Payton Planar Magnetics Ltd.

Annual Report 2018

Contents

The Board of Directors' Report[1] on Corporate Affairs

We are pleased to present the Board of Directors' report on the affairs of Payton Planar Magnetics Ltd. and its consolidated subsidiaries for the year ended on December 31, 2018

***Notice**: This report contains certain forward-looking statements and information relating to the Company that are based on the beliefs of the Management of the Company as well as assumptions made by and information currently available to the Management of the Company. Such statements reflect the current views of the Company with respect to future events. Management emphasizes that the assumptions do not in any way imply commitment towards realization. The outcome of which is subject to certain risks and other factors, which may be outside of the Company's control. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results or outcomes may vary materially from those described herein as projected, anticipated, believed, estimated, expected or intended.*

Reference in this report to forward looking statement shall be by stating that such information is given by way of estimation, evaluation, assessment, intentions, expectations, beliefs and similar terms, but it is possible that such information shall be given under other phrases.

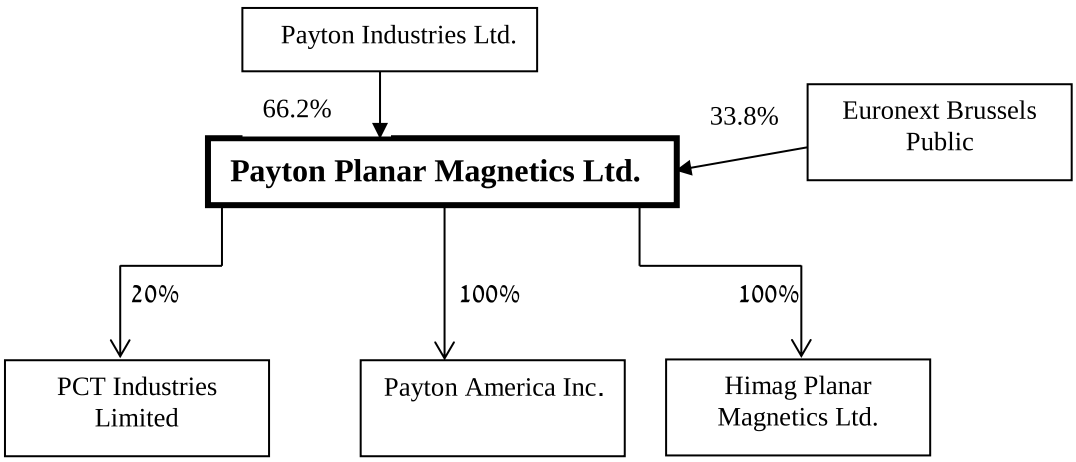
1. A concise description of the corporation and its business environment

A. The Group

The Group includes Payton Planar Magnetics Ltd. ("the Company"), its consolidated subsidiaries and it's Investee.

The Company holds two fully owned subsidiaries: (1) Payton America Inc., in Florida, USA, which mainly engages in the manufacture and marketing of transformers for the US domestic market; and (2) Himag Planar Magnetics Ltd., in the UK, which mainly engages in the development, manufacture and marketing of transformers and serves as the Group base for the UK and the European markets.

Effective from October 1, 2018, the Company entered into a strategic investment in equity accounted investee by acquiring 20% of the rights of a Hong-Kong holding company that fully owns a manufacturing subsidiary in China. The Chinese manufacturing subsidiary mentioned above is engaged in manufacturing and assembly, serves as one of Payton's major Manufacturing Partners.



[1] The financial statements as at December 31, 2018 form an integral part thereof.

B. The Group's main fields of activity and changes that occurred in the period from January to December 2018

The Company, an Israeli high-tech enterprise, develops manufactures and markets Planar and Conventional transformers worldwide. The Company was founded in order to revolutionize the traditional approach to the design and manufacture of transformers through the concept of planar transformers. The Company completed its initial public offering in 1998 on the EuroNext Stock Exchange.

During year 2018, the Group kept expanding its regular course of business. Sales volume increased by 38% compared to last year. Sales increase is attributed mainly to volume increase in existing projects.

As from January 1, 2018 - the Group initially applies International Financial Reporting Standard 15 ("IFRS 15" or "the standard") which provides guidance on revenue recognition. The Group elected to apply the standard using the cumulative effect approach, with an adjustment to the balance of retained earnings as at January 1, 2018 and without a restatement of comparative data. According to the standard, the Group recognizes revenue from goods with no alternative use over time, unlike the previous accounting treatment by which the Group recognized revenue based on delivery of the goods. The effect of the initial application of the standard on the Condensed Consolidated Financial Statements as of December 31, 2018 is detailed in note 2F(1) to the Financial Statements as at December 31, 2018.

On March 26, 2018 - the Company's Board of Directors decided to pay the shareholders a dividend for the financial year 2017, at the amount of USD 3,092 thousand (USD 0.175 per share, paid in full on May 24, 2018). On October 15, 2018, the General Meeting approved the said amount as final.

On October 17, 2018 - further to what was reported on the board of directors' report dated August 16, 2018 regarding the state of affairs of the Company, for the reporting period ended on June 30, 2018, the Company has completed and executed a strategic investment agreement, at the amount of USD 1 million, with an Hong-Kong holding company - PCT Industries Limited (hereinafter - "PCT") holding a fully owned subsidiary in Dongguan, China, engaging in manufacturing and assembly, which currently serves as one of the Company's major manufacturing Partners (subcontractors) in China. This agreement became valid on ***October 1, 2018***. In exchange for the investment the Company has been granted 20% of the rights in PCT and proportional representation on its board. It is noted that, in accordance with the investment agreement, the Company was granted an option to increase its share up to 35% of the rights in PCT at preferred terms.
This strategic investment may enable the Company a better foothold and exposure to the Chinese local market.
See also note 8 to the consolidated financial statements as at December 31, 2018.

On March 27, 2019 - the Company's Board of Directors decided to pay the shareholders a dividend for the financial year 2018, at the amount of USD 5,300 thousand (USD 0.3 per share, to be paid during June 2019).

C. Sales

The Group main customer base is related to the telecom, automotive and power electronic market. Additional markets the Group aims are Industrial and medical markets. During 2018, the Company keeps operating to expand its activity in: North America, Japan, China, S. Korea and UK.

Sales for the year ended December 31, 2018 amounted to USD 45,623 thousand compared with USD 33,043 thousand for the year ended December 31, 2017.

Revenues for the year ended 2018 consisted of recurring sales to existing customers and sales to new ones.

The Sales were generated primarily from telecom, automotive companies and industrial.

D. Principal customers

The consolidated sales revenues include sales to major customers (which make up in excess of 10% of the sales of the Group).

	For the year ended December 31	**For the year ended December 31**
	2018	**2017**
Tech-Front (Shanghai) Computer Co., Ltd.	22%	18%
Customer B	14%	10%
Customer C	13%	*

* Less than 10% of the Group's consolidated sales.

E. Global Environment and External factors effect on the Group's activity

In 2019 the Group will continue investing efforts to expand its production capacity as well as integration of automation. In addition to its normal course of business the Group will continue its ongoing searching of new markets as well as other business opportunities in order to keep expanding its core business. The Group estimates that the market trend in year 2019 will reflect a slowdown in the global economy as well as decrease in market demands.

Global fluctuations also affect the Group performances when it comes to currency exposure. Both, in Israel and in the UK, there are currency fluctuations in the exchange rates of the main currency (USD) vis-à-vis the NIS and the GBP.

Company Management is closely monitoring all above-mentioned market fluctuations and will continue to track their developments and effects. In addition, Company's Management is taking necessary actions in order to cope with the situation, to the greatest extent possible.

As a result of the Company's conservative cash policy, management estimates that the Group is financially strong and no liquidity problems are expected in the foreseeable future.

F. Marketing

- The Group participates in leading electronic exhibitions. During 2018 the Group participated in APEC in San-Antonio TX, USA (March, 2018), PCIM Europe 2018 Exhibition, Nuremberg, Germany (June, 2018), New-Tech Exhibition, Tel-Aviv, Israel (May, 2018) , Electronica 2018 Exhibition, Munich, Germany (November, 2018) and others.

- Company is serving Key customers with routine visits and latest technology development updates.

The Company strategy, which enables fulfilling the mission of gaining worldwide recognition and market share growth, is:

- Targeting world leaders in their fields. Having these leaders as our customers is convincing other second tier companies to adopt the Planar Technology.
- Focusing on Automotive (EV/HEV) and Telecom addition to the power electronic markets.
- Use the Group own sales team as well as its sales representatives' network as sales channels.
- Expanding our activity in China, Japan, North America and S. Korea markets.
- Deepening activity with existing customers.
- Maintaining the wide presence and global recognition.

G. Manufacturing

The group intends to expand and diversify its manufacturing capacity and capabilities, through manufacturing partners in the Far East in China and the Philippines. This activity objective is to increase flexible production capacity, to enable mass production quantities, lower products costs and increase competitiveness.

H. Competition

In the recent years there has been an increasing interest of magnetics manufacturers to get into the Planar field. We can note that there are more and more companies that are trying to design and manufacture the planar components. However, the Company believes in its technology advantage Know-how and capabilities. It estimates it could generally benefit from an increasing competition in the market due to greater exposure of the technology.

The Company cannot estimate its future market share. The following companies are considered as its potential competitors: Pulse and Coilcraft - from the U.S.A. and Premo - from Spain.

I. Order Backlog

As at December 31, 2018 this backlog amounted to USD 16,026 thousand, and as of March 12, 2019 to USD 14,358 thousand (December 31, 2017 - USD 16,796 thousand). The backlog is composed of the Company and its two fully owned subsidiaries firm orders.

Management estimates that most of the backlog as of 31.12.18 will be supplied until the end of December 2019.

It is noted that the above statement is a forward-looking statement as defined above.

J. Framework agreements that do not constitute binding orders

In 2018, the Company entered into framework agreements for the supply of magnetic components for the automotive industry for the electric/hybrid vehicle (HEV). The nature of activity in the automotive industry is characterized by projects with a life span of about 5 to 7 years.

The engagement was done by means of a Nomination Letter defining the basic terms of the parties' engagement in the project, such as prices (including annual discounts), terms of payment and the annual quantities expected over the projects' life. In addition, the Company and the Customer have signed an agreement that includes general and accepted terms and conditions of engagement in the industry, which regulate the general commercial relations between the parties (the Nomination Letter and the general terms of engagement are referred to above and hereinafter together as: "**the Framework Agreements**").

It is noted that the amounts and quantities specified in the Framework Agreements do not constitute as binding orders and the Customer is entitled to cancel, delay or reduce his actual orders, compared with the scope specified in the Framework Agreements, without the Company having any case against him. However, the Framework Agreements' forecast binds the Company to supply the quantities specified in the Framework Agreements as required.

Detailed below are the scope of the framework agreements the company is engaged, as of December 31, 2018 and March 12, 2019:

	December 31, 2018*	March 12, 2019*
	USD Millions	USD Millions
To be supplied in 2019	1	7
To be supplied in 2020	4	12
To be supplied in 2021	9	14
To be supplied in 2022 until 2025	32	41
Total	46	74

* The data detailed in the table above includes sales to one customer (customer C) for a number of different automotive projects, assuming that there will be no changes compared to the situation at the time of signing the framework agreements and that the sales specified in the framework agreements will be made accordingly. It should be emphasized that this section, including the Company's assessments detailed therein, includes forward-looking information, based on forecasts provided by the customer in the framework agreements (which, as mentioned above, are not binding on the customer), on the company’s estimations and on the duration of the engagement with its customer. Actual results may differ materially.

The Company is used to receive from the customer, on a regular basis, forecast of orders for the coming 1-9 months including general indications for longer terms, in order to plan the production of the total quantities reflected for the total expected demands.

It is noted that the above statement is a forward-looking statement as defined above.

K. Human Resources

A factor of importance to the Company’s success is its ability to attract, train and retain highly-skilled technical, and more specifically, qualified electronics engineers with experience in high frequency magnetics and with a comprehensive understanding of high frequency magnetics, managerial, sales and marketing personnel. Competition for such personnel is intense. The Company constantly betterments its personnel and has so far succeeded in recruiting the appropriate personnel as required. This personnel is important in maintaining the pace in research, design and technical customer support. The Company is confident however, that the challenges inherent in its operations will satisfy its Company’s future recruitment needs. By the end of 2018, the Group employed 200 people. The Company retains employment contracts with most of its key employees and is of the opinion that relations with its employees are satisfactory.

L. Quality Control

Payton Group has the ISO9001:2015 certification for its quality system. It has UL recognition for the use of several Electrical Insulation Systems classes B, F and H in its products, also has recognition of the construction of a family of magnetic components as complying with the requirements of UL and IEC 60950 standards of safety. Payton is authorized by an accredited testing agency to apply the CE mark to many of its commercial transformers.

Payton also meets recognized international safety standards and conforms to MIL.T, CSA VDE and other standards. The Company is certified with ISO14001:2015 (Environmental standard). Payton is a Lead Free company as required by the 2002/95/EC RoHS directive.
The Company is certified with two important International Quality Management Standards: for Automotive - IATF 16949:2016 and for Space & Avionic - AS9100 (at Payton America only).

M. Objective and Business Strategy

Since its incorporation, Payton has provided innovative and affordable Planar Magnetic solutions to the Power Electronic Industry.
By doing so, it has become the undisputable worldwide market leader in the Planar Magnetics Technology, with a customer base of leading technology-driven OEM's.
Payton plans to maintain its lead and continue to facilitate the transition of the Magnetics market to the Planar Technology by:

1. Maintaining business efficiency, operational efficiency and constant search for cost saving solutions.
2. Maintaining and strengthening its current customer base. This will enable Payton to build a track record as a reliable high-volume Planar component supplier to leading OEM's.
3. Selectively developing additional key strategic customers, especially in China, Japan, North America, India, S.Korea in order to further propagate Payton Planar unique technology.
4. Aiming and focusing on new high growth segments such as Automotive (EV/HEV) in addition to the present Telecom and industrial markets.
5. Continuing to educate the Power Electronics industry about Planar technology.
6. Continuing to develop its mass production expertise and capacities to a level that will enable Payton to address the large price-sensitive segments and mass production quantities segments of the global Magnetics market.
7. Payton is constantly looking for business opportunities to expand its core business with synergetic product lines.

It is noted that the above statement is a forward-looking statement as defined above.

N. Coming year outlook

In the coming year (2019) Payton plans to continue improving efficiency as well as increasing production capabilities and production automation, all this, as part of the Group plan to continue its regular course of business, enlarging its market share and maximize business challenges to the greatest possible extent. Nevertheless, the Group estimates that the market trend in year 2019 will reflect a slowdown in the global economy, a decrease in demand and a shortening of lead-time typical during a slowdown in the Electronics industry.
The group will continue its ongoing search for business and M&A opportunities, synergetic to its core business, in order to expand its activity.
It is noted that the above statement is a forward-looking statement as defined above.

O. Risk Factors

	Major Impact	Medium Impact	Small Impact
Macro Risks		▪ Chinese currency evaluation against the USD increases cost of goods sold. In addition, the increase of the minimum wages in China may increase the labor costs. ▪ Evaluation/Devaluation of the local currencies, NIS and GBP reflects an increase/decrease in labor costs and other operating costs. ▪ Changes in regulation and changes in international tariffs.	▪ Currency exposure during credit term period with regards to invoices issued in local currency. ▪ Currency exposure against the Group's functional currency (USD), in relation to sales priced in other currencies, mainly, GBP and Euro.
Market Risks		▪ Metals prices fluctuations especially: Copper, Aluminum, Tin and Silver, which are part of the transformers bill of materials. ▪ Automotive industry - alongside the opportunity for a large growth there is an Inherent risk since there is no commitments from the customer end (the Frame agreements are non-binding). In addition, the growing competition in this industry creates a constant pressure to reduce prices and margins.	
Specific Risks		▪ Manufacturing partners dependency.	

P. Current Shareholders position

Shareholder name	Number of shares	Percentage of the outstanding shares	Comments
Payton Industries Ltd.	11,694,381	66.2%	Israeli company traded in the Tel Aviv stock exchange.
Public	5,976,394	33.8%	Listed on the EuroNext since June 1998.
Total	17,670,775	100.0%	Total outstanding shares.

2. Financial position

A. Statement of Financial Position as at December 31, 2018

Cash and cash equivalents and Short-term Deposits **-** these items amounted to a total of USD 30,932 thousand as at December 31, 2018 compared to USD 24,448 thousand as at December 31, 2017.
The Company profitability during year 2018 attributed the increase in its solid cash position, inducing covering back the cash paid out as dividend, at the amount of USD 3,092 thousand, on May, 2018.

Other accounts receivable **-** these amounted to USD 1,779 thousand as at December 31, 2018 compared with USD 406 thousand as at December 31, 2017. The increase in this item is due to the implementation of IFRS 15, the new revenue recognition standard, which requires the Company to recognize revenues over time instead of upon delivery. Revenues recorded prior to delivery are recorded against "contract assets", which are presented among "other accounts receivable". As at December 31, 2018, such contact assets amounted to approximately USD 1.35 million. Since the Company adopted IFRS 15 using the cumulative effect approach, there were no contract assets recorded at December 31, 2017.

Investment in equity accounted investee **-** amounted to USD 1,015 thousand as at December 31, 2018. See paragraph 1B above - investment in PCT, and note 8 to the Consolidated Financial Statements as at December 31, 2018.

Trade payables **-** amounted to USD 1,891 thousand as at December 31, 2018 compared to USD 3,092 thousand as at December 31, 2017. The decrease in this item resulted mainly due to advance payment made to two main suppliers, manufacturing partners in the Far East, and also due to decrease in purchases near the reports date.

Deferred tax liabilities **-** amounted to USD 1,103 thousand as at December 31, 2018 compared to USD 767 thousand as at December 31, 2017. The increase in this item resulted mainly due to increase in differences of fixed assets accumulated depreciation (between the books and for tax purpose).

B. Interest rate, Currency and Market exposure - Data and Policy

Interest rate exposure
The Group’s interest rate exposure relates mainly to its balance of cash equivalents and short-term bank deposits. These balances are mostly held in USD bearing interest rates given by banks (interest rate - about 3.5%), which changes from time to time.

Data on linkage terms
The financial statements of the Company reflect the functional currency of the Company, which is the USD.
Most of the Group's sales (92%) in the reported periods were in USD or were linked to the USD. Approximately 4% of the Group’s sales in 2018 were in Euro, 1% were in NIS, and about 3% were in GBP.

During 2018, approximately 94% of the costs of raw material and finished goods purchased by the Group were in USD or were linked to the USD.
During 2018, approximately 80% of the Group’s salaries were in New Israeli Shekel ("NIS") and about 9% were in GBP.

Currency exposure risks

Since most of the Group's sales and purchases were in USD or linked to the USD, the Group's gross profit was exposed to the changes in exchange rates of the USD in relation to the Euro, the GBP and to the local New Israeli Shekel ("NIS") mostly with regards to labor costs and other operating costs (see also Data on linkage terms, above).

The Group is exposed to erosion of the USD in relation to the NIS and the GBP. Most of the Group’s salaries and other operating costs are fixed in the local currencies. Fluctuation of the U.S. Dollar with relation to local currencies (NIS & GBP) has an influence on the operating results of the Company.

Devaluation of the Euro(€) and Pound(£) in relation to the U.S. Dollar leads to a decrease in Group’s assets held in those currencies.

The Company is subcontracting in China. Devaluation of the U.S. Dollar with relation to the Chinese currency has an indirect effect on the Group’s cost of goods sold.

Market risks

During 2018 the Company used some derivatives as a tool for hedging, especially in order to hedge mostly its labor costs paid in NIS. With regards to all other operating costs, there is no need to use derivatives, since hedging is being kept inherently as part of the operational activity.

C. Operating results

Summary of Consolidated Statements of Income
US Dollars in thousands

Payton Planar Magnetics Ltd.
Consolidated Comprehensive Income Statements

	Total 2018	Total 2017	Half year 7-12/18	Half year 1-6/18
Sales revenues	45,623	33,043	23,567	22,056
Cost of sales	25,192	20,064	12,911	12,281
Gross profit	*20,431*	*12,979*	*10,656*	*9,775*
Development costs	(1,335)	(1,240)	(616)	(719)
Selling & marketing expenses	(2,261)	(2,269)	(1,111)	(1,150)
General & administrative expenses	(3,403)	(2,948)	(1,646)	(1,757)
Other income (expenses), net	2	4	(5)	7
Operating income	*13,434*	*6,526*	*7,278*	*6,156*
Finance income, net	241	313	144	97
Share of profits of equity accounted investee	24	-	24	-
Profit before income taxes	*13,699*	*6,839*	*7,446*	*6,253*
Income taxes	(2,338)	(1,295)	(1,280)	(1,058)
Net profit for the year/period	*11,361*	*5,544*	*6,166*	*5,195*
Other comprehensive income (loss) items that will not be transferred to profit &loss				
Remeasurement of defined benefit plan, net of taxes	62	(37)	62	-
Share of other comprehensive loss of equity accounted investee	(9)	-	(9)	
Total other comprehensive income (loss)	53	(37)	53	-
Total comprehensive income for the year/period	*11,414*	*5,507*	*6,219*	*5,195*

General Note: The Group is exposed to abrasion of the USD in relation to the NIS, Euro (€) and the Pound (£). Most of the Group’s salaries and other operating costs are fixed in the local currencies. Revaluation of the local currencies drives to an increase or decrease in labor costs and other operating costs, thus, affects the operating results of the Company**.**

Sales revenues - The Group’s sales revenues for year 2018 were USD 45,623 thousand compared with USD 33,043 thousand in year 2017 increase of 38%. Sales increase was attributed mainly due to ramp-up of few existing projects.

Gross profit **-** The Group’s gross results for the year ended December 31, 2018 were USD 20,431 thousand, compared with USD 12,979 thousand, in the year ended December 31, 2017. The increase in the gross profit relates mainly due to different products mix and production locations of each year, as well as efficiency achieved by the volume increase.

Development costs **-** Payton’s R&D strategy is aimed on maintaining the leadership of the Planar Technology. The R&D department works in conjunction with R&D departments of the forerunners of today’s global technology, and together they define tomorrow’s technological needs. Costs were based upon time expended by the department’s employees. The Group’s development costs for the year ended December 31, 2018 were USD 1,335 thousand compared with USD 1,240 thousand in the year ended December 31, 2017. The increase is mainly explained by an increase in Engineering & Development team labor costs.

Selling & marketing expenses **-** The Group’s selling & marketing expenses are mainly comprised of: (1) commissions to the Group's reps’ and Marketing Personnel, which are calculated as a portion of sales (It is noted that not all the sales are subject to reps’ commissions) and of (2) other selling expenses (fixed) based on management policy. The Group’s marketing efforts are concentrated through participation in major power electronic shows around the world and by collaborating with its worldwide rep's Network. The Group’s selling & marketing expenses for the year ended December 31, 2018 amounted to USD 2,261 thousand (5%) compared with USD 2,269 thousand (7%) in the year ended December 31, 2017. The decrease in the portion of these expenses out of total sales stemmed, inter alia, from the increase in sales to customers which were not subject to reps’ commission.

General & Administrative expenses - The Group’s General & Administrative expenses for the year ended December 31, 2018 amounted to USD 3,403 thousand compared with USD 2,948 thousand in the year ended December 31, 2017. The increase in these expenses relates mainly due to an increase in management incentives derived from the profits increase and from increase in non-recurring other General & Administrative expenses.

Information regarding - Transactions with related parties *(pursuant to note 16 G to the Consolidated Financial Statements as at December 31, 2018)*

Compensation and benefits to key management personnel and interested parties (including directors) that are employed by the Group:

	Year ended December 31				**December 31**	
	2018		**2017**		**2018**	**2017**
	Number of People	**Amount**	**Number of People**	**Amount**	**Outstanding balance**	
		$ thousands		**$ thousands**	**$ thousands**	**$ thousands**
Short-term employee benefits (*)		**501**		803	**28**	164
Post-employment benefits		**83**		98	**56**	64
	4	**584**	5	901	**84**	228

(*) For the year ended December 31, 2017 - Including full year compensation paid to a related party that starting November 1, 2017 providing his services through his fully owned company - see Note 13B.

Compensation to key management personnel (including directors) that are not employed by the Group:

	Year ended December 31				December 31	
	2018		2017		2018	2017
	Number of People	Amount	Number of People	Amount	Outstanding balance	
		$ thousands		$ thousands	$ thousands	$ thousands
Total compensation to directors not employed by the Group	**3**	**36**	3	36	**9**	8
Total compensation to key management personnel not employed by the Group (*)	**2**	**1,298**	1	758	**564**	288
Accounts receivable- The Parent Company	-	-	-	-	**103**	105

(*) Management fees and related benefits to Wichita Ltd. (see Note 13A) and to Yaarh-Looking To The Future Ltd. (see Note 13B) include an amount of USD 153 thousand (year ended December 31, 2017: USD 149 thousand) and an amount of USD 208 thousand, respectively, recorded as selling and marketing expenses.

Inter-company transactions between the Company and its two fully owned subsidiaries (Payton America Inc. and Himag Planar Magnetics Ltd.) include, inter alia, the following: Buy & Resale, engineering support, marketing, administrative and management services. All the inter-company transactions are being eliminated within consolidated financial statements.

3. Liquidity

A. Operating activities

Cash flows generated from operating activities for the year ended December 31, 2018 amounted USD 11,098 thousand, compared with the cash flows generated from operating activities of USD 7,813 thousand for the year ended December 31, 2017. The increase in the cash flows from operating activities resulted mostly from the increase in the profit for the year, decrease in other accounts receivables and in trade accounts receivables as well as from other non-cash adjustments and changes in assets and liabilities.

B. Investing activities

Cash flows used for investing activities in the year ended December 31, 2018 amounted USD 5,699 thousand compared with USD 7,798 thousand in the year ended December 31, 2017. During year 2018 the cash flows were mostly invested in short term bank deposits. An amount of USD 1 million was used for the investment in PCT (see paragraph 1B, above).

C. Financing activities

Cash flows used for financing activities in the year ended December 31, 2018 amounted USD 3,092 thousand compared with cash flows used for financing activities of USD 3,116 thousand in the year ended December 31, 2017. Dividend at the amount of USD 3,092 thousand, USD 0.175 per share, (announced March 26, 2018) was paid in full on May 2018.

4. **Financing sources**

The Group financed its activities during the reported periods from its own resources.

5. **Subsequent Events**

On March 27, 2019, the Company’s Board of Directors decided to pay the shareholders a dividend for the financial year 2018 at the amount USD 5,300 thousand (USD 0.3 per share, to be paid on June 2019). The dividend is submitted to a tax withholding of 15%.

During 2018 and thereafter, the Company engaged in few material framework agreements for the supply of magnetic components to the automotive industry. However, as at the signing date of the report, it seems that year 2019 is characterized, inter alia, by signs of a slowdown in the global economy. For details, see also paragraphs 1J, 1E, 1N and 1I, respectively, above.

It should be clarified that the Company's assessments above are forward looking information, and it is clarified that the actual results may differ materially from the implications of this information.

6. **External factors effects**

Revaluation/devaluation of the local currencies, NIS and GBP, in relation to the U.S. Dollar leads to an increase/decrease (respectively) in labor costs and other operating costs. Most of the Group’s salaries and other operating costs are fixed in local currencies; therefore, the operating results are affected.

Devaluation of the Euro(€) and Pound(£) in relation to the U.S. Dollar leads to a decrease in Group’s assets in those currencies.

See also paragraph 1O above (Risk Factors).

To the best of the Board of Directors’ and management’s knowledge, except the above mentioned, there have been no significant changes in external factors that may materially affect the Company’s financial position or results of operations.

7. Statement by senior management in accordance with article 12, § 2 (3°) of the Royal Decree per 14.11.2007

Pursuant to article 13 § 2,3 of the Royal Decree of 14 November 2007, David Yativ Chairman of the Board of Directors declares, on behalf of and for the account of Payton Planar Magnetics that, as far as is known to him,

a) The financial statements at December 31, 2018 are drawn up in accordance with IFRS-reporting as adopted by the European Union and present a true and fair view of the equity, financial situation and results of the company

b) The report gives a true and fair view of the main events of the financial year, their impact on the financial statements, the main risk factors and uncertainties, as well as the main transactions with related parties and their possible impact on the financial statements.

The Company's Board of Directors wishes to thank our shareholders for their continuance trust and belief.

The Company's Board of Directors wishes to express its sincere thanks to the entire personnel for their efforts and contribution to the Group's affairs.

Ness-Ziona, March 27, 2019.

David Yativ **Chairman of the Board of Directors**	**Doron Yativ** **Director and C.E.O.**

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Independent Auditors' Report

To the Shareholders of Payton Planar Magnetics Ltd.

Opinion

We have audited the consolidated financial statements of Payton Planar Magnetics Ltd. ("the Company"), which comprise the consolidated statement of financial position as at December 31, 2018, the consolidated statements of profit or loss and other comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as at December 31, 2018, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditors' Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Israel, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Revenue recognition

Revenue is a key performance indicator and of importance to the financial statements users. The Company has issued clear guidelines to its executives not to take any account of the pressure to meet expectations when preparing the financial statements. Nevertheless, the pressure to report on high revenues to the investors, form an inherent risk that revenue at year-end may be recognized prematurely.

With respect to this audit matter, our audit procedures included extended sampling of transactions recorded close to the end of the year and checking that such transactions had met all criteria for revenue recognition in 2018, and therefore were included in the appropriate period. Such sampling included obtaining evidence from external sources as to the delivery of the products before year-end, based on the various shipping terms. We also checked if any credit notes were issued in the subsequent period for revenues that were recognized in 2018, in order to obtain evidence of proper revenue recognition in 2018.

Other Information

Management is responsible for the other information. The other information comprises the Board of Directors' Report on Corporate Affairs.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit 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 Company's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditors' report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditors' report is Ehud Lev.

Somekh Chaikin
Certified Public Accountants (Isr.)
(A member of KPMG International)

March 27, 2019

Consolidated Statements of Financial Position as at December 31

	Note	2018 $ thousands	2017* $ thousands
Current assets			
Cash and cash equivalents	4	**7,366**	5,089
Short-term deposits and investments	5	**23,566**	19,359
Trade accounts receivable	6	**6,151**	6,545
Other accounts receivable	6	**1,779**	406
Inventory	7	**3,281**	3,647
Total current assets		**42,143**	35,046
Non-current assets			
Investment in equity accounted investee	8	**1,015**	-
Fixed assets	9	**11,256**	11,641
Intangible assets		**22**	22
Deferred taxes	17	**-**	3
Total non-current assets		**12,293**	11,666
Total assets		**54,436**	46,712

* See Note 2F(1) regarding initial application of IFRS 15, *Revenue from Contracts with Customers*. According to the transitional method that was chosen, comparative data were not restated.

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

Consolidated Statements of Financial Position as at December 31 (cont'd)

	Note	2018 $ thousands	2017* $ thousands
Liabilities and equity			
Current liabilities			
Trade payables		**1,891**	3,092
Other payables	10	**1,682**	1,478
Current tax liability		**1,062**	926
Employee benefits	11	**378**	457
Total current liabilities		**5,013**	5,953
Non-current liabilities			
Employee benefits	11	**399**	514
Deferred tax liabilities	17	**1,103**	767
Total non-current liabilities		**1,502**	1,281
Total liabilities		**6,515**	7,234
Equity			
Share capital	15	**4,836**	4,836
Share premium		**8,993**	8,993
Retained earnings		**34,092**	25,649
Total equity		**47,921**	39,478
Total liabilities and equity		**54,436**	46,712

David Yativ	Doron Yativ	Michal Lichtenstein
Chairman of the Board of Directors	Chief Executive Officer	V.P. Finance & CFO

Date of approval of the financial statements: March 27, 2019

* See Note 2F(1) regarding initial application of IFRS 15, *Revenue from Contracts with Customers*. According to the transitional method that was chosen, comparative data were not restated.

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

Consolidated Statements of Profit or Loss and Other Comprehensive Income for the year ended December 31

	Note	2018 $ thousands	2017* $ thousands
Revenues	16A	**45,623**	33,043
Cost of sales	16B	**(25,192)**	(20,064)
Gross profit		**20,431**	12,979
Development costs		**(1,335)**	(1,240)
Selling and marketing expenses	16C	**(2,261)**	(2,269)
General and administrative expenses	16D	**(3,403)**	(2,948)
Other income, net	16E	**2**	4
Operating profit		**13,434**	6,526
Finance income	16F	**392**	357
Finance expenses	16F	**(151)**	(44)
Finance income, net		**241**	313
Share of profits of equity accounted investee		**24**	-
Profit before income taxes		**13,699**	6,839
Income taxes	17	**(2,338)**	(1,295)
Profit for the year		**11,361**	5,544
Other comprehensive income (loss) items that will not be transferred to profit and loss			
Remeasurement of defined benefit plan, net of taxes	11	**62**	(37)
Share of other comprehensive loss of equity accounted investee		**(9)**	-
Total other comprehensive income (loss)		**53**	(37)
Total comprehensive income for the year		**11,414**	5,507
Basic and diluted earnings per share (in $)	18	**0.64**	0.31

* See Note 2F(1) regarding initial application of IFRS 15, *Revenue from Contracts with Customers*. According to the transitional method that was chosen, comparative data were not restated.

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

Consolidated Statements of Changes in Equity for the year ended December 31

	Share capital		Share	Retained	
	Number of shares	$ thousands	premium $ thousands	earnings $ thousands	Total $ thousands
Balance at January 1, 2017	17,670,775	4,836	8,993	23,234	37,063
Total comprehensive income for the year					
Profit for the year	-	-	-	5,544	5,544
Other comprehensive loss	-	-	-	(37)	(37)
Total comprehensive income for the year	-	-	-	5,507	5,507
Transactions with owners recognized directly in equity					
Dividend to owners	-	-	-	(3,092)	(3,092)
Balance at December 31, 2017	17,670,775	4,836	8,993	25,649	39,478
Effect of initial application of IFRS 15*	**-**	**-**	**-**	**121**	**121**
Balance as at January 1, 2018	**17,670,775**	**4,836**	**8,993**	**25,770**	**39,599**
Total comprehensive income for the year					
Profit for the year	**-**	**-**	**-**	**11,361**	**11,361**
Other comprehensive income	**-**	**-**	**-**	**53**	**53**
Total comprehensive income for the year	**-**	**-**	**-**	**11,414**	**11,414**
Transactions with owners, recognized directly in equity					
Dividend to owners	**-**	**-**	**-**	**(3,092)**	**(3,092)**
Balance at December 31, 2018	**17,670,775**	**4,836**	**8,993**	**34,092**	**47,921**

* See Note 2F(1) regarding initial application of IFRS 15, *Revenue from Contracts with Customers*. According to the transitional method that was chosen, comparative data were not restated.

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

Consolidated Statements of Cash Flows for the year ended December 31

	Note	2018 $ thousands	2017* $ thousands
Operating activities			
Profit for the year		**11,361**	5,544
Adjustments to reconcile profit to net cash generated from operating activities:			
Depreciation and amortization	9	**905**	931
Income taxes	17	**2,338**	1,295
Share of profits of equity accounted investee	8	**(24)**	-
Capital gain on sale of fixed assets	16E	**(2)**	(4)
Finance income, net	16F	**(350)**	(301)
(Decrease) increase in employee benefits	11	**(117)**	154
Decrease in trade accounts receivable	6	**394**	1,248
(Increase) decrease in other accounts receivable	6	**(773)**	150
(Increase) decrease in inventory	7	**(84)**	21
Decrease in trade payables		**(1,202)**	(663)
Increase in other payables	10	**204**	77
Interest received	16F	**379**	214
Interest paid	16F	**(24)**	(7)
Tax paid	17	**(1,907)**	(846)
Cash flows generated from operating activities		**11,098**	7,813
Investing activities			
Investment in deposits, net	5	**(4,182)**	(7,254)
Acquisition of equity accounted investee	8	**(1,000)**	-
Investment in fixed assets	9	**(527)**	(555)
Proceeds from sale of fixed assets	9, 16E	**10**	11
Cash flows used for investing activities		**(5,699)**	(7,798)
Financing activities			
Payment of contingent consideration		**-**	(24)
Dividend paid	15	**(3,092)**	(3,092)
Cash flows used for financing activities		**(3,092)**	(3,116)
Net increase (decrease) in cash and cash equivalents		**2,307**	(3,101)
Cash and cash equivalents at beginning of the year		**5,089**	8,150
Effect of exchange rate fluctuations on cash and cash equivalents		**(30)**	40
Cash and cash equivalents at end of the year		**7,366**	5,089

* See Note 2F(1) regarding initial application of IFRS 15, *Revenue from Contracts with Customers*. According to the transitional method that was chosen, comparative data were not restated.

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

Note 1 - General

A. Reporting entity

Payton Planar Magnetics Ltd. ("the Company") was incorporated in December 1992. The address of the Company's registered office is 3 Ha'avoda Street, Ness-Ziona.
The Company is a subsidiary of Payton Industries Ltd. (the "Parent Company") and its ultimate controlling shareholder is Mr. David Yativ. The securities of the Company are registered for trade on the Euronext stock exchange in Brussels.

The consolidated financial statements of the Group as at and for the year ended December 31, 2018 comprise the Company and its subsidiaries (together referred to as the "Group").

The Group develops, manufactures and markets planar and conventional transformers and operates abroad through its subsidiaries and distributors.

B. Definitions

In these financial statements –

1. **The Company** – Payton Planar Magnetics Ltd.

2. **The Group** – The Company and its subsidiaries.

3. **Payton Industries Ltd.** – Parent company, traded on the Tel Aviv Stock Exchange.

4. **Subsidiaries** – Companies, the financial statements of which are fully consolidated, directly or indirectly, with the financial statements of the Company.

5. **Investee companies** – Subsidiaries and companies, the Company's investment in which is stated, directly or indirectly, on the equity basis.

6. **Related party** – Within its meaning in IAS 24 (2009), "Related Party Disclosures".

7. **Israeli CPI** – The Consumer Price Index as published by the Central Bureau of Statistics in Israel.

8. **NIS** – The Israeli currency – New Israeli Shekel.

9. **$** – U.S. Dollar.

10. **GBP** – Great Britain Pound.

Note 2 - Basis of Preparation

A. Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) and its interpretations adopted by the International Accounting Standards Board ("IASB").

The consolidated financial statements were authorized for issue by the Company's Board of Directors on March 27, 2019.

B. Functional and presentation currency

These consolidated financial statements are presented in U.S. dollars, which is the Company's functional currency, and have been rounded to the nearest thousand. The U.S. dollar is the currency that represents the principal economic environment in which the Company operates.

C. Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis except for the following assets and liabilities:

* Financial instruments, including derivatives, measured at fair value through profit or loss;
* Deferred tax assets and liabilities;
* Employee benefit assets and liabilities
* Investment in equity accounted investee

For further information regarding the measurement of these assets and liabilities see Note 3 regarding significant accounting policies.

D. Operating cycle

The operating cycle of the Group is one year. Thus, current assets and current liabilities include items the realization of which is intended and anticipated to take place within one year.

E. Use of estimates and judgments

The preparation of financial statements in conformity with IFRSs requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

The preparation of accounting estimates used in the preparation of the Group's financial statements requires management of the Company to make assumptions regarding circumstances and events that involve considerable uncertainty. Management of the Company prepares the estimates on the basis of past experience, various facts, external circumstances, and reasonable assumptions according to the pertinent circumstances of each estimate.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Note 2 - Basis of Preparation (cont'd)

E. Use of estimates and judgments (cont'd)

Determination of fair value
Preparation of the financial statements requires the Group to determine the fair value of certain assets and liabilities.

Further information about the assumptions that were used to determine fair value is included in Note 14, on financial instruments.

When determining the fair value of an asset or liability, the Group uses observable market data as much as possible. There are three levels of fair value measurements in the fair value hierarchy that are based on the data used in the measurement, as follows:

- 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 (unobservable inputs).

F. Initial application of new standards, amendments to standards and interpretations

As from January 1, 2018, the Group applies the new standards and amendments to standards described below:

(1) IFRS 15, *Revenue from Contracts with Customers*

As from January 1, 2018, the Group initially applies International Financial Reporting Standard 15 ("IFRS 15" or "the standard") which provides guidance on revenue recognition.

The Group elected to apply the standard using the cumulative effect approach, with an adjustment to the balance of retained earnings as at January 1, 2018 and without a restatement of comparative data.

The standard introduces a new five steps model for analyzing transactions so as to determine when to recognize revenue and at what amount. The Group's revenue is generated from the sale of goods manufactured according to customer specifications and based on NCNR terms (non-cancelation and non-refundable). The Group is entitled to reimbursement of the costs incurred to date, including a reasonable margin. Customer-specific goods cannot be sold to any other customer and therefore have no alternative use.

According to the standard, the Group recognizes revenue from goods with no alternative use over time, unlike the previous accounting treatment by which the Group recognized revenue only when the goods were transferred to the customer or to its forwarder.

Note 2 - Basis of Preparation (cont'd)

F. Initial application of new standards, amendments to standards and interpretations (cont'd)

(1) IFRS 15, *Revenue from Contracts with Customers* (cont'd)

The table below presents the cumulative effect on the items affected by the initial application in the statement of financial position as at January 1, 2018:

	According to the previous policy	The change	According to IFRS 15
	$ thousands	$ thousands	$ thousands
Other accounts receivable	406	600	1,006
Inventory	3,647	(450)	3,197
Deferred tax liabilities	767	29	796
Retained earnings	25,649	121	25,770

The tables below present the effects on the statement of financial position as at December 31, 2018 and on the statement of profit or loss for the year then ended, assuming that the previous revenue recognition policy would have continued in that period:

Effect on the statement of financial position as at December 31, 2018:

	According to the previous policy	The change	According to IFRS 15
	$ thousands	$ thousands	$ thousands
Other accounts receivable	427	1,352	1,779
Inventory	4,129	(848)	3,281
Deferred tax liabilities	1,007	96	1,103
Retained earnings	33,684	408	34,092

Note 2 - Basis of Preparation (cont'd)

F. Initial application of new standards, amendments to standards and interpretations (cont'd)

(1) IFRS 15, *Revenue from Contracts with Customers* (cont'd)

Effect on the statement of proit or loss for the year ended December 31, 2018:

	According to the previous policy	The change	According to IFRS 15
	$ thousands	$ thousands	$ thousands
Revenues	44,271	1,352	45,623
Cost of sales	(24,344)	(848)	(25,192)
Gross profit	19,927	504	20,431
Operating profit	12,930	504	13,434
Profit before income taxes	13,195	504	13,699
Income taxes	(2,242)	(96)	(2,338)
Profit for the year	10,953	408	11,361
Basic and diluted earnings per share (in $)	0.62	0.02	0.64

(2) IFRS 9 (2014), *Financial Instruments*

As from January 1, 2018 the Group applies IFRS 9, Financial Instruments ("IFRS 9"), which replaces IAS 39, Financial Instruments: Recognition and Measurement ("IAS 39").
Additionally, following the application of IFRS 9, the Group has adopted consequential amendments to IFRS 7, Financial Instruments: Disclosures, and to IAS 1, Presentation of Financial Statements.

IFRS 9 changes the classification of financial assets and contains three principal categories for financial assets. This change did not have an effect on the Group due to its limited classes of financial assets. IFRS 9 also replaces the impairment model of IAS 39 with an 'expected credit loss' (ECL) model. In respect of the Group's financial assets, the model applies to financial assets measured at amortized cost and contract assets (as defined in IFRS 15). The new impairment model of IFRS 9 did not have a material effect on the Group.

IFRS 9 also introduces a new hedge accounting model, which did not have an effect on the Group since the Group does not apply hedge accounting.

Note 3 - Significant Accounting Policies

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements, and have been applied consistently by Group entities.

A. Basis of consolidation

1. Business combinations

Business combinations, including business combinations under common control, are accounted for using the acquisition method.

The acquisition date is the date on which the acquirer obtains control over the acquiree. Control exists when the Group is exposed, or has rights, to variable returns from its involvement with the acquiree and it has the ability to affect those returns through its power over the acquiree. Substantive rights held by the Group and others are taken into account when assessing control.

The Group recognizes goodwill on acquisition according to the fair value of the consideration transferred less the net amount of the identifiable assets acquired and the liabilities assumed.

On the acquisition date, the acquirer recognizes a contingent liability assumed in a business combination if there is a present obligation resulting from past events and its fair value can be reliably measured.

The consideration transferred includes the fair value of the assets transferred to the previous owners of the acquiree and the liabilities incurred by the acquirer to the previous owners of the acquiree. In addition, the consideration transferred includes the fair value of any contingent consideration. After the acquisition date, the Group recognizes changes in the fair value of contingent consideration classified as a financial liability in profit or loss.

Costs associated with the acquisition that were incurred by the acquirer in the business combination such as legal and valuation consulting fees are expensed in the period the services are received.

2. Subsidiaries

Subsidiaries are entities controlled by the Group. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the Group.

3. Investment in associates (equity accounted investees)

Associates are those entities in which the Group has significant influence, but not control or joint control, over the financial and operating policies. There is a rebuttable presumption that significant influence exists when the Group holds between 20% and 50% of another entity. In assessing significant influence, potential voting rights that are currently exercisable or convertible into shares of the investee are taken into account.

Associates are accounted for using the equity method (equity accounted investees) and are recognized initially at cost. The cost of the investment includes transaction costs. Transaction costs that are directly attributable to an acquisition of an associate are added to the cost of the investment on the acquisition date. The consolidated financial statements include the Group's share of the income and expenses in profit or loss and of other comprehensive income of equity accounted investees, after adjustments to align the accounting policies with those of the Group, from the date that significant influence or joint control commences until the date that significant influence or joint control ceases.

The Group discontinues applying the equity method from the date it loses significant influence in an associate and it accounts for the retained investment as a financial asset or subsidiary, as relevant.

Note 3 - Significant Accounting Policies (cont'd)

A. Basis of consolidation (cont'd)

4. Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealized income or expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

Unrealized gains arising from transactions with associates are eliminated against the investment to the extent of the Group's interest in these investments. Unrealized losses are eliminated in the same way as unrealized gains, but only to the extent that there is no evidence of impairment.

B. Foreign currency transactions

Transactions in foreign currencies are translated to the functional currency of the Group at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to the functional currency at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortized cost in the functional currency at the beginning of the year, adjusted for effective interest and payments during the year, and the amortized cost in foreign currency translated at the exchange rate at the end of the year.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

Foreign currency differences arising on translation are recognized in profit or loss.

C. Financial instruments

1. Non-derivative financial assets - policy applicable as from January 1, 2018

Initial recognition and measurement of financial assets

The Group initially recognizes trade receivables and debt instruments issued on the date that they are created. All other financial assets are recognized initially on the trade date at which the Group becomes a party to the contractual provisions of the instrument.

A financial asset is initially measured at fair value plus transaction costs that are directly attributable to the acquisition or issuance of the financial asset. A trade receivable without a significant financing component is initially measured at the transaction price.

Derecognition of financial assets

Financial assets are derecognized when the contractual rights of the Group to the cash flows from the asset expire, or the Group transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. When the Group retains substantially all of the risks and rewards of ownership of the financial asset, it continues to recognize the financial asset.

Classification of financial assets into categories and the accounting treatment of each category

Financial assets are classified at initial recognition to one of the following measurement categories: amortized cost or fair value through profit or loss.

Financial assets are not reclassified in subsequent periods unless, and only if, the Group changes its business model for the management of financial debt assets, in which case the affected financial debt assets are reclassified at the beginning of the period following the change in the business model.

Note 3 - Significant Accounting Policies (cont'd)

C. Financial instruments (cont'd)

1. Non-derivative financial assets - policy applicable as from January 1, 2018 (cont'd)

Classification of financial assets into categories and the accounting treatment of each category **(cont'd)**
A financial asset is measured at amortized cost if it meets both of the following conditions and is not designated at fair value through profit or loss:
- It is held within a business model whose objective is to hold assets so as to collect contractual cash flows; and
- The contractual terms of the financial asset give rise to cash flows representing solely payments of principal and interest on the principal amount outstanding on specified dates.

All financial assets not classified as measured at amortized cost are measured at fair value through profit or loss. On initial recognition, the Group designates financial assets at fair value through profit or loss if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Subsequent measurement and gains and losses
Financial assets at fair value through profit or loss
These assets are subsequently measured at fair value. Net gains and losses, including any interest income or dividend income, are recognized in profit or loss.

Financial assets at amortized cost
These assets are subsequently measured at amortized cost using the effective interest method. The amortized cost is reduced by impairment losses. Interest income, foreign exchange gains and losses and impairment are recognized in profit or loss. Any gain or loss on derecognition is recognized in profit or loss.

2. Non-derivative financial assets - policy applicable before January 1, 2018

Initial recognition of financial assets
The Group initially recognizes loans and receivables and deposits on the date that they are created. All other financial assets acquired in a regular way purchase, are recognized initially on the trade date at which the Group becomes a party to the contractual provisions of the instrument, meaning on the date the Group undertook to purchase or sell the asset. Non-derivative financial instruments comprise trade and other receivables, deposits and cash and cash equivalents.

Derecognition of financial assets
Financial assets are derecognized when the contractual rights of the Group to the cash flows from the asset expire, or the Group transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred.

Regular way sales of financial assets are recognized on the trade date, meaning on the date the Group undertook to sell the asset.

See 3 hereunder regarding the offset of financial assets and financial liabilities.

Note 3 - Significant Accounting Policies (cont’d)

C. Financial instruments (cont'd)

2. Non-derivative financial assets - policy applicable before January 1, 2018 (cont'd)

Classification of financial assets into categories and the accounting treatment of each category
The Group classifies its financial assets according to the following categories:

Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition loans and receivables are measured at amortized cost using the effective interest method, less any impairment losses.

Loans and receivables comprise cash and cash equivalents, trade and other receivables.

Cash and cash equivalents comprise cash balances available for immediate use and call deposits. Cash equivalents comprise short-term highly liquid investments (with original maturities of three months or less) that are readily convertible into known amounts of cash and are exposed to insignificant risks of change in value.

3. Non-derivative financial liabilities

The Group has the following non-derivative financial liabilities: trade and other payables.

Initial recognition of financial liabilities
Financial liabilities are recognized initially on the trade date at which the Group becomes a party to the contractual provisions of the instrument.

Financial liabilities are recognized initially at fair value less any directly attributable transaction costs. Subsequent to initial recognition these financial liabilities are measured at amortized cost using the effective interest method.

Derecognition of financial liabilities
Financial liabilities are derecognized when the obligation of the Group, as specified in the agreement, expires or when it is discharged or cancelled.

Offset of financial instruments
Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Group currently has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

Note 3 - Significant Accounting Policies (cont’d)

C. Financial instruments (cont’d)

4. Derivative financial instruments

Economic hedges
Hedge accounting is not applied to derivative instruments that economically hedge financial assets and liabilities denominated in foreign currencies. Change in the fair value of such derivatives are recognized in profit or loss under financing income or expenses.

5. Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares are recognized as a deduction from equity.

D. Fixed assets

1. Recognition and measurement

Fixed asset items are measured at cost less accumulated depreciation and accumulated impairment losses.

Cost includes expenditure that is directly attributable to the acquisition of the asset.

Purchased software that is integral to the functionality of the related equipment is capitalized as part of that equipment.

When major parts of a fixed asset item have different useful lives, they are accounted for as separate items (major components) of fixed assets.

Gains and losses on disposal of a fixed asset item are determined by comparing the proceeds from disposal with the carrying amount of the asset, and are recognized net within “other income” or “other expenses”, as relevant, in profit or loss.

2. Subsequent costs

The cost of replacing part of a fixed asset item and other subsequent expenses are capitalized if it is probable that the future economic benefits associated with them will flow to the Group and their cost can be measured reliably. The carrying amount of the replaced part of a fixed asset item is derecognized. The costs of day-to-day servicing are recognized in profit or loss as incurred.

3. Depreciation

Depreciation is a systematic allocation of the depreciable amount of an asset over its useful life. The depreciable amount is the cost of the asset, less its residual value.

An asset is depreciated from the date it is ready for use, meaning the date it reaches the location and condition required for it to operate in the manner intended by management.

Depreciation is recognized in profit or loss on a straight-line basis over the estimated useful lives of each part of fixed asset item, since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the assets. Leased assets under finance lease agreements including lands are depreciated over the shorter of the lease term and their useful lives, unless it is reasonably certain that the Group will obtain ownership by the end of the lease term. Freehold land is not depreciated.

Note 3 - Significant Accounting Policies (cont'd)

D. Fixed assets (cont'd)

3. Depreciation (cont'd)

The estimated useful lives for the current and comparative periods are as follows:

Buildings	7-50 years	(mainly 50 years)
Machinery and equipment	3-7 years	(mainly 7 years)
Motor vehicles	7 years	
Computers	3-7 years	(mainly 3 years)
Office equipment	3-14 years	(mainly 14 years)
Land under finance leases	70 years	

Depreciation methods, useful lives and residual values are reviewed at the end of each reporting year and adjusted if appropriate.

E. Intangible assets

Goodwill

Goodwill that arises upon a business acquisition is presented as part of intangible assets. For information on measurement of goodwill at initial recognition, see Paragraph A(1) of this note.

Goodwill, having an indefinite useful life, is not systematically amortized but is tested for impairment at least once a year.

In subsequent periods, goodwill is measured at cost less accumulated impairment losses.

F. Inventories

Inventories are measured at the lower of cost and net realizable value. Inventory is based on the first-in first-out (FIFO) principle and its cost includes expenditure incurred in acquiring the inventories and the costs incurred in bringing them to their existing location and condition. In the case of manufactured inventories and work in progress, cost includes an appropriate share of production overheads based on normal operating capacity. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

G. Impairment

1. Non-derivative financial assets - policy applicable as from January 1, 2018

Financial assets and contract assets

The Group recognizes a provision for expected credit losses in respect of financial assets at amortized cost and contract assets (as defined in IFRS 15).

The Group has elected to measure the provision for expected credit losses in respect of trade receivables and contract assets at an amount equal to the full lifetime credit losses of the instrument.

Note 3 - Significant Accounting Policies (cont'd)

G. Impairment (cont'd)

1. Non-derivative financial assets - policy applicable as from January 1, 2018 (cont'd)

Financial assets and contract assets (cont'd)

When determining whether the credit risk of a financial asset has increased significantly since initial recognition, and when estimating expected credit losses, the Group considers reasonable and supportable information that is relevant and available with no undue cost or effort. Such information includes quantitative and qualitative information, and an analysis, based on the Group's past experience and informed credit assessment, and it includes forward looking information.

The Group assumes that the credit risk of a financial asset has increased significantly since initial recognition when contractual payments are past due for more than 90 days.
The Group considers a financial asset to be in default when the borrower is unlikely to pay its credit obligations to the Group in full or the contractual payments of the financial asset are past due for more than 180 days.

Lifetime expected credit losses are expected credit losses that result from all possible default events over the expected life of the financial asset. 12-month expected credit losses are the expected credit losses that result from possible default events within the 12 month period after the reporting date. The maximum period considered when assessing expected credit losses is the maximum contractual period over which the Group is exposed to credit risk.

Measurement of expected credit losses

Expected credit losses are a probability-weighted estimate of credit losses. Credit losses are measured as the present value of the difference between the cash flows due to the Group in accordance with the contract and the cash flows that the Group expects to receive.

Expected credit losses are discounted at the effective interest rate of the financial asset.

Credit-impaired financial assets

At each reporting date, the Group assesses whether financial assets carried at amortized cost are credit-impaired. A financial asset is 'credit-impaired' when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

Evidence that a financial asset is credit-impaired includes the following events: significant financial difficulty of the borrower; a breach of contract such as a default or payments being past due; the restructuring of a payment due to the Group on terms that the Group would not consider otherwise; or it is probable that the borrower will enter bankruptcy or other financial reorganization.

Presentation of provision for expected credit losses in the statement of financial position

Provisions for expected credit losses of financial assets measured at amortized cost are deducted from the gross carrying amount of the financial assets.

Note 3 - Significant Accounting Policies (cont'd)

G. Impairment (cont'd)

1. Non-derivative financial assets - policy applicable as from January 1, 2018 (cont'd)

Write-off

The gross carrying amount of a financial asset is written off when the Group does not have reasonable expectations of recovering a financial asset at its entirety or a portion thereof. This is usually the case when the Group determines that the debtor does not have assets or sources of income that may generate sufficient cash flows for paying the amounts being written off. However, financial assets that are written off could still be subject to enforcement activities in order to comply with the Group's procedures for recovery of amounts due. Write-off constitutes a de-recognition event.

2. Non-derivative financial assets - policy applicable before January 1, 2018

A financial asset not carried at fair value through profit or loss is tested for impairment when objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably.

Objective evidence that financial assets are impaired can include default by a debtor, restructuring of an amount due to the Group on terms that the Group would not consider otherwise, indications that a debtor or issuer will enter bankruptcy.

The Group considers evidence of impairment for receivables at both a specific asset and collective level. All individually significant receivables are assessed for specific impairment. All individually significant receivables found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. In assessing collective impairment the Group uses historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgment as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical trends.

An impairment loss is recognized in profit or loss and reflected in a provision for loss against receivables.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognized in profit or loss and reflected in a provision for loss against the balance of the financial asset measured at amortized cost.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost, the reversal is recognized in profit or loss.

The carrying amounts of the Group's non-financial assets, other than inventories and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated.

Note 3 - Significant Accounting Policies (cont'd)

G. Impairment (cont'd)

3. Non-financial assets

Once a year and on the same date, or more frequently if there are indications of impairment, the Group estimates the recoverable amount of each cash generating unit that contains goodwill.

For the purpose of impairment testing, assets that cannot be tested individually 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 (the "cash-generating unit").

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs of disposal. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects the assessments of market participants regarding the time value of money and the risks specific to the asset or cash-generating unit, for which the estimated future cash flows from the asset or cash-generating unit were not adjusted.

Goodwill acquired in a business combination is allocated to groups of cash-generating units, including those existing in the Group before the business combination, that are expected to benefit from the synergies of the combination.

An impairment loss is recognized if the carrying amount of an asset or cash-generating unit exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss. As regards cash-generating units that include goodwill, an impairment loss is recognized when the carrying amount of the cash-generating unit, after including the balance of goodwill, exceeds its recoverable amount. Impairment losses recognized in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amounts of the other assets in the cash-generating unit on a pro rata basis.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, for which impairment losses were recognized in prior periods, an assessment is performed at each reporting date for any indications that these losses have decreased or no longer exist. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

Note 3 - Significant Accounting Policies (cont'd)

H. 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 as defined benefit plans.

(a) Defined contribution plans

A defined contribution plan is a post-employment benefit plan under which an entity pays fixed contributions into a separate entity and has no legal or constructive obligation to pay further amounts.

Obligations for contributions to defined contribution pension plans are recognized as an expense in profit or loss in the periods during which related services are rendered by employees.

(b) Defined benefit plans

A defined benefit plan is a post-employment benefit plan other than a defined contribution plan.

The Group's net obligation in respect of defined benefit pension plans is calculated separately for each plan by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods. That benefit is discounted to determine its present value, and the fair value of any plan assets is deducted. The Group determines the net interest expense (income) on the net defined benefit liability (asset) for the period by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the then-net defined benefit liability (asset). The discount rate is the yield at the reporting date on high quality NIS-denominated corporate debentures, that have maturity dates approximating the terms of the Group's obligations. The calculation is performed by a qualified actuary using the projected unit credit method.

Remeasurements of the net defined benefit liability (asset) comprise actuarial gains and losses, the return on plan assets (excluding interest) and the effect of the asset ceiling (if any, excluding interest). Remeasurements are recognized immediately directly in retained earnings through other comprehensive income.

Net interest costs on a net defined obligation are presented under salaries expenses.

The Group has executive insurance policies that were issued before 2004 according to which the profit in real terms accumulated on the severance pay component will be paid to the employees upon their retirement. In respect of such policies, plan assets include both the balance of the severance pay component and the balance of the profit in real terms (if any) on the severance pay deposits that accumulated until the reporting date, and are presented at fair value.

Note 3 - Significant Accounting Policies (cont'd)

H. Employee benefits (cont'd)

2. Short term benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided or upon the actual absence of the employee when the benefit is not accumulated (such as maternity leave).

A liability is recognized for the amount expected to be paid under short term cash bonus if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

The employee benefits are classified, for measurement purposes, as short-term benefits or as other long-term benefits depending on when the Group expects the benefits to be wholly settled.

I. Revenue

1. *Policy applicable as from January 1, 2018*

As from January 1, 2018, the Group initially applies International Financial Reporting Standard 15 ("IFRS 15" or "the standard") which provides guidance on revenue recognition.

The standard introduces a new five step model for recognizing revenue from contracts with customers:
(1) Identifying the contract with the customer.
(2) Identifying distinct performance obligations in the contract.
(3) Determining the transaction price.
(4) Allocating the transaction price to distinct performance obligations.
(5) Recognizing revenue when the performance obligations are satisfied.

Identifying the contract
The Group accounts for a contract with a customer only when the following conditions are met:
(a) The parties to the contract have approved the contract (in writing, orally or according to other customary business practices) and they are committed to satisfying the obligations attributable to them;
(b) The Group can identify the rights of each party in relation to the goods that will be transferred;
(c) The Group can identify the payment terms for the goods that will be transferred;
(d) The contract has a commercial substance (i.e. the risk, timing and amount of the entity's future cash flows are expected to change as a result of the contract); and
(e) It is probable that the consideration, to which the Group is entitled to in exchange for the goods transferred to the customer, will be collected.

Identifying performance obligations
In accordance with the standard, the Group should identify distinct performance obligations in contract with customers. The Group is characterized by transactions with a one performance obligation in each contract.

Determining the transaction price
The transaction price is the amount of the consideration to which the Group expects to be entitled in exchange for the goods promised to the customer.

Note 3 - Significant Accounting Policies (cont'd)

I. Revenue (cont'd)

1. *Policy applicable as from January 1, 2018 (cont'd)*

Satisfaction of performance obligations
Revenue is recognized when the Group satisfies a performance obligation by transferring control over promised goods to the customer.
The Group's revenue is generated from the sale of goods manufactured according to customer specifications and based on NCNR terms (non-cancelation and non-refundable). The Group is entitled to reimbursement of the costs incurred to date, including a reasonable margin. Customer-specific goods cannot be sold to any other customer and therefore have no alternative use.
According to the IFRS 15, the Group recognizes revenue from goods with no alternative use over time, unlike the previous accounting treatment by which the Group recognized revenue only when the goods were transferred to the customer or to its forwarder.

Contract asset
A contract asset is recognized when the Group has a right to consideration for goods transferred to the customer.
A contract asset referring to goods with no alternative use is recognized as receivables.

2. *Policy applicable before January 1, 2018*

Revenue from the sale of goods in the ordinary course of business is measured at the fair value of the consideration received or receivable. When the credit period is short and constitutes the accepted credit in the industry, the future consideration is not discounted.

Revenue is recognized when persuasive evidence exists (usually in the form of an executed sales agreement) that the significant risks and rewards of ownership have been transferred to the buyer, recovery of the consideration is probable, the associated costs and possible return of goods can be estimated reliably, there is no continuing management involvement with the goods, and the amount of revenue can be measured reliably.

Transfer of risks and rewards occurs when the goods are transferred to the customer or to its forwarder.

J. Development costs

Development costs are mainly incurred to customize products for individual contracts. These development costs are expensed as incurred.

K. Leases

Lease of a land from the Israel Lands Administration where the Group assumes substantially all the risks and rewards of ownership is classified as finance leases. Upon initial recognition, the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Future payments for exercising an option to extend the lease from the Israel Lands Administration are not recognized as part of an asset and corresponding liability since they constitute contingent lease payments that are derived from the fair value of the land on the future dates of renewing the lease agreement.
Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

Note 3 - Significant Accounting Policies (cont'd)

L. Finance income and expenses

Finance income comprises interest income on funds invested and changes in the fair value of financial assets at fair value through profit or loss. Interest income is recognized as it accrues, using the effective interest method.

Finance expenses comprise changes in the fair value of financial assets at fair value through profit or loss and impairment losses recognized on financial assets (other than losses on trade receivables that are presented under general and administrative expenses).

In the statement of cash flows, interest paid and interest received are presented as part of cash flows from operating activities.

Foreign currency gains and losses are reported on a net basis as either finance income or finance expenses depending on whether foreign currency movements are in a net gain or net loss position.

M. Income tax

Income tax comprises current and deferred tax. Current tax and deferred tax are recognized in profit or loss, or are recognized directly in other comprehensive income to the extent they relate to items recognized directly in other comprehensive income.

Current taxes
Current tax is the expected tax payable (or receivable) on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date. Current taxes also include taxes in respect of prior years.

Offset of current tax assets and liabilities
Current tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and there is intent to settle current tax liabilities and assets on a net basis or the tax assets and liabilities will be realized simultaneously.

Uncertain tax positions
A provision for uncertain tax positions, including additional tax and interest expenses, is recognized when it is more probable than not that the Group will have to use its economic resources to pay the obligation.

Deferred taxes
Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized for the following temporary differences: the initial recognition of goodwill and differences relating to investments in subsidiaries, to the extent that it is probable that they will not reverse in the foreseeable future and to the extent the Group controls the date of reversal.

The measurement of deferred tax reflects the tax consequences that would follow the manner in which the Group expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

Note 3 - Significant Accounting Policies (cont'd)

M. Income tax (cont'd)

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

A deferred tax asset is recognized for unused tax losses, tax benefits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

Deferred tax assets that were not recognized are reevaluated at each reporting date and recognized if it has become probable that future taxable profits will be available against which they can be utilized.

Offset of deferred tax assets and liabilities
Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity.

N. Earnings per share

The Group presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the year, adjusted for treasury shares. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders of the Company and the weighted average number of ordinary shares outstanding, after adjustment for treasury shares, for the effects of all dilutive potential ordinary shares, which comprise convertible debentures, share options and share options granted to employees.

O. New standards, amendments to standards and interpretations not yet adopted

(1) IFRS 16, *Leases* (hereinafter in this section: "IFRS 16" or "the standard")

The standard replaces IAS 17, Leases and its related interpretations. The standard's instructions annul the existing requirement from lessees to classify leases as operating or finance leases. Instead of this, for lessees, the new standard presents a unified model for the accounting treatment of all leases according to which the lessee has to recognize a right-of-use asset and a lease liability in its financial statements. IFRS 16 includes certain exceptions and expedients. Due to the fact that the Group does not have any material leased assets, in its opinion the effect on the financial statements will be immaterial.

(2) IFRIC 23, *Uncertainty Over Income Tax Treatments*

IFRIC 23 clarifies how to apply the recognition and measurement requirements of IAS 12 for uncertainties in income taxes. According to IFRIC 23, when determining the taxable profit, tax bases, unused tax losses, unused tax credits and tax rates when there is uncertainty over income tax treatments, the entity should assess whether it is probable that the tax authority will accept its tax position.
The Group has examined the effects of applying IFRIC 23, and in its opinion the effect on the financial statements will be immaterial.

Note 4 - Cash and Cash Equivalents

	December 31 2018	December 31 2017
	$ thousands	$ thousands
Bank balances	**4,366**	3,087
Call deposits	**3,000**	2,002
	7,366	5,089

The Group's exposure to interest rate and currency risks concerning cash and cash equivalents is disclosed in Note 14 on financial instruments.

Note 5 - Short-term Deposits and Investments

Include mainly, short-term deposits in dollars, bearing interest at an annual rate of approximately 2.98% - 3.65% (December 31, 2017: 1.59% - 2.07%).

The Group's exposure to interest rate risk concerning deposits is disclosed in Note 14 on financial instruments.

Note 6 - Trade and Other Accounts Receivable

	December 31 2018	December 31 2017
	$ thousands	$ thousands
Trade accounts receivable		
Trade receivables	**6,154**	6,548
Less provision for doubtful debts	**(3)**	(3)
	6,151	6,545
Other accounts receivable		
Contract assets, see Note 2F(1)	**1,352**	-
Government institutions	**54**	96
Related parties	**103**	105
Derivative instruments	**-**	25
Other receivables	**270**	180
	1,779	406

The Group's exposure to credit and currency risks concerning trade and other accounts receivable is disclosed in Note 14 on financial instruments.

Note 7 - Inventory

	December 31 2018	December 31 2017
	$ thousands	$ thousands
Raw and packing material	**2,836**	2,466
Work-in-process	**221**	231
Finished products	**224**	950
	3,281	3,647

Note 8 - Investment in Equity Accounted Investee

On October 17, 2018 the Company acquired a 20% of the rights of a Hong-Kong holding company - PCT Industries Limited (hereinafter – "PCT"), holding a fully owned manufacturing subsidiary in Dongguan, China, engaging in manufacturing and assembly, which currently serves as one of Payton's major Manufacturing Partners, for a cash consideration of USD 1 million (hereinafter: "the investment agreement"). The investment agreement became valid on October 1, 2018.

The excess consideration paid over the fair value of net identifiable assets was attributed to land and buildings (net of deferred tax liabilities) and was included as part of the investment aforesaid.

In accordance with the investment agreement, the Company was granted an option to increase its share up to 35% of the rights in PCT.
The fair value of this option as at December 31, 2018 amounted USD 100 thousand, based on an external independent valuation, is presented under "Investment in Equity Accounted Investee". The fair value of the option is estimated according to various scenarios using the Monte Carlo model and according to risk-free rate between 2.4% -2.6%.

Note 9 - Fixed Assets

	Machinery and equipment	Motor vehicles	Computers and Office equipment	Land and Buildings	Total
			$ thousands		
December 31, 2018					
Cost					
Balance as of January 1, 2018	**3,181**	**452**	**1,258**	**12,118**	**17,009**
Acquisitions	**273**	**34**	**220**	**1**	**528**
Disposals	**(30)**	**(42)**	**-**	**(22)**	**(94)**
Balance as of December 31, 2018	**3,424**	**444**	**1,478**	**12,097**	**17,443**
Accumulated depreciation					
Balance as of January 1, 2018	**2,218**	**158**	**827**	**2,165**	**5,368**
Depreciation for the year	**229**	**67**	**160**	**449**	**905**
Disposals	**(30)**	**(39)**	**-**	**(17)**	**(86)**
Balance as of December 31, 2018	**2,417**	**186**	**987**	**2,597**	**6,187**
Carrying amounts as of December 31, 2018	**1,007**	**258**	**491**	**9,500**	**11,256**
Carrying amounts					
January 1, 2018	**963**	**294**	**431**	**9,953**	**11,641**
December 31, 2018	**1,007**	**258**	**491**	**9,500**	**11,256**

Note 9 - Fixed Assets (cont'd)

	Machinery and equipment	Motor vehicles	Computers and Office equipment	Land and Buildings	Total
			$ thousands		
December 31, 2017					
Cost					
Balance as of January 1, 2017	2,783	454	1,125	12,100	16,462
Acquisitions	398	23	133	18	572
Disposals	-	(25)	-	-	(25)
Balance as of December 31, 2017	3,181	452	1,258	12,118	17,009
Accumulated depreciation					
Balance as of January 1, 2017	1,963	107	695	1,712	4,477
Depreciation for the year	255	69	132	453	909
Disposals	-	(18)	-	-	(18)
Balance as of December 31, 2017	2,218	158	827	2,165	5,368
Carrying amounts as of December 31, 2017	963	294	431	9,953	11,641
Carrying amounts					
January 1, 2017	820	347	430	10,388	11,985
December 31, 2017	963	294	431	9,953	11,641

A. Details on land rights used as fixed assets by the Group

The land on which the Company's premises in Israel are built, has a carrying amount of USD 1,286 thousand as at December 31, 2018 (December 31, 2017: USD 1,307 thousand) and is leased from the Israel Lands Administration under a capital lease ending on June 30, 2032. The Company has the right to extend the lease period by another 49 years under certain circumstances.

B. Acquisition of fixed assets on credit

During the year ended December 31, 2018, the Company acquired fixed assets on credit in the amount of USD 24 thousand (December 31, 2017: USD 23 thousand).

C. Additional information

The Group has assets that have been fully depreciated and are still in use. As at December 31, 2018 the original cost of such assets is USD 2,009 thousand (December 31, 2017: USD 1,831 thousand).

Note 10 - Other Payables

	December 31 2018 $ thousands	December 31 2017 $ thousands
Employees and related benefits	**692**	711
Derivative instruments	**17**	-
Other payables and accrued expenses	**973**	767
	1,682	1,478

The Group’s exposure to currency and liquidity risks concerning other payables is disclosed in Note 14 on financial instruments.

Note 11 - Employee Benefits

Employee benefits include post-employment benefits and short-term benefits.

Composition of employee benefits:

	December 31 2018 $ thousands	December 31 2017 $ thousands
Presented under current liabilities:		
Short-term employee benefits	**378**	457
Presented under non-current liabilities:		
Net liability for defined benefit plan	**399**	514
Total employee benefits	**777**	971

A. Post-employment benefit plans - defined benefit plan

The Group has defined benefit plans for which it makes contributions to appropriate insurance policies.

Risks affiliated with the Group’s liability for defined benefit obligations refer to deviations in salary increases, deviations in assets performances from the expectation, as well as change in interest rate environment.
For sensitivity analyses, reflecting the effect of changes in salary increase assumptions and interest rate, see 6 hereinafter.

Note 11 - Employee Benefits (cont'd)

A. Post-employment benefit plans - defined benefit plan (cont'd)

	December 31 2018	December 31 2017
	$ thousands	$ thousands
Present value of defined benefit obligation	**1,549**	1,744
Fair value of plan assets	**(1,150)**	(1,230)
Recognized liability for defined benefit obligations	**399**	514

1. Movements in the present value of the defined benefit obligations

	2018	2017
	$ thousands	$ thousands
Defined benefit obligations as at January 1	**1,744**	1,479
Benefits paid	**(94)**	(279)
Change in population	**-**	214
Current service costs	**85**	76
Interest costs	**64**	68
Changes in respect of foreign exchange differences	**(145)**	179
Remeasurement of defined benefit plan	**(105)**	7
Defined benefit obligation as at December 31	**1,549**	1,744

2. Movements in plan assets

	2018	2017
	$ thousands	$ thousands
Fair value of plan assets as at January 1	**1,230**	1,120
Contributions by employer	**70**	63
Funded benefits paid	**(60)**	(245)
Change in population	**-**	186
Interest income	**32**	29
Changes in respect of foreign exchange differences	**(94)**	116
Remeasurement of defined benefit plan	**(28)**	(39)
Fair value of plan assets as at December 31	**1,150**	1,230

Note 11 - Employee Benefits (cont'd)

A. Post-employment benefit plans - defined benefit plan (cont'd)

3. Expenses recognized in profit or loss

	For the year ended December 31	
	2018	2017
	$ thousands	$ thousands
Current service costs	**85**	76
Interest costs	**64**	68
Interest income	**(32)**	(29)
Change in population	**-**	28
Net change in respect of foreign exchange differences	**(51)**	63
	66	206

4. Recognized in other comprehensive income

	For the year ended December 31	
	2018	2017
	$ thousands	$ thousands
Defined benefit obligation:		
Actuarial gains (losses) from changes in financial assumptions	**81**	(99)
Actual return less interest income	**2**	11
Other actuarial gains	**39**	60
Changes in respect of foreign exchange differences	**(17)**	21
	105	(7)
Plan assets:		
Actual return less interest income	**19**	23
Other actuarial gains	**9**	16
	28	39
Net actuarial gains (losses) in the year	**77**	(46)

Note 11 - Employee Benefits (cont'd)

A. Post-employment benefit plans - defined benefit plan (cont'd)

5. Actual return

	For the year ended December 31	
	2018	2017
	%	%
Actual return on plan assets	**2.28**	2.43

6. Actuarial assumptions and sensitivity analyses

Principal actuarial assumptions at the reporting date (expressed as weighted averages):

	2018	2017
	%	%
Discount rate as at December 31	**2.36**	1.87
Future salary growth	**3**	3
Leave rates for employees:		
Less than 10 years of service	**5**	5
10 years of service or more	**2**	2

Assumptions regarding future mortality are based on published statistics and mortality tables.

Reasonably possible changes at the reporting date to one of the relevant actuarial assumptions, holding other assumptions constant, would have affected the defined benefit obligation by the amounts shown below:

	1% Increase		1% Decrease	
	December 31		December 31	
	2018	2017	2018	2017
	$ thousands	$ thousands	$ thousands	$ thousands
Future salary growth	**162**	197	**(121)**	(154)
Discount rate	**(113)**	(145)	**154**	189

7. Effect of the plan on the Group’s future cash flows

The Group expects to pay approximately USD 70 thousand in contributions to the funded defined benefit plan in 2019.

The Group estimates the plan’s duration (based on weighted average) to be 10.64 years at the end of the reporting period (2017: 11.45 years).

Note 11 - Employee Benefits (cont'd)

B. Post-employment benefit plans - defined contribution plan

	For the year ended December 31	
	2018	2017
	$ thousands	$ thousands
Amount recognized as expense in respect of defined contribution plan	**462**	411

C. Short-term employee benefits

	December 31 2018	December 31 2017
	$ thousands	$ thousands
Provision for vacation and recreation	**378**	343
Liabilities for bonus	**-**	83
Post-employment liability	**-**	31
	378	457

Note 12 - Investments in Subsidiaries

Details of the subsidiaries, their activities and the Company's interest therein as at December 31, 2018:

A. Payton America Inc. (hereinafter "Payton America"):
Payton America, a fully owned U.S. corporation, located in Florida U.S.A., manufactures and sells Planar transformers and inductors.

B. Himag Planar Magnetics Ltd. (hereinafter "Himag Planar"):
Himag Planar, a fully owned UK subsidiary, incorporated during December 2012 for the purpose of the business activity acquisition of Himag Solutions Ltd. The investment in Himag Planar includes capital notes in USD which do not bear any interest.

Note 13 - Commitments and Contingent Liabilities

A. According to a Management Services Agreement signed between the Company and Wichita Ltd., a management company under the full control of Mr. David Yativ (approved by the Company's General meeting dated July 17, 2017), David Yativ will continue to provide management services as the Active Chairman of the Company for a period of 3 years, as of November 1, 2017. For providing these services by David Yativ his management company will be entitled to management fee at a monthly amount of USD 42 thousand (linked to the local Israeli index according to the base index known on April 9, 2017) which shall be raised by 3% in April 2018, April 2019 and April 2020, and a yearly bonus calculated as 3.4% of the annual profit before income taxes and before any other profit based bonus.

B. According to a Management Services Agreement (replacing the employment agreement of Mr. Doron Yativ) that was signed between the Company and Yaarh - Looking To The Future Ltd., a management company under the full control of Mr. Doron Yativ (approved by the Company's General meeting dated October 15, 2018), Doron Yativ will continue to provide his services as the Company's C.E.O, for a period of 3 years, starting November 1, 2017. For providing these services by Doron Yativ his management company will be entitled to management fee at a monthly amount of USD 21 thousand (linked to the local Israeli index according to the base index known on April 9, 2017) which shall be raised by 3% in April 2018, April 2019 and April 2020, and a yearly bonus calculated as 2% of the annual profit before income taxes and before any other profit based bonus.

Note 14 - Financial Instruments

A. Overview

The Group has exposure to the following risks from its use of financial instruments:

- Credit risk
- Liquidity risk
- Market risk (including currency and interest risks)

This note presents quantitative and qualitative information about the Group’s exposure to each of the above risks, and the Group’s objectives, policies and processes for measuring and managing risk.
The Board of Directors has overall responsibility for the establishment and oversight of the Group’s risk management framework.

B. Credit risk

The Group’s revenues are derived from sales to customers in Israel, Asia, Europe, America and other countries around the world. The Company’s Management regularly monitors the customers’ balances and includes specific provisions for doubtful debts in the financial statements that adequately reflect, in the opinion of management, the loss inherent in debts the collection of which is doubtful.

The Group has credit risk insurance for most of its local and other customers, whose yearly activity exceeds USD 5 thousand and USD 10 thousand, respectively.

The Group’s cash surpluses are invested in banks. The Group has a surplus cash investment policy for the purpose of reducing risk or maintaining liquidity. This policy is reviewed and updated from time to time according to market changes.

Note 14 - Financial Instruments (cont'd)

B. Credit risk (cont'd)

1. Exposure to credit risk

The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was:

	December 31	
	2018	**2017**
	Carrying amount	
	$ thousands	**$ thousands**
Cash and cash equivalents	**7,366**	5,089
Short-term deposits and investments	**23,566**	19,359
Trade accounts receivable	**6,151**	6,545
Other accounts receivable	**1,455**	105
	38,538	31,098

The aforementioned balances are presented under the items of cash and cash equivalents, short-term deposits, trade accounts receivable and other accounts receivable.

The maximum exposure to credit risk for cash and cash equivalents at the reporting date by geographic region was:

	December 31	
	2018	**2017**
	Carrying amount	
	$ thousands	**$ thousands**
Israel	**5,678**	3,155
U.S.A.	**1,604**	1,718
U.K.	**74**	209
Asia	**10**	7
	7,366	5,089

The maximum exposure to credit risk for short term deposits and investments at the reporting date by geographic region was:

	December 31	
	2018	**2017**
	Carrying amount	
	$ thousands	**$ thousands**
Israel	**18,480**	17,327
U.S.A.	**5,086**	2,032
	23,566	19,359

Note 14 - Financial Instruments (cont'd)

B. Credit risk (cont'd)

1. Exposure to credit risk (cont'd)

The maximum exposure to credit risk for trade receivables at the reporting date by geographic region was:

	December 31	
	2018	2017
	Carrying amount	
	$ thousands	$ thousands
Israel	**66**	771
Asia	**2,249**	2,672
U.K.	**431**	241
Other countries in Europe	**936**	805
U.S.A.	**2,459**	2,039
Canada	**10**	17
	6,151	6,545

Principal customers of the Group at the reporting date:

	December 31	
	2018	2017
	Carrying amount	
	$ thousands	$ thousands
Customer A	**831**	1,333
Customer B	**385**	452
Customer C	**1,597**	*

* Less than 10% of the Group's consolidated sales (see Note 16A).

2. Aging of debts and impairment losses

The aging of trade receivables at the reporting date was:

	December 31			
	2018		2017	
	Gross	Impairment	Gross	Impairment
	$ thousands	$ thousands	$ thousands	$ thousands
Not past due	**3,533**	**-**	5,042	-
Past due 0-30 days	**1,669**	**-**	941	-
Past due 31-120 days	**934**	**-**	522	-
Past due 121 days to one year	**12**	**-**	40	-
Past due more than one year	**6**	**(3)**	3	(3)
	6,154	**(3)**	6,548	(3)

Note 14 - Financial Instruments (cont'd)

C. Liquidity risk

The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation.

The following are the contractual maturities of financial liabilities based on the actual rates at the reporting date, including estimated interest payments:

	December 31, 2018		
	Carrying amount	Contractual cash flows	6 months or less
		$ thousands	
Non-derivative financial liabilities			
Trade payables	**1,891**	**1,891**	**1,891**
Other payables	**973**	**973**	**973**
	2,864	**2,864**	**2,864**

	December 31, 2017		
	Carrying amount	Contractual cash flows	6 months or less
		$ thousands	
Non-derivative financial liabilities			
Trade payables	3,092	3,092	3,092
Other payables	767	767	767
	3,859	3,859	3,859

D. Market risk

The Group's normal course of business is being managed in the U.S. dollar currency, thus, most of the market risks are hedged.
Group uses, from time to time, derivatives as a tool for hedging, in order to neutralize fluctuations in profit or loss.

1. Foreign currency risk

Currency risk

Since most of the Group's sales are in US dollar, the Group's gross profit is exposed to the changes in exchange rates of the US dollar in relation to the NIS and to the Chinese currency with regards to labor costs and costs of raw materials. The Company uses derivatives, from time to time, as a tool for economic hedging, especially in order to hedge labor costs and other costs paid in NIS.

As at December 31, 2018, the Group has open future transactions as following:

1. Purchase of an option to sell USD 2,000 thousand for NIS 7,410 thousand, the market value of which was estimated at an income of USD 30 thousand.

2. Sale of an option to purchase USD 4,000 thousand for NIS 14,874 thousand, the market value of which was estimated at an expense of USD (47) thousand.

Note 14 - Financial Instruments (cont'd)

D. Market risk (cont'd)

1. Foreign currency risk (cont'd)

As at December 31, 2017, the Group has open future transactions as following:

1. Purchase of an option to sell USD 1,500 thousand for NIS 5,250 thousand, the market value of which was estimated at an income of USD 36 thousand.
2. Sale of an option to purchase USD 3,000 thousand for NIS 10,829 thousand, the market value of which was estimated at an expense of USD (11) thousand.

(a) The exposure to foreign currency risk

The Group's exposure to foreign currency risk was as follows based on notional amounts:

	December 31, 2018					
	Dollar	**NIS**	**Euro**	**GBP**	**Other**	**Total**
	$ thousands					
Current assets:						
Cash and cash equivalents	**6,507**	**423**	**362**	**63**	**11**	**7,366**
Short-term deposits and investments	**23,566**	**-**	**-**	**-**	**-**	**23,566**
Trade and other receivables	**6,778**	**364**	**69**	**395**	**-**	**7,606**
Current liabilities:						
Trade payables	**(1,347)**	**(440)**	**(10)**	**(94)**	**-**	**(1,891)**
Other payables	**(833)**	**(128)**	**(7)**	**-**	**(5)**	**(973)**
	34,671	**219**	**414**	**364**	**6**	**35,674**

	December 31, 2017					
	Dollar	**NIS**	**Euro**	**GBP**	**Other**	**Total**
	$ thousands					
Current assets:						
Cash and cash equivalents	4,905	50	42	85	7	5,089
Short-term deposits	19,359	-	-	-	-	19,359
Trade and other receivables	5,434	736	254	226	-	6,650
Current liabilities:						
Trade payables	(2,575)	(399)	(20)	(98)	-	(3,092)
Other payables	(599)	(147)	(12)	(5)	(4)	(767)
	26,524	240	264	208	3	27,239

Note 14 - Financial Instruments (cont'd)

D. Market risk (cont'd)

1. Foreign currency risk (cont'd)

(a) The exposure to foreign currency risk (cont'd)

Information regarding significant exchange rates:

	Year ended December 31		Year ended December 31	
	2018	2017	2018	2017
	Rate of change		Reporting date spot rate	
	%	%	NIS	NIS
1 US dollar	**8.10**	(9.83)	**3.748**	3.467

	Year ended December 31		Year ended December 31	
	2018	2017	2018	2017
	Rate of change		Reporting date spot rate	
	%	%	Euro	Euro
1 US dollar	**4.55**	(12.20)	**0.873**	0.835

	Year ended December 31		Year ended December 31	
	2018	2017	2018	2017
	Rate of change		Reporting date spot rate	
	%	%	GBP	GBP
1 US dollar	**5.68**	(9.10)	**0.782**	0.740

(b) Sensitivity analysis

A weakening of the USD against the following currencies as at December 31 would have increased (decreased) equity and profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular interest rates, remain constant. The analysis is performed on the same basis for 2017.

	Profit or loss	
	December 31 2018	December 31 2017
	$ thousands	$ thousands
Increase in the exchange rate of:		
5% in the NIS	**11**	12
5% in the Euro	**21**	13
5% in the GBP	**18**	10

A strengthening of the USD against the above currencies as at December 31 would have had the equal but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remain constant.

Note 14 - Financial Instruments (cont'd)

D. Market risk (cont'd)

2. Interest rate risk

The Group's exposure to market risk for changes in interest rates relates primarily to cash equivalents and short-term deposits (in US dollars) which bear interest rates given by or affected by banks in the range of 2.98%-3.65% which changes from time to time.

(a) Profile

At the reporting date the interest rate profile of the Group's interest-bearing financial instruments was:

	December 31	
	2018	2017
	Carrying amount	
	$ thousands	$ thousands
Fixed rate instruments		
Financial assets	**26,566**	21,361

(b) Fair value sensitivity analysis for fixed rate instruments

The Group does not account for any fixed rate financial assets at fair value through profit or loss. Therefore a change in interest rates at the reporting date would not affect profit or loss.

E. Fair value

The carrying amounts of financial assets and liabilities, including cash and cash equivalents, trade receivables, other receivables, other short-term investments, trade payables, other payables, derivative instruments and other liabilities are the same or proximate to their fair value.
The fair value of the option to increase the Company's share of the rights in equity accounted investee, is presented in the Statement of Financial Positon based on an external independent valuation (Level 3). The fair value of the option is estimated according to various scenarios using the Monte Carlo model and according to risk-free rate between 2.4% -2.6% (see Note 8).

Note 15 - Share Capital and Reserves

A. Share capital - Composition

	Number of shares	
	Authorized	Issued and paid
	December 31, 2018 and 2017	
Ordinary shares of NIS 1 each	**20,000,000**	**17,670,775**

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to Company's residual assets.

Note 15 - Share Capital and Reserves (cont'd)

B. Dividends

The following dividends were paid by the Company:

	December 31	
	2018	**2017**
	$ thousands	**$ thousands**
USD 0.175 per ordinary share	**3,092**	3,092

Note 16 - Statement of Profit or Loss Data

A. Revenues

1. Revenues

	For the year ended December 31	
	2018	**2017**
	$ thousands	**$ thousands**
Export	**44,718**	32,006
Local	**905**	1,037
	45,623	33,043

2. Principal customers

The sales revenues include sales to principal customers (which make up in excess of 10% of the sales of the Group):

	For the year ended December 31	
	2018	**2017**
	%	**%**
Customer A	**22**	18
Customer B	**14**	10
Customer C	**13**	*

* Less than 10% of the Group's consolidated sales.

Note 16 - Statement of Profit or Loss Data (cont'd)

B. Cost of sales

	For the year ended December 31	
	2018	2017
	$ thousands	$ thousands
Materials consumed	**17,301**	13,307
Salaries and related benefits	**5,626**	5,044
Depreciation and amortization	**589**	639
Other manufacturing expenses	**1,390**	1,175
Change inventory of finished products and work in process	**286**	(101)
	25,192	20,064

Includes inventory write-off of USD 117 thousand and USD 83 thousand for the years ended December 31, 2018 and 2017, respectively.

C. Selling and marketing expenses

	For the year ended December 31	
	2018	2017
	$ thousands	$ thousands
Salaries and related benefits *	**917**	1,035
Sales commissions	**867**	838
Advertising and marketing	**57**	46
Exhibits and travel abroad	**315**	264
Other	**105**	86
	2,261	2,269

* Includes expenses relate to related parties in the amount of USD 361 thousand and USD 365 thousand for the years ended December 31, 2018 and 2017, respectively.

D. General and administrative expenses

	For the year ended December 31	
	2018	2017
	$ thousands	$ thousands
Salaries and related benefits	**1,111**	1,229
Office rent, maintenance and communications	**197**	195
Depreciation	**316**	292
Professional services	**240**	235
Management fees and related benefits to related parties	**924**	609
Other	**615**	388
	3,403	2,948

Note 16 - Statement of Profit or Loss Data (cont'd)

E. Other income, net

	For the year ended December 31	
	2018	2017
	$ thousands	$ thousands
Capital gain on sale of fixed assets	**2**	4

F. Finance income and expenses

	For the year ended December 31	
	2018	2017
	$ thousands	$ thousands
Finance income		
Interest income from bank deposits	**392**	267
Exchange rate differences, net	**-**	26
Other	**-**	64
	392	357
Finance expenses		
Bank charges and others	**25**	37
Interest for delayed tax payments	**24**	7
Exchange rate differences, net	**27**	-
Other	**75**	-
	151	44

G. Transactions and balances with related parties

Compensation and benefits to key management personnel and interested parties (including directors) that are employed by the Group:

	Year ended December 31				December 31	
	2018		2017		2018	2017
	Number of People	Amount	Number of People	Amount	Outstanding balance	
		$ thousands		$ thousands	$ thousands	$ thousands
Short-term employee benefits (*)		**501**		803	**28**	164
Post-employment benefits		**83**		98	**56**	64
	4	**584**	5	901	**84**	228

(*) For the year ended December 31, 2017 - Including full year compensation paid to a related party that starting November 1, 2017 providing his services through his fully owned company - see Note 13B.

Note 16 - Statement of Profit or Loss Data (cont'd)

G. Transactions and balances with related parties (cont'd)

Compensation to key management personnel (including directors) that are not employed by the Group:

	Year ended December 31				December 31	
	2018		2017		2018	2017
	Number of People	Amount	Number of People	Amount	Outstanding balance	
		$ thousands		$ thousands	$ thousands	$ thousands
Total compensation to directors not employed by the Group	**3**	**36**	3	36	**9**	8
Total compensation to key management personnel not employed by the Group (*)	**2**	**1,298**	1	758	**564**	288
Accounts receivable- The Parent Company	**-**	**-**	-	-	**103**	105

(*) Management fees and related benefits to Wichita Ltd. (see Note 13A) and to Yaarh-Looking To The Future Ltd. (see Note 13B) include an amount of USD 153 thousand (year ended December 31, 2017: USD 149 thousand) and an amount of USD 208 thousand, respectively, recorded as selling and marketing expenses.

Inter-company transactions between the Company and its two fully owned subsidiaries (Payton America Inc. and Himag Planar Magnetics Ltd.) include, inter alia, the following: Buy&Resale, engineering support, marketing, administrative and management services. All the inter-company transactions are being eliminated within consolidated financial statements.

Note 17 - Income Taxes

A. Details regarding the tax environment of the Company

1. Corporate tax rate

(a) Presented hereunder are the tax rates relevant to companies that are not entitled to benefits according to the Law for the Encouragement of Capital Investments in the years 2017 – 2018:

2017 – 24%
2018 – 23%

On December 22, 2016 the Knesset plenum passed the Economic Efficiency Law (Legislative Amendments for Achieving Budget Objectives in the Years 2017 and 2018) – 2016, by which, inter alia, the corporate tax rate would be reduced from 25% to 23% in two steps. The first step will be to a rate of 24% as from January 2017 and the second step will be to a rate of 23% as from January 2018.
As a result of the reduction in the tax rate to 23% in two steps, the deferred tax balances as at December 31, 2018 were calculated according to the new tax rate specified in the Economic Efficiency Law (Legislative Amendments for Achieving Budget Objectives in the Years 2017 and 2018), at the tax rate expected to apply on the date of reversal.

Current taxes for the reported periods are calculated according to the tax rates presented above. See also Note 17A(4) hereunder.

(b) According to various amendments to the Income Tax Ordinance (New Version) – 1961, IFRS shall not apply when determining the taxable income for the 2007 through 2013 tax years even if IFRS was applied when preparing the financial statements.

2. The Dollar regulations

The Company, being a "foreign investment company", elected to be taxed as from the year 2009, based upon its results in dollars and according to applicable income tax regulations (hereinafter - "the Dollar regulations").

3. Tax benefits under the Law for the Encouragement of Industry (Taxes), 1969

The Company currently qualifies as an “Industrial Company” as defined in the Law for the Encouragement of Industry (Taxes) - 1969 and accordingly it is entitled to benefits, of which the most significant one is higher rates of depreciation.

4. Tax benefits under the Law for the Encouragement of Capital Investments - 1959 ("the Investment Law")

<u>Amendment to the Law for the Encouragement of Capital Investments - 1959</u>
The Company is subject to the Law for the Encouragement of Capital Investments - 1959 which was amended last in 2010 (hereinafter - “the Amendment to the Law”). The Amendment to the Law provisions apply to preferred income derived or accrued in 2011 and thereafter by a preferred company, per the definition of these terms in the Amendment to the Law.

Note 17 - Income Taxes (cont'd)

A. Details regarding the tax environment of the Company (cont'd)

4. Tax benefits under the Law for the Encouragement of Capital Investments - 1959 ("the Investment Law") (cont'd)

Amendment to the Law for the Encouragement of Capital Investments – 1959 (cont'd)
The Amendment provides that only companies in Development Area A will be entitled to the grants track and that they will be entitled to receive benefits under this track and under the tax benefits track at the same time. In addition, a preferred enterprise track was introduced, which mainly provide a uniform and reduced tax rate for all the company's income entitled to benefits. 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, which raised the tax rates on preferred income as from the 2014 tax year as follows: 9% for Development Area A and 16% for the rest of the country.

The Amendment to the Law 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 20% shall apply to a dividend distributed out of preferred income to an individual shareholder or foreign resident, subject to double taxation prevention treaties.

On December 22, 2016, the Israeli parliament passed a law that reduces the tax rate on preferred income for companies located in Development Area A from 9% to 7.5%, commencing on January 1, 2017.

The Company complies with the conditions provided in the amendment to the Law for the Encouragement of Capital Investments for inclusion in the scope of the tax benefits track.

B. Details regarding the tax environment of the subsidiary in USA

Payton America is subject to the tax rate of its country of domicile.
The primary tax rates applicable to the subsidiary are 21% Federal Tax (2017 Federal Tax at gradual rates up to 34%) and 5% State Tax.

C. Details regarding the tax environment of the subsidiary in UK

Himag Planar is subject to the tax rate of its country of domicile.
The primary tax rate applicable to the subsidiary is 20%.

D. Final tax assessments

The Company has final tax assessments up to and including the 2012 tax year.

With few exceptions the U.S. subsidiary is no longer subject to U.S. Federal income tax examinations by tax authorities for years before 2015.

Note 17 - Income Taxes (cont'd)

E. Composition of income tax expense

	For the year ended December 31	
	2018	2017
	$ thousands	$ thousands
Current year taxes	**2,043**	1,094
Deferred tax expense - creation and reversal of temporary differences, net	**295**	201
	2,338	1,295

F. Reconciliation between the theoretical tax on the pre-tax profit and the tax expense

A reconciliation of the statutory tax expense, assuming all income is taxed at the statutory rate applicable to the income of companies in Israel, and their actual tax expense, is as follows:

	For the year ended December 31	
	2018	2017
	$ thousands	$ thousands
Tax rate	**23%**	24%
Profit before tax	**13,699**	6,839
Income tax using the domestic corporations tax rate	**3,151**	1,641
Neutralization of tax calculated in respect of the Company's share in profits of equity accounted investee	**(3)**	-
Tax saving in respect of foreign subsidiaries	**(108)**	(5)
Non-deductible expenses and tax exempt income, net	**12**	4
Tax benefits due to Preferred Enterprise status	**(709)**	(429)
Others	**(5)**	84
	2,338	1,295

Note 17 - Income Taxes (cont'd)

G. Deferred tax assets and liabilities

(1) Recognized deferred tax assets and liabilities

Deferred taxes in respect of companies in Israel are calculated according to the tax rate anticipated to be in effect on the date of reversal as stated above. Deferred taxes in respect of foreign subsidiary are calculated according to the relevant tax rates.

Deferred tax assets and liabilities are attributable to the following items:

	Carry-forward tax losses	Employee benefits	Fixed assets	Investment in Equity accounted investee	Other	Total
			$ thousands			
Balance as at January 1, 2017	39	125	(736)	-	-	(572)
Changes recognized in profit or loss	(15)	28	(214)	-	-	(201)
Changes recognized in other comprehensive income	-	9	-	-	-	9
Balance as at December 31, 2017	24	162	(950)	-	-	(764)
Effect of initial application of IFRS 15	**-**	**-**	**-**	**-**	**(29)**	**(29)**
Changes recognized in profit or loss	**(24)**	**(7)**	**(194)**	**(3)**	**(67)**	**(295)**
Changes recognized in other comprehensive income	**-**	**(15)**	**-**	**-**	**-**	**(15)**
Balance as at December 31, 2018	**-**	**140**	**(1,144)**	**(3)**	**(96)**	**(1,103)**

	Carry-forward tax losses	Employee benefits	Fixed assets	Investment in equity accounted investee	Other	Total
			$ thousands			
Deferred tax assets	**-**	**140**	**-**	**-**	**-**	**140**
Offset of balances						**(140)**
Deferred tax asset in statement of financial position as at December 31, 2018						**-**
Deferred tax liability	**-**	**-**	**(1,144)**	**(3)**	**(96)**	**(1,243)**
Offset of balances						**140**
Deferred tax liability in statement of financial position as at December 31, 2018						**(1,103)**

Note 17 - Income Taxes (cont'd)

G. Deferred tax assets and liabilities (cont'd)

(1) Recognized deferred tax assets and liabilities (cont'd)

	Carry-forward tax losses	Employee benefits	Fixed assets	Total
	$ thousands			
Deferred tax assets	24	162	-	186
Offset of balances				(183)
Deferred tax asset in statement of financial position as at December 31, 2017				3
Deferred tax liability	-	-	(950)	(950)
Offset of balances				183
Deferred tax liability in statement of financial position as at December 31, 2017				(767)

(2) Unrecognized deferred tax liabilities

As at December 31, 2018 a deferred tax liability in the amount of USD 339 thousand (2017: USD 167 thousand) for temporary differences in the amount of USD 1,475 thousand (2017: USD 725 thousand) related to an investment in a subsidiary was not recognized because the decision as to whether to incur the liability rests with the Group and it is satisfied that it will not be incurred in the foreseeable future.

(3) Unrecognized deferred tax assets

As at December 31, 2018 deferred tax assets have not been recognized mainly in respect of tax losses in the amount of USD 1,263 thousand (2017: USD 1,323 thousand) since currently it is not probable that future taxable profit will be available, against which the Group can utilize the benefits.

Note 18 - Earnings per Share

Basic and diluted earnings per share

	For the year ended December 31	
	2018	**2017**
Profit for the year ($ thousands)	**11,361**	5,544
Issued ordinary shares (in thousands of shares)	**17,671**	17,671
Basic and diluted earnings per ordinary share (in $)	**0.64**	0.31

Note 19 - Entity Wide Disclosures

A. The Group has one operating segment, the transformer segment. The Group's chief operating decision maker makes decisions and allocates resources with respect to all the transformers as a whole.

Management observes the operating data up to the net profit, in consistent of the consolidated financial reports presented in accordance with IFRS.

In presenting information on the basis of geographical segments, segment revenue is based on the geographical location of customers and segment assets are based on the geographical location of the assets.

	For the year ended December 31, 2018				
	Israel	**Europe**	**America**	**Asia**	**Total**
	$ thousands	**$ thousands**	**$ thousands**	**$ thousands**	**$ thousands**
Revenues	**1,532**	**8,815**	**13,334**	**21,942**	**45,623**
Non-current assets	**9,728**	**875**	**675**	**1,015**	**12,293**

	For the year ended December 31, 2017				
	Israel	**Europe**	**America**	**Asia**	**Total**
	$ thousands	**$ thousands**	**$ thousands**	**$ thousands**	**$ thousands**
Revenues	1,503	7,867	8,475	15,198	33,043
Non-current assets	10,075	890	698	-	11,663

B. Information about sales to principal customers - see Note 16A(2).

Note 20 - Subsequent Events

On March 27, 2019, the Company's Board of Directors decided to pay the shareholders a dividend for the financial year 2018 at the amount of USD 5,300 thousand (USD 0.3 per share, to be paid during June 2019).