at least equal to three hundred twenty-five percent (325.0%) of the amount (as reasonably determined by Bank) of all outstanding Obligations (plus the amount of the Term Loan Advance or 2013 Term Loan Advance, as applicable, requested), and such other shares of stock in Given owned by Borrower and other assets over which Borrower grants a first priority security interest and a first ranking fixed pledge and charge to Bank (if and to the extent provided in this Agreement and/or the Debenture), all in accordance with the Debenture Fixed Charge Agreement attached hereto as **Exhibit C** (as amended by a certain Amendment to the Debenture Fixed Charge Agreement dated as of April 25, 2013, and as further amended, modified or restated from time to time, the “**Debenture**”). In addition, prior to and as a condition precedent to requesting and receiving any Term Loan Advance or 2013 Term Loan Advance, Borrower shall (a) execute and deliver to Bank such additional debentures, or amendments to the Debenture, as requested by Bank, to give Bank a first priority security interest and a first ranking fixed pledge and charge over the Collateral (each such new and/or amended debenture shall be included in the definition of the term “**Debenture**” herein), and provide Bank with evidence satisfactory to Bank that all filings in connection therewith have been made with the Registrar (including, without limitation, duly executed and stamped forms with a “received stamp” by the Registrar with respect thereto), and (b) deliver to Bank (at Bank’s Israeli office) the certificates evidencing the shares of stock in Given owned by Borrower that constitute, or will constitute, Collateral.”

9 The Loan Agreement shall be amended by deleting the following, appearing as Section 8.1 thereof:

“ **8.1 Payment Default.** Borrower fails to (a) make any payment of principal or interest on any Credit Extension on its due date, or (b) pay any other Obligations within three (3) Business Days after such Obligations are due and payable (which three (3) Business Day cure period shall not apply to payments due on the applicable Term Loan Maturity Date). During the cure period, the failure to make or pay any payment specified under clause (a) or (b) hereunder is not an Event of Default (but no Credit Extension will be made during the cure period);”

and inserting in lieu thereof the following:

“ **8.1 Payment Default.** Borrower fails to (a) make any payment of principal or interest on any Credit Extension, or any payment of the Unused Commitment Fee, on its due date, or (b) pay any other Obligations within three (3) Business Days after such Obligations are due and payable (which three (3) Business Day cure period shall not apply to payments due on the applicable Term Loan Maturity Date or the applicable 2013 Term Loan Maturity Date). During the cure period, the failure to make or pay any payment specified under clause (a) or (b) hereunder is not an Event of Default (but no Credit Extension will be made during the cure period);”

10 The Loan Agreement shall be amended by deleting the following, appearing as Section 8.9 thereof:

“ **8.9 Subordinated Debt.** Any document, instrument, or agreement evidencing any Subordinated Debt shall for any reason be revoked or invalidated or otherwise cease to be in full force and effect, any Person shall be in breach thereof or contest in any manner the validity or enforceability thereof or deny that it has any further liability or obligation thereunder, or the Obligations shall for any reason be subordinated or shall not have the priority contemplated by this Agreement.”

and inserting in lieu thereof the following:

“ **8.9 Subordinated Debt.** Any document, instrument, or agreement evidencing any Subordinated Debt shall for any reason be revoked or invalidated or otherwise cease to be in full force and effect, any Person shall be in breach thereof or contest in any manner the validity or enforceability thereof or deny that it has any further liability or obligation thereunder, or the Obligations shall for any reason be subordinated or shall not have the priority contemplated by this Agreement; or

**8.10 Mandatory Prepayment.** Borrower fails or neglects to perform any obligation in Section 2.1.2(f).”

11 The Loan Agreement shall be amended by inserting the following new definitions, to appear alphabetically in Section 13.1 thereof:

“ **“2013 Term Loan Advance”** and **“2013 Term Loan Advances”** are defined in Section 2.1.2(a).”

“ **“2013 Term Loan Advance Amount”** is Twenty-Five Million Dollars (\$25,000,000.00), provided that, if, as of December 31, 2013, Borrower has not requested, and Bank has not made, 2013 Term Loan Advances with an aggregate original principal amount of at least Ten Million Dollars (\$10,000,000.00), then the 2013 Term Loan Advance Amount shall, as of January 1, 2014 and at all times thereafter, be reduced by the difference between (a) Ten Million Dollars (\$10,000,000.00) and (b) the aggregate original principal amount of 2013 Term Loan Advances requested by Borrower, and made by Bank, on or before December 31, 2013.”

“ **“2013 Term Loan Maturity Date”** is, for each 2013 Term Loan Advance, the date that is twenty-four (24) months after the Funding Date of such 2013 Term Loan Advance.”

“ **“2013 Draw Period”** is the period of time commencing upon the First LMA Closing Date through the earlier to occur of (a) October 30, 2014, and (b) an Event of Default.”

“ **“Early Prepayment Amount”** is defined in Section 2.1.2(f) of this Agreement.”

“ **“First LMA Closing Date”** is April 25, 2013.”

“ **“Qualifying Proceeds”** are the aggregate proceeds consisting of cash or proceeds converted into cash by Borrower, resulting from a Qualifying Transaction and which were actually received by Borrower.”

“ **“Qualifying Transaction”** is a single transaction from a sale, assignment, disposition of assets, liquidation, merger, consolidation, change of ownership, or other similar transaction, with respect to any one (1) of Borrower’s portfolio companies (including, without limitation, any sale of equity or debt securities of any of Borrower’s portfolio companies), entitling Borrower to receive aggregate proceeds in an amount of at least Thirty Million Dollars (\$30,000,000.00) (including, without limitation, from equity, debt or otherwise, and whether immediate, deferred, escrowed or otherwise).”

“ **“Unused Commitment Fee”** is defined in Section 2.3(c) of this Agreement.”

12 The Loan Agreement shall be amended by deleting the following text, appearing in the definition of “Permitted Indebtedness” in Section 13.1 thereof:

“ (e) unsecured Indebtedness in favor of DIC, IDBD or IDBH, provided that such unsecured Indebtedness (i) is Subordinated Debt, (ii) is not incurred prior to Borrower requesting and receiving Term Loan Advances in an aggregate amount of Thirty Million Dollars (\$30,000,000.00), (iii) does not exceed at any time, in the aggregate, Thirty Million Dollars (\$30,000,000.00), and (iv) is not repaid (in whole or in part) until such time as (A) the Obligations are fully paid in cash, (B) Bank has no commitment or obligation to lend any further funds to Borrower, and (C) all financing agreements between Bank and Borrower are terminated by Borrower or Bank pursuant to the terms hereunder;”

and inserting in lieu thereof the following:

“ (e) unsecured Indebtedness in favor of DIC, IDBD or IDBH, provided that such unsecured Indebtedness (i) is Subordinated Debt, (ii) is not incurred prior to Borrower requesting and receiving Term Loan Advances and 2013 Term Loan Advances in an aggregate amount of (A) Five Million Dollars (\$5,000,000.00) plus (B) the 2013 Term Loan Advance Amount, (iii) does not exceed at any time, in the aggregate, Thirty Million Dollars (\$30,000,000.00), and (iv) is not repaid (in whole or in part) until such time as (A) the Obligations are fully paid in cash, (B) Bank has no commitment or obligation to lend any further funds to Borrower, and (C) all financing agreements between Bank and Borrower are terminated by Borrower or Bank pursuant to the terms hereunder;”



13 The Loan Agreement shall be amended by deleting the following definitions appearing in Section 13.1 thereof:

“ **“Credit Extension”** is any Term Loan Advance.”

“ **“Draw Period”** is the period of time commencing upon the Effective Date through the earlier to occur of (a) the date that is eighteen (18) months from the Effective Date, and (b) an Event of Default.”

“ **“Obligations”** are Borrower’s obligations to pay when due any debts, principal, interest, Term Loan Advance Fees, the Commitment Fee, Bank Expenses and other amounts Borrower owes Bank now or later, whether under this Agreement, the Loan Documents, or otherwise, including, without limitation, all Secured Amounts (as defined in the Debenture), including interest accruing after Insolvency Proceedings begin and debts, liabilities, or obligations of Borrower assigned to Bank, and to perform Borrower’s duties under the Loan Documents.”

“ **“Term Loan Advance”** and **“Term Loan Advances”** are defined in Section 2.1.2(a).”

and inserting in lieu thereof the following:

“ **“Credit Extension”** is any Term Loan Advance or 2013 Term Loan Advance.”

“ **“Draw Period”** is the period of time commencing upon the Effective Date through the earlier to occur of (a) the date immediately preceding the First LMA Closing Date, and (b) an Event of Default.”

“ **“Obligations”** are Borrower’s obligations to pay when due any debts, principal, interest, Term Loan Advance Fees, the Commitment Fee, the Unused Commitment Fee, Bank Expenses and other amounts Borrower owes Bank now or later, whether under this Agreement, the Loan Documents, or otherwise, including, without limitation, all Secured Amounts (as defined in the Debenture), including interest accruing after Insolvency Proceedings begin and debts, liabilities, or obligations of Borrower assigned to Bank, and to perform Borrower’s duties under the Loan Documents.”

“ **“Term Loan Advance”** and **“Term Loan Advances”** are defined in Section 2.1.1(a).”

14 The Payment/Advance Form appearing as **Exhibit A** to the Loan Agreement is hereby deleted and replaced with the Payment/Advance Form attached as **Schedule 1** hereto.

4. FEES AND EXPENSES. Borrower shall pay to Bank a modification fee equal to One Hundred Twenty-Five Thousand Dollars (\$125,000.00), which fee shall be due on the date hereof and shall be deemed fully earned as of the date hereof. Borrower shall also reimburse Bank for all reasonable legal fees and expenses incurred in connection with this amendment to the Existing Loan Documents.
5. RATIFICATION OF DEBENTURE. Borrower hereby ratifies, confirms and reaffirms, all and singular, the terms and conditions of the Debenture, and acknowledges, confirms and agrees that the Debenture shall remain in full force and effect and that the indebtedness secured thereby includes, without limitation, the Obligations.
6. CONSISTENT CHANGES. The Existing Loan Documents are hereby amended wherever necessary to reflect the changes described above.
7. NO DEFENSES OF BORROWER. Borrower hereby acknowledges and agrees that Borrower has no offsets, defenses, claims, or counterclaims against Bank with respect to the Obligations, or otherwise, and that if Borrower now has, or ever did have, any offsets, defenses, claims, or counterclaims against Bank, whether known or unknown, at law or in equity, all of them are hereby expressly WAIVED and Borrower hereby RELEASES Bank from any liability thereunder.
8. CONTINUING VALIDITY. Borrower understands and agrees that in modifying the existing Obligations, Bank is relying upon Borrower's representations, warranties, and agreements, as set forth in the Existing Loan Documents and as updated (with respect to Borrower's representations and warranties) as shown on Schedule 2 attached hereto. Except as expressly modified pursuant to this Loan Modification Agreement, the terms of the Existing Loan Documents remain unchanged and in full force and effect. Bank's agreement to modifications to the existing Obligations pursuant to this Loan Modification Agreement in no way shall obligate Bank to make any future modifications to the Obligations. Nothing in this Loan Modification Agreement shall constitute a satisfaction of the Obligations. It is the intention of Bank and Borrower to retain as liable parties all makers of Existing Loan Documents, unless the party is expressly released by Bank in writing. No maker will be released by virtue of this Loan Modification Agreement.
9. COUNTERSIGNATURE. This Loan Modification Agreement shall become effective only when it shall have been executed by Borrower and Bank.

*[The remainder of this page is intentionally left blank]*

This Loan Modification Agreement is executed as of the date first written above.

**BORROWER:**

**ELRON ELECTRONIC INDUSTRIES LTD.**

By: /s/Ari Bronshtein & Yaron Elad

Name: /s/Ari Bronshtein & Yaron Elad

Title: CEO, CFO

**BANK:**

**SILICON VALLEY BANK**

By: /s/ David Reimer

Name: /s/ David Reimer

Title: SVP

SCHEDULE 1

**EXHIBIT A – LOAN PAYMENT/ADVANCE REQUEST FORM**

DEADLINE FOR SAME DAY PROCESSING IS NOON EASTERN TIME

Fax To:

Date: \_\_\_\_\_

**Loan Payment:**

ELRON ELECTRONIC INDUSTRIES LTD.

From Account # \_\_\_\_\_  
(Deposit Account #)

To Account # \_\_\_\_\_  
(Loan Account #)

Principal \$ \_\_\_\_\_

and/or Interest \$ \_\_\_\_\_

Authorized Signature: \_\_\_\_\_

Phone Number: \_\_\_\_\_

Print Name/Title: \_\_\_\_\_

**LOAN ADVANCE:**

Complete *Outgoing Wire Request* section below if all or a portion of the funds from this loan advance are for an outgoing wire.

From Account # \_\_\_\_\_  
(Loan Account #)

To Account # \_\_\_\_\_  
(Deposit Account #)

Amount of 2013 Term Loan Advance \$ \_\_\_\_\_

All Borrower's representations and warranties in the Loan Agreement (as amended) are true, correct and complete in all material respects on the date of the request for an advance; provided, however, that such materiality qualifier shall not be applicable to any representations and warranties that already are qualified or modified by materiality in the text thereof; and provided, further that those representations and warranties expressly referring to a specific date shall be true, accurate and complete in all material respects as of such date:

Authorized Signature: \_\_\_\_\_

Phone Number: \_\_\_\_\_

Print Name/Title: \_\_\_\_\_

**OUTGOING WIRE REQUEST:**

**Complete only if all or a portion of funds from the loan advance above is to be wired.**

Deadline for same day processing is noon, Eastern Time

Beneficiary Name: \_\_\_\_\_

Amount of Wire: \$ \_\_\_\_\_

Beneficiary Bank: \_\_\_\_\_

Account Number: \_\_\_\_\_

City and State: \_\_\_\_\_

Beneficiary Bank Transit (ABA) #: \_\_\_\_\_

Beneficiary Bank Code (Swift, Sort, Chip, etc.): \_\_\_\_\_  
**(For International Wire Only)**

Intermediary Bank: \_\_\_\_\_

Transit (ABA) #: \_\_\_\_\_

For Further Credit to: \_\_\_\_\_

Special Instruction: \_\_\_\_\_

*By signing below, I (we) acknowledge and agree that my (our) funds transfer request shall be processed in accordance with and subject to the terms and conditions set forth in the agreements(s) covering funds transfer service(s), which agreements(s) were previously received and executed by me (us).*

Authorized Signature: \_\_\_\_\_

Print Name/Title: \_\_\_\_\_

Telephone #: \_\_\_\_\_

2<sup>nd</sup> Signature (if required): \_\_\_\_\_

Print Name/Title: \_\_\_\_\_

Telephone #: \_\_\_\_\_

SCHEDULE 2

**Exhibit 8.1**

The following table sets forth a list of our subsidiaries. Omitted from the table are those subsidiaries which are not significant subsidiaries (as defined in rule 1-02(w) of Regulation S-X of the Securities Exchange Act of 1934, as amended).

<b>Name of Subsidiary</b>	<b>Jurisdiction of Incorporation</b>
Elbit Ltd.	Israel
DEP Technology Holdings Ltd.	Israel
Given Imaging Ltd.*	Israel
RDC Rafael Development Corporation Ltd.	Israel
R.D.Seed Ltd.(formerly Navitrio Ltd.)	Israel

\* For more details regarding the Given Merger in February 2014, see Item 4.

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**CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Ari Bronshtein, certify that:

1. I have reviewed this annual report on Form 20-F of Elron Electronic Industries Ltd. (the "Company");
  2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
  3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;
  4. The Company's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Company and have:
    - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
    - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
    - (c) Evaluated the effectiveness of the Company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
    - (d) Disclosed in this report any change in the Company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting; and
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5. The Company's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company's auditors and the audit committee of the Company's board of directors (or persons performing the equivalent functions):
- (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal control over financial reporting.

Date: March 11, 2014

/s/ Ari Bronshtein  
Ari Bronshtein  
Chief Executive Officer  
(principal executive officer)

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**CERTIFICATION OF THE CHIEF FINANCIAL OFFICER**  
**PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Yaron Elad, certify that:

1. I have reviewed this annual report on Form 20-F of Elron Electronic Industries Ltd. (the "Company");
  2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
  3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;
  4. The Company's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Company and have:
    - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
    - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
    - (c) Evaluated the effectiveness of the Company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
    - (d) Disclosed in this report any change in the Company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting; and
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5. The Company's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company's auditors and the audit committee of the Company's board of directors (or persons performing the equivalent functions):
- (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal control over financial reporting.

Date: March 11, 2014

/s/ Yaron Elad  
\_\_\_\_\_  
Yaron Elad  
Vice President & Chief Financial Officer  
(principal financial officer)

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**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report on Form 20-F of Elron Electronic Industries, Ltd. (the "Company") for the fiscal year ended December 31, 2013, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Ari Bronshtein, Chief Executive Officer, hereby certifies, pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (i) The Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934; and
- (ii) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 11, 2014

/s/Ari Bronshtein  
\_\_\_\_\_  
Ari Bronshtein  
Chief Executive Officer  
(principal executive officer)

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**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report on Form 20-F of Elron Electronic Industries, Ltd. (the "Company") for the fiscal year ended December 31, 2013, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Yaron Elad, Vice President\* and Chief Financial Officer, hereby certifies, pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (i) The Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934; and
- (ii) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 11, 2014

/s/ Yaron Elad  
\_\_\_\_\_  
Yaron Elad  
Vice - President & Chief Financial Officer  
(principal financial officer)

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in the Registration Statements (Form S-8, No. 333-111310 and 333-152335) pertaining to the Employees' Stock Option Plans of Elron Electronic Industries Ltd. of our reports dated March 11, 2014, with respect to the consolidated financial statements of Elron Electronic Industries Ltd. and the effectiveness of internal control over financial reporting of Elron Electronic Industries Ltd. included in this Annual Report on Form 20-F for the year ended December 31, 2013.

Tel-Aviv, Israel  
March 11, 2014

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

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**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in the registration statement on Form S-8 (No. 333-111310 and 333-152335) pertaining to the Employees' Stock Option Plans of Elron Electronic Industries Ltd of our report dated February 25, 2014 with respect to the consolidated financial statements of Pocared Diagnostics Ltd included in this Annual Report on Form 20-F for the year ended December 31, 2013.

Tel-Aviv, Israel  
March 11, 2014

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

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**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**The Board of Directors**  
**Given Imaging Ltd.**

We consent to the incorporation by reference in the registration statements (File No. 333-111310 and 333-152335) on Form S-8 of Elron Electronic Industries Ltd. of our report dated February 27, 2014, with respect to the consolidated balance sheets of Given Imaging Ltd. (the "Company") as of December 31, 2013 and 2012, and the related consolidated statements of income and comprehensive income, changes in stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2013, which report appears in the December 31, 2013 annual report on Form 20-F of Elron Electronic Industries Ltd.

**Somekh Chaikin**  
**Certified Public Accountants (Israel)**  
**Member firm of KPMG International**

Haifa, Israel  
March 10, 2014

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