

ELBIT VISION SYSTEMS LTD.

(An Israeli Corporation)

2015 CONSOLIDATED FINANCIAL STATEMENTS

ELBIT VISION SYSTEMS LTD.

2015 CONSOLIDATED FINANCIAL STATEMENTS

TABLE OF CONTENTS

	<u>Page</u>
REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM	2
CONSOLIDATED FINANCIAL STATEMENTS:	
Balance sheets as of December 31, 2015 and 2014	3-4
Statements of operations for the year ended December 31, 2015, 2014 and 2013	5
Statements of changes in shareholders' equity (Deficiency) for the year ended December 31, 2015, 2014 and 2013	6
Statements of cash flows for the year ended December 31, 2015, 2014 and 2013	7-8
Notes to Financial Statements	9-29



REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM
To the Board of Directors and Shareholders of
Elbit Vision Systems Ltd.

We have audited the accompanying consolidated balance sheets of Elbit Vision Systems Ltd. and subsidiaries ("the Company") as of December 31, 2015 and 2014, and the related consolidated statements of operations, stockholders' equity (deficiency), and cash flows for each of the three years in the period ended December 31, 2015. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company and subsidiaries as of December 31, 2015 and 2014, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2015, in conformity with accounting principles generally accepted in the United States of America.


Brightman Almagor Zohar & Co.
Certified Public Accountants

A member firm of Deloitte Touche Tohmatsu Limited

Tel Aviv, Israel March 29, 2016

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ELBIT VISION SYSTEMS LTD.
CONSOLIDATED BALANCE SHEETS
U.S. dollars in thousands

	<u>Note</u>	<u>December 31,</u>	
		<u>2 0 1 5</u>	<u>2 0 1 4</u>
Assets			
CURRENT ASSETS:			
Cash and cash equivalents		3,305	1,067
Restricted deposit (short term)	11A	69	44
Trade account receivables (net of allowance for doubtful account 2015- \$85 thousands, 2014- \$60 thousands)	12A1	1,383	901
Other receivables	12A2	78	110
Inventories	3	1,419	965
Total current assets		<u>6,254</u>	<u>3,087</u>
INVESTMENTS AND LONG-TERM RECEIVABLES:			
Severance pay fund	6	193	194
Other long-term receivables and investment	4	67	79
		<u>260</u>	<u>273</u>
PROPERTY AND EQUIPMENT (net of accumulated depreciation and amortization)	5	<u>36</u>	<u>27</u>
OTHER ASSETS			
Goodwill		<u>242</u>	<u>242</u>
Total assets		<u>6,792</u>	<u>3,629</u>

The accompanying notes are an integral part of the financial statements

ELBIT VISION SYSTEMS LTD.
CONSOLIDATED BALANCE SHEETS (Cont.)
U.S. dollars in thousands

	Note	December 31,	
		2015	2014
Liabilities and shareholders' equity			
CURRENT LIABILITIES:			
Credit from banks	12C	149	183
Current Maturities of Long Term Loan from Shareholders and Other		-	170
Trade account payable		1,171	637
Deferred income	2I(3)	324	578
Other payable	12B	441	457
Total current liabilities		2,085	2,025
LONG-TERM LIABILITIES:			
Long term loans (net of current maturities)	7	373	484
Other Long Terms Liabilities	8	429	526
Accrued severance pay	6	206	207
Total long-term liabilities		1,008	1,217
Total liabilities		3,093	3,242
SHAREHOLDERS' EQUITY:			
Share capital - ordinary shares of NIS 1 par value ("Ordinary Shares"); Authorized - 120,000,000 Ordinary Shares as of December 31, 2015 and 2014	9		
Issued and outstanding:			
December 31, 2015– 93,207,243 Ordinary shares		21,837	19,775
December 31, 2014 – 85,184,782 Ordinary shares			
Additional paid-in capital		22,006	22,874
Accumulated deficit		(40,144)	(42,262)
Total shareholders' Equity		3,699	387
Total liabilities and shareholders' Equity		6,792	3,629

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

ELBIT VISION SYSTEMS LTD.
CONSOLIDATED STATEMENTS OF OPERATIONS
U.S. dollars in thousands (except per share data)

	Note	Year ended December 31,		
		2015	2014	2013
Revenues:				
Sale of products		8,085	5,718	3,365
Services rendered		1,043	926	893
		<u>9,128</u>	<u>6,644</u>	<u>4,258</u>
Cost of revenues:				
Cost of products sold	12D	3,072	2,514	1,780
Cost of services rendered		810	631	699
		<u>3,882</u>	<u>3,145</u>	<u>2,479</u>
Gross profit		5,246	3,499	1,779
Research and development		765	560	625
Marketing and selling		1,411	1,187	1,022
General and administrative		808	729	866
Operating Profit (loss)		2,262	1,023	(734)
Financial expenses - net	12E	(144)	(365)	(278)
Profit (loss) before taxes on income		2,118	658	(1,012)
Taxes on income	10	-	-	-
Net Profit (loss) for the year		2,118	658	(1,012)
Profit (loss) per share:				
Basic earnings (loss) per share		0.025	0.008	(0.013)
Diluted earnings (loss) per share		0.025	0.008	(0.013)
Weighted average number of shares used in				
Computation of Profit (loss) per share –				
Basic (in thousands)		85,461	82,183	78,155
Diluted (in thousands)		85,681	83,519	78,155

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

ELBIT VISION SYSTEMS LTD.
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (DEFICIENCY)

	Share capital		Additional paid-in Capital*	Accumulated deficit	Total shareholders' Equity (Deficiency)
	Number of shares	Amount			
	In thousands		U.S. dollars in thousands		
BALANCE – January 1, 2013	74,916	16,939	24,695	(41,908)	(274)
CHANGES DURING 2013:					
Loss for the year	-	-	-	(1,012)	(1,012)
Issuance of share capital and warrants (note 9a)(*)	5,882	1,615	(1,290)	-	325
Issuance of debt beneficiary conversion feature	-	-	50	-	50
Revaluation of convertible loan and warrants	-	-	27	-	27
Share based compensation expenses	-	-	12	-	12
BALANCE – DECEMBER 31, 2013	<u>80,798</u>	<u>18,554</u>	<u>23,494</u>	<u>(42,920)</u>	<u>(872)</u>
CHANGES DURING 2014:					
Profit for the year	-	-	-	658	658
Issuance of share capital and warrants (note 9a)(**)	4,386	1,221	(991)	-	230
Reclassification of warrants to equity	-	-	330	-	330
Share based compensation expenses	-	-	41	-	41
BALANCE – DECEMBER 31, 2014	<u>85,184</u>	<u>19,775</u>	<u>22,874</u>	<u>(42,262)</u>	<u>387</u>
CHANGES DURING 2015:					
Profit for the year	-	-	-	2,118	2,118
Issuance of share capital and warrants (note 9a)	7,833	2,015	(867)	-	1,148
Exercise of Share based compensation	190	47	(37)	-	10
Share based compensation expenses	-	-	36	-	36
BALANCE – DECEMBER 31, 2015	<u>93,207</u>	<u>21,837</u>	<u>22,006</u>	<u>(40,144)</u>	<u>3,699</u>

(*) Net of share issuance costs in the amount of \$20.

(**) Net of share issuance costs in the amount of \$20.

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

ELBIT VISION SYSTEMS LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS
U.S. dollars in thousands

	Year ended December 31,		
	2015	2014	2013
Cash flows from operating activities:			
Net profit (loss)	2,118	658	(1,012)
Adjustments to reconcile net profit (loss) to			
Net cash provided by (used in) operating activities:			
Depreciation and amortization	6	13	17
Impairment of investment	-	-	65
Changes in warrants to issues shares	-	-	45
Revaluation of convertible loan and warrants	-	285	27
Liability for employee rights upon retirement	-	(5)	1
Stock based compensation	36	41	12
Changes in operating assets and liabilities:			
Decrease (increase) in trade accounts receivable	(482)	112	86
Decrease in other accounts receivable	32	10	39
Increase (decrease) in trade accounts payable	534	(101)	(179)
Changes in Deferred income	(254)	540	(26)
Increase (decrease) in other accounts payable	(16)	(21)	8
Increase in inventories	(454)	(100)	(92)
Net cash provided by (used in) operating activities	1,520	1,432	(1,009)
Cash flows from investing activities:			
Purchase of property and equipment	(15)	(9)	(5)
Long-term receivables	12	8	34
Investment in restricted deposit	(25)	(10)	(4)
Net cash provided by (used in) investing activities	(28)	(11)	25

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

ELBIT VISION SYSTEMS LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS (CONT.)
U.S. dollars in thousands

	Year ended December 31,		
	2015	2014	2013
Cash flows from financing activities:			
Issuance of share capital and warrants - net of issuance costs	1,158	230	178
Short-term credit from bank – net	(34)	-	-
Repayments of loan from Shareholder	-	(200)	(169)
Repayments from Long- terms loan	(170)	(354)	-
Repayments of Long- terms loan from banks and other	(208)	(182)	(183)
Other Long terms liabilities	-	-	(82)
	746	(506)	(256)
Net cash provided by (used in) financing activities	746	(506)	(256)
Net increase (decrease) in cash and cash equivalents	2,238	915	(1,240)
Balance of cash and cash equivalents at Beginning of year	1,067	152	1,392
	3,305	1,067	152
Balance of cash and cash equivalents at end of year	3,305	1,067	152
Non cash activities:			
Conversion of convertible debt to equity	-	-	147
Reclassification of warrants to equity	-	330	-
Discount on convertible notes recognized to beneficial conversion feature	-	-	50
Supplemental disclosure of cash flow Information - cash paid during the year for:			
Interest paid - net	19	39	42

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

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S dollars in Thousand

NOTE 1 - GENERAL

Elbit Vision Systems Ltd. (the "Company") is an Israeli corporation, which, together with its subsidiaries (the "Group"), is principally engaged in the design, development, manufacturing and marketing automatic vision inspection and quality monitoring systems, and rendering services related to those systems.

Elbit Vision Systems Inc. ("EVS Inc.") incorporated in Delaware U.S.A. is wholly-owned subsidiary, engaged in the selling and marketing of the Company's products worldwide.

In September 2004, the Company completed the acquisition of the entire shareholding of ScanMaster Systems (IRT) Ltd. ("ScanMaster Ltd."), an Israeli company and IRT ScanMaster System Inc. ("ScanMaster Inc."), a new Hampshire corporation (collectively - "ScanMaster"). ScanMaster is engaged in the development, manufacturing and marketing of equipment for the ultrasonic inspection of industrial parts and components for the automotive and transportation industries, the metal industry as well as applications for aircraft and jet engine inspection. During May 2010 the company sold all its shares in Scanmaster.

In 2009 the Company experienced significant difficulties in sales and incurred heavy losses that led the Company to sell its investment in ScanMaster Ltd. and the Assets and Liabilities of ScanMaster Inc. The purchasers repay loan of \$550 thousands in cash and undertook to repay the Company the sum of \$675 thousands in satisfaction of all remaining debt owed by ScanMaster Ltd. to the Company, over a period of 10 years in equal quarterly installments starting January 1, 2011. Following this Loan agreement, in 2012 the loan was reduced in \$450 thousands.

In connection with the sale the Company restructured its debt with the Banks. Pursuant to the agreements the banks forgave part of the debt such that the Company's remaining debt is \$1.6 million dollars over a period of 10 years started January 1, 2011.

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES

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

A. Use of estimates in the preparation of financial statements:

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting years. Actual results could differ from those estimates.

Estimates and assumptions which, in the opinion of management, are significant to the underlying amounts included in the financial statements and for which it would be reasonably possible that future events or information could change those estimates include: (i) impairment assessments of goodwill and long-lived assets; (ii) realization of deferred income tax assets; and (iii) provisions for obsolete and slow moving inventory. These estimates are discussed further throughout the accompanying notes.

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S dollars in Thousand

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

B. Functional Currency and Financial Statements in U.S. Dollars:

The currency of the primary economic environment in which operations of the company and its subsidiaries are conducted is the U.S. dollar (the "dollar").

Virtually all sales by the Company and its subsidiaries are made outside Israel in non-Israeli currencies, mainly the dollar. Most purchases of materials and components are made in dollars or in Israeli currency under contracts linked to the dollar. In addition, most marketing and service costs are incurred outside Israel, primarily in dollars, through the Company's wholly-owned non-Israeli subsidiaries. Thus, the functional currency of the Company and its subsidiaries is the dollar.

Transactions in currencies other than each company's functional currency are translated based on the average currency exchange rates in accordance with the principles set forth in ASC 830-10, "Foreign Currency Translation". All gains and losses from translation of monetary balance sheet items and transactions denominated in currencies other than the functional currency are recorded in the statements of income as financial income, net as they arise.

C. Principles of consolidation:

The consolidated financial statements include the financial statements of the company and its wholly-owned subsidiaries.

All material inter-company transactions and balances have been eliminated.

D. Cash Equivalents:

Cash equivalent consist of short-term highly liquid investments, that are readily convertible into cash with original maturities when purchased of three month or less.

E. Allowance for doubtful accounts:

The allowance for doubtful accounts has been made on the specific identification basis.

F. Inventories:

Inventories are stated at the lower of cost or market. Cost is determined as follows:

Raw materials and spare parts - on moving average basis.

Products in process and finished products – on basis of production costs.

Inventories are written-down for estimated obsolescence, based on assumptions about future demand and market conditions.

G. Property and equipment:

(1) Property and equipment are stated at cost. Depreciation is calculated by the straight-line method over the estimated useful lives of assets, as follows:

	<u>%</u>
Machinery and equipment	10-33 (mainly 33%)
Office furniture and equipment	6-20
Vehicles	15-20

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S dollars in Thousand

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

G. Property and equipment: (Cont.)

Leasehold improvements are amortized by the straight-line method over the term of the lease, or the estimated useful life of the improvements, whichever is shorter.

- (2) **Impairment of long-lived assets** - Impairment examinations and recognition are performed and determined based on the provisions of ASC 360-10, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("ASC 360-10"). ASC 360-10 requires that long-lived assets and certain identifiable assets held for use be reviewed for impairment on a periodic basis, or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of an asset to be held and used is determined by a comparison of the carrying amount of the asset and the amount of undiscounted future net cash flows to be generated by the asset or assets group. In the event that an asset is considered to be impaired, an impairment charge is recorded in the amount by which the carrying amount of the asset exceeds its estimated fair value.

H. Other assets- Goodwill and Intangible Assets:

- **Goodwill**

Under ASC 350-20, "Goodwill and Other Intangible Assets" ("ASC 350-10"), goodwill is not amortized to earnings, but rather is subject to periodic testing for impairment, at the reporting unit level, at least annually or more frequently if certain events or indicators of impairment occur. Impairment is the condition that exists when the carrying amount of goodwill exceeds its implied fair value. Measurement of an impairment loss is an estimate, performed based on the following: If the fair value of the reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired. If the carrying amount of the reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. The Group uses the discounted cash flow method to determine the fair value of the reporting unit.

The Company has designated December 31 of each year as the date on which it will perform its annual goodwill and impairment test.

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S dollars in Thousand

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

I. Revenue recognition:

(1) Sale of products:

(a) General

Revenues from sales of products and supplies are recognized when an arrangement exists, delivery has occurred and title passed to the customer, Group's price to the customer is fixed or determinable and collectibility is reasonably assured.

In some cases, the Company grants its customers a trial period, usually several months, in order to evaluate prototype of the system's performance. In case that the systems performance meets the customer's requirements, it purchases the system at the end of the trial period. The Company does not recognize sales revenue from products shipped to customers for trial until such products are actually purchased. Until purchased, these products are recorded as consignment inventory at the lower of cost or market as of December 31, 2015 the Company has \$142 thousands in consignment.

(b) Right of return

The Group does not provide, in the normal course of business, a right of return to its customers.

(c) Multiple Deliverables

The Company's multiple deliverable arrangements consist primarily of tangible products and professional services. The Company is unable to establish VSOE for all deliverables in an arrangement with multiple elements. Further, the Company is unable to reliably determine what similar competitor products' and services' selling prices are on a standalone basis and therefore is not able to determine TPE. As the Company is unable to establish VSOE or TPE, it uses BESP in its allocation of arrangement consideration. The objective of BESP is to determine the price at which the Company would transact a sale if the product or service were sold on a standalone basis. The Company determines BESP for a product or a service based on its past and current pricing practices. The determination of BESP is made through consultation with and formal approval by the Company's management. We have establish processes to update BESP for each element, when appropriate, to ensure that it reflects recent pricing experience.

(2) Services rendered

Service revenue in respect of the Group's products is recognized ratably over the contractual period, or as services are performed.

(3) Deferred income

The deferred income balance as of December 31, 2015 and 2014 include amounts of revenues that were invoiced and cash was received, but deferred due to elements of the arrangements not yet delivered as of year end.

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S dollars in Thousand

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

J. Research and development:

Research and development expenses net of third party grants, are expensed as incurred.

The Company has no obligation to repay the grants if sales are not generated.

K. Advertising expenses:

Advertising expenses are expensed as in incurred. Advertising expenses for the years ended December 31, 2015, 2014 and 2013 were \$ 109 thousands, \$ 52 thousands and \$ 81 thousands, respectively.

L. Deferred income taxes:

The company accounts for income taxes in accordance with ASC 740-10, "Accounting for Income Taxes" ("ASC 740-10"). Deferred income taxes are determined by the asset and liability method based on the estimated future tax effects attributable to temporary differences between income tax bases of assets and liabilities and their reported amounts in the financial statements, and to carryforwards for tax losses and deductions. Deferred tax balances are computed using the enacted tax rates to be in effect at the time when these differences are expected to reverse, as they are known at the balance sheet date.

Deferred tax assets and liabilities are classified as current or non-current according to the classification of the respective asset or liability, or the expected reversal date of the specific temporary difference, if not related to a specific asset or liability.

Valuation allowances in respect of deferred tax assets are established when it is more likely than not that all or a portion of the deferred income tax assets will not be realized.

M. Income (loss) per share ("EPS"):

Basic EPS is computed based on the weighted average number of shares outstanding during each year. Total common stock equivalents, related to options and warrants 3,962,744, 12,352,988 and 11,095,515 shares for the years 2015, 2014 and 2013, respectively, were excluded from EPS calculation, because the effect of such options and warrants is antidilutive.

N. Stock-based compensation:

The Company recognizes \$ 36 thousands of compensation expenses in 2015 as a result of the application of ASC 718-10. According to "share base compensation" accounting, the Company recorded compensation for stock options granted to employees and directors over the vesting period of the options based on the difference, if any, between the exercise price of the options and the market price of the underlying shares at that date.

As to information about the stock option plans and assumptions see Note 9b.

O. Reclassification:

Certain comparative figures have been reclassified to conform to the current year presentation.

P. Consentration of credit risk:

As of December 31, 2015 and 2014, the Group held cash and cash equivalents and short-term bank deposits, most of which were deposited with major Israeli, European, and U.S. banks. The Company is of the opinion that the credit risk in respect of these balances is insignificant.

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S dollars in Thousand

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

P. Concentration of credit risk (Cont.):

The Group performs ongoing credit evaluations of its customers for the purpose of determining the appropriate allowance for doubtful accounts. In respect of sales to customers in emerging economies, the Group requires letters of credit from banks.

Q. Issuance of shares, warrants and a convertible note to an investor:

The December 2012 Agreement (see note 9A (3)), included a shares, convertible debt instrument with stock warrants, and a beneficial conversion features. Under ASC 470-20-25, the Company separated the shares, debt instruments and the warrants based on their relative fair value for the liability components and for the equity components. The company accounted for the first warrants as an equity component and the second warrants as a liability component under the provision of ASC 815-10. In addition, the Company concluded that the liability component includes beneficial conversion features. Under ASC 470-20-25, issuers of certain debt instruments with beneficial conversion features need to allocate to an equity component. The Company separated it accordingly.

NOTE 3 - INVENTORIES

	December 31,	
	2 0 1 5	2 0 1 4
	\$ in thousands	
Raw materials	1,066	606
Work in process	177	225
Finished products	176	134
	1,419	965

The balances are net of write-down of \$643 thousands as of December 31, 2015 and 2014.

NOTE 4 - OTHER LONG-TERM RECEIVABLES AND INVESTMENT

	December 31,	
	2 0 1 5	2 0 1 4
	\$ in thousands	
Deposits on leased vehicle and other(see also Note 8b2)	11	11
Loan to non-affiliated companies (see Note 1)	56	68
	67	79

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S dollars in Thousand

NOTE 5 - PROPERTY AND EQUIPMENT

A. Comprised as follows:

	December 31,	
	2 0 1 5	2 0 1 4
	\$ in thousands	
Machinery and equipment	1,725	1,710
Leasehold improvements	24	24
Office furniture and equipment	44	44
	1,793	1,778
Less - accumulated depreciation and amortization	1,757	1,751
	36	27

- B.** Depreciation and amortization expenses totaled \$6 thousands, \$13 thousands, and \$17 thousands, in the years ended December 31, 2015, 2014 and 2013, respectively.

NOTE 6 - ACCRUED SEVERANCE PAY, NET

- A.** The Company's liability for severance pay is calculated in accordance with Israeli law based on the latest salary paid to employees and the length of employment in the Company.

Part of the liability is funded through individual insurance policies.

The policies are assets of the company and, under labor agreement subject to certain limitation, they may be transferred to ownership of the beneficiary employees.

- B.** A U.S. subsidiary provides defined contribution plan for the benefit of its employees. Under this plan, contributions are based on specific percentages of pay.

NOTE 7 - LONG TERM LOANS

A. Composed as follows:

	December 31,	
	2 0 1 5	2 0 1 4
	\$ in thousands	
Loans from banks	373	484

In June 2010, the Company signed new agreements with Bank Le'umi Le'Israel Ltd and Bank Hapoalim Ltd (the "Banks"), for the restructuring of its bank debt. Pursuant to the agreements with the Banks, the Banks forgave approximately \$2.4M of debt from the Company and its subsidiary ScanMaster Systems (IRT) Ltd. ("ScanMaster Ltd."), and have agreed to the repayment by the Company of \$1 million over 5 years and a further \$600 thousands over 10 years.

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S dollars in Thousand

NOTE 7 - LONG TERM LOANS (Cont.)

A. Composed as follows: (Cont.)

In May 2010 the Company signed agreements with its major shareholders to loan US \$100 thousands. The loan is repayable upon fulfillment of certain conditions (as further elaborated in the agreement) aimed to ensure the Company achieved financial stability prior to repayment.

Further, the Company's major shareholders agreed to delay payment of the first US \$100 thousands of their salary until July 2011, at which time the company shall repay them in three equal monthly installments.

In May 2010 the Company signed loan agreement with Mivtach (former Shareholder) of approximately \$850 thousands to which the Company will repay the loan over five years in equal quarterly installments, plus interest at the US Dollar annual LIBOR rate. The Company pay the last payment on October 2015.

B. The liabilities (net of current maturities) mature in the following years after the balance sheet dates:

	December 31,	
	2 0 1 5	2 0 1 4
	\$ in thousands	
2015	-	149
2016	149	149
2017	149	149
2018 and thereafter	75	37
	373	484

NOTE 8 - OTHER LONG TERMS LIABILITIES

A. Royalties

(1) The Company is committed to pay royalties to the Government of Israel based on proceeds from sales of products in the research and development of which the Government participates by way of grants. At the time the grants were received, successful development of the related projects was not assured.

In the case of failure of a project that was partly financed as above, the Company is not obligated to pay any such royalties.

Under the terms of the Company's funding from the Israeli Government, royalties of 3%-5% are payable on sales of products developed from a project so funded, up to 100% of the amount of the grant received by the Company (dollar linked); as from January 1, 2001 - with the addition of an annual interest rate based on Libor.

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S dollars in Thousand

NOTE 8 - OTHER LONG TERMS LIABILITIES (Cont.)

A. Royalties (Cont.)

- (2) The Company is committed to pay royalties to the Government of Israel in respect of marketing expenses in which the Government participated by way of grants. At the time the grants were received, successful development of the related projects was not assured. In the case of failure of a project that was partly financed as above, the Company is not obligated to pay any such royalties. The royalties are payable at the rate of 4% of the increase in export sales, up to the amount of the dollar-linked grant received. No royalties were paid in the reported years to the Government of Israel.

On November 7, 2007, the Company received a letter from the Ministry of Trade, Industry and Labor – Fund for the Encouragement of Marketing Abroad (the “Fund”), claiming that it had failed to pay royalties to the Fund since 1999 in the aggregate amount of \$480 thousands. On November 21, 2007, the Company sent a letter to the Fund in which it stated that the Fund had not requested any of these royalties for many years despite the Company's written request to clarify the issue. In its letter the Company stated that a material amount of the royalties could no longer be claimed due to the operation of the statute of limitations and that in any event the Fund may be estopped from making at least part of the claims as a result of its non-response to the Company's inquiry. On December 18, 2007, the Company met with representatives of the Fund to discuss the issue. The Company have yet to receive a response to the meeting. The Company recorded an allowance of \$ 90 thousands on account of this claim.

On March 3, 2013, the Company received an email notification which was sent on behalf of the Ministry stating that the Company had received funding from the Fund in the past and requesting information relating to the Company's export revenues. The Company has not responded.

The maximum royalty amount payable the Company expects to pay to the Government of Israel under 1 and 2 above ,at December 31, 2015 is approximately \$451 thousands.

In January 2011 the Company signed an agreement with the office of the Chief scientist of to repay the Copmany debt during the next ten years with monthly installment of \$9.2 thousands (36 thousands NIS) per month.

B. Lease commitments

- (1) The premises occupied by the Company and certain subsidiaries are rented under various operating lease agreements. The lease agreements for the premises expire in 2018.

To secure the amounts due to the lessor, the Company has deposited a total of \$ 26 thousands.

Minimum lease commitments of the Company and the subsidiaries under the above leases, at rates in effect as of December 31, 2015, are as follows:

	<u>\$ in thousands</u>
Year ending December 31:	
2016	85
2017	75
2018	38
	<u>198</u>

The rental payments for the premises in Israel, which constitute most of the above

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S dollars in Thousand

amounts, are payable in Israeli currency linked to the US Dollar.

Rental expenses totaled \$ 86 thousands, \$ 92 thousands, and \$ 87 thousands in the years ended December 31, 2015, 2014 and 2013, respectively.

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S dollars in Thousand

NOTE 8 - OTHER LONG TERMS LIABILITIES (Cont.)

B. Lease commitments (Cont.)

- (2) The Company leases motor vehicles under long-term operating lease agreements. The lease agreements expire on various dates ending in 2015 – 2018 (with prior notice of cancellation clauses).

Minimum lease commitments of the Company under the above leases, at rates in effect on December 31, 2015, are as follows:

	<u>\$ in thousands</u>
2016	68
2017	36
2018	9
	<u>113</u>

To secure the amounts due to the lessor, the Company has deposited a total of \$ 6 thousand. The deposits are unlinked and presented among other long-term receivables.

Lease expenses in 2015, 2014 and 2013, amounted to \$ 102 thousands, \$ 98 thousands and \$ 109 thousands respectively.

C. Guarantees

As of December 31, 2015, the Company gave \$41 thousands guarantees to its customers.

NOTE 9 - SHAREHOLDER' EQUITY

A. Authorized, issued and outstanding shares

- (1) The Company's Ordinary Shares are traded in the United States on the OTC Bulletin Board market under the symbol EVSNF.OB.
- (2) In December 2009 the Company issued Mivtach Shamir Holdings Ltd. 18,664,078 ordinary shares for \$0.097 per share for a total amount of \$1,810,416. This amount include conversion of Loan received from Mivtach during 2009 in an amount of \$627,000. Pursuant to the transaction, Mivtach was also issued warrants to purchase 9,332,039 of the Company's ordinary shares at an exercise price per share of \$0.139, exercisable for a period of 4 years.

In May 2010, The current new shareholders of the Company purchased all those shares and Warrants. These warrants were fortified in June 2011.

- (3) In December 2012, The Company issued Mr. Gross some financial instruments in consideration of \$760 thousands (net of \$40 thousands issuance expenses) which include shares, warrants and a convertible note. The Company issued 5,263,158 ordinary shares for \$0.095 per share. The Company also issued warrants ("The first warrants") to purchase 2,105,263 of the Company's ordinary shares at an exercise price per share of \$0.095 amounting \$200 thousands, vested in fully upon issuance, exercisable through February 2015. The Convertible Note Agreement is on the principal amount of \$300 thousands. The maturity date of the Note is, May 2013, after the maturity date the conversion option expires, and the loan is supposed to be returned in 12 monthly installments.

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S dollars in Thousand

NOTE 9 - SHAREHOLDER' EQUITY (Cont.)

A. Authorized, issued and outstanding shares (Cont.)

- (4) The Note bears interest at a per annum rate of Libor rate. The Note and accrued interest are convertible to common stock of the Company at a conversion rate of \$0.095 per share. In case that Mr. Gross would convert more than 50% of the aggregated amount of the principal amount of the convertible note and the first warrants, the Company would issue Mr. gross warrants ("the second warrants"). The principal amount of the second warrants would be in proportion to percentage converted/exercised from the principal amount of the convertible note and the first warrants. The second warrants could amount up to \$1 million of the Company's ordinary shares at an exercise price per share of \$0.17 or \$0.20 depends on The company's revenue on the year ended 2014. The second warrants would be vested in fully upon issuance, exercisable through February 2015.

In May 2013 Mr. Gross convert the convertible note to Company's shares and the Company reduces the Conversion rate to \$0.085 and postponed the exercisable date of the second warrants to December 2015. In August 2014 the company set the exercise price of the second warrants to \$0.17 accordingly, the Company reclassified the warrants to Equity. On December 31,2015 Mr. Gross exercise the second warrants for \$0.17 per share.

- (5) In July 2014 The Company issued shares 4,166,667 to SMD Advanced Technologies Ltd. ("SMD") controlled by Mr. Yaacov Kotlicki ,and warrants to purchase another 1,833,334 shares for a price of \$146,667 valid until July 2017. During December 2015, SMD exercise its warrants.

B. Share option plans:

(1) The plans:

- (a) In November 2003, the Board of Directors of the Company adopted the Employee Share Option Plan (2003) (hereafter – The 2003 Plan).

Under the 2003 plan, options to purchase an aggregate of 3,500,000 ordinary shares are available to be awarded to employees, directors or consultants of the Company or any of its subsidiaries.

Under the 2003 plan, options usually vest over a period of four years from the date of grant, in equal parts each year.

The 2003 Plan is valid for ten years and will expire on November 30, 2013, except for options outstanding on that date.

- (b) In March 2006, the Board of Directors of the Company adopted the Employee Share Option Plan (2006) (hereafter – The 2006 Plan).

Under the 2006 plan, options to purchase an aggregate of 2,000,000 ordinary shares are available to be awarded to employees, directors or consultants of the Company or any of its subsidiaries. The Board of the Company increase the aggregate number of option to 4,500,000 for 2006 plan.

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S dollars in Thousand

NOTE 9 - SHAREHOLDER' EQUITY (Cont.)

B. Share option plans: (Cont.)

(1) The plans: (Cont.)

- (c) Under the 2006 plan, options usually exercisable over a period up to ten years following the date of grant, if not exercised earlier, or 6 months after termination of the employment, will generally vest as to 25-33% commencing the beginning of the second year after the grant and as to an additional 25-33% in each of the remaining years thereafter, assuming continuous employment with the Company through such periods.

The 2006 Plan is valid for ten years and will expire in March, 2016, except for options outstanding on that date.

The exercise price of options granted under the 2003 plan is to be not less than 85% of the fair market value of the ordinary share on the date of grant. All of the outstanding options from the 2003 and 2006 plan are to expire no later than 10 years following the date of grant.

During 2013, and 2014 no options were exercised. During 2015, 190,000 options were exercised.

The 2003 and 2006 plans are subject to the terms stipulated by Section 102 of the Israeli Income Tax Ordinance.

The amount allowed as an expense for tax purposes, at the time the employee utilizes such benefit, is limited to the amount of the benefit that is liable to tax as labor income, in the hands of the employee; all being subject to the restrictions specified in Section 102 of the Income Tax Ordinance.

The aforementioned expense will be recognized in the tax year that the benefit is credited to the employee.

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S dollars in Thousand

NOTE 9 - SHAREHOLDER' EQUITY (Cont.)

B. Share option plans: (Cont.)

(2) Options granted to employees:

(a) A summary of the status of the above plans in respect of options granted to employees, directors and consultant of the Company and its subsidiaries as of December 31, 2015, 2014 and 2013, and changes during the years ended on those dates, is presented below:

	Year ended December 31,					
	2 0 1 5		2 0 1 4		2 0 1 3	
	Number	Weighted average exercise price	Number	Weighted average exercise price	Number	Weighted average exercise price
Options outstanding at beginning of year	4,227,610	0.1	4,804,444	0.4	5,509,563	0.45
Changes during the year:						
Granted (1)	535,000	0.17	1,140,000	0.08	345,000	0.09
Exercised	(190,000)	0.05	-	-	-	-
Forfeited	(382,191)	0.11	(1,716,834)	0.92	(1,050,119)	0.43
Options outstanding at end of year	<u>4,190,419</u>	<u>0.11</u>	<u>4,227,610</u>	<u>0.1</u>	<u>4,804,444</u>	<u>0.43</u>
Options exercisable at year end	<u>3,170,424</u>	<u>0.10</u>	<u>3,169,583</u>	<u>0.11</u>	<u>3,689,416</u>	<u>0.4</u>
Weighted average fair value of options granted during the year (2)	<u>\$0.12</u>		<u>\$0.04</u>		<u>\$0.09</u>	

(1) Options granted in 2015, 2014 and 2013 were granted with exercise price that was at market value or above.

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S dollars in Thousand

NOTE 9 - SHAREHOLDER' EQUITY (Cont.)

B. Share option plans: (Cont.)

(2) Options granted to employees (Cont.):

(a) (Cont.)

(2) The fair value of each option granted is estimated on the date of grant using the Black-Scholes option-pricing model in 2014 and 2015, with the following weighted average assumptions:

	Year ended December 31,		
	2015	2014	2013
Dividend yield	<u>0%</u>	<u>0%</u>	<u>0%</u>
Expected volatility	<u>81%</u>	<u>64%</u>	<u>64%</u>
Risk-free interest rate	<u>1.72%</u>	<u>1.5%</u>	<u>1.5%</u>
Expected life - in years	<u>6.5</u>	<u>4</u>	<u>4</u>

Dividend yield - Management used an expected dividend yield based primarily on past experience applicable as of the grant date.

Expected volatility - Management estimated volatility based on the historical volatility of the Company's ordinary shares, being the only traded financial instrument of the Company, using in most cases daily observations of the Company's price share to determine the standard deviation.

Risk free interest rate - The risk-free interest rate is based on the implied yield in effect at the time of each option grant, based on U.S. Treasury zero-coupon bond issued with equivalent remaining terms.

Management estimates forfeiture rates at the date of grant, which are adjusted in subsequent periods if the actual forfeiture rates differ from those initially estimated. Management uses historical data to estimate pre-vesting option forfeiture rates and records share-based compensation expense only for those awards that are expected to vest.

(b) The following table summarizes certain information about options granted to employees and directors of the Company which were outstanding and exercisable under the above plans as of December 31, 2015:

Exercise prices	Options outstanding		Options exercisable	
	Number outstanding at December 31, 2015	Weighted average remaining contractual life	Number exercisable at December 31, 2015	Weighted average remaining contractual life
\$		Years		Years
0.05-0.32	4,000,419	0.03-9.82	2,980,424	0.03-8.88
0.4-0.46	127,500	1.28-2.12	127,500	1.28-2.12
0.49	25,000	2.01	25,000	2.01
0.75-0.78	37,500	0.12-1.29	37,500	0.15-1.29
	<u>4,190,419</u>		<u>3,170,424</u>	

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S dollars in Thousand

NOTE 9 - SHAREHOLDER' EQUITY (Cont.)

B. Share option plans: (Cont.)

(2) Options granted to employees (Cont.):

- (c) As of December 31, 2015 the aggregate intrinsic value for the option exercisable was \$299 thousands with a weighted average remaining contractual life of 5.9 years.

The unrecognized compensation expenses calculated under the fair value method for stock options expected to vest as of December 31, 2015 is approximately \$ 55 thousands and is expected to be recognized over a weighted average period of 1 year.

NOTE 10 - TAXES ON INCOME

A. Tax Rates Applicable To The Income Of The Company:

The Company's taxable income is subject to income tax at the regular corporate rate of 26.5% and in US 35%.

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S dollars in Thousand

NOTE 10 - TAXES ON INCOME (Cont.)

B. Deferred Income Taxes:

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

	Year ended december 31,	
	2015	2014
Net loss carry-forward	10,004	10,525
Other additions for tax Purposes	183	154
Net deferred tax asset before valuation allowance	<u>10,187</u>	<u>10,679</u>
Valuation allowance	<u>(10,187)</u>	<u>(10,679)</u>
Net deferred tax asset	<u><u>-</u></u>	<u><u>-</u></u>

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The most significant component of the Company's deferred tax assets is the accumulated net operating losses carry-forward among the two subsidiaries due to the uncertainty of the realization of such tax benefits.

The Company has provided a full valuation allowance in respect of deferred tax assets resulting from tax loss carry-forward and other temporary differences. Management currently believes that since the Company has a history of losses it is more likely than not that the deferred tax regarding the loss carry-forward and other temporary differences will not be realized in the foreseeable future.

Net profit (loss) was incurred as following:

	Year ended december 31,	
	2015	2014
United States	(461)	(238)
Israel	2,579	896
	<u>2,118</u>	<u>658</u>

C. Tax Loss Carry-Forwards:

Net operating loss carry-forwards as of December 31, 2015 are as follows:

Israel	38,926
United States *	<u>1,218</u>
	<u><u>40,144</u></u>

Net operating loss carry-forwards as of December 31, 2014 are as follows:

Israel	41,684
United States *	<u>757</u>
	<u><u>42,441</u></u>

Net operating losses in Israel may be carried forward indefinitely.

Net operating losses in the U.S. are available through 2027.

- * Utilization of U.S. net operating losses may be subject to substantial annual limitation due to the "change in ownership" provisions of the Internal Revenue Code of 1986 and similar state

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S dollars in Thousand

NOTE 10 - TAXES ON INCOME (Cont.)

C. Tax Loss Carry-Forwards (Cont.):

provisions. The annual limitation may result in the expiration of net operating losses before utilization.

NOTE 11 - LIABILITIES SECURED BY PLEDGES AND RESTRICTION PLACED IN RESPECT OF LIABILITIES

A. The Company has registered fixed charge on bank deposits in favor of certain banks. The bank deposits are used to secure a credit line granted to the Company by the banks, and as collateral for guarantees provided to its customers.

As of December 31, 2015, the bank deposits amount to \$ 69 thousands;

B. The Company have registered floating liens on all of their assets in favor of.

NOTE 12 - SUPPLEMENTARY INFORMATION:

	December 31,	
	2 0 1 5	2 0 1 4
	\$ in thousands	
A. Accounts receivable		
(1) Trade - allowance for doubtful accounts:		
Balance at beginning of year	60	60
Charged to statement of operations	25	-
Balance at end of year	85	60
(2) Other receivables:		
Prepaid expenses	12	27
Israeli Government departments and agencies	57	72
Other	9	11
	78	110

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S dollars in Thousand

NOTE 12 - SUPPLEMENTARY INFORMATION (Cont.):

	December 31,	
	2015	2014
	\$ in thousands	
B. Other payable:		
Employees and employee institutions	75	43
Israeli Government departments and agencies	112	115
Provision for vacation and recreation pay	76	71
Provision for product warranty	113	91
Liability for commissions to agents	21	93
Accrued expenses and sundry	44	44
	441	457

	% interest rate as of December 31, 2015	December 31,	
		2015	2014
		\$ in thousands	
C. Credit from banks:			
Short-term loans from banks:			
Linked to the Dollar (See Note 7(a))	2.5	149	183
		149	183

	Year ended December 31,		
	2015	2014	2013
	\$ in thousands		
D. Cost of revenues:			
Industrial operations:			
Materials consumed	2,263	1,635	994
Payroll and related expenses	504	479	503
Subcontracted work	306	278	312
Depreciation and amortization	1	2	3
Other production expenses	808	751	667
	3,882	3,145	2,479

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S dollars in Thousand

NOTE 12 - SUPPLEMENTARY INFORMATION: (Cont.)

E. Financial expenses:

	Year ended December 31,		
	2015	2014	2013
	\$ in thousands		
Income:			
Exchange differences	-	27	-
Other	2	2	3
	2	29	3
Expenses:			
Interest			
In respect of liability to related parties	-	11	6
In respect of credit from banks	19	28	35
Exchange differences	60	-	108
Revaluation of convertible loan and warrants	-	285	27
Warrants to issued shares compensation	-	-	45
Other	67	70	60
	146	394	281
	(144)	(365)	(278)

NOTE 13 - RELATED PARTIES

	Year ended December 31,		
	2015	2014	2013
	\$ in thousands		
Managements fees – included in General and administrative	430	343	379

Balance with related parties:

	Year ended December 31,		
	2015	2014	2013
	\$ in thousands		
Short Terms Loan	-	-	200

ELBIT VISION SYSTEMS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S dollars in Thousand

NOTE 14 - GEOGRAPHICAL SEGMENTS

Geographic information:

- (1) The Company's revenues by geographic areas (based on location of customers) are as follows:

	Year ended December 31,		
	2015	2014	2013
	\$ in thousands		
North America (mainly the United States)	2,646	1,720	1,043
Germany	424	442	232
Italy	403	399	248
Turkey	200	241	-
UK	-	221	61
Russia	230	146	
Other European countries	1,000	1,384	995
China	2,824	1,420	688
India	598	80	194
Japan	437	200	553
Israel	165	210	180
Other Far Eastern countries	201	181	64
	<u>9,128</u>	<u>6,644</u>	<u>4,258</u>

- (2) The Company's long-lived assets by geographic areas are as follows:

	Year ended	
	December 31,	
	2015	2014
	\$ in thousands	
Israel	526	530
U.S.A.	12	12
	<u>538</u>	<u>542</u>