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**SECURITIES AND EXCHANGE COMMISSION**

Washington D.C. 20549

**FORM 20-F**

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

**OR**

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

**For the fiscal year ended December 31, 2010**

**OR**

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

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

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

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

**Commission file number: 0-21388**

**MAGAL SECURITY SYSTEMS LTD.**

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

**Israel**

(Jurisdiction of incorporation or organization)

**P.O. Box 70, Industrial Zone, Yehud 56100, Israel**

(Address of principal executive offices)

**Ilan Ovadia, Chief Financial Officer**

**Magal Security Systems Ltd.**

**P.O. Box 70, Industrial Zone**

**Yehud 56100, Israel**

**+972-3-5391444 (phone), +972-3-5366245 (fax)**

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

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

Title of each class  
**Ordinary Shares, NIS 0.1 Par Value**

Name of each exchange on which registered  
**NASDAQ Global Market**

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

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

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

**Ordinary Shares, par value NIS 1.0 per share .....10,396,548**  
(as of December 31, 2010)

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

Yes  No

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

Yes  No

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

Yes  No

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

Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

U.S. GAAP

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

Other

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

Item 17

Item 18

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

Yes  No

This Annual Report on Form 20-F is incorporated by reference into the Registrant's Registration Statements on Form S-8, File Nos. 333-127340 and 333-164696.

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## INTRODUCTION

Magal Security Systems Ltd. is a leading international solutions provider of safety, security, site management and intelligence gathering and compilation solutions and products. Based on more than 25 years of experience and interaction with customers, we have developed a unique set of solutions and products, optimized for perimeter, outdoor and general security applications. Our turnkey solutions are typically integrated and managed by sophisticated modular command and control software, supported by expert systems for real-time decision support. Our broad portfolio of critical infrastructure protection and site protection technologies includes a variety of smart barriers and fences, fence mounted detectors, virtual gates, buried and concealed detection systems and a sophisticated protection package for sub-surface intrusion. A world class innovator in the development of closed circuit television, intelligence video analysis and motion detection technology for outdoor operation, we have successfully installed customized solutions and products in more than 75 countries worldwide. Our ordinary shares are traded on the NASDAQ Global Market and on the Tel Aviv Stock Exchange under the symbol "MAGS." Our address on the Internet is [www.magal-s3.com](http://www.magal-s3.com). The information on our website is not incorporated by reference into this annual report. As used in this annual report, the terms "we," "us" and "our" mean Magal Security Systems Ltd. and its subsidiaries, unless otherwise indicated.

We have trademark rights in the United States and other national jurisdictions arising out of our trademark registrations, applications and/or use of the following trademarks and service marks: SENSTAR-STELLAR logo, the S logos, SENSTAR-STELLAR, SENSTAR-STELLAR (and design) SENSTAR, PANTHER, GUIDAR, REPELS, SENNET, PERIMITRAX, INTELLI-FLEX, INTELLI-FIELD, INTELLIFIBER, X-FIELD, OMNITRAX, STARLED, STARNET, FRONTLINE, E-FIELD, E-FLEX, ARMOURFLEX, FLASH, FLARE, SENTRAX, OMNITRAX, XFIELD, FLEX-PS, FLEX-PI, ULTRAWAVE, FORTIS, PIPEGUARD, DTR, PINPOINTER, DreamBox, MAESTRODB, the Magal logo and all other marks used to identify particular products and services associated with our businesses. Any other trademarks and trade names appearing in this annual report are owned by their respective holders.

Our consolidated financial statements appearing in this annual report are prepared in U.S. dollars and in accordance with generally accepted accounting principles in the United States, or U.S. GAAP. All references in this annual report to "dollars" or "\$" are to U.S. dollars and all references in this annual report to "NIS" are to New Israeli Shekels. The representative exchange rate between the NIS and the dollar as published by the Bank of Israel on December 31, 2010 was NIS 3.549 per \$1.00.

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

This Annual Report on Form 20-F contains various "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and within the Private Securities Litigation Reform Act of 1995, as amended. Such forward-looking statements reflect our current view with respect to future events and financial results. Forward-looking statements usually include the verbs, "anticipates," "believes," "estimates," "expects," "intends," "plans," "projects," "understands" and other verbs suggesting uncertainty. We remind readers that forward-looking statements are merely predictions and therefore inherently subject to uncertainties and other factors and involve known and unknown risks that could cause the actual results, performance, levels of activity, or our achievements, or industry results, to be materially different from any future results, performance, levels of activity, or our achievements expressed or implied by such forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. We undertake no obligation to publicly release any revisions to these forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. We have attempted to identify additional significant uncertainties and other factors affecting forward-looking statements in the Risk Factors section which appears in Item 3.D "Key Information -Risk Factors."

**PART I**

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

Not applicable.

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

Not applicable.

**ITEM 3. KEY INFORMATION**

**A. Selected Consolidated Financial Data.**

The following selected consolidated financial data for and as of the five years ended December 31, 2010 are derived from our audited consolidated financial statements which have been prepared in accordance with U.S. GAAP. We have derived the following selected consolidated financial data as of December 31, 2009 and 2010 and for each of the years ended December 31, 2008, 2009 and 2010 from our consolidated financial statements set forth elsewhere in this annual report that have been prepared in accordance with U.S. GAAP. We have derived the following selected consolidated financial data as of December 31, 2006, 2007 and 2008 and for each of the years ended December 31, 2006 and 2007 from our audited consolidated financial statements not included in this annual report. The selected consolidated financial data set forth below should be read in conjunction with and are qualified entirely by reference to Item 5 “Operating and Financial Review and Prospects” and our audited consolidated financial statements and notes thereto included elsewhere in this annual report.

	<b>Year Ended December 31,</b>				
	<b>2006<sup>(1)</sup></b>	<b>2007<sup>(1)(2)</sup></b>	<b>2008<sup>(2)</sup></b>	<b>2009<sup>(2)</sup></b>	<b>2010</b>
	(in thousands except per share data)				
<b>Consolidated Statement of Operations Data:</b>					
Revenues	\$ 63,600	\$ 62,695	\$ 57,105	\$ 54,518	\$ 49,699
Cost of revenues	37,236	38,156	37,559	33,404	31,400
Gross profit	26,364	24,539	19,546	21,114	18,299
<b>Operating expenses:</b>					
Research and development, net	5,378	5,310	5,556	5,059	4,105
Selling and marketing, net	11,603	11,073	12,953	10,820	11,261
General and administrative	5,547	6,057	10,243	8,100	7,593
Impairment of goodwill and other intangible assets	-	-	2,772	-	-
Post employment and termination benefits	-	904	2,582	-	-
Total operating expenses	22,528	23,344	34,106	23,979	22,959
Operating income (loss)	3,836	1,195	(14,560)	(2,865)	(4,660)
Financial expenses, net	864	2,059	1,314	1,568	967
Income (loss) before income taxes	2,972	(864)	(15,874)	(4,433)	(5,627)
Income taxes (tax benefit)	943	276	3,066	864	602
Income (loss) from continuing operations	2,029	(1,140)	(18,940)	(5,297)	(6,229)
Income (loss) from discontinued operations, net	(1,219)	3,022	(13,662)	4,216	-
Net income (loss)	\$ 810	\$ 1,882	\$ (32,602)	\$ (1,081)	\$ (6,229)
Less: net income attributable to non-controlling interest	-	-	-	54	(24)
Net income (loss) attributable to Magal's shareholders	\$ 810	\$ 1,882	\$ (32,602)	\$ (1,135)	\$ (6,205)
Basic net earnings (loss) per share from continuing operations	\$ 0.20	\$ (0.11)	\$ (1.82)	\$ (0.52)	\$ (0.6)
Basic net earnings (loss) per share from discontinued operations	(0.12)	0.29	(1.32)	0.41	-
Basic net earnings (loss) per share	\$ 0.08	\$ 0.18	\$ (3.14)	\$ (0.11)	\$ (0.6)
Diluted net earnings (loss) per share from continuing operations	\$ 0.20	\$ (0.11)	\$ (1.82)	\$ (0.52)	\$ (0.6)
Diluted net earnings (loss) per share from discontinued operations	\$ (0.12)	\$ 0.29	\$ (1.32)	\$ 0.41	\$ -
Diluted net earnings (loss) per share	\$ 0.08	\$ 0.18	\$ (3.14)	\$ (0.11)	\$ (0.6)
Weighted average number of ordinary shares used in computing basic net earnings per share	10,384,047	10,394,989	10,396,548	10,396,548	10,396,548
Weighted average number of ordinary shares used in computing diluted net earnings per share	10,441,824	10,431,103	10,396,548	10,398,624	10,396,548

	<b>As of December 31,</b>				
	<b>2006<sup>(1)</sup></b>	<b>2007<sup>(1)</sup></b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
	(in thousands)				
<b>Consolidated Balance Sheets Data:</b>					
Cash and cash equivalents	\$ 4,908	\$ 9,205	\$ 16,835	\$ 11,869	\$ 16,596
Short and long-term bank deposits, restricted deposits, marketable securities and escrow deposit	22,053	26,972	8,137	2,019	4,888
Working capital	39,884	41,526	16,240	20,646	26,612
<b>Total assets</b>	<b>103,681</b>	<b>126,157</b>	<b>90,537</b>	<b>60,650</b>	<b>65,497</b>
Short-term bank credit (including current maturities of long-term loans)	17,821	20,737	23,995	10,058	9,830
Long-term bank loans	7,399	3,095	2,282	548	50
Loan from related party	-	-	-	-	9,907
Total shareholders' equity	58,150	65,578	30,718	32,309	28,016
Ordinary shares issued and outstanding	10,391,548	10,396,548	10,396,548	10,396,548	10,396,548

(1) In December 2007, we disposed of our U.S. based video monitoring business. Accordingly, the operating results, balance sheet and cash flows relating to the video monitoring operations were presented in our statements of income, balance sheets and cash flows as discontinued operations, and the comparative operating results for prior years were reclassified.

(2) In September 2009, our Board of Directors resolved to discontinue the operations of the European integration subsidiary that we acquired in September 2007. The subsidiary was sold in December 2009. Accordingly, operating results and cash flows for the years ended December 31, 2007, 2008 and 2009, as well as the capital gain resulting from the sale, were reclassified to disclose the results of that subsidiary as discontinued operations.

**B. Capitalization and Indebtedness.**

Not applicable.

**C. Reasons for the Offer and Use of Proceeds.**

Not applicable.

**D. Risk Factors.**

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

**Risks Related to Our Business**

**We have incurred operating losses and may not be able to achieve and sustain profitable operations. We may not have sufficient resources to fund our working capital requirements in the future.**

We incurred operating losses in the last three fiscal years and we may not be able to achieve and sustain profitable operations in the future. In the years ended December 31, 2008, 2009 and 2010, we recorded a net loss of \$32.6 million, \$1.1 million and \$6.2 million, respectively. As of December 31, 2010, our accumulated deficit was \$33.7 million. Even if we return to profitability, our future net income may not offset our cumulative losses. To the extent that we continue to incur operating losses, we may not have sufficient working capital to fund our operations in the future. If we are not able to successfully complete our proposed rights offering, we will be required to obtain financing from other sources. Such financing may not be available in the future, or, if available, may not be on terms favorable to us. If adequate funds are not available to us, our business, results of operations and financial condition will be materially and adversely affected.

**We may not be able to implement our new strategic plan and may not be able to successfully expand our business activity and increase our sales.**

In June 2010, we adopted a new strategic plan in an effort to reduce expenses and increase our business activity and sales. We determined to focus our business on our sensor activity, broaden our sales channels and close certain technology gaps in response to new demands in the market place. We intend to implement such strategic plan either through organic growth or the acquisition of, or investment in, businesses, products and technology that complement our business. We also intend to improve our presence in selected territories in order to increase our exposure to small and medium size business opportunities as a solution provider. We may not be able to implement our new strategic plan and may not be able to successfully expand our business activity and increase our sales. If we are successful in the implementation of our strategic plan, we may be required to hire additional employees in order to meet customer demands, and if we are unable to attract or retain qualified employees, our business could be adversely affected.

**Unfavorable global economic conditions may adversely affect our customers, which directly impacts our business and results of operations.**

Our operations and performance depend on our customers, including those from the governmental sector, having adequate resources to purchase our products. The turmoil in the credit markets and the global economic downturn during 2008 and 2009 generally adversely impacted our customers and potential customers. Although global economic conditions have stabilized or improved, there is continuing economic uncertainty. Customers have reduced and may continue to reduce their purchasing activities in response to lack of credit, economic uncertainty, budget deficits and concern about the stability of markets in general, and have reduced or delayed purchases of our products. As a result of slow moving inventory due to a global economic slowdown, we may be required in the future to record impairment charges relating to the carrying value of our intangible assets and goodwill, increase our reserves for doubtful accounts and further write-down our tax assets. In addition, the fair value of some of our assets may decrease as a result of an uncertain economy and as a result, we may be required to record impairment charges in the future. If global economic and market conditions or economic conditions in key markets remain uncertain or weaken further, our financial condition and operating results may be materially adversely affected.

On March 11, 2011, an earthquake off the eastern coast of Japan triggered a devastating tsunami tidal wave, causing damage and destruction. It is too early to predict the long-term impact of this disaster on the economy of Japan and elsewhere.



**Our revenues depend on government procurement procedures and practices. A substantial decrease in our customers' budgets would adversely affect our results of operations.**

Our products are primarily sold to governmental agencies, governmental authorities and government-owned companies, many of which have complex and time consuming procurement procedures. A substantial period of time often elapses from the time we begin marketing a product until we actually sell that product to a particular customer. In addition, our sales to governmental agencies, authorities and companies are directly affected by these customers' budgetary constraints and the priority given in their budgets to the procurement of our products. A decrease in governmental funding for our customers' budgets would adversely affect our results of operations. This risk is heightened during periods of global economic slowdown.

Accordingly, governmental purchases of our systems, products and services may decline in the future as the governmental purchasing agencies may terminate, reduce or modify contracts or subcontracts if:

- their requirements or budgetary constraints change;
- they cancel multi-year contracts and related orders if funds become unavailable;
- they shift spending priorities into other areas or for other products; or
- they adjust contract costs and fees on the basis of audits.

Any such event may have a material adverse affect on us.

**The loss of one or more of our key customers would result in a loss of a significant amount of our revenues.**

A relatively few customers account for a large percentage of our revenues. For the years ended December 31, 2008, 2009 and 2010, revenues generated from sales to the Israeli Ministry of Defense, or MOD, and Israeli Defense Forces, or IDF, accounted for 10.8%, 19.6% and 13.4%, respectively, of our revenues. The MOD, IDF or any of our other major customers may not maintain their volume of business with us or, if such volume is reduced, other customers generating similar revenues may not replace the lost business. The loss of one or more of our key customers without replacement by a customer or customers of similar volume would have a material adverse effect on our financial results.

**We depend on large orders from a relatively small number of customers for a substantial portion of our revenues. As a result, our revenues and operating results may vary from quarter to quarter.**

We receive large orders from a relatively small number of customers and our revenues and operating results are subject to substantial periodic variations. Individual orders from customers can represent a substantial portion of our revenues in any one period and significant orders by a customer during one period may not be followed by further orders from the same customer in subsequent periods. As a result, our revenues and operating results for a specific quarter may not be indicative of our future performance and quarter-to-quarter comparisons of our operating results may not be meaningful, making it difficult for investors to evaluate our future prospects based on the results of any quarter. In addition, we have a limited order backlog, which makes revenues in any quarter substantially dependent upon orders we deliver in that quarter.

**We may be adversely affected by our long sales cycles.**

We have in the past and expect in the future to experience long time periods between initial sales contacts and the execution of formal contracts for our products and completion of product installations. The cycle from first contact to revenue generation in our business involves, among other things, selling the concept of our technology and products, developing and implementing a pilot program to demonstrate the capabilities and accuracy of our products, negotiating prices and other contract terms, and, finally, installing and implementing our products on a full-scale basis. This cycle entails a substantial period of time, sometimes as much as one or more years, and the lack of revenues during this cycle and the expenses involved in bringing new sales to the point of revenue generation may put a substantial strain on our resources.

**Our failure to retain and attract personnel could harm our business, operations and product development efforts.**

Our products require sophisticated research and development, marketing and sales and technical customer support. Our success depends on our ability to attract, train and retain qualified research and development, marketing and sales and technical customer support personnel. Competition for personnel in all of these areas is intense and we may not be able to hire sufficient personnel to achieve our goals or support the anticipated growth in our business. If we fail to attract and retain qualified personnel, our business, operations and product development efforts would suffer.

**Our financial results may be adversely affected by currency fluctuations.**

We sell most of our products in North America, Europe and Israel. Our revenues are primarily denominated in U.S. dollars, Euros and NIS, while a portion of our expenses, primarily labor expenses, is incurred in NIS and Canadian Dollars. Additionally, certain assets, especially trade receivables, as well as part of our liabilities are denominated in NIS. As a result, fluctuations in rates of exchange between the U.S. dollar and non-U.S. dollar currencies may affect our operating results and financial condition. The dollar cost of our operations in Israel may be adversely affected by the appreciation of the NIS against the U.S. dollar. In addition, the value of our non-U.S. dollar revenues could be adversely affected by the depreciation of the U.S. dollar against such currencies. In 2008, 2009 and 2010, the NIS appreciated by approximately 1.1%, 0.7% and 6.0%, respectively, against the U.S. dollar, which had an adverse effect on our results of operations. In 2008 and 2010, the Euro depreciated against the U.S. dollar by 5.3%, and 7.4%, respectively, while in 2009 the Euro appreciated against the U.S. dollar by 3.5%. In addition, the U.S. dollar cost of our operations in Canada is influenced by the exchange rate between the U.S. dollar and the Canadian dollar. In 2008, the Canadian dollar depreciated against the U.S. dollar by approximately 19.7%, while in 2009 and 2010 the Canadian dollar appreciated against the U.S. dollar by 16.6% and 4.9%, respectively. During the years ended December 31, 2008, 2009 and 2010, foreign currency fluctuations had an adverse impact on our results of operations and we recorded foreign exchange losses, net of \$246,000, \$1,138,000 and \$199,000, respectively. Our results of operations may continue to be materially adversely affected by currency fluctuations in the future.

**If we do not receive Israeli MOD approvals necessary for us to export the products we produce in Israel, our revenues may decrease.**

Israel's defense export policy regulates the sale of a number of our systems and products. Current Israeli policy encourages export to approved customers of defense systems and products, such as ours, as long as the export is consistent with Israeli government policy. A license is required to initiate marketing activities. We are also required to obtain a specific export license for any hardware exported from Israel. We may not be able to receive all the required permits and licenses for which we may apply in the future. If we do not receive the required permits for which we apply, our revenues may decrease.

We are subject to laws regulating export of "dual use" items (items that are typically sold in the commercial market, but that also may be used in the defense market) and defense export control legislation. Additionally, our participation in governmental procurement processes in Israel and other countries is subject to specific regulations governing the conduct of the process of procuring defense contracts. Furthermore, solicitations for procurements by governmental purchasing agencies in Israel and other countries are governed by laws, regulations and procedures relating to procurement integrity, including avoiding conflicts of interest and corruption in the procurement process. We may not be able to respond quickly and effectively to changing laws and regulations and any failure to comply with such laws and regulations may subject us to significant liability and penalties.

**We face risks associated with doing business in international markets.**

A large portion of our sales is to markets outside of Israel. For the years ended December 31, 2008, 2009 and 2010 approximately 78.8%, 76.2% and 80.2%, respectively, of our revenues were derived from sales to markets outside of Israel. A key component of our strategy is to continue to expand in such international markets. Our international sales efforts are affected by costs associated with the shipping of our products and risks inherent in doing business in international markets, including:

- different and changing regulatory requirements in the jurisdictions in which we currently operate or may operate in the future;
- fluctuations in foreign currency exchange rates;
- export restrictions, tariffs and other trade barriers;
- difficulties in staffing, managing and supporting foreign operations;
- longer payment cycles;
- difficulties in collecting accounts receivable;
- political and economic changes, hostilities and other disruptions in regions where we currently sell or products or may sell our products in the future; and
- seasonal reductions in business activities.

Negative developments in any of these areas in one or more countries could result in a reduction in demand for our products, the cancellation or delay of orders already placed, difficulty in collecting receivables, and a higher cost of doing business, any of which could adversely affect our business, results of operations or financial condition.

**Reduction in Israeli government spending or changes in priorities for homeland security products may adversely affect our financial condition, operating results and prospects.**

Historically a significant portion of our revenues were from sales to the Israeli government and our financial condition, operating results and prospects would be adversely affected by Israeli government budget cutbacks or spending reductions. We believe that the success and growth of our business will continue to depend to a certain extent upon our successful procurement of Israeli government contracts. The award of additional contracts from the Israeli government could be adversely affected by spending reductions or budget cutbacks at government agencies that currently use or are likely to use our products. The Israeli government may reduce its expenditures for homeland security or change its defense priorities in the coming years. Our programs may be affected in the future if there is a reduction in Israeli government defense spending for our programs or a change in priorities to products other than ours. Accordingly, changes in government contracting policies, budgetary constraints and delays or changes in the appropriations process could have an adverse affect on our business, financial condition and results of operations.

**We may not be able to implement our growth strategy and may not be able to successfully integrate the operations of acquired businesses into our business.**

As part of our growth strategy, we intend to acquire or invest in complementary (including competitive) businesses, products and technologies. We may not be able to consummate any acquisition or investment in the future. In addition, the process of integrating acquired assets into our operations may result in unforeseen operating difficulties and expenditures and may absorb significant management attention that would otherwise be available for the ongoing development of our business. We may not be able to realize the anticipated benefits of any acquisition. Moreover, future acquisitions by us could result in potentially dilutive issuances of our equity securities, the incurrence of debt and contingent liabilities and amortization expenses related to identifiable intangible assets, any of which could materially adversely affect our operating results and financial position. Acquisitions also involve other risks, including risks inherent in entering markets in which we have no or limited prior experience. Our failure to successfully integrate the operations of an acquired business or to retain key employees of acquired businesses and integrate and manage our growth may have a material adverse effect on our business, financial condition, results of operation or prospects.

**We may not be able to protect our proprietary technology and unauthorized use of our proprietary technology by third parties may impair our ability to compete effectively.**

Our success and ability to compete depend in large part upon protecting our proprietary technology. We have approximately 13 patents and have three patent applications pending. We also rely on a combination of trade secret and copyright law and confidentiality, non-disclosure and assignment-of-inventions agreements to protect our proprietary technology. It is our policy to protect our proprietary rights in our products and operations through contractual obligations, including confidentiality and non-disclosure agreements with certain employees, distributors and agents, suppliers and subcontractors. These measures may not be adequate to protect our technology from third-party infringement, and our competitors may independently develop technologies that are substantially equivalent or superior to ours. Additionally, our products may be sold in foreign countries that provide less protection to intellectual property than that provided under U.S. or Israeli laws.

**Claims that our products infringe upon the intellectual property of third parties may require us to incur significant costs, enter into licensing agreements or license substitute technology.**

Third parties may in the future assert infringement claims against us or claims asserting that we have violated a patent or infringed upon a copyright, trademark or other proprietary right belonging to them. Any infringement claim, even one without merit, could result in the expenditure of significant financial and managerial resources to defend against the claim. In addition, we purchase components for our turnkey products from independent suppliers. Certain of these components contain proprietary intellectual property of these independent suppliers. Third parties may in the future assert claims against our suppliers that such suppliers have violated a patent or infringed upon a copyright, trademark or other proprietary right belonging to them. If such infringement by our suppliers or us were found to exist, a party could seek an injunction preventing the use of their intellectual property. Moreover, a successful claim of product infringement against us or a settlement could require us to pay substantial amounts or obtain a license to continue to use such technology or intellectual property. Infringement claims asserted against us could have a material adverse effect on our business, operating results and financial condition.

**Undetected defects in our products may increase our costs and impair the market acceptance of our products.**

The development, enhancement and implementation of our complex systems entail substantial risks of product defects or failures. Despite testing by us and our customers, errors may be found in existing or new products, resulting in delay or loss of revenues, warranty expense, loss of market share or failure to achieve market acceptance. Moreover, the complexities involved in implementing our systems entail additional risks of performance failures. We may encounter substantial delays or other difficulties due to such complexities. Any such occurrence could have a material adverse effect upon our business, financial condition and results of operations. In addition, the potential harm to our reputation that may result from product defects or implementation errors could be damaging to us.

**The market for our products is characterized by changing technology, requirements, standards and products, and we may be adversely affected if we do not respond promptly and effectively to these changes.**

The market for our products is characterized by evolving technologies, changing industry standards, changing regulatory environments, frequent new product introductions and rapid changes in customer requirements. The introduction of products embodying new technologies and the emergence of new industry standards and practices can render existing products obsolete and unmarketable. Our future success will depend on our ability to enhance our existing products and to develop and introduce, on a timely and cost-effective basis, new products and product features that keep pace with technological developments and emerging industry standards and address the increasingly sophisticated needs of our customers.

In the future:

- we may not be successful in developing and marketing new products or product features that respond to technological change or evolving industry standards;
- we may experience difficulties that could delay or prevent the successful development, introduction and marketing of these new products and features; or
- our new products and product features may not adequately meet the requirements of the marketplace and achieve market acceptance.

If we are unable to respond promptly and effectively to changing technology, we will be unable to compete effectively in the future.

**If subcontractors and suppliers terminate our arrangements with them, or amend them in a manner detrimental to us, we may experience delays in production and implementation of our products and our business may be adversely affected.**

We acquire most of the components utilized in our products, including our turnkey solutions, from a limited number of suppliers. We may not be able to obtain such items from these suppliers in the future or we may not be able to obtain them on satisfactory terms. Temporary disruptions of our manufacturing operations would result if we were required to obtain materials from alternative sources, which may have an adverse effect on our financial results. In addition, the installation of our fence mounted vibration detection systems in Israel is outsourced primarily to two subcontractors. If either or both of such subcontractors were to be unable or unwilling to continue to perform such services, we would have to identify and qualify one or more substitute subcontractors to perform such services. This could cause delays in the implementation of our fence mounted vibration detection systems in Israel, the costs associated with installing such systems may increase and our business may be adversely affected.

**We currently benefit from government programs and tax benefits that may be discontinued or reduced in the future, which would increase our future tax expenses.**

We currently benefit from grants and tax benefits under Israeli government programs, which require us to meet specified conditions, including, but not limited to, making specified investments from our equity in fixed assets and paying royalties with respect to grants received. In addition, some of these programs restrict our ability to manufacture particular products or transfer particular technology outside of Israel. If we fail to comply with these conditions in the future, the benefits we receive could be cancelled and we could be required to refund any payments previously received under these programs, including any accrued interest, or pay increased taxes or royalties. Such a result would adversely affect our results of operations and financial condition. The Israeli government has reduced the benefits available under these programs in recent years and these programs and benefits may be discontinued or curtailed in the future. If the Israeli government ends these programs and benefits, our business, financial condition, results of operations and net income could be materially adversely affected.

**We may fail to maintain effective internal control over financial reporting, which could result in material misstatements in our financial statements.**

The Sarbanes-Oxley Act of 2002 imposes certain duties on us and our executives and directors. Our efforts to comply with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 governing internal controls and procedures for financial reporting, which started in connection with our Annual Report on Form 20-F for the year ended December 31, 2006, have resulted in increased general and administrative expense and a diversion of management time and attention, and we expect these efforts to require the continued commitment of significant resources. Section 404 of the Sarbanes-Oxley Act requires management's annual review and evaluation of our internal control over financial reporting in connection with the filing of the annual report on Form 20-F for each fiscal year. We may identify material weaknesses or significant deficiencies in our internal control over financial reporting. Failure to maintain effective internal control over financial reporting could result in material misstatements in our financial statements. Any such failure could also adversely affect the results of our management's evaluations and annual auditor reports regarding the effectiveness of our internal control over financial reporting. Failure to maintain effective internal control over financial reporting could result in investigation or sanctions by regulatory authorities and could have a material adverse effect on our operating results, investor confidence in our reported financial information and the market price of our ordinary shares.

#### **Risks Relating to Our Ordinary Shares**

**Volatility of the market price of our ordinary shares could adversely affect our shareholders and us.**

The market price of our ordinary shares has been, and is likely to be, highly volatile and could be subject to wide fluctuations in response to numerous factors, including the following:

- actual or anticipated variations in our quarterly operating results or those of our competitors;
- announcements by us or our competitors of technological innovations or new and enhanced products;
- developments or disputes concerning proprietary rights;

- introduction and adoption of new industry standards;
- changes in financial estimates by securities analysts;
- market conditions or trends in our industry;
- changes in the market valuations of our competitors;
- announcements by us or our competitors of significant acquisitions;
- entry into strategic partnerships or joint ventures by us or our competitors;
- additions or departures of key personnel;
- political and economic conditions, such as a recession or interest rate or currency rate fluctuations or political events; and
- other events or factors in any of the countries in which we do business, including those resulting from war, incidents of terrorism, natural disasters or responses to such events.

In addition, the stock market in general, and the market for Israeli companies and home defense companies in particular, has been highly volatile. Many of these factors are beyond our control and may materially adversely affect the market price of our ordinary shares, regardless of our performance. In the past, following periods of market volatility, shareholders have often instituted securities class action litigation relating to the stock trading and price volatility of the company in question. If we were involved in any securities litigation, it could result in substantial cost to us to defend and divert resources and the attention of management from our business.

**We do not expect to distribute dividends in the foreseeable future.**

We currently intend to retain our current and any future earnings to finance operations and expand our business and, therefore, do not expect to pay any dividends in the foreseeable future. According to the Israeli Companies Law, a company may distribute dividends out of its profits (as defined by the Israeli Companies Law), provided that there is no reasonable concern that such dividend distribution will prevent the company from paying all its current and foreseeable obligations, as they become due, or otherwise upon the permission of the court. The declaration of dividends is subject to the discretion of our board of directors and would depend on various factors, including our operating results, financial condition, future prospects and any other factors deemed relevant by our board of directors. You should not rely on an investment in our company if you require dividend income from your investment.

**Risks Relating to Our Location in Israel**

**Political, economic and military instability in Israel may disrupt our operations and negatively affect our business condition, harm our results of operations and adversely affect our share price.**

We are incorporated under the laws of the State of Israel, and our principal executive offices and some of our manufacturing and research and development facilities are located in Israel. As a result, political, economic and military conditions affecting Israel directly influence us. Any major hostilities involving Israel, a full or partial mobilization of the reserve forces of the Israeli army, the interruption or curtailment of trade between Israel and its present trading partners, or a significant downturn in the economic or financial condition of Israel could have a material adverse effect on our business, financial condition and results of operations.

Since the establishment of the State of Israel in 1948, Israel and its Arab neighbors have engaged in a number of armed conflicts. A state of hostility, varying from time to time in intensity and degree, has led to security and economic problems for Israel. Major hostilities between Israel and its neighbors may hinder Israel's international trade and lead to economic downturn. This, in turn, could have a material adverse effect on our operations and business. Since September 2000, there has been an increase in unrest and terrorist activity in Israel of varying levels of severity through 2010. In recent years, there has been an escalation in violence among Israel, Hamas, Hezbollah, the Palestinian Authority and other groups. Recently, countries in the region have experienced political instability, the effects of which are currently difficult to assess. Ongoing or future violence between Israel and the Palestinians as well as tension between Israel and neighboring Syria and Lebanon or Iran or political instability in the region would likely disrupt international trading activities in Israel and may have a material adverse effect on our business, financial conditions and results of operations.

Furthermore, we could be adversely affected by the interruption or reduction of trade between Israel and its trading partners. Some countries, companies and organizations continue to participate in a boycott of Israeli companies and others doing business with Israel or with Israeli companies. As a result, we are precluded from marketing our products to these countries, companies and organizations. Foreign government defense export policies towards Israel could also make it more difficult for us to obtain the export authorizations necessary for our activities. Also, over the past several years there have been calls in Europe and elsewhere to reduce trade with Israel. Restrictive laws, policies or practices directed towards Israel or Israeli businesses may have an adverse impact on our operations, our financial results or the expansion of our business.

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

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

**Your rights and responsibilities as a shareholder will be governed by Israeli law and differ in some respects from the rights and responsibilities of shareholders under U.S. law.**

We are incorporated under Israeli law. The rights and responsibilities of holders of our ordinary shares are governed by our memorandum of association and articles of association and by Israeli law. These rights and responsibilities differ in some respects from the rights and responsibilities of shareholders in typical U.S. corporations. In particular, a shareholder of an Israeli company has a duty to act in good faith in exercising his or her rights and fulfilling his or her obligations toward the company and other shareholders and to refrain from abusing his power in the company, including, among other things, in voting at the general meeting of shareholders on certain matters. Israeli law provides that these duties are applicable in shareholder votes on, among other things, amendments to a company's articles of association, increases in a company's authorized share capital, mergers and interested party transactions requiring shareholder approval. In addition, a controlling shareholder of an Israeli company or a shareholder who knows that it possesses the power to determine the outcome of a shareholder vote or who has the power to appoint or prevent the appointment of a director or executive officer in the company has a duty of fairness toward the company. However, Israeli law does not define the substance of this duty of fairness. Because Israeli corporate law has undergone extensive revision in recent years, there is little case law available to assist in understanding the implications of these provisions that govern shareholder behavior.

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

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

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

**As a foreign private issuer whose shares are listed on the NASDAQ Global Market, we may follow certain home country corporate governance practices instead of certain NASDAQ requirements. We follow Israeli law and practice instead of NASDAQ rules regarding the director nomination process, compensation of executive officers and the requirement that our independent directors have regularly scheduled meetings at which only independent directors are present.**

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

**ITEM 4. Information on the Company**

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

We were incorporated under the laws of the State of Israel on March 27, 1984 under the name Magal Security Systems Ltd. We are a public limited liability company under the Israeli Companies Law, 5739-1999, and operate under this law and associated legislation. Our principal executive offices and primary manufacturing and research and development facilities are located near Tel Aviv, Israel, in the Yehud Industrial Zone. Our mailing address is P.O. Box 70, Industrial Zone, Yehud 56100, Israel and our telephone number is +972-3-539-1444. Our agent for service of process in the United States is Senstar Inc., 13800 Coppermine Road, Second Floor, Herndon, Virginia 20171. Our address on the Internet is [www.magal-S3.com](http://www.magal-S3.com). The information on our website is not incorporated by reference into this annual report.

We are a leading international solutions provider of security, safety and site management solutions and products. Based on more than 35 years of experience and interaction with customers, we have developed a unique set of solutions and products, optimized for perimeter, outdoor and general security applications. Our turnkey solutions are typically integrated and managed by sophisticated modular command and control software, supported by expert systems for real-time decision support. Our broad portfolio of critical infrastructure and site protection technologies includes a variety of smart barriers and fences, fence mounted detectors, virtual (volumetric) fences and gates, buried and concealed detection systems and a sophisticated protection package for sub-surface intrusion. A world class innovator in the development of closed-circuit television, or CCTV, intelligent video analytics, or IVA, and motion detection technology for outdoor operation, we have successfully installed customized solutions and products in more than 75 countries worldwide.

*New Strategic Plan.* In June 2010, we adopted a new strategic plan in an effort to establish a viable growth path for our business. Pursuant to the strategic plan, we decided to focus our growth plan on our historical primary markets: perimeter products and solutions and turnkey projects. We have appointed a new products sales vice president who is focused solely on the sales of our perimeter products. We intend to increase revenues in this segment by locating new channels to promote and market our products, maintaining technology leadership, investing in our research and development activities, entering into original equipment manufacturer, or OEM, agreements and by acquiring technologies or by mergers and acquisitions. We intend to focus on and improve our presence in emerging markets such as Brazil, Russia, India and China, or the BRIC countries, in order to increase our exposure to small and medium size business opportunities for both our perimeter products and solutions and turnkey projects segments. We are also investing in our employees in order to enhance their professional skills and efficiency.



*Bridge Loan.* To allow us to begin to implement our new strategic plan, on September 8, 2010, Ki Corporation Limited, or Ki Corporation, a company affiliated with Mr. Nathan Kirsh, our principal shareholder and a director, provided us with a bridge loan in the principal amount of \$10.0 million. If not repaid within 180 days, the bridge loan will begin to accrue interest at the rate of LIBOR + 4% per year, calculated from the date of the loan and accumulated on a quarterly basis. However, if the \$15 million rights offering that we intend to initiate during 2011 occurs within 240 days from the date of the loan, the loan will not bear any interest. Our Audit Committee and Board of Directors believe that the loan is on terms that are favorable to our company, as the market interest rate for similar loans in Israel is approximately 6.7% per year. The loan is due and payable on January 10, 2012, and we have an option to extend the maturity date for an additional 60 days. Any interest will be paid together with, and in the same manner as, the principal, no later than the maturity date. We intend to use part of the proceeds from the rights offering that we intend to initiate during 2011 for the repayment of the bridge loan, which amounts to \$10.0 million as of the date of this annual report. We have undertaken to repay such amount within five business days after the successful completion of the rights offering.

*Capital expenditures.* Our capital expenditures for the years ended December 31, 2008, 2009 and 2010 were approximately \$1.4 million, \$2.0 million and \$0.4 million, respectively. These expenditures were principally for the renovation and expansion of our offices and production facilities in Israel, as well as for computers, other machinery, commercial vehicles and equipment. The high level of capital expenditures in 2008 and 2009 were primarily attributable to the renovation and expansion work at our executive offices and factory in Israel that we commenced in 2008 as well as the implementation of a new ERP system and an upgrade of our computer systems in Israel.

## **B. Business Overview.**

### **Overview and Strategy**

We develop, manufacture, market and sell comprehensive computerized security systems to high profile customers. Our systems are used in more than 75 countries to protect sensitive facilities, including national borders, military bases, power plants, airports, seaports, prisons, industrial sites, oil and gas facilities, refineries and municipalities from intrusion, crime, sabotage or vandalism to infrastructure, assets and personnel.

Based on more than 35 years of experience and interaction with customers, we have developed a comprehensive set of solutions and products, optimized for perimeter, outdoor and general security applications. Our portfolio of mission critical infrastructure and site protection technologies includes a variety of smart fences and barriers, fence mounted sensors, virtual (volumetric) fences and gates, buried and concealed detection systems and a sophisticated protection package for sub-surface intrusion. As a world class innovator in outdoor video motion detection, or VMD, and IVA applications, we deliver comprehensive IP technology and traditional CCTV solutions.

Our integrated solutions are based on a broad in-house product portfolio, complemented by OEM and third party products. A typical turnkey solution is integrated and managed by our Fortis - a sophisticated, geographical information system, or GIS, based command and control system.

A typical turnkey project consists of the following phases:

- Studying and understanding customers' requirements and conducting an environmental and site analysis;
- Conducting a terrain survey;
- Detailed planning that is focused and tailored around the users – first responders and operators in the command and control center(s);
- Implementation - manufacturing, purchasing, integration, testing and installing the project;

- Commissioning and training; and
- Post-sales support.

Our revenues are principally derived from:

- Sales of security products;
- Installation of comprehensive security solutions and / or turnkey projects derived from process bids leading to fixed-price contracts; and
- Services and maintenance, based on post sale maintenance contracts.

Our primary objective is to become a leading international solution provider of safety, security and site management solutions and products. To achieve this objective, we are implementing a business strategy incorporating the following key elements:

- *Leverage existing customer relationships.* We believe that we have the capability to offer certain of our customers a comprehensive security package. As part of our product development process, we seek to maintain close relationships with our customers to identify market needs and to define appropriate product specifications. We intend to expand the depth and breadth of our existing customer relationships while initiating similar new relationships.
- *Refine and broaden our product portfolio.* We have identified the security needs of our customers and intend to enhance our current products' capabilities, develop new products, acquire complementary technologies and products and enter into OEM agreements with third parties in order to meet those needs.
- *Refine and broaden our integration and turnkey delivery capabilities.* As a solution provider we depend on our capability to tailor specific solutions for each customer. Our integration building blocks and our execution skills are key factors in achieving our growth and profitability.
- *Enter new markets and strengthen presence in existing markets.* We intend to continue to penetrate new geographic markets by various means, including the establishment of alliances with local distributors and international integrators of security systems. We also intend to increase our marketing efforts in our existing markets and to acquire or invest in complementary businesses.

### **Emerging Opportunity**

The rapid introduction of digital communication and information technology into the security market provides the opportunity to consolidate safety and site management with security applications. Cities and municipalities, air and sea ports, chemical factories and critical infrastructure sites are already implementing and enjoying the benefits of this approach to security management. The integration allows users to share dispersed sensors (such as cameras and emergency buttons), IT systems, traffic management tools and other resources and feed them into a single command and control platform. Users from different functions within organizations can now share the same information, allowing for improved communication and coordination, whether it is a routine operation or crisis situation. We believe that we are well positioned and on the forefront of this emerging market opportunity.

### **Products and Services**

#### ***General***

Our products are focused around outdoor and perimeter intrusion detection systems, or PIDS, and applications contributing to security, outdoors safety and also site management. Our products are categorized into four families of systems:

- Perimeter security systems, consisting of a mix of PIDS technologies with physical barrier solutions;
- CCTV systems;
- Command and control systems; and
- Miscellaneous systems tailored for specific vertical market needs.

#### *Perimeter Security Systems*

Perimeter security systems enable customers to monitor, limit and control access by unauthorized personnel to specific regions or areas. High-end perimeter systems are sophisticated in nature and are used for correctional facilities, borders, nuclear and conventional power plants, air and sea ports, military installations and other high security installations. In early 2010, two independent research organizations, Frost & Sullivan and IMS Research, recognized our company as the number one provider of PIDS technology.

Our line of perimeter security systems utilizes sophisticated sensor devices to detect and locate intruders and identify the nature of intrusions. Our perimeter security systems have been installed along thousands of kilometers of borders and facility boundaries throughout the world, including more than 600 correctional institutions and prisons in the United States and in several other countries. In addition, we have installed several hundred kilometers of high security smart perimeter systems along Israel's borders.

Our line of outdoor perimeter security systems consists of the following:

- Taut wire – hybrid perimeter intrusion detection systems with physical barrier;
- Fence mounted vibration detection systems – mechanical, copper “microphonic” wire sensors or fiber optic sensors;
- Smart barriers – a variety of: robust detection grids, gates and innocent looking fences, designed to protect water passages, VIP residences and other outdoor applications;
- Buried cable sensors;
- Electrical field disturbance sensors (volumetric); and
- Microwave sensors.

#### *Taut Wire Perimeter Intrusion Detection Systems*

Our taut wire perimeter systems consist of wire strung at high tension between anchor posts. Sensor posts are located at the middle between anchor posts. These sensor posts contain one or more devices that detect changes in the tension being exerted on and by the taut wires. Any force applied against these wires or released from them (such as by cutting) that is not within the parameters designed into the sensors themselves or programmed into the central control units, automatically triggers an alarm. Taut wire technology provides three critical elements of protection against unauthorized intruders: deterrence, detection and delaying (until first responders may react and intercept the intruder).

Our sealed sensors are not affected by radio frequency interference, climatic or atmospheric conditions, or electrical transients from power lines or passing vehicles. The sensors self-adjust to, or remain unaffected by, extreme temperature variation, minor soil movements and other similar environmental changes that might trigger false alarms in less sophisticated systems. Our taut wire perimeter systems are designed to discriminate automatically between fence tension changes typically caused by small animals or violent weather and forces more typically exerted by a human intruder.

Our taut wire perimeter systems offer customers a wide range of installation options. Sensor posts can be as far as 200 feet apart, with relatively inexpensive ordinary fence anchor posts between them. These systems may stand alone, be mounted on a variety of fence posts or added to an existing wall or other structure, or mounted on short posts, with or without outriggers.

Taut wire perimeter systems have been approved by various Israeli and U.S. security and military authorities. We have installed several hundred kilometers of these perimeter systems along Israel's borders to assist in preventing unauthorized entry and infiltration. Our taut wire perimeter systems are typically sold to the end user for between \$75 to \$190 per meter (depending, among other things, on the model, height, density, and corrosion protection level of the system).

#### *Fence Mounted Vibration Detection Systems*

We offer various types of vibration detection systems. While less sensitive than taut wire installations, the adaptability of these systems to a wide range of pre-existing barrier structures makes these products viable alternatives for cost-conscious customers. Our vibration detection devices are most effective when installed on common metal fabric perimeter systems, such as chain link or welded mesh. In our BARRICADE system, electro-mechanical sensors are attached to fence panels approximately three meters apart on any of several common types of fence structures. Once attached to the fence, each sensor detects vibrations in the underlying structures. The sensor system's built-in electro-mechanical filtering combines with system input from a weather sensor to minimize the rate of false alarms from wind, hail or other sources of nuisance vibrations. Our BARRICADE II system leverages the same configuration of the first generation and adds a ranging feature, which provides the capability to locate the exact vibrated sensor (rather than causing an alarm of a full physical segment of approximately 100 meters).

Intelli-FLEX, Intelli-FIBER and fence protection systems, or FPS, microprocessor-based triboelectric and electric cable fence sensors are vibration sensitive transducers. These systems detect any attempt to cut, climb or penetrate the fence and have microphonic properties. The microphonic feature permits audio to be used for low-cost alarm assessment, providing users with an additional tool for determining the nature of an attempted intrusion. Our vibration detection system is typically sold to the end user for between \$15 to \$60 per meter.

We recently developed and began to sell the Pinpointer, a fence-mounted vibration sensor that is capable of defining the exact location of an intrusion to within 2 to 3 meters (6.5 to 10 ft.). While maintaining the legacy features of the original sensor, Pinpointer has the ability to identify the exact disturbed sensor along a long chain of sensors, which are typically 2 to 3 meters (6.5 to 10 ft.) apart.

#### *Buried Cable Sensor*

Omnitrax is a fifth generation, covert outdoor perimeter security intrusion detection sensor that generates an invisible radar detection field around buried sensor cables. An alarm is emitted and the exact location identified within one meter if an intruder disturbs the field. Targets are detected by their conductivity, size and movement and the digital processor is able to filter out common alarms caused by environmental conditions and small animals. The Omnitrax system is sold for between \$40 to \$80 per meter.

#### *Electrical Field Disturbance Sensors*

Terrain following volumetric sensors can detect intrusions before the intruder touches the sensor. They can be installed on buildings, free-standing posts, existing fences, walls or rooftops, and will sense changes in the electrostatic field when events, such as intruders penetrating through the wires, take place. The system's tall, narrow, well contained detection zone allows the sensor to be installed in almost any application and minimizes nuisance alarms caused by nearby moving objects. Our flagship product is X-Field; it consists of a set of four and/or eight parallel field sensing wires and is sold for between \$100 and \$190 per meter. We also offer a deployable volumetric sensor, used to protect military forces deployed on short notice who need fast reaction with minimal effort.

### *Microwave Products*

We also offer a range of bi-static microwave products that are designed for stable, reliable operation in extreme outdoor environments. Coverage distances range from 180 meters to 450 meters. During the second quarter of 2011, we expect to launch a new version of our microwave product, which has a K band improved sensor, is fully digital and has extended processing and communication features.

### *CCTV Systems*

We have a proven track record in delivering CCTV and IVA solutions that are designed for use in outdoor applications.

#### *DreamBox/Maestro DB*

At the heart of our CCTV solution, we typically supply an integrated control system which seamlessly integrates real time video with other sensors (such as PIDS) and information layers. For example, a megapixel VMD camera covering a wide area can automatically start tracking a suspect detected by the PIDS. In parallel, the IP camera can increase the streamed video frame rate and alarm the control center guard to examine the intruder. Our investments in IVA tools help eliminate dependency on constant human monitoring. Automatic tools and algorithms extract abnormalities and only irregular events are transferred and analyzed for verification. This approach saves bandwidth and storage and more importantly requires human intervention only when needed. Our unique to the industry IVA / VMD has been developed to meet the challenge of the outdoor environment (such as weather effects, moving objects like trees, glare and flashing lights).

DreamBox is a real-time all-in-one multimedia analysis and management platform that is designed for use in outdoor security applications. It supports both analog and IP cameras and integrates many CCTV related applications into one box. DreamBox has a built in autonomous network switch that supports a unique meshed distributed architecture to enable data sharing, processing and storage between all units on the network. These features ensure high data redundancy, no single points of failure and no need for a central server.

Maestro DB is our new fully digital generation management platform that is designed for use in outdoor security applications. It supports only IP streamed video from IP cameras (if the camera source is analogue, an encoder is used). Maestro DB uses an enhanced software version of the original DreamBox and runs on COTS servers. Maestro DB supports high resolution video inputs (megapixel and high definition).

DreamBox and Maestro DB fit any sensitive critical site that requires real-time multi-media surveillance, providing strong motion detection and analysis. The systems are ideal for outdoor applications where cameras are covering wide areas and data may be dispersed in multiple locations, yet the entire site needs to function as a single, coherent and centrally managed data center.

Our video solutions have a proven track record in high-end vertical markets that require outdoor security such as military bases, government organizations, airports, seaports, mass transportation, correctional facilities, utilities and industrial sites.

DreamBox and Maestro DB do not try to compete with other commercial off-the-shelf CCTV products and solutions. We are focused on high-end customers who cannot rely on standard indoor products and requires tailored, modular and flexible solutions at an affordable price.

#### *MTC-1500E*

MTC-1500E is a high-end yet affordable, dual technology (thermal and charge-coupled device) outdoor surveillance system. A high-quality image rendered by the thermal sensor provides long distance detection and recognition of humans in day, night and under poor visibility conditions. The two cameras are mounted on a single pedestal and controlled through an agile and accurate pan-tilt-zoom-focus engine.

The MTC-1500E is suitable for the protection of any critical object or site. Markets for the system include airports, seaports, critical border crossings, utilities (such as oil, gas, refineries and water dams).

## *MSS-1500*

MSS-1500 is a dual camera (day and night) system designed for outdoor rapid deployment operations. The system is tailored for law enforcement, security and special operations forces. It enables camera installation close to the required observation area and communicates data to a remote center. The deployable element has a low footprint for concealed operation and can be put into operation within less than five minutes.

The system has been designed and packaged to support defense, law enforcement and security special operations in various vertical markets and scenarios. These applications include intelligence-based operations for border protection, homeland security and fighting organized crime. Other applications include securing VIPs while they commute or providing surveillance protection of exposed perimeter zones in construction sites.

## *MagCam*

The MagCam is a combination of day/night camera and illuminator installed within a taut wire perimeter intrusion detection system to provide complete and uniform fence surveillance under both very bright daylight and total darkness. Combined with the DTR taut wire system's alarm, the system displays a clear view of the alerted section and its neighboring sections, enabling the operator to verify and assess the relevant region. Connecting the MagCam to our DreamBox or Maestro DB provides an exceptional second intrusion detecting layer based on sophisticated outdoor video analytics, such as virtual fence algorithms.

## *Command and Control Systems*

The development of communication and IT technology has significantly affected the security market. Multiple security systems and technologies, sometimes supplied by different vendors, can now be integrated into a unified command and control system. We offer three types of command and control systems:

- Fortis – a high-end comprehensive command and control system
- StarNet 1000 - a basic security management system, or SMS; and
- Network Manager – a middleware (software) package.

## *Fortis*

FORTIS, a physical security information system, is a comprehensive, wide area and real time command and control solution, designed for entities requiring management of security, safety and dispatching. It is designed to manage all daily routines and site activities, security, regular and irregular events as well as crisis situations.

FORTIS architecture integrates with legacy systems and sensors from the physical level through a configuration and business logic layer and up to the situational awareness and management levels. It is based on a strong GIS engine, which creates a common layer for inputs, outputs and presentation. The GIS engine enables the display of synchronized information in time and space across all screens such as location of mobile forces, located alarms from stationary sensors, video of related cameras, pop-ups of associated radar screens and managed voice communication related to the managed area. Real-time information enables security personnel to respond immediately, while maintaining a full two-way communication and situational awareness between the command and control center(s) and the first responders.

The target markets for Fortis are municipalities, city protection applications and, as part of other integrated solutions supplied by us, for use in airport, border and homeland security applications.

## *StarNet 1000*

StarNet 1000, an SMS, is suitable as a high-end system for basic sites, consisting of a PIDS with a few other devices. MX is another SMS that is being sold and supported only in the United States, and we intend to retire this system during 2012.

### *Network Manager*

Network Manager is a middleware (software) package that is as an interface between our family of PIDS sensors and any command and control solution, be it our own system or an external third party application. It is provided to integrators with a full software development kit to enable fast integration of our PIDS into any other SMS and physical security information system.

### *Miscellaneous Systems*

#### *Sub-Terrain Protection*

We offer an innovative, covert security system known as PipeGuard that is designed to protect underground pipelines, safes and other buried assets from theft, vandalism and third-party damage.

A PipeGuard solution will include an array of standalone sensors, all communicating within a meshed network that senses any attempt to dig close to the protected assets. It can be integrated into a full turnkey solution, including perimeter intrusion protection, ground or air patrols and alarm monitoring and control. PipeGuard combines geophones with advanced technology recognition algorithm capabilities based on the analysis of seismic signals to effectively filter out false alarms. This intelligent signal processing provides a high probability of detection and low false and nuisance alarm rates.

We believe that the target markets for PipeGuard are in the western and developed countries where environmental issues are, or will become, regulated. PipeGuard is an ideal solution for alerting utility operators early enough before digging causes catastrophic damage to existing oil and gas pipes.

#### *Life Safety / Duress Alarm Products*

Our products include high reliability, personal, portable duress alarm systems to protect personnel in prisons. These products identify individuals in distress and can pinpoint the location of the distress signal with an indoor-to-outdoor and floor-to-floor accuracy unmatched by any other product.

Flash and flare personal emergency locating systems use radio frequency technology to provide a one touch emergency system that is so small it can be worn on a belt. The systems, sold to prisons, consist of transmitters that send distress signals to receivers mounted throughout the building. Receivers relay the signal to a central location, indicating that someone requires assistance and their location in the building. The systems employ automated testing procedures that help to reduce maintenance costs. The hardware and software was developed and researched in the United States and competes against infrared and other similar technologies.

PAS is another personal alarm system that uses an ultrasonic based emergency notification system. The system, sold mainly to prisons in the United States, allows individuals moving throughout a facility to quickly indicate their exact location in a crisis situation.

### **Marketing, Sales and Distribution**

We believe that our reputation as a vendor of high-security products in one of the world's most security conscious countries often provides us and our sales representatives with direct access to senior government and corporate officials in charge of security matters elsewhere.

Our sales efforts focus on:

- Products (mainly PIDS). Products are sold indirectly through system integrators and distribution channels. Due to the sophistication of our products, we often need to approach end-users directly and be in contact with system integrators, however the sale is directed through a third party; and
- Solutions. This part of the business deals with end-customers or high-end system integrators. We offer a full comprehensive solution, which includes our in-house portfolio of products and products manufactured by third parties. Solutions are focused around our core strategy (outdoor security, safety and site management). In many cases we take responsibility for the full turnkey solution and we integrate and deliver a full solution, including civil works, installation, training, warranty and after sale support.

We have sales offices in the United States, the United Kingdom, Germany, Mexico, China, Romania, Colombia and Spain, as well as in our two main offices in Israel and Canada.

The following table shows the breakdown of our consolidated revenues for the calendar years 2008, 2009 and 2010 by operating segment:

	Year Ended December 31,		
	2008	2009	2010
	(In thousands)		
Perimeter products	\$ 41,378	\$ 39,102	\$ 33,248
Turnkey projects	15,727	15,416	17,249
Eliminations	-	-	(798)
Total	\$ 57,105	\$ 54,518	\$ 49,699

#### Customers

The following table shows the geographical breakdown of our consolidated revenues for the calendar years 2008, 2009 and 2010:

	Year Ended December 31,		
	2008	2009	2010
	(In thousands)		
Israel	\$ 12,097	\$ 12,968	\$ 9,838
North America	15,648	13,763	15,393
Europe	15,603	10,808	9,787
South and Latin America	4,542	3,986	9,958
Africa	1,319	1,567	345
Others	7,896	11,426	4,378
Total	\$ 57,105	\$ 54,518	\$ 49,699

For the years ended December 31, 2008, 2009 and 2010, revenues generated from sales to the MOD and IDF accounted for 10.8%, 19.6% and 13.4%, respectively, of our revenues. In addition, the Mexican Federal Prisons Authority or SSP, a client in Mexico, accounted for 11.4% of our revenues in the year ended December 31, 2010. We cannot assure you that the MOD, IDF, SSP or any of our other major customers will maintain their volume of business with us or that, if such volume is reduced, other customers generating similar revenues will replace the lost business. The loss of one or more of our key customers without replacement by a customer or customers of similar volume would have a material adverse effect on our financial results.

#### Support and Maintenance

Our systems are installed by us or by the customer after appropriate training, depending on the size of the specific project and the location of the customer's facilities, as well as on the customer's prior experience with our systems. We generally provide our customers with training on the use and maintenance of our systems. This training is conducted either on-site or at our facilities. In addition, some of our local perimeter security systems customers have signed maintenance contracts with us. For systems installed outside of Israel, maintenance is provided by an independent third party, by distributors or by the end-user. We also provide services, maintenance and support on an "as needed" basis.

The life expectancy of a high-security perimeter system is approximately ten years. Consequently, many miles of perimeter systems need to be replaced each year.



During 2010, we derived approximately 6.4 % of our total revenues from maintenance and services.

#### **Research and Development; Royalties**

We place considerable emphasis on research and development to improve our existing products and technology and to develop new products and technology. We believe that our future success will depend upon our ability to enhance our existing products and technology and to introduce on a timely basis new commercially viable products and technology addressing the needs of our customers. We intend to continue to devote a significant portion of our personnel and financial resources to research and development. As part of our product development process, we seek to maintain close relationships with our customers to identify market needs and to define appropriate product specifications. Our development activities are a direct result of the input and guidance we receive from our marketing personnel during our annual meetings with such personnel. In addition, the heads of research and development for each of our development centers discussed below meet annually to identify market needs for new products.

Our research and development expenses during 2008, 2009 and 2010 were approximately \$5.6 million, \$5.1 million and \$4.1 million, respectively. In addition to our own research and development activities, we also acquire know-how from external sources. We cannot assure you that any of our research and development projects will yield profitable results.

We have the following two development centers, each of which develops products and technologies based on its area of expertise:

- In Israel - we develop a wide range of products including our taut wire, mechanical vibration, video and high-end SMS, command and control systems and PipeGuard; and
- In Canada - we develop our buried cable sensors, fence mounted vibration detection systems, mechanical, copper and fiber-optic fence sensors, electrostatic volumetric detection, medium to high-end control systems, microwave detection, personal alarm systems and small to medium control systems.

#### *Office of the Chief Scientist of the Israeli Ministry of Industry, Trade and Labor*

We have historically sought co-financing of our development projects from the Office of the Chief Scientist of the Israeli Ministry of Industry, Trade and Labor, or the OCS. We are obligated to pay royalties to the OCS, amounting to 3% to 4.5% of revenues derived from sales of the products funded with these grants and ancillary services, up to an amount equal to 100% of the grants received, linked to the U.S. dollar. All grants received after January 1, 1999 also bear interest equal to the 12 month LIBOR rate. The obligation to pay these royalties is contingent on actual sales of the products, and in the absence of such sales, no payment is required. We paid royalties of \$125,000, \$172,000 and \$0 in the years ended December 31, 2008, 2009 and 2010, respectively. As of December 31, 2010, our aggregate contingent obligation to the OCS was \$1.2 million.

The terms of these grants require that the manufacture of products developed with these grants be performed in Israel and prohibit transferring technology developed with grants without the prior consent of the Research Committee of the OCS. We cannot assure you that, if requested, the OCS will grant such consent in the event we seek to transfer any of our technology. Each application to the OCS is reviewed separately, and we cannot assure you that the Israeli Government will continue to support our research and development.

#### *Scientific Research and Experimental Development Tax Incentive Program*

Introduced by the Canadian Government in the 1980s, the Scientific Research and Experimental Development, or SR&ED, tax incentive program is intended to encourage Canadian businesses of all sizes to conduct applied research and development in Canada that will lead to new, improved, or technologically advanced products, processes, principles, methodologies or materials. The SR&ED program gives claimants cash refunds and/or tax credits for their expenditures on eligible research and development work done in Canada. Qualifying expenditures may include wages, materials, machinery, equipment, travel and training expenses, property taxes, utility expenses, some overhead and SR&ED contracts from experimental development, applied research, basic research and support work.

Under the SR&ED tax incentive program, Canadian-controlled private corporations are entitled to an investment tax credit of 35% for the first \$2 million in qualified expenditures and 20% on any excess amount. Other Canadian corporations, proprietorships, partnerships, and trusts are entitled to an investment tax credit of 20% of all qualified expenditures. For the years ended December 31, 2008, 2009 and 2010, our Canadian subsidiary recognized \$202,000, \$167,000 and \$218,000, respectively, of investment tax credits. As of December 31 2010, our Canadian subsidiary made a full valuation allowance in respect of such investment tax credits.

#### **Manufacturing and Supply**

Our manufacturing operations consist of designing and developing our products, fabricating and assembling components and finished products, quality control and final testing. Substantially all of our manufacturing operations are currently performed at our facilities in Yehud, Israel and Ottawa, Canada. See Item 4D., "Information on the Company - Property, Plants and Equipment."

We acquire most of the components utilized in our products, including our turnkey products, and certain services from a limited number of suppliers and subcontractors. We cannot assure you that we will continue to be able to obtain such items from these suppliers on satisfactory terms. Alternative sources of supply are available, and therefore we are not dependent upon these suppliers and subcontractors. We also maintain an inventory of systems and spare parts in order to enable us to overcome potential temporary supply shortages until an alternate source of supply is available. Nevertheless, temporary disruptions of our manufacturing operations would result if we were required to obtain materials from alternative sources, which may have an adverse effect on our financial results.

#### **Competition**

*PIDS sensors.* The principal factors affecting competition in the market for security systems are a system's high probability for detection and low probability of false and nuisance alarms. We believe that a manufacturer's reputation for reliable equipment is a major competitive advantage, and that such a reputation will usually be based on the performance of the manufacturer's installed systems. Additional competitive factors include quality of customer support, maintenance and price.

The PIDS market is very fragmented. According to Frost & Sullivan and IMS Research, we rank first based on market share with approximately 15%-20% of the market in April 2010. Our competition includes: South West Microwave Inc., Future Fiber Technology Pty, Elfar Ltd. and RB-Tec Ltd. in Israel, and Detektion Security Systems Inc., Fiber Sensys Inc., Optellios Inc, Geoquip Ltd., GPS and Cias outside of Israel.

*Turn Key Projects and Solutions.* Hundreds of solution providers offer security products and services. Most of the integrators focus on indoor applications, but some also offer outdoor solutions. Most of the market players are local to their countries; however some are global, such as Honeywell and Siemens. In some cases we may cooperate with global integrators or may supply equipment to them. We believe that our principal competitors in Israel for our security products are Elbit Systems, Mer and Orad.

We believe that our principal competitor for the PipeGuard system is Future Fibre Technologies Pty. Ltd. of Australia.

We believe that our principal competitors for personal emergency location systems are Actall Corp. and Visonic Networks. Some of our competitors and potential competitors have greater research, development, financial and personnel resources, including governmental support, or more extensive business experience than we do. We cannot assure you that we will be able to maintain the quality of our products relative to those of our competitors or continue to develop and market new products effectively.

#### **Intellectual Property Rights**

We have approximately 13 patents issued and have three patent applications pending in the United States and in several other countries and have obtained licenses to use proprietary technologies developed by third parties. We cannot assure you:

- that patents will be issued from any pending applications, or that the claims allowed under any patents will be sufficiently broad to protect our technology;
- that any patents issued or licensed to us will not be challenged, invalidated or circumvented; or
- as to the degree or adequacy of protection any patents or patent applications may or will afford.

In addition, we claim proprietary rights in various technologies, know-how, trade secrets and trademarks relating to our principal products and operations. We cannot assure you as to the degree of protection these claims may or will afford. It is our policy to protect our proprietary rights in our products and operations through contractual obligations, including confidentiality and non-disclosure agreements with certain employees and distributors. We cannot assure you as to the degree of protection these contractual measures may or will afford. Although we are not aware that we are infringing upon the intellectual property rights of others, we cannot assure you that an infringement claim will not be asserted against us in the future. We believe that our success is less dependent on the legal protection that our patents and other proprietary rights may or will afford than on the knowledge, ability, experience and technological expertise of our employees. We cannot provide any assurance that we will be able to protect our proprietary technology. The unauthorized use of our proprietary technology by third parties may impair our ability to compete effectively. We could become subject to litigation regarding intellectual property rights, which could seriously harm our business.

We have trademark rights associated with our use of Flash and Intelli-FLEX, and rights obtained by trademark registration for Flare, Perimitrax, Panther, Intelli-FIELD, Intelli-Fiber, Flex-PS, Flex PI Ultrawave, Senstar, Senstar-Stellar and the Senstar-Stellar logo, Sentrax, Omnitrax, Xfield, DTR, Pinpointer, DreamBox, Maestro DB, Fortis, Pipeguard and the Magal logo.

**Government Regulations**

Israel’s defense export policy regulates the sale of a number of our systems and products. Current Israeli policy encourages export to approved customers of defense systems and products, such as ours, as long as the export is consistent with Israeli government policy. A license is required to initiate marketing activities. We are also required to obtain a specific export license for any hardware eventually exported from Israel. We cannot assure you that we will receive all the required permits and licenses for which we may apply in the future.

In 2007, an Israeli law regulating export of “dual use” items (items that are typically sold in the commercial market, but which may also be used in the defense market) came into effect. In addition, a new Defense Export Control Law was adopted in 2007 and the law’s supplemental regulations became effective in February 2008. Such laws enhance enforcement of export control legislation, provide certain exemptions from license requirements and broaden certain areas of licensing, particularly with respect to transfer of technology. In addition, our participation in governmental procurement processes in Israel and other countries is subject to specific regulations governing the conduct of the process of procuring defense contracts. Furthermore, solicitations for procurements by governmental purchasing agencies in Israel and other countries are governed by laws, regulations and procedures relating to procurement integrity, including avoiding conflicts of interest and corruption in the procurement process.

In addition, antitrust laws and regulations in Israel and other countries often require governmental approvals for transactions that are considered to limit competition. Such transactions may include cooperative agreements for specific programs or areas, as well as mergers and acquisitions.

**C. Organizational Structure.**

We, or one of our subsidiaries, own 100% of the outstanding capital stock of subsidiaries operating in Canada, Colombia, Germany, Mexico, the United Kingdom, the United States, Romania and Spain. Set forth below are our significant subsidiaries:

Subsidiary Name	Country/State of Incorporation/Organization	Ownership Percentage
Senstar Corp	Canada	100%
Senstar Stellar LA	Mexico	100%

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

Our principal facility in Israel is a two-story 2,533 square meter facility located on a 4,352 square meter parcel in the Yehud Industrial Zone, which is owned by us and registered in our name. Approximately 600 square meters are devoted to administrative, marketing and management functions and approximately 700 square meters are used for engineering, system integration and customer service. We use the remaining 1,233 square meters for production management and production operations, including manufacturing, assembly, testing, warehousing, shipping and receiving. In 2007, we entered into a lease for a one-story 810 square meter facility located on a 1,820 square meter parcel in the Yehud Industrial Zone for \$-84,000 per year for use in production and operations. The lease is for a period of 23 years. The products that we manufacture at our facilities in the Yehud Industrial Zone include our taut-wire intrusion detection systems, our vibration detection systems, our video-motion detection systems, MagNet, Fortis, DreamBox, PipeGuard, MTC-1500, MSS-1500 and other perimeter systems.

We own a 33,000 square foot facility in Carp, Ontario, Canada. Approximately 9,000 square feet are devoted to administrative, marketing and management functions, and approximately 8,000 square feet are used for engineering, system integration and customer service. We use the remaining 16,000 square feet for production operations, including cable manufacturing, assembly, testing, warehousing, shipping and receiving. We own an additional 182,516 square feet of vacant land adjacent to this property, which is being held for future expansion. We also rent 358,560 square feet of land near this facility for use as an outdoor sensor test and demonstration site for our products including the Perimitrax/Panther 2000 and Omnitrex buried cable intrusion detection systems, the Intelli-Field electro static detection system, the X-Field volumetric system, the Intelli-FLEX microphonic fence detection system, Flash and Flare, and various perimeter monitoring and control systems. The rent for this site is Canadian \$3,500 per year plus taxes under a lease that expires in November 2014. In addition, we lease a 1,900 square foot facility adjacent to our Carp, Ontario property for Canadian \$20,000 per year plus taxes for use as additional storage and system integration space under a month to month tenancy.

We also lease small offices in China, Colombia, Germany, Mexico, Romania, Spain, the United Kingdom, and Virginia and California in the United States, for our sales and marketing entities. The aggregate annual rent for such offices was approximately \$328,000 in 2010.

We believe that our facilities are suitable and adequate for our current operations and the foreseeable future.

**ITEM 4A. Unresolved Staff Comments**

None.

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

*The following discussion of our results of operations and financial condition should be read in conjunction with our consolidated financial statements and the related notes thereto included elsewhere in this annual report. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors, including, but not limited to, those set forth in Item 3.D. "Key Information-Risk Factors."*

**A. Operating Results.**

**Overview**

We develop, manufacture, market and sell complex computerized security systems. Our systems are used in more than 75 countries to protect aircraft, national borders and sensitive facilities, including military bases, power plant installations, airports, postal facilities, prisons and industrial locations from terrorism, theft and other security threats.

Our revenues are derived from our two operating segments:

- Perimeter Products segment - sales of perimeter products, including services and maintenance that are performed either on a fixed-price basis or pursuant to time-and-materials based contracts, and
- Turnkey Projects segment - installation of comprehensive turnkey solutions for which revenues are generated from long-term fixed price contracts.

#### *Perimeter Products Segment*

During 2008, our Perimeter Products segment included the operations of four subsidiaries, Senstar Stellar Corp, or Senstar Canada, Senstar GmbH, or Senstar Germany, Senstar Limited, or Senstar UK, and Magal Senstar Inc., or the U.S. Subsidiary. The Perimeter Products segment also included our operations in Israel during 2008. We acquired Senstar Canada and Senstar Germany in January 1997 and at the same time, established Senstar UK and considered Senstar Canada, Senstar Germany and Senstar UK as one operating unit due to the commonality of their operations and products, with Senstar Germany and Senstar UK acting as distributors for Senstar Canada. Our U.S. subsidiary, which we acquired in September 1997, was considered a separate operating unit within the Perimeter Products segment. In connection with our strategic plan, we consolidated certain of our subsidiaries' operations. Accordingly, during 2010 Senstar Canada, Senstar Germany, Senstar UK and the U.S subsidiary are considered as one reporting unit within the Perimeter Products segment. The Israeli operations of the Perimeter Products segment as well as the Spanish operations are considered as two separate reporting units within that segment.

#### *Turnkey Projects Segment*

The Turnkey Projects segment has operations worldwide and the segment includes a number of reporting units operating in Israel, Mexico, Colombia and a division of Senstar Canada.

#### *New Strategic Plan*

In June 2010 we adopted a new strategic plan, which we believe provides a foundation for the future growth in our revenues. This projected growth, which is not expected to be immediate, is based on the growing worldwide demand for perimeter security, especially in the BRIC countries. As part of our strategic plan, we intend to stimulate revenue growth by introducing new sales channels for our products as well as creating long-term alliances with large international integrators in order to increase the sales of our products to such integrators. We are also investing in research and development in order to maintain our leadership position in the PIDS market. In addition, we intend to enter into new OEM agreements, purchase third party technologies or enter into mergers and acquisitions transactions in order to maintain and enhance our technological prominence. We also intend to increase our sales efforts for our perimeter solutions and turn-key projects in those territories where we see growing demand, such as the BRIC countries, and plan to improve our presence in these territories either through the establishment of local offices or through joint-ventures and partnering with local entities.

#### *Business Challenges/Areas of Focus*

Our primary business challenges and areas of focus include:

- continuing the growth of revenues and profitability of our perimeter security system line of products;
- enhancing the introduction and recognition of our new products into the markets;
- penetrating new markets and strengthening our presence in existing markets; and
- succeeding in selling our comprehensive turnkey solutions.

Our business is subject to the effects of general global economic conditions. If general economic conditions or economic conditions in key markets remain uncertain or weaken further, demand for our products could be adversely affected.

#### Key Performance Indicators and Sources of Revenues

Our management believes that our revenues, sources of revenues and operating income (loss) are among the key performance indicators for our business.

Our revenues from our perimeter products and turnkey projects segments for the three years ended December 31, 2008, 2009 and 2010 were as follows:

	Year Ended December 31,		
	2008	2009	2010
	(In thousands)		
Perimeter products	\$ 41,378	\$ 39,102	\$ 33,248
Turnkey projects	15,727	15,416	17,249
Eliminations	-	-	(798)
Total	<u>\$ 57,105</u>	<u>\$ 54,518</u>	<u>\$ 49,699</u>

The increase in revenues from turnkey projects was primarily due to the operations of our Mexican subsidiary, which received a large scale project in 2010.

Our operating loss from our perimeter products and turnkey projects segments for the three years ended December 31, 2008, 2009 and 2010 were as follows:

	Year Ended December 31,		
	2008	2009	2010
	(In thousands)		
Perimeter products	\$ (9,330)	\$ (1,053)	\$ (1,641)
Turnkey projects	(5,230)	(1,812)	(2,716)
Eliminations	-	-	(303)
Total	<u>\$ (14,560)</u>	<u>\$ (2,865)</u>	<u>\$ (4,660)</u>

Our losses were primarily due to the global economic slowdown and the reduction in governments spending that began in the latter part of 2008. As orders and new projects were delayed, competition increased and margins were squeezed. We believe that this trend is beginning to reverse and that government spending in certain territories is returning to previous levels. To the extent this reversal continues, we believe that the combination of increased revenues and the impact of the cost saving measures we took in 2009 and 2010 will improve our profitability.

#### Cost and Expenses

**Cost of revenues.** Our cost of revenues for perimeter products consists of component and material costs, direct labor costs, subcontractors costs, shipping expenses, overhead related to manufacturing and depreciation. Our cost of revenues for turnkey projects consists primarily of component and material costs, subcontractor costs, direct labor costs and overhead related to the turnkey projects.

Our gross margin is affected by the proportion of our revenues generated from perimeter products, turnkey projects. Our revenues from perimeter products generally have higher gross margins than our other segment.

**Research and development expenses, net.** Research and development expenses, net consists primarily of expenses for on-going research and development activities and other related costs.

**Selling and marketing expenses.** Selling and marketing expenses consist primarily of commission payments, compensation and related expenses of our sales teams, attendance at trade shows and advertising expenses and related costs for facilities and equipment.

**General and administrative expenses.** Our general and administrative expenses consist primarily of salary and related costs associated with our executive and administrative functions, legal and accounting expenses, allowances for doubtful accounts and bad debts and other miscellaneous expenses. Staff costs include direct salary costs and related costs, such as severance pay, social security and retirement fund contributions, vacation and other pay.

**Depreciation and Amortization.** The amount of depreciation and amortization attributable to our business segments for the years ended December 31, 2008, 2009 and 2010 are as follows:

	Year Ended December 31,		
	2008	2009	2010
	(In thousands)		
Perimeter products	\$ 782	\$ 1,166	\$ 945
Turnkey projects	409	38	117
Total	<u>\$ 1,191</u>	<u>\$ 1,204</u>	<u>\$ 1,062</u>

**Financial Expenses, Net.** Financial expenses, net include exchange rate differences arising from changes in the value of monetary assets and monetary liabilities stated in currencies other than the functional currency of each entity, currency and hedge transactions, interest charged on loans from banks as well as interest income on our cash and cash equivalents and short term investments.

**Tax expense.** Tax expense consists of federal, state and local taxes on the income of our business. We paid income taxes in Germany and Canada in 2008, in Germany, Spain and Mexico in 2009 and in Germany, Colombia and Mexico in 2010, but did not pay taxes elsewhere because of our operating losses.

#### **Discussion of Critical Accounting Policies**

The preparation of financial statements in conformity with U.S. GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and the use of different assumptions would likely result in materially different results of operations. Critical accounting policies are those that are both most important to the portrayal of our financial position and results of operations and require management's most difficult, subjective or complex judgments. Although not all of our significant accounting policies require management to make difficult, subjective or complex judgments or estimates, the following policies and estimates are those that we deem most critical:

#### **Revenue Recognition**

We generate our revenues mainly from (i) installation of comprehensive turnkey systems for which revenues are generated from long-term fixed price contracts; and (ii) sales of perimeter products, including services and maintenance that are performed either on a fixed-price basis or as time-and-materials based contracts, and (iii) services and maintenance, which are performed either on a fixed-price basis or as time-and-materials based contracts.

Revenues from installation of comprehensive turnkey systems are generated from fixed-price contracts according to which the time between the signing of the contract and the final customer acceptance is usually over one year. Such contracts require significant customization for each customer's specific needs and, as such, revenues from this type of contract are recognized in accordance with ASC, 605-35 "Revenue Recognition -Construction-Type and Production-Type Projects," using contract accounting on a percentage of completion method. Accounting for long-term contracts using the percentage-of-completion method stipulates that revenue and expense are recognized throughout the life of the contract, even though the project is not completed and the purchaser does not have possession of the project. Percentage of completion is calculated based on the "Input Method."

Turnkey projects costs include materials purchased to produce the solutions, related labor and overhead expenses and subcontractor's costs. The percentage to completion is measured by monitoring costs and efforts devoted using records of actual costs incurred to date in the project compared to the total estimated project requirement, which corresponds to the costs related to earned revenues. The amounts of revenues recognized are based on the total fees under the agreements and the percentage of completion achieved. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are first determined, in the amount of the estimated loss on the entire contract.

Estimated gross profit or loss from long-term contracts may change due to changes in estimates resulting from differences between actual performance and original forecasts. Such changes in estimated gross profit are recorded in results of operations when they are reasonably determinable by management, on a cumulative catch-up basis.

We believe that the use of the percentage of completion method is generally appropriate as we have the ability to make reasonably dependable estimates of the extent of progress towards completion, contract revenues and contract costs. In addition, executed contracts include provisions that clearly specify the enforceable rights regarding services to be provided and received by the parties to the contracts, the consideration to be exchanged and the manner and the terms of settlement, including in cases of termination for convenience. In most cases we expect to perform our contractual obligations and our customers are expected to satisfy their obligations under the contract.

Fees are payable upon completion of agreed upon milestones and subject to customer acceptance. Amounts of revenues recognized in advance of contractual billing are recorded as unbilled accounts receivable. The period between most instances of advanced recognition of revenues and the customers' billing generally ranges between one to six months. As of December 31, 2010, we had recorded \$2.9 million of such unbilled receivables.

Services and maintenance are performed under either fixed-price based or time-and-materials based contracts. Under fixed-price contracts, we agree to perform certain work for a fixed price. Under time-and-materials contracts, we are reimbursed for labor hours at negotiated hourly billing rates and for materials. Such service contracts are not in the scope of ASC 605-35, and accordingly, related revenues are recognized in accordance with SAB No. 104, as those services are performed or over the term of the related agreements provided that, an evidence of an arrangement has been obtained, fees are fixed and determinable and collectability is reasonably assured.

Deferred revenue includes unearned amounts under installation service contracts, service contracts and maintenance agreements.

#### ***Inventories***

Inventories are stated at the lower of cost or market value. We periodically evaluate the quantities on hand relative to historical and projected sales volumes, current and historical selling prices and contractual obligations to maintain certain levels of parts. Based on these evaluations, inventory write-offs are provided to cover risks arising from slow-moving items, discontinued products, excess inventories, market prices lower than cost and adjusted revenue forecasts. Cost is determined as follows:

- Raw materials, parts and supplies - using the "first-in, first-out" method.
- Work-in-progress and finished products - on the basis of direct manufacturing costs with the addition of allocable indirect manufacturing costs.

During 2008, 2009 and 2010, we recorded inventory write-offs from continuing operations in the amounts of \$2.0 million, \$1.4 million and \$0.3 million, respectively. Such write-offs were included in cost of revenues.

#### ***Income taxes***

We account for income taxes in accordance with ASC 740 "Income Taxes." This statement prescribes the use of the liability method whereby deferred tax asset and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. We provide a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.



As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and we must establish a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. Increases in the valuation allowance result in additional expense to be reflected within the tax provision in the consolidated statement of income.

At December 31, 2010, we had a net deferred tax asset of \$284,000 attributable to our subsidiaries. We had total estimated available carryforward tax losses of \$24.8 million with respect to our operations in Israel. As of December 31, 2010, we recorded a full valuation allowance on these carryforward tax losses due to the uncertainty of their future realization. As of December 31, 2010, our subsidiaries had estimated total available carryforward tax losses of \$9.2 million, of which \$8.3 million was attributable to our U.S. subsidiary, which may be used as an offset against future taxable income for periods ranging between 11 and 19 years. As of December 31, 2010, we recorded a full valuation allowance for our subsidiaries' carryforward tax losses due to the uncertainty of their future realization. Utilization of U.S. net operating losses may be subject to a substantial annual limitation due to the "change in ownership" provisions of the Internal Revenue Code of 1986 and similar state provisions. The annual limitation may result in the expiration of net operating losses before utilization.

On January 23, 2011 the Israeli Tax Authorities issued a tax assessment of NIS 2.3 million (approximately \$0.6 million) in connection with the tax years 2005-2006. We believe, but cannot provide any assurance, that we will be able to offset this tax assessment against our available carryforward tax losses. We recorded a full valuation allowance on these carry forward tax losses and as such, the offset will not have a financial impact on our income statement.

#### **Goodwill**

We have recorded goodwill as a result of past acquisitions, which represents the excess of the cost over the net fair value of the assets of the businesses acquired. We follow ASC 350, "Intangibles – Goodwill and Other," which requires goodwill to be tested for impairment, at the reporting unit level, at least annually or between annual tests in certain circumstances, and written down when impaired, rather than being amortized. We perform our annual goodwill impairment test at December 31 of each year, or more often if indicators of impairment are present.

ASC 350 prescribes a two phase process for impairment testing of goodwill. The first phase screens for impairment, while the second phase (if necessary) measures impairment. In the first phase of impairment testing, goodwill attributable to each of the reporting units is tested for impairment by comparing the fair value of each reporting unit with its carrying value. If the carrying value of the reporting unit exceeds its fair value, the second phase is then performed. The second phase of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. Fair value is determined using discounted cash flows, based on the income approach, as we believe that this approach best approximates the reporting unit's fair value at this time. Significant estimates used in the methodologies include estimates of future cash flows, future short-term and long-term growth rates and weighted average cost of capital for each of the reportable units.

The material assumptions used for the income approach for 2010 were five years of projected net cash flows, a discount rate of 15.5% and a long-term growth rate of 1.0%. We considered historical rates and current market conditions when determining the discount and growth rates to use in our analysis. If these estimates or their related assumptions change in the future, we may be required to record impairment charges for our goodwill.

As required by ASC 820, "Fair Value Measurements and disclosures," we apply assumptions that market place participants would consider in determining the fair value of a reporting unit.

Prior to December 31, 2008, we had goodwill attributable to our Perimeter Products segment relating to our acquisitions of Senstar Germany and Senstar Canada in January 1997 and our acquisition of our U.S. subsidiary in September 1997. In 2008, due to the economic crisis in the United States and the decline in government spending, our revenues attributable to the U.S. market declined and as a result, we determined that the fair value of the U.S. subsidiary had significantly declined and recorded a \$2.4 goodwill impairment charge attributable to the U.S. subsidiary. Prior to December 31, 2008, we also had goodwill attributable to Turnkey Projects segment relating to our former European subsidiary that we acquired in late 2007 and subsequently sold back to its former owner in December 2009. In 2008, we determined that the fair value of the European subsidiary had decreased and as a result, wrote-off the related goodwill in the amount of \$8.4 million. Following the 2008 impairments, there is no goodwill allocated to the Turnkey Projects segment and the only remaining goodwill on our balance sheet relates to Senstar Germany and Senstar Canada within the Perimeter Products segment. During 2009 and 2010 no impairment losses were identified.

#### ***Impairment of long lived assets***

Our long-lived assets and certain identifiable intangibles are reviewed for impairment in accordance with ASC 360 "Property, Plant, and Equipment" whenever events or changes in circumstances indicate that the carrying amount of a group of assets may not be recoverable. Recoverability of a group of assets to be held and used is measured by a comparison of the carrying amount of the group to the future undiscounted cash flows expected to be generated by the group. If such group of assets is considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds their fair value.

During 2009 and 2010, no impairment losses were identified. In 2008, we determined that \$1.7 million of intangible assets attributable to customers of our European subsidiary had been impaired and as a result, we recorded an impairment charge of \$1.7 million attributable to such intangible assets. As of December 31, 2008, following such impairment, we had \$2.5 million of intangible assets attributable to customers of our European subsidiary. In addition, impairment of other intangible assets amounted to approximately \$350,000 in 2008 attributable to the write-off of certain know-how.

As required by ASC 820, "Fair Value Measurements and Disclosures," we apply assumptions that market place participants would consider in determining the fair value of our long-lived assets.

#### ***Functional Currency and Financial Statements in U.S. Dollars***

We have determined that our reporting currency is the U.S. dollar. As of October 1, 2006, our functional currency changed from the U.S. dollar to NIS. Translation adjustments resulting from translating our financial statements from NIS to the U.S. dollar are reported as a separate component in shareholders' equity. As of December 31, 2008, 2009 and 2010, our foreign currency translations totaled \$3.3 million, \$3.9 million and \$3.4 million, respectively.

Accordingly, as of December 31, 2008, 2009 and 2010, we recorded accumulated foreign currency translation (expense) income of approximately (\$3.3 million), \$1.4 million and \$1.2 million, respectively, included in our balance sheets as part of "accumulated other comprehensive income." As of December 31, 2008, 2009 and 2010, foreign currency translation adjustments, net of \$2.5 million, \$3.8 million and \$5.0 million, respectively, were included under "accumulated other comprehensive income."

The first step in the translation process is to identify the functional currency for each entity included in the financial statements. The accounts of each entity are then "re-measured" in its functional currency. All transaction gains and losses from the re-measurement of monetary balance sheet items are reflected in the statement of operations as financial income or expenses, as appropriate.

After the re-measurement process is complete the financial statements are translated into the reporting currency, which is the U.S. dollar, using the current rate method. Equity accounts are translated using historical exchange rates. All other balance sheet accounts are translated using the exchange rates in effect at the balance sheet date. Statement of operations amounts have been translated using the average exchange rate for the year. The resulting translation adjustments are reported as a component of shareholders' equity in accumulated other comprehensive income (loss).

### **Concentrations of credit risk**

Financial instruments that are potentially subject to concentrations of credit risk consist principally of cash and cash equivalents, short and long-term bank deposits, marketable securities, unbilled accounts receivable, trade receivables, long-term trade receivables and long-term loans.

Of our cash and cash equivalents, marketable securities and restricted short-term and long-term bank deposits at December 31, 2010, \$14.7 million was deposited with major Israeli and U.S. banks; and \$6.8 million was deposited with the Royal Bank of Canada, Deutsche Bank and Fianzaz Atlas. Cash and cash equivalents deposited in the United States may be in excess of insured limits and are not insured in other jurisdictions. Generally these deposits maybe redeemed upon demand and therefore bear low risk.

The short-term and long-term trade receivables and the unbilled accounts receivable of our company and our subsidiaries are derived from sales to large and solid organizations located mainly in Israel, the United States, Canada, Mexico and Europe. We perform ongoing credit evaluations of our customers and to date have not experienced any material losses. An allowance for doubtful accounts is determined with respect to those amounts that we have determined to be doubtful of collection and in accordance with an aging policy. In certain circumstances, we may require letters of credit, other collateral or additional guarantees. During the years ended December 31, 2008, 2009 and 2010, we recorded \$755,000 (not including \$468,000 recorded under discontinued operations), (\$153,000) and \$601,000 of expenses (income) related to doubtful accounts, respectively. As of December 31, 2010, our allowance for doubtful accounts amounted to \$0.9 million.

A loan granted to a third party entity in connection with a possible future cooperation between us and the entity is secured by a personal guarantee of the beneficial owner of the entity. However, in 2008 we evaluated the likelihood of the repayment of the loan and due to anticipated difficulties in implementation of the projects for which the loan was provided, we estimated that 50% of the loan will not be repaid and therefore, recorded a provision of \$550,000 attributable to the loan. In 2009, we further evaluated the likelihood of repayment of this loan and due to the global economic climate at the time and the prospects of the projects for which the loan was provided, we determined that the loan will not be repaid in full and therefore recorded an additional provision of \$319,000 attributable to this loan. In 2010, due to anticipated difficulties in the implementation of the projects for which the loan was provided we estimated that the repayment of the loan was not probable, and therefore made a provision for the entire loan balance.

We have no significant off-balance sheet concentration of credit risks, such as foreign exchange contracts or foreign hedging arrangements, except derivative instruments, which are detailed below.

### **Results of Operations**

Our operating results have been negatively impacted during the last three years due to the global economic slowdown and the reduction in governments spending that began in the latter part of 2008. As orders and new projects were delayed, competition increased and margins were squeezed. We believe that this trend is beginning to reverse and that government spending in certain territories is returning to previous levels.

Due to the nature of our customers and products, our revenues are often generated from a relatively small number of large orders. Consequently, individual orders from individual customers can represent a substantial portion of our revenues in any one period and significant orders by any customer during one period may not be followed by further orders from the same customer in subsequent periods. Our revenues and operating results may, therefore, vary substantially from period to period. Consequently, we do not believe that our revenues and operating results should necessarily be judged on a quarter-to-quarter comparative basis.

The following table presents certain financial data expressed as a percentage of revenues for the periods indicated:

	Year Ended December 31,		
	2008	2009	2010
Revenues	100.0%	100.0%	100%
Cost of revenues	65.8	61.3	63.2
Gross profit	34.2	38.9	36.8
Operating expenses:			
Research and development, net	9.7	9.3	8.3
Selling and marketing, net	22.7	19.8	22.7
General and administrative	17.9	14.8	15.3
Impairment of goodwill and other intangible assets	4.9	-	-
Post employment and termination benefits	4.5	-	-
Operating loss	(25.5)	(5.2)	(9.5)
Financial expenses, net	(2.3)	(2.9)	(1.9)
(Loss) before income taxes	(27.8)	(8.1)	(11.4)
Income taxes	5.4	1.6	1.2
Loss from continuing operations	(32.2)	(9.7)	(12.6)
Loss from discontinued operations, net	(23.9)	7.7	-
Net loss	(57.1)%	(2.0)%	(12.6)%

#### Year Ended December 31, 2010 Compared with Year Ended December 31, 2009

**Revenues.** Revenues decreased by 8.8% from \$54.5 million for the year ended December 31, 2009 to \$49.7 million for the year ended December 31, 2010. Revenues from sales of perimeter systems decreased by 15% from \$39.1 million in 2009 to \$33.3 million in 2010, primarily due to a reduction in sales to the Israeli MOD as well as reduced sales to the Far East markets. Revenues from security turnkey projects increased by 11.9% from \$15.4 million in 2009 to \$17.2 million in 2010, primarily due to a large project received by our Mexican subsidiary. We anticipate that our revenues will increase in 2011 as a result of anticipated improvements in the global economy and our improved backlog compared to our backlog in 2010.

**Cost of revenues.** Cost of revenues decreased by 6% from \$33.4 million for the year ended December 31, 2009 to \$31.4 million for the year ended December 31, 2010. This decrease was primarily due to the reduction in revenues. Cost of revenues as a percentage of revenues increased from 61.3% in 2009 to 63.2% in 2010, primarily due to the reduced sales without a matching reduction in fixed costs. Our cost of revenues as a percentage of revenues was adversely impacted by the devaluation in the NIS and Canadian dollar against the U.S. dollar exchange rate in 2010, as the percentage of our cost of revenues denominated in NIS and Canadian dollars is higher than the percentage of revenues denominated in NIS and Canadian dollars.

**Research and development expenses, net.** Research and development expenses, net decreased by 18.9% from \$5.1 million for the year ended December 31, 2009 to \$4.1 million for the year ended December 31, 2010. The decrease in research and development expenses is primarily attributable to the shutdown of our U.S. subsidiary's research and development department due to the consolidation of the North American business into one unit in the second quarter of 2009 and a reduction in number of employees in our research and development staff in Canada and Israel. Research and development expenses, net amounted to 9.3% of revenues in 2009, compared to 8.3% in 2010, due to our lower revenues in 2010. We anticipate that our research and development expenses will not materially change in 2011.

**Selling and marketing expenses, net.** Selling and marketing expenses, net increased by 4.1% from \$10.9 million for the year ended December 31, 2009 to \$11.3 million for the year ended December 31, 2010. The increase in selling and marketing expenses in 2010 was primarily due to increased sales commissions which derive from the different mix of revenues in 2010 compared with 2009, as well as selling expenses incurred by our Colombian subsidiary, which started its operation in 2010. The increase is also attributable to the appreciation of the NIS and the Canadian dollar against the U.S. dollar in 2010, which increased the U.S. dollar value of our NIS and Canadian dollar denominated expenses. The increase in selling and marketing expenses was offset in part by the reduction in employees in our Canadian subsidiary. Selling and marketing expenses, net amounted to 19.8% and 22.7% of revenues in 2009 and 2010, respectively.

**General and administrative expenses.** General and administrative expenses decreased by 6.3% from \$8.1 million for the year ended December 31, 2009 to \$7.6 million for the year ended December 31, 2010. The decrease in general and administrative expenses in 2010 was primarily due to the consolidation of the North American business into one unit in the second quarter of 2009, a decrease in legal and accounting expenses and a decrease in stock option expenses. The decrease was partially offset by the appreciation of the NIS and Canadian dollar against the U.S. dollar in 2010, which increased the U.S. dollar value of our NIS and Canadian dollar denominated expenses, and expenses incurred by our Colombian subsidiary, which started its operation in 2010. General and administrative expenses amounted to 14.8% of revenues in 2009 compared to 15.3% in 2010.

**Impairment of goodwill and other intangible assets.** We did not record any impairment of goodwill and other intangible assets for the years ended December 31, 2009 and 2010.

**Post employment and termination benefits.** We did not record any post employment and termination benefits expense in 2009 and 2010.

**Operating loss.** We had an operating loss of \$2.9 million for the year ended December 31, 2009 compared to an operating loss of \$4.7 million for the year ended December 31, 2010. The operating losses of our business segments for the years ended December 31, 2009 and 2010 are as follows:

	Year Ended December 31,	
	2009	2010
	(In thousands)	
Perimeter products	\$ (1,053)	\$ (1,641)
Turnkey projects	(1,812)	(2,716)
Eliminations	-	(303)
Total	<u>\$ (2,865)</u>	<u>(4,660)</u>

The operating loss of our perimeter products segment increased from \$1.1 million for the year ended December 31, 2009 to \$1.6 million for the year ended December 31, 2010, primarily as a result of a lower volume of revenues while a significant amount of our expenses with respect to such segment's operations are fixed as well as an increase in the U.S. dollar value of our non-U.S. dollar denominated expenses due to changes in foreign currency exchange rates in 2010. The operating loss of our turnkey projects segment increased from \$1.8 million for the year ended December 31, 2009 to \$2.7 million for the year ended December 31, 2010, primarily as a result of a less profitable mix of projects in 2010 as well as an increase in the U.S. dollar value of our non-U.S. dollar denominated expenses due to changes in foreign currency exchange rates in 2010.

**Financial expenses, net.** Financial expenses, net, decreased from \$1.6 million for the year ended December 31, 2009 to \$1.0 million for the year ended December 31, 2010, a decrease of 38.3%. The decrease was primarily due to foreign exchange losses, net that was offset in part by interest on a related party loan.

**Income taxes.** We recorded income tax expense of \$0.9 million for the year ended December 31, 2009 compared to income tax expense of \$0.6 million for the year ended December 31, 2010. The decrease in income taxes was primarily as a result of reversing in the 2009 valuation allowance on deferred taxes relating to carry forward tax losses, which was offset in part by increased tax expenses relating to our profitable foreign subsidiaries in Mexico, Colombia and Germany.

#### Year Ended December 31, 2009 Compared with Year Ended December 31, 2008

**Revenues.** Revenues decreased by 4.5% from \$57.1 million for the year ended December 31, 2008 to \$54.5 million for the year ended December 31, 2009. Revenues from sales of perimeter systems decreased by 5.5% from \$41.4 million in 2008 to \$39.1 million in 2009, primarily due to a reduction in sales in Western Europe as a result of the global economic slowdown and reduced spending in such market. Revenues from security turnkey projects decreased by 2.0% from \$15.7 million in 2008 to \$15.4 million in 2009, primarily due to a reduction in system installations by our Canadian subsidiary

**Cost of revenues.** Cost of revenues decreased by 11.1% from \$37.6 million for the year ended December 31, 2008 to \$33.4 million for the year ended December 31, 2009. The decrease was primarily due to a decrease in the U.S. dollar value of our non-U.S. dollar denominated expenses as a result of changes in foreign currency exchange rates in 2009, as well as a more favorable mix of products and projects. Cost of revenues also benefited from the rationalization of costs and consolidation of the North American business into one unit during the second quarter of 2009. In 2008 and 2009, our cost of revenues also includes a loss provision attributable to two strategic projects that had a negative gross margin, which loss was lower in 2009 compared to 2008. Cost of revenues as a percentage of revenues decreased from 65.8% in 2008 to 61.3% in 2009, primarily due to a more favorable mix of products and projects in 2009 compared to 2008 and a decrease in inventory write-off from \$2.0 million in 2008 to \$1.4 million in 2009, despite the lower volume of sales in 2009 compared to 2008. Our cost of revenues as a percentage of revenues was also positively impacted by the decline in the average NIS/U.S. dollar exchange rate in 2009, as the percentage of our cost of revenues denominated in NIS is higher than the percentage of revenues denominated in NIS.

**Research and development expenses, net.** Research and development expenses, net decreased by 8.9% from \$5.6 million for the year ended December 31, 2008 to \$5.1 million for the year ended December 31, 2009. The decrease in research and development expenses is primarily attributable to the decrease in the number of our U.S. subsidiary's research and development staff due to the consolidation of the North American business into one unit and the decline in the average exchange rate of the NIS against the U.S. dollar in 2009, which reduced the U.S. dollar value of our NIS denominated expenses. Research and development expenses, net amounted to 9.7% of revenues in 2008, compared to 9.3% in 2009.

**Selling and marketing expenses, net.** Selling and marketing expenses, net decreased by 16.5% from \$13.0 million for the year ended December 31, 2008 to \$10.9 million for the year ended December 31, 2009. The decrease in selling and marketing expenses in 2009 was primarily due to the decrease in the number of our U.S. subsidiary's selling and marketing staff due to the consolidation of the North American business into one unit. Sales commissions also decreased in 2009 due to a different mix of revenues in 2009 compared to 2008. The decrease in selling and marketing expenses is also attributable to the decline in the average exchange rate of the NIS against the U.S. dollar in 2009, which reduced the U.S. dollar value of our NIS denominated expenses. Selling and marketing expenses, net amounted to 22.7% and 19.8% of revenues in 2008 and 2009, respectively.

**General and administrative expenses.** General and administrative expenses decreased from \$10.2 million for the year ended December 31, 2008 to \$8.1 million for the year ended December 31, 2009, a decrease of 20.9%. The decrease in general and administrative expenses in 2009 was primarily due to an approximately \$1.0 million decrease in the allowance for doubtful accounts in such period. In 2008, we significantly increased the allowance for doubtful accounts as a result of the global economic downturn, which had an adverse affect on the liquidity of some of our customers. In 2009, costs associated with our compliance with the requirements of the Sarbanes-Oxley Act of 2002 (including the implementation of internal controls) as well as other audit and legal expenses also decreased by approximately \$1.0 million. The decrease in general and administrative expenses is also attributable to the decline in the average exchange rate of the NIS against the U.S. dollar in 2009, which reduced the U.S. dollar value of our NIS denominated expenses. General and administrative expenses amounted to 17.9% of revenues in 2008 compared to 14.8% in 2009.

**Impairment of goodwill and other intangible assets.** In 2008, following our annual impairment test of goodwill and long lived assets, we determined that the fair value of our European subsidiary acquired in September 2007 had decreased and that as a result, goodwill in the amount of \$8.4 million had been impaired. As a result, for the year ended December 31, 2008, we recorded a non-cash goodwill impairment charge of \$8.4 million. In addition, we determined that \$1.7 million of intangible assets attributable to customers of our European subsidiary had been impaired and as a result, we recorded a \$1.7 million impairment charge. The goodwill and intangible assets impairment is classified as a discontinued operation. Following the 2008 annual impairment test, we also determined that the fair value of our U.S. subsidiary had significantly declined and that as a result, goodwill in the amount of \$2.4 million attributable to the U.S. subsidiary had been impaired. Impairment of other intangible assets amounted to approximately \$350,000 in 2008 attributable to the write-off of certain know-how. We did not record any impairment of goodwill and other intangible assets for the year ended December 31, 2009.

**Post employment and termination benefits.** For the year ended December 31, 2008, we recorded a post employment and termination benefits expense of \$2.6 million, or 4.5% of our total revenues, related to benefits payable to our former president and chief executive officer as well as other senior employees in connection with their retirement from their respective offices. We did not record any post employment and termination benefits expense in 2009.

**Operating loss.** We had an operating loss of \$14.6 million for the year ended December 31, 2008 compared to an operating loss of \$2.9 million for the year ended December 31, 2009. The operating losses of our business segments for the years ended December 31, 2008 and 2009 are as follows:

	Year Ended December 31,	
	2008	2009
	(In thousands)	
Perimeter products	\$ (9,330)	\$ (1,053)
Turnkey projects	(5,230)	(1,812)
Total	<u>\$ (14,560)</u>	<u>\$ (2,865)</u>

The operating loss of our perimeter products segment decreased from \$9.3million for the year ended December 31, 2008 to \$1.1 million for the year ended December 31, 2009, primarily as a result of a decrease in the U.S. dollar value of our non- U.S. dollar denominated expenses as a result of changes in foreign currency exchange rates in 2009, as well as a more favorable mix of products. Cost of revenues and operating expenses had also decreased due to the rationalization of costs and consolidation of the North American business into one unit in during the second quarter of 2009. The operating loss of our turnkey projects segment decreased from \$5.2 million in the year ended December 31, 2008 to \$1.8 million for the year ended December 31, 2009, primarily as a result of a more profitable mix of projects in 2009. In 2008 and 2009, we also recorded a loss provision attributable to two strategic projects that had a negative gross margin, which loss was lower in 2009 compared to 2008.

**Financial expenses, net.** Financial expenses, net, increased from \$1.3 million for the year ended December 31, 2008 to \$1.6 million for the year ended December 31, 2009, an increase of 19.3%. The increase was primarily due to an increase in foreign exchange losses, net that was offset in part by a gain from the sale of marketable securities compared to a loss from the sale of marketable securities in 2008.

**Income taxes.** We recorded an income tax expense of \$0.9 million for the year ended December 31, 2009 compared to an income tax expense of \$3.1 million for the year ended December 31, 2008, primarily as a result of valuation allowances recorded in 2009 with respect to our Canadian subsidiary's investment tax credit asset, due to the uncertainty of its future realization. In 2008, we recorded a full valuation allowance with respect to our carryforward tax losses due to the uncertainty of their future realization.

#### Seasonality

Our operating results are characterized by a seasonal pattern, with a higher volume of revenues towards the end of the year and lower revenues in the first part of the year. This pattern, which is expected to continue, is mainly due to two factors:

- our customers are mainly budget-oriented organizations with lengthy decision processes, which tend to mature late in the year; and
- due to harsh weather conditions in certain areas in which we operate during the first quarter of the calendar year, certain services are put on hold and consequently payments are delayed.

See also Item 3.D. "Key Information–Risk Factors." Our revenues are dependent on government procurement procedures and practices, and because we receive large product orders from a relatively small number of customers, our revenues and operating results are subject to substantial periodic variations.

## Impact of Inflation and Currency Fluctuations on Results of Operations, Liabilities and Assets

We sell most of our products in North America, Europe and Israel. Our financial results, which are reported in U.S. dollars, are affected by changes in foreign currency. Our revenues are primarily denominated in U.S. dollars, Euros and NIS, while a portion of our expenses, primarily labor expenses, is incurred in NIS and Canadian Dollars. Additionally, certain assets, especially trade receivables, as well as part of our liabilities are denominated in NIS. As a result, fluctuations in rates of exchange between the U.S. dollar and non-U.S. dollar currencies may affect our operating results and financial condition. The dollar cost of our operations in Israel and Canada may be adversely affected by the appreciation of the NIS and the Canadian dollar against the U.S. dollar. In addition, the value of our non-U.S. dollar revenues could be adversely affected by the depreciation of the U.S. dollar against such currencies.

The appreciation of the NIS and the Canadian dollar in relation to the U.S. dollar has the effect of increasing the U.S. dollar value of any unlinked assets and the U.S. dollar amounts of any unlinked liabilities and increasing the U.S. dollar value of revenues and expenses denominated in other currencies. Conversely, the depreciation of the NIS and the Canadian dollar in relation to the U.S. dollar has the effect of reducing the U.S. dollar value of any of our liabilities which are payable in NIS or in Canadian dollars (unless such costs or payables are linked to the U.S. dollar). Such depreciation also has the effect of decreasing the U.S. dollar value of any asset that is denominated in NIS and Canadian dollars or receivables payable in NIS or Canadian dollars (unless such receivables are linked to the U.S. dollar). In addition, the U.S. dollar value of revenues and expenses denominated in NIS or Canadian dollars would increase. Because foreign currency exchange rates fluctuate continuously, exchange rate fluctuations may have an impact on our profitability and period-to-period comparisons of our results. The effects of foreign currency re-measurements are reported in our consolidated financial statements in current operations.

The following table presents information about the rate of inflation in Israel, the rate of devaluation or appreciation of the NIS against the dollar, and the rate of inflation in Israel adjusted for the devaluation:

Year ended December 31,	Israeli inflation rate %	NIS devaluation (appreciation) rate %	Israeli inflation adjusted for devaluation (appreciation) %
2006	(0.1)	(8.2)	8.1
2007	3.4	(9.0)	12.4
2008	3.8	(1.1)	4.9
2009	3.9	(0.7)	4.6
2010	2.7	(6.0)	8.7

In addition, the U.S. dollar cost of our operations in Canada is influenced by the exchange rate between the U.S. dollar and the Canadian dollar. In 2008, the Canadian dollar depreciated against the U.S. dollar by approximately 19.7%, while in 2009 and 2010 the Canadian dollar appreciated against the U.S. dollar by 16.6% and 4.9%, respectively.

We recorded foreign currency exchange losses, net of \$246,000, \$1,138,000 and \$199,000 for the years ended December 31, 2008, 2009 and 2010, respectively. We cannot assure you that in the future our results of operations may not be materially adversely affected by currency fluctuations.

To manage this risk, from time to time, we have entered into forward exchange contracts to hedge some of our foreign currency exposure relating to revenue and unbilled accounts receivable denominated in foreign currencies. We recorded \$291,000, \$0 and \$0 of financial expenses attributable to forward exchange contracts transactions for the years ended December 31, 2008, 2009 and 2010, respectively.

### Conditions in Israel

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



## Effective Corporate Tax Rate

Israeli companies are generally subject to income tax on their worldwide taxable income. The applicable rate for 2010 was 25%. The rate was reduced to 24% in 2011, and will be further reduced to 23% in 2012, 22% in 2013, 21% in 2014, 20% in 2015 and 18% in 2016 and thereafter. However, certain of our manufacturing facilities have been granted "Approved Enterprise" status under the Law for the Encouragement of Capital Investments, 1959, as amended, commonly referred to as the Investments Law, and, consequently, are eligible, subject to compliance with specified requirements, for tax benefits beginning when such facilities first generate taxable income. The tax benefits under the Investments Law are not available with respect to income derived from products manufactured outside of Israel. We have derived, and expect to continue to derive, a substantial portion of our income from our Approved Enterprise facilities. Subject to certain restrictions, we are entitled to a tax exemption in respect of income derived from our approved facilities for a period of two years, commencing in the first year in which such income is earned, and will be entitled to a reduced tax rate of 10% to 25% for an additional five to eight years depending on our compliance as a foreign investors' company. If we do not qualify as a foreign investors' company, we will instead be entitled to a reduced rate of 25% for an additional five years, rather than eight years. A foreign investors' company is defined in the Investments Law as a company in which more than 25% of its shareholders are non-Israeli residents. Pursuant to the Investments Law, a foreign investors' company is entitled to benefits for a period of up to ten years (the actual length of the benefits period is graduated based on the percentage of foreign ownership).

Our effective corporate tax rate may substantially exceed the Israeli tax rate. Our U.S. subsidiaries will generally be subject to applicable federal, state, local and foreign taxation, and we may also be subject to taxation in the other foreign jurisdictions in which we own assets, have employees or conduct activities. Because of the complexity of these local tax provisions, it is not possible to anticipate the actual combined effective corporate tax rate, which will apply to us.

As of December 31, 2010, we had net deferred tax asset of \$284,000 attributable to our subsidiaries. We had total estimated available carryforward tax losses of \$24.8 million with respect to our operations in Israel to offset against future taxable income. We have recorded a full valuation allowance over such carryforward tax losses due to the uncertainty of their future realization. As of December 31, 2010, our subsidiaries had estimated total available carryforward tax losses of \$9.2 million, which may be used as an offset against future taxable income for periods ranging between 11 and 19 years. As of December 31, 2010, we recorded a full valuation allowance for our subsidiaries' carryforward tax losses due to the uncertainty of their future realization. Utilization of U.S. net operating losses may be subject to a substantial annual limitation due to the "change in ownership" provisions of the Internal Revenue Code of 1986 and similar state tax law provisions. The annual limitation may result in the expiration of net operating losses before utilization.

## Trade Relations

Israel is a member of the United Nations, the International Monetary Fund, the International Bank for Reconstruction and Development, and the International Finance Corporation. Israel is a member of the World Trade Organization and is a signatory to the General Agreement on Tariffs and Trade. In addition, Israel has been granted preferences under the Generalized System of Preferences from the United States, Australia, Canada and Japan. These preferences allow Israel to export the products covered by such programs either duty-free or at reduced tariffs. In June 2010, Israel joined the Organization for Economic Co-operation and Development, or the OECD, an international organization whose members are governments of mostly developed economies. The OECD's main goal is to promote policies that will improve the economic and social well-being of people around the world.

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

## Recently Issued Accounting Standards

In January 2010, the FASB updated the "Fair Value Measurements Disclosures" codified in ASC 820. More specifically, the update requires an entity to disclose (a) separately the amounts of significant transfers in and out of Levels 1 and 2 fair value measurements and to describe the reasons for the transfers; and (b) information about purchases, sales, issuances and settlements to be presented separately (i.e. to present the activity on a gross basis rather than net) in the reconciliation for fair value measurements using significant unobservable inputs (Level 3 inputs). The update clarifies existing disclosure requirements for the level of disaggregation used for classes of assets and liabilities measured at fair value, and requires disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements using Level 2 and Level 3 inputs. The update became effective in 2010, except for the gross presentation of the Level 3 roll forward information, which is required for annual reporting as of December 31, 2010. The adoption of the new guidance did not have a material impact on our consolidated financial statements.

In February 2010, the FASB issued Accounting Standard Update, or ASU, 2010-09 "Amendments to Certain Recognition and Disclosure Requirements of Subsequent Events" codified in ASC 855. The update removes the requirement to disclose the date through which subsequent events were evaluated in both originally issued and reissued financial statements for "SEC Filers." ASU 2010-09 still requires our company to evaluate subsequent events through the date that the financial statements are issued. The adoption of the new guidance did not have a material impact on our consolidated financial statements.

In December 2010, the FASB Emerging Issues Task Force issued ASU 2010-28, "When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts" codified in ASC 350, "Intangibles - Goodwill and Other." Under ASC 350, testing for goodwill impairment is a two-step test, in which Step 1 compares the fair value of the reporting unit to its carrying amount. If the fair value of the reporting unit is less than its carrying value, Step 2 is completed to measure the amount of impairment, if any. ASU 2010-28 modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 if it appears more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity would consider whether there are any adverse qualitative factors indicating that an impairment may exist (e.g., a significant adverse change in the business climate). We do not believe that the adoption of the new guidance will have a material impact on our consolidated financial statements.

### **B. Liquidity and Capital Resources**

From our inception until our initial public offering in March 1993, we financed our activities mainly through cash flow from operations and bank loans. In March 1993, we received proceeds of \$9.8 million from an initial public offering of 1,380,000 ordinary shares. In February 1997, we raised \$9.4 million from a follow-on offering of 2,085,000 ordinary shares and in April 2005, we raised an additional \$14.9 million from a follow-on offering of 1,700,000 ordinary shares. The proceeds from these offerings together with cash flow from operations and our credit facilities are our main sources of working capital.

The nature of the business and management of the European subsidiary that we purchased in 2007 required us to invest an inordinate amount of management time and effort, which we believed was not justified in light of the financial results of this subsidiary. As a result, we determined to dispose of such subsidiary and in December 2009, we sold all of our interests in the European subsidiary. We received total proceeds of Euro 2.9 million for the sale, including repayment in full of Euro 1.8 million of loans granted by us to the European subsidiary. In addition, Euro 620,000 that we had deposited in escrow as a contingent purchase price in connection with our acquisition of the European subsidiary was released back to us in connection with our sale of the subsidiary.

In June 2010, we adopted a new strategic plan in an effort to establish a viable path for the growth of our business. We decided to focus on our historical primary markets: perimeter products and solutions and turnkey projects. We appointed a new vice president - products for our perimeter products segment, who is focused solely on the sales of our products. We intend to increase revenues in this segment by locating new channels to promote and market our products, maintaining technology leadership, investing in our research and development activities, entering into OEM, agreements and by acquiring technologies or by mergers and acquisitions. We also intend to focus and improve our presence in emerging markets such as the BRIC countries in order to increase our exposure to small and medium size business opportunities for both our perimeter products and solutions and turnkey projects segments. We are also investing in our employees in order to enhance their professional skills and efficiency.

We expect that our research and development expenses in 2011 will be approximately \$4 million. Our research and development plan for 2011 covers the following main areas:

- Sensor development - We intend to continue the development of new and innovative sensors based on existing, new and hybrid technologies. Most of the development will be based on in-house competencies, however we may acquire some know-how externally.
- Sensor improvements – We are conducting an ongoing program of improvement of our existing sensors in order to enhance performance, reliability and capability to source and produce and reduce cost.
- Security Management Systems – We intend to continue to develop our two levels of security management systems:
  - o High-end systems – Physical security information management systems, mainly used as part of a turnkey solution, as a comprehensive command and control solution, designed for entities requiring management of security, safety, site management and dispatching. These systems are designed to manage both daily routines and crisis situations.
  - o Low-end systems – Basic SMS typically used for managing and controlling the PIDS of a site.

We are also developing an interface package to facilitate integration of our sensors into a third party SMS/command and control system.

- Video systems – We will continue to develop our video management software to improve the IVA and cope with advanced video protocols such as regular IP streaming, megapixel and high definition video cameras.

To allow us to begin to implement our new strategic plan, on September 8, 2010, Ki Corporation, a company affiliated with Mr. Nathan Kirsh, our principal shareholder and a director, provided us with a bridge loan in the principal amount of \$10.0 million. The bridge loan will accrue interest at the rate of LIBOR + 4% per year, calculated from the date of the loan and will accumulate on a quarterly basis; however, if the rights offering that we intend to initiate during 2011 occurs within 240 days from the date of the loan, the loan will not bear any interest. Our Audit Committee and Board of Directors believe that the loan is on terms that are favorable to our company, as the market interest rate for similar loans in Israel is approximately 6.7% per year. The loan is due and payable on January 10, 2012, and we have an option to extend the maturity date for an additional 60 days. Any interest will be paid together with, and in the same manner as, the principal, no later than the maturity date. We intend to use part of the proceeds from the rights offering that we intend to initiate during 2011 for the repayment of the bridge loan, which amounts to \$10.0 million, plus accrued interest of \$0.367 million as of March 31, 2011. We have undertaken to repay such amount within five business days after the successful completion of the rights offering.

During 2011, we intend to effectuate a rights offering and private placement. The rights offering will be a \$15 million rights offering to purchase our ordinary shares, and holders who fully exercise their basic subscription rights will be also entitled to subscribe for additional rights that remain unsubscribed as a result of any unexercised basic subscription rights at the same price per share. Mr. Nathan Kirsh, our principal shareholder and a director, has undertaken to exercise, directly or through entities affiliated with him, his basic subscription right in full and his over-subscription right in full, up to our receiving proceeds of no more than \$15 million in the rights offering. The rights offering was approved by our shareholders at an extraordinary general meeting held on August 12, 2010.

The private placement that we intend to initiate in 2011 will take place two business days prior to the record date of the rights offering and will be for 150,000 of our ordinary shares to Ki Corporation, a company owned by Mr. Nathan Kirsh. The initial private placement price per share will be equal to the closing price of our ordinary shares on the NASDAQ Global Market on the date prior to the private placement. Upon the effective date of the rights offering, the price per share paid by Ki Corporation will be adjusted to the higher of the price per share in the rights offering and the closing price of our ordinary shares on the NASDAQ Global Market on the date prior to the effective date of the rights offering, but in any event not less than the initial purchase price paid in the private placement. The private placement consideration to be received from Ki Corporation will be paid to us by means of a partial offset against the outstanding principal amount and accrued interest under the bridge loan that it provided to us on September 8, 2010. The private placement was approved by our shareholders at an extraordinary general meeting held on August 12, 2010 as a private placement that intends to allow Mr. Kirsh and his affiliates to hold more than 25% of our outstanding share capital

In September 2010, we sold a 20,000 square foot facility in Fremont, California that formerly served as a manufacturing and sales facility for aggregate proceeds of \$2.1 million.

Our working capital at December 31, 2009 and 2010, was \$20.6 million and \$26.6 million, respectively. Cash and cash equivalents amounted to \$11.9 million at December 31, 2009 compared to \$16.6 million at December 31, 2010. Short-term and long-term bank deposits, restricted bank deposits and escrow deposits amounted to \$1.2 million at December 31, 2009 compared to \$4.9 million at December 31, 2010. Our cash and cash equivalents, short and long-term bank deposits are held mainly in U.S. dollars, Euros and NIS.

As a result of our recent financings, we believe that our current cash and cash equivalents, including bank facilities, bank deposits and our expected cash flows from operations in 2011 will be sufficient to meet our cash requirements through 2012. However, our liquidity could be negatively affected by a decrease in demand for our products, including the impact of potential reductions in customer purchases that may result from the current general economic climate.

## Cash Flows

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

	Year ended December 31,		
	2008	2009	2010
	(in thousands)		
Net cash provided by (used in) continuing operations	\$ 1,093	\$ 5,651	\$ (3,980)
Net cash (used in) provided by discontinued operations	(378)	120	(17)
Net cash provided by (used in) operating activities	715	5,771	(3,997)
Net cash provided by (used in) investing activities	6,639	3,988	(1,116)
Net cash provided by (used in) financing activities	2,665	(14,514)	8,709
Effect of exchange rate changes on cash and cash equivalents	(2,389)	(211)	1,131
Increase (decrease) in cash and cash equivalents	7,630	(4,966)	4,727
Cash and cash equivalents at the beginning of the year	9,205	16,835	11,869
Cash and cash equivalents at the end of the year	16,835	11,869	16,596

Net cash used in operating activities was approximately \$4 million in the year ended December 31, 2010 compared to net cash provided by operating activities of \$5.7 million in the year ended December 31, 2009 and \$1.1 million in the year ended December 31, 2008. Net cash used in operating activities in the year ended December 31, 2010 was primarily attributable to an increase of \$2.8 million in trade receivables, an increase of \$1 million in other accounts receivable and prepaid expenses, an increase of \$0.5 million in accrued interest and exchange differences on short term and long term deposits and long term loans, an increase in deferred income taxes of \$0.2 million and a decrease of \$0.3 million in trade payables. This was offset in part by \$1.1 million of depreciation and amortization expense, a decrease in unbilled accounts receivables and long term trade receivables of \$3.2 million and \$0.3 million, respectively, \$0.9 million of stock based compensation, a decrease of \$1 million in inventory, a \$0.2 million write-off of long term loans and an increase of \$0.2 million in other accounts payable and accrued expenses.

Net cash provided by operating activities in the year ended December 31, 2009 was primarily attributable to \$1.2 million of depreciation and amortization expenses, a \$0.3 million write-off of a long-term loan, \$0.7 million of stock-based compensation expense, a decrease in trade receivables of \$3.9 million, a decrease of \$3.9 million in inventories, a decrease of \$0.8 million in deferred income taxes, a \$2.0 million decrease in other accounts receivable and prepaid expenses, an increase of \$0.6 million in customer advances and a \$0.4 million increase in accrued severance pay, which was offset in part by a decrease of \$0.6 million in unbilled accounts receivable, a decrease of \$0.9 million in trade payables, a decrease of \$1.6 million in other accounts payable and accrued expenses and by a gain from discontinued operations of \$4.2 million.

Net cash provided by operating activities in the year ended December 31, 2008 was primarily attributable to a loss from discontinued operations of \$13.7 million, a \$2.8 million non-cash goodwill and other intangible assets impairment charge, \$1.2 million of depreciation and amortization expenses, a decrease in trade receivables of \$10.6 million, a decrease in inventories of \$2.0 million, an increase of \$2.4 million in deferred income taxes, a decrease of \$1.2 million in customer advances and a decrease of \$1.7 million in accrued interest and exchange differences on marketable securities and short-term and long-term bank deposits. This was offset in part by a decrease in trade payables of \$1.7 million and an increase in unbilled accounts receivables of \$1.2 million.

Net cash used in investing activities was approximately \$1.1 million for the year ended December 31, 2010 compared to net cash provided by investing activities of approximately \$4.0 million for the year ended December 31, 2009 and approximately \$6.6 million for the year ended December 31, 2008. In the year ended December 31, 2010, we invested in restricted long term and short term bank deposits of \$2.1 million and \$3 million, respectively and purchased \$ 0.4 million and \$24,000 of property and equipment and know-how and patents. These amounts were offset in part by the sale of short term bank deposits of \$1.9 million, the realization of \$0.5 million from the release of funds from a restricted deposit and proceeds of \$2.1 million from sale of property and equipment.

In the year ended December 31, 2009, we received proceeds of \$2.9 million from the sale of our European subsidiary, \$1.3 million and \$0.9 million from the sale of short-term bank deposits and marketable securities, respectively, and \$0.9 million from the release of an escrow deposit, which amounts were offset in part by purchases of \$2.0 million of property and equipment and \$27,000 of know-how and patents.

In the year ended December 31, 2008, we received proceeds of \$3.8 million from the sale of marketable securities and \$11.1 million from the sale of short-term bank deposits, which were offset in part by purchases of \$1.4 million and \$2.0 million of short-term bank deposits and marketable securities, respectively. In addition, we purchased \$1.4 million of property, plant and equipment and \$29,000 of know-how and patents.

In the year ended December 31, 2010, net cash provided by financing activities was \$8.7 million, primarily attributable to the \$10 million bridge loan that we received from Ki Corporation, a company affiliated with Mr. Nathan Kirsh, our principal shareholder and a director and an increase in short term bank credit of \$0.5 million, which amounts were offset in part by the repayment of long term loans of \$1.9 million.

In the year ended December 31, 2009, net cash used in financing activities was \$14.5 million, primarily attributable to a decrease of \$14.5 million in short-term bank credits and the repayment of a \$0.8 million long-term bank loan, which was offset by net cash provided by discontinued operations of \$0.8 million.

In the year ended December 31, 2008, net cash provided by financing activities was \$2.7 million, primarily due to an increase of \$7.0 million in short-term bank credits, which was offset by the repayment of \$4.3 million of long-term bank loans.

We had capital expenditures of approximately \$1.4 million, \$2.0 million and \$0.4 million in the years ended December 31, 2008, 2009 and 2010, respectively. These capital expenditures were principally for computers, other machinery and equipment and for expanding and renovating our facilities. We estimate that our capital expenditures for 2011 will total approximately \$0.8 million, all of which will relate to our perimeter security and project segments. We expect to finance these expenditures primarily from our cash and cash equivalents, operating cash flows and our credit facilities. However, the actual amount of our capital expenditures will depend on a variety of factors, including general economic conditions and changes in the demand for our products.

## Credit Lines and Other Debt

Short-term and long-term bank credit at December 31, 2009 and 2010 was \$10.6 million and \$9.9 million, respectively. Our highest level of short-term and long-term bank borrowings in the years ended December 31, 2009 and 2010, was \$26.3 million and \$10.6 million, respectively.

We currently have credit lines with Bank Leumi Le-Israel B.M., or BLL, Union Bank of Israel Ltd., or Union Bank, and Bank Hapoalim B.M. totaling \$17.8 million in the aggregate (of which \$7.8 million is reserved exclusively for guarantees) and \$3.2 million was available at December 31, 2010. There are no restrictions as to our use of any of these credit lines. In January 2010, we entered into a new credit arrangement with these banks and granted the banks a first degree fixed charge over our registered but unissued share capital and goodwill and a first degree floating charge over all of our assets and rights. Our loans under these credit lines are denominated in dollars and NIS. As part of the restructuring of our credit arrangements, we have concluded and repaid in full all of our credit facilities with Mizrahi Tefahot Bank B.M. As of December 31, 2010, we were not under any obligation to maintain financial ratios or other terms in respect of our credit lines. In addition, our subsidiaries currently have credit lines with the Royal Bank of Canada and Deutsche Bank, totaling \$4.5 million in the aggregate, of which \$2 million was available at December 31, 2010.

Our Canadian subsidiary, which is primarily engaged in sale of perimeter products and turnkey projects, has undertaken to maintain general covenants and the following financial ratios and terms in respect of its outstanding credit lines: a quick ratio of not less than 1.25:1; a ratio of total liabilities to tangible net worth of not greater than 0.75:1; and tangible net worth of at least \$10.0 million. As of December 31, 2010, our Canadian subsidiary was in compliance with these ratios and terms.

As of December 31, 2010, our outstanding balances under our credit lines in Israel consisted of:

- Short-term NIS-denominated loans of approximately \$9.3 million, bearing interest at an average rate of 5.5%;
- Long-term U.S. dollar-denominated loan of approximately \$0.5 million, bearing interest at an average rate of 1%;
- Long-term NIS-denominated loan of approximately \$0.08 million, bearing interest at an average rate of 3%; and
- Several bank performance and advance payment guarantees totaling approximately \$4.7 million, at an annual cost of 1%-1.5%.

As of December 31, 2010, the outstanding balances under the credit lines of our subsidiaries consisted of:

- Several bank performance and advance payment guarantees totaling approximately \$2.5 million, at an annual cost of 0.85%-1.8%.

## C. Research and Development, Patents and Licenses.

### Government Grants

We participate in programs sponsored by the Israeli Government for the support of research and development activities. In the past we have received royalty-bearing grants from the OCS for certain of our research and development projects for perimeter security products. We did not obtain any grants from the OCS for the years ended December 31, 2008, 2009 and 2010. We are obligated to pay royalties to the OCS amounting to 3%-4.5% of revenues derived from sales of the products funded with these grants and ancillary services, up to 100% of the grants received, linked to the U.S. dollar. All grants received after January 1, 1999 also bear interest equal to the 12 month LIBOR rate. The obligation to pay these royalties is contingent on actual sales of the products, and in the absence of such sales no payment is required.

For the years ended December 31, 2008, 2009 and 2010, we paid the OCS royalties in the amount of \$125,000, \$172,000 and \$0, respectively. These royalties related to sales of perimeter security products and management security systems. As of December 31, 2010, we had a contingent obligation to pay royalties to the OCS in the amount of approximately \$1.2 million upon the successful sale of perimeter security products developed under research and development programs sponsored by the OCS.

The Israeli Government, through the Fund for the Encouragement of Marketing Activities, or the Fund, awarded us grants for overseas marketing expenses during the years 2001 to 2003. To date, we have received an aggregate of \$253,000 in grants from the Fund. Under the terms of the grants, we are obligated to pay certain royalties on the increase in export sales between the year the grant was received and the years after, up to the amount of the grants we received. During the years ended December 31, 2008, 2009 and 2010, we did not pay any royalties. As of December 31, 2010, we had a remaining contingent obligation to the Fund of \$82,000.

#### **Investment Tax Credit**

Our Canadian subsidiary is eligible for investment tax credits for its research and development activities and for certain current and capital expenditures. For the years ended December 31, 2008, 2009 and 2010, our Canadian subsidiary recognized \$202,000, \$167,000 and \$218,000, respectively, of investment tax credits.

In addition, as of December 31, 2010, our Canadian and U.S. subsidiaries had available investment tax credits of approximately \$970,000 to reduce future federal and provincial income taxes payable. These credits will expire in 2025 through 2030. As of December 31, 2010, our subsidiaries made a full valuation allowance in respect of such investment tax credits.

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

We incurred losses in each the three years ended December 31, 2010, primarily due to the global economic slowdown and the reduction in government spending that began in the latter part of 2008. As orders and new projects were delayed, competition increased and margins were squeezed.

We believe that this trend is beginning to reverse and that government spending in certain territories is returning to previous levels. We have recently acquired large scale projects and have begun to see an upturn in the market and hope that this will continue through 2011. To the extent this reversal continues, we believe that the combination of increased revenues and the impact of the cost saving measures we took in 2009 and 2010 will improve our profitability.

As of December 31, 2010, our backlog amounted to approximately \$50.2 million, of which approximately \$34.2 million is expected to be delivered by the end of 2011 and \$16.1 million is expected to be delivered thereafter.

See also discussion in Item 5A. "Operating and Financial Review and Prospects - Operating Results."

#### **E. Off-Balance Sheet Arrangements.**

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

#### **F. Tabular Disclosure of Contractual Obligations.**

The following table summarizes our minimum contractual obligations and commercial commitments as of December 31, 2010 and the effect we expect them to have on our liquidity and cash flow in future periods.

Contractual Obligations	Payments due by period				
	Total	Less than 1 year	1-2 years	3-5 years	More than 5 years
	(in thousands)				
Long-term bank debt obligations	\$ 553	\$ 503	\$ 50	-	-
Loan from related party, including interest payable	\$ 10,137	-	\$ 10,137	-	-
Operating lease obligations	\$ 2,875	\$ 822	\$ 863	\$ 295	\$ 895
Purchase obligations	-	-	-	-	-
Other long-term liabilities reflected on our balance sheet under U.S. GAAP	\$ 3,394	-	-	-	\$ 3,394
Total	\$ 16,959	\$ 1,325	\$ 11,050	\$ 295	\$ 4,289

In addition, we have guaranteed advance payments, the performance of our work and provided warranties for the performance of our work to certain of our customers (usually governmental entities). Such guarantees are required by contract for our performance during the installation and operational period of projects throughout Israel and the rest of the world. The performance guarantees typically expire soon after certain milestones are met and warranty guarantees typically expire at the end of the warranty period. The maximum potential amount of future payments we could be required to make under our guarantees at December 31, 2010 was \$7.2 million. We have not recorded any liability for such amounts as we expect that our performance will be acceptable and to date, no performance bank guarantees have been exercised against us except with respect to our dispute relating to an airport project in Eastern Europe. See Item 8.A - "Consolidated Statements and Other Financial Information-Legal Proceedings."

#### ITEM 6. Directors, Senior Management and Employees

##### A. Directors and Senior Management.

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

Name	Age	Position
Jacob Perry(1) (2)	67	Chairman of the Board of Directors
Eitan Livneh	57	President and Chief Executive Officer
Hagai Katz	60	Senior Vice President - Marketing
Asaf Even-Ezra	45	Senior Vice President –Worldwide Sales
Yehonatan Ben-Hamozeg	52	Senior Vice President – Product Development and Projects
Ilan Ovadia	44	Senior Vice President – Finance, Chief Financial Officer and Secretary
Jacob Even-Ezra (1)(3)	80	Director
Nathan Kirsh	79	Director
Shaul Kobrinsky(1)(2)(3)(4)	59	External Director
Zeev Livne(1)	66	Director
Jacob Nuss(3)	63	Director
Barry Stiefel	61	Director
Liza Singer (1)(2)(3)(4)	41	External Director

- (1) Member of our Mergers and Acquisitions Committee.
- (2) Member of our Rights Offering Committee.
- (3) Member of our Audit Committee.
- (4) Member of our Investment Committee.

Mr. Jacob Even-Ezra is the father of Mr. Asaf Even-Ezra. There are no other family relationships among our directors and senior executives.



**Jacob Perry** has served as the chairman of our board of directors since January 2008. Prior thereto, Mr. Perry served as the deputy chairman of our board of directors from 2006 and has served as a director of our company since December 2002. From 1995 to December 2002, Mr. Perry served as the president and chief executive officer of Cellcom Israel Ltd., one of Israel's leading cellular phone operators. Mr. Perry served 29 years with the Israeli General Security Service and served as its director from 1988 until 1995. Mr. Perry has also served as a coordinator to the Israeli Prime Minister on the subject of prisoners of war and missing persons. Mr. Perry was a board member of El-Al Israel Airlines and a member of the management of many public organizations. Mr. Perry is also a chairman of the board of directors of Mizrahi Tefahot Bank B.M. Mr. Perry serves as a director of Tamarind Technologies and New Kopel, an Israeli vehicle and car service group. Mr. Perry holds a B.A. degree in Oriental Studies and History of the Jewish People from Tel Aviv University and completed the Advanced Management Program at Harvard Business School.

**Eitan Livneh** has served as our president and chief executive officer since August 2009. Prior to joining our company and from February 2007, Mr. Livneh served as President and chief executive officer of Tadiran Telecom Ltd., a leading Israel-based telecommunications company. Between January 2000 and February 2007, Mr. Livneh was the chief executive officer of Elgo Irrigation Ltd., and prior to that, a general manager at Packer Plada Group Ltd. From 1989 to 1994, Mr. Livneh was vice president, marketing and assistant to the President of Elisra Electronic Systems Ltd. Mr. Livneh holds a B.A. degree in Economics and Business Administration from Bar-Ilan University, Tel Aviv, Israel.

**Hagai Katz** has served as our senior vice president - marketing and business development since July 2010, and previously served as our general manager, Israel division and corporate vice president - marketing and products from January 2009. Prior to joining our company and from 2007, Mr. Katz served as the chief executive officer of Transtech Airport Solutions Ltd. From 2004 to 2007, Mr. Katz served as the chief executive officer of UAV Tactical Systems Ltd., based in the United Kingdom. Prior to that, Mr. Katz served in a number of leading technology companies, including NICE Systems (NASDAQ: NICE), where he served in various senior positions including chief operating officer and President of its video analytics division. Mr. Katz holds a B.A. degree in Computer Sciences from the Technion - Israel Institute of Technology and a M.Sc. degree in Business Engineering from the Ben-Gurion University of the Negev.

**Asaf Even-Ezra** has served as our senior vice president – worldwide sales since December 2008. Mr. Even-Ezra joined our company in 1995 and served as our vice president - Israel and West European sales and marketing from 1998 to July 2007 and as our executive vice president - sales and marketing from July 2007 to December 2008. Mr. Even-Ezra holds a B.A. degree and an M.B.A. degree in Business, both from the New York Institute of Technology.

**Yehonatan Ben-Hamozeg** has served as our senior vice president – product development and projects since January 2009. Mr. Ben Hamozeg joined our company in December 2002 and served as our vice president - integrated systems development until January 2009. Before joining our company, Mr. Ben Hamozeg served in the IDF for 24 years and retired as a Colonel. Mr. Ben Hamozeg holds a B.A. degree in Economics and Statistics and an M.B.A. degree in Business Management, both from Haifa University.

**Ilan Ovdia** joined our company in December 2009 as our chief financial officer and secretary and has served as our senior vice president - finance, chief financial officer and secretary since February 2010. Prior to joining our company, Mr. Ovdia served for four years as executive vice president, chief financial officer and vice president of human resources of Haifa Chemicals Ltd. From 2000 to 2004, Mr. Ovdia served as the chief financial officer and vice president of Operations of Elgo Irrigation Ltd. Mr. Ovdia also served as financial manager of Shapir Marine and Civil Engineering Ltd., an infrastructure and contracting company, and as the financial manager of Hapach Metal Industries Ltd., an Israeli public company. Mr. Ovdia is qualified as a Chartered Public Accountant (Israel) and served as a senior portfolio coordinator at PriceWaterhouseCoopers. Mr. Ovdia holds a B.A. degree in Accounting and Economics and an M.B.A. degree (magna cum laude), both from the Hebrew University of Jerusalem.

**Jacob Even-Ezra** has served as a director since 1984 and is a member of our investment committee. From 1984 until December 2007, Mr. Even-Ezra served as the chairman of our board of directors. From 1984 until 2006, Mr. Even-Ezra served as our chief executive officer, and from 1987 until 1990 he also served as our president. Mr. Even-Ezra is currently a member of the Executive Council and the Management Committee of Tel Aviv University. From 1985 to 1988, Mr. Even-Ezra also served as the chairman of the Israel Export Institute. Mr. Even-Ezra holds a B.Sc. degree in Electrical Engineering from the Technion - Israel Institute of Technology.

**Nathan Kirsh** has served as a director since 1984. Mr. Kirsh is an independent investor. Mr. Kirsh serves as one of the trustees of the Eurona Foundation, the beneficial owner of 100% of the ordinary shares of our company that are held by Mira Mag Inc. Mr. Kirsh holds a B.S. degree in Commerce from the University of Witwatersrand, Johannesburg, South Africa.

**Shaul Kobrinsky** has served as an outside director since July 2004 and is the chairman of our audit committee and the Financial Statements Review Committee, and a member of our investment committee, mergers and acquisition committee and rights offering committee. Mr. Kobrinsky has served as the President and Chief Executive Officer of Urdan Industries Ltd., an investment and holding company since 1997. Since 2003, Mr. Kobrinsky has served as senior managing director of Alagem Capital Group, a Beverly Hills based investment group. From 1989 to 1997, Mr. Kobrinsky served as chief executive officer of Cargal Ltd., an Israeli company that manufactures corrugates. Prior to that and from 1984, Mr. Kobrinsky served as deputy managing director of Clal Industries Ltd., a holding and investment company. Mr. Kobrinsky holds a B.A. degree in Economics from Tel Aviv University. Mr. Kobrinsky is a member of the Antitrust Court of the State of Israel.

**Zeev Livne** has served as a director since July 2004. Mr. Livne has served as the chairman of Livne Strategic Consultants Ltd. since 2001. Prior to that, Mr. Livne served in the Israel Defense Forces, or IDF, for 39 years and retired as a Major General. During his long military career with the IDF, Mr. Livne served as the Defense Attaché to the United States and Canada from 1997 to 2001, Military Secretary to the Prime Minister of Israel from 1996 to 1997 and Ground Force Commander from 1994 to 1996. From 1992 to 1994, Mr. Livne established the IDF Home Front Command and served as its first Commander. Mr. Livne serves on the board of directors of PAZKAR Ltd., a private Israeli company. Mr. Livne holds a B.A. degree in History from Tel Aviv University and an M.A. degree in Geography from the University of Haifa.

**Jacob Nuss** has served as a director since 1993 and is a member of our audit committee. Mr. Nuss has served as the vice president - internal auditing of Israel Aircraft Industries Ltd., or IAI, since 2004, and served as IAI's deputy vice president - internal auditing from 1999 to 2003. From 1993 to 1999, Mr. Nuss served as the director of finance of IAI's electronics group. From 1991 to 1993, Mr. Nuss served as assistant to the chairman of the board of directors of IAI. Mr. Nuss has served in various financial management capacities at IAI since 1975. Mr. Nuss holds a B.A. degree in Economics and Business Management from Bar Ilan University and an M.B.A. degree in Business from Tel Aviv University. Mr. Nuss holds a certificate in internal auditing.

**Barry Stiefel** has served as a director since November 2008. Mr. Stiefel served as a director of one of our UK subsidiaries from 1986 to 1990. Since 2001, Mr. Stiefel has served as a consultant for a number of companies, including Premedia Limited and its subsidiaries. From 1990 until 2001, Mr. Stiefel was the chief executive officer of Meridian VAT Reclaim Group, which he founded. Between 1985 and 1990, Mr. Stiefel served as consultant in the field of trade finance. From 1981 to 1985, Mr. Stiefel served as finance director of Fisher Brothers Lumber Company Limited, a South African company. Mr. Stiefel holds a B.Sc. degree in Mathematics and Chemistry and a B.A. degree in Accounting, both from the University of Witwatersrand in South Africa. Mr. Stiefel is a chartered accountant in South Africa and is registered as an auditor (not in public practice) in the United Kingdom.

**Liza Singer** has served as an external director since June 2010 and is a member of our audit committee, mergers and acquisition committee, rights offering committee and investment committee. Ms. Singer has served since 2003 as the owner's representative of the Lewis Trust Group, an investment assessment and development entity that focuses on tourist projects and the development of marine and hotels resorts. During 2007, Ms. Singer also served as the Chief Operating Officer and Country Manager of Brack Capital Real Estate. Between 2002 and 2003, Ms. Singer served as the Vice President of Business Development of the Baran Group, a provider of engineering and construction services. From 2000 to 2001, Ms. Singer served as investment director of Syntek Capital, a private-equity investment company, and between 1999 and 2000, Ms. Singer served as an associate at APAX Partners & Co., a venture capital fund. Mr. Singer was also an accountant at Kesselman & Kesselman, the Israeli member firm of PricewaterhouseCoopers. Ms. Singer has an LLB degree, a BA degree in accounting and an MBA degree, all from Tel Aviv University. Ms. Singer is a certified public accountant (Israel) and a registered lawyer in the Israeli Bar Association.

All of our directors were elected at our 2010 annual general meeting held on June 23, 2010. Messrs. Perry, Even-Ezra, Kirsh, Livne, Nuss and Stiefel will serve as directors until our 2011 annual general meeting of shareholders. Mr. Kobrinsky and Ms. Singer, who were elected to serve as external directors within the meaning of the Israeli Companies Law, will serve for terms of three years. An attempt to replace the majority of our board of directors by certain dissident shareholders was rejected by our shareholders at an extraordinary general meeting held on August 12, 2010.

## **B. Compensation**

During the year ended December 31, 2010, our executive officers and directors as a group (consisting of 13 persons) earned aggregate compensation of approximately \$2.0 million for their services as officers and directors, of which \$1.9 million was paid in 2010. As of December 31, 2010, the aggregate amount set aside or accrued for pension, retirement, recreation payments and vacation or similar benefits for our directors and executive officers was approximately \$1.2 million. In addition, we have provided automobiles to our executive officers at our expense, and Mr. Jacob Even-Ezra, a director, is reimbursed for the costs of a chauffeur.

We pay Mr. Perry, the chairman of our board of directors, a monthly salary of NIS 50,000 (approximately \$14,088). Such compensation is linked to the Israeli consumer price index and is adjusted every six months. As of March 31, 2011, the adjusted salary amounted to NIS 53,305 (approximately \$15,019). Mr. Perry is also entitled to an annual bonus equal to 5% of our company's annual income before taxes, but in any event not more than \$500,000 per year, provided that our senior management is entitled to receive performance bonuses for the given year. In addition, Mr. Perry is entitled to the following benefits: an executive level car, mobile phone, daily newspaper and reimbursement of home communication expenses up to NIS 1,000 a month (approximately \$282) against receipts. However, we will not be obliged to provide such benefits to the extent that such benefits are provided to Mr. Perry by another employer. Currently Mr. Perry's car, mobile phone, 60% of his home communication expenses and a daily newspaper are provided to Mr. Perry by another employer.

We pay our external directors and our independent directors (directors who are not employees of our company or officers or employees of any entity that beneficially owns 5% or more of our ordinary shares) an annual fee of NIS 64,175 (approximately \$18,083) and a fee of NIS 2,390 (approximately \$673) for each board or committee meeting that they attend. Such amounts are linked to the Israeli consumer price index and are updated on a semi-annual basis and accordingly, were adjusted to reflect changes in the Israeli consumer price index in February and August 2010 and February 2011.

As of December 31, 2010, our directors and executive officers as a group, then consisting of 13 persons, held options to purchase an aggregate of 868,000 ordinary shares, having exercise prices ranging from \$3.48 to \$7.59. Generally, the options vest over a two to four years period. Of such options, options to purchase 83,336 ordinary shares expire in August 2014; options to purchase 300,000 ordinary shares expire in three equal portions of 100,000 ordinary shares each in August 2013, 2014 and 2015; options to purchase 24,500, 24,500, 48,500, 48,500 and 22,000 ordinary shares expire in April 2013, 2014, 2015, 2016 and 2017, respectively; options to purchase 34,000, 58,000, and 58,000 ordinary shares expire in December 2013, 2014 and 2015, respectively; options to purchase 20,833 ordinary shares expire in each of November 2014, February 2015, May 2015, August 2015, November 2015, February 2016, May 2016 and August 2016, or earlier upon termination of employment as an executive officer or service as a director of our company. All of such options were granted under our 2003 Stock Option Plan. See this Item 6E. "Directors, Senior Management and Employees - Share Ownership - Stock Option Plans."

We follow Israeli law and practice instead of the requirements of the NASDAQ Listing Rules regarding the compensation of our chief executive office and other executive officers. See Item 16G. "Corporate Governance."

## **C. Board Practices**

### **Introduction**

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

## **Election of Directors**

Our articles of association provide for a board of directors of not less than three and not more than 11 members, as may be determined from time to time at our annual general meeting. Our board of directors is currently composed of eight directors.

Our directors (except the external directors, as detailed below), are elected by our shareholders at our annual general meeting and hold office until the next annual general meeting. All the members of our board of directors (except the external directors), may be reelected upon completion of their term of office. Our annual general meetings of shareholders are held at least once every calendar year, but not more than 15 months after the last preceding annual general meeting. In the intervals between our annual general meetings of shareholders, the board of directors may from time to time appoint a new director to fill a casual vacancy or to add to their number, and any director so appointed will remain in office until our next annual general meeting of shareholders and may be re-elected.

Under the Israeli Companies Law, our board of directors is required to determine the minimum number of directors who must have "accounting and financial expertise," as such term is defined in regulations promulgated under the Israeli Companies Law. Our board of directors has determined that at least one director must have "accounting and financial expertise." Our board of directors has further determined that Ms. Liza Singer has the requisite "accounting and financial expertise."

We do not follow the requirements of the NASDAQ Listing Rules regarding the nomination process of directors, and instead, we follow Israeli law and practice, in accordance with which our directors are recommended by our board of directors for election by our shareholders. See Item 16G. "Corporate Governance."

## **External and Independent Directors**

*External directors.* The Israeli Companies Law requires Israeli companies with shares that have been offered to the public in or outside of Israel to appoint at least two external directors. The Israeli Companies Law provides that a person may not be appointed as an external director if the person, or the person's relative, partner, employer or an entity under that person's control, has or had during the two years preceding the date of appointment any affiliation with the company, or any entity controlling, controlled by or under common control with the company. The term "relative" means a spouse, sibling, parent, grandparent, child or child of spouse or spouse of any of the above. Pursuant to a recent amendment to the Israeli Companies Law, that will become effective as of May 14, 2011 the definition of "relative" is expanded to include also a sibling, brother, sister or parent of the foregoing relatives. In general, the term "affiliation" includes an employment relationship, a business or professional relationship maintained on a regular basis, control and service as an office holder. Under the recent amendment to the Israeli Companies Law, effective as of May 14, 2011, if the company does not have a controlling shareholder or a shareholder holding at least 25% of the voting rights and includes, "affiliation" also includes a relationship, at the time of the appointment, with the chairman of the board, the chief executive officer, a substantial shareholder or the most senior financial officer of such company. Regulations promulgated under the Israeli Companies Law include certain additional relationships that would not be deemed an "affiliation" with a company for the purpose of service as an external director. In addition, no person may serve as an external director if the person's position or other activities create, or may create, a conflict of interest with the person's responsibilities as director or may otherwise interfere with the person's ability to serve as director. If, at the time an external director is appointed, all current members of the board of directors are of the same gender, then that external director must be of the other gender. A director of one company may not be appointed as an external director of another company if a director of the other company is acting as an external director of the first company at such time

At least one of the elected external directors must have "accounting and financial expertise" and any other external director must have "accounting and financial expertise" or "professional qualification," as such terms are defined by regulations promulgated under the Israeli Companies Law. However, Israeli companies listed on certain stock exchanges outside Israel, including The NASDAQ Global Market, such as our company, are not required to appoint an external director with "accounting and financial expertise" if a director with accounting and financial expertise who qualifies as an independent director for purposes of audit committee membership under the laws of the foreign country in which the stock exchange is located serves on its board of directors. All of the external directors of such a company must have "professional qualification."

The external directors are elected by shareholders at a general meeting. The shareholders voting in favor of their election must include at least one-third of the shares of the non-controlling shareholders of the company who voted on the matter. This minority approval requirement need not be met if the total shareholdings of those non-controlling shareholders who vote against their election represent 1% or less of all of the voting rights in the company. However, pursuant to the recent amendment to the Israeli Companies Law, effective as of May 14, 2011, the required special majority is increased to a simple majority of the shares voted by shareholders other than controlling shareholders or shareholders who have a personal interest in the election of the outside director (unless such personal interest is not related to such persons relationship with the controlling shareholder). This majority requirement will not be required if the total number of shares of such non-controlling shareholders and disinterested shareholders who vote against the election of the outside director represent 2% or less of the voting rights in the company.

In general, under the Israeli Companies Law currently in effect, external directors serve for a three-year term and may be reelected to one additional three-year term. However, Israeli companies listed on certain stock exchanges outside Israel, including The NASDAQ Global Market, such as our company, may appoint an external director for additional terms of not more than three years subject to certain conditions. Such conditions include the determination by the audit committee and board of directors, that in view of the director's professional expertise and special contribution to the company's board of directors and its committees, the appointment of the external director for an additional term is in the best interest of the company. External directors can be removed from office only by the same special percentage of shareholders that can elect them, or by a court, and then only if the external directors cease to meet the statutory qualifications with respect to their appointment or if they violate their fiduciary duty to the company.

Pursuant to the recent amendment to the Israeli Companies Law, effective as of May 14, 2011, the term of office of an external director may be extended by the shareholders following the initial three year term for two additional three years terms, at the nomination of either the board of directors or any shareholder(s) holding at least 1% of the voting rights in the company. If the board of directors proposed the nominee, the reelection must be approved by the shareholders in the same manner required to appoint external directors for an initial term, as described above. If such reelection is proposed by shareholders, such reelection requires the approval of the majority of the shareholders voting on the matter, excluding the votes of any controlling shareholder and other shareholders having a personal interest in the matter as a result of their relationship with the controlling shareholder(s), provided that, the aggregate votes cast by shareholders who are not controlling shareholders and do not have a personal interest in the matter as a result of their relationship with the controlling shareholder(s) who voted in favor of the nominee constitute more than 2% of the voting rights in the company.

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

*Independent Directors.* In general, NASDAQ Listing Rules require that the board of directors of a NASDAQ-listed company have a majority of independent directors and that its audit committee have at least three members and be comprised only of independent directors, each of whom satisfies the respective "independence" requirements of NASDAQ and the Securities and Exchange Commission. However, foreign private issuers, such as our company, may follow certain home country corporate governance practices instead of certain requirements of the NASDAQ Listing Rules. On June 30, 2006, we provided NASDAQ with a notice of non-compliance with respect to the requirement to maintain a majority of independent directors, as defined under NASDAQ Listing Rules. Instead, under Israeli law and practice we are required to appoint at least two external directors, within the meaning of the Israeli Companies Law, to our board of directors. In addition, in accordance with the rules of the Securities and Exchange Commission and NASDAQ, we have the mandated three independent directors, as defined by the rules of the Securities and Exchange Commission and NASDAQ, on our audit committee.

Our board of directors has determined that Ms. Singer and Mr. Kobrinsky qualify both as independent directors under the requirements of the Securities and Exchange Commission and NASDAQ and as external directors under the requirements of the Israeli Companies Law. Our board of directors has further determined that Messrs. Nuss and Livne qualify as independent directors under the requirements of the Securities and Exchange Commission and NASDAQ.

#### **Audit Committee**

Under the Israeli Companies Law, the board of directors of any public company must establish an audit committee. The audit committee must consist of at least three directors and must include all of the external directors. Pursuant to recent amendment to the Israeli Companies Law, effective as of May 14, 2011, the majority of the members of the audit committee must be independent directors. Such independent directors must meet all of the standards required of an external director and may not serve as a director for more than consecutive nine years (a cessation of service as a director for up to two years during any nine year period will not be deemed to interrupt the nine year period). The audit committee may not include the chairman of the board of directors; any director employed by the company or providing services to the company on an ongoing basis; or a controlling shareholder or any of the controlling shareholder's relatives. Under the recent amendment to the Israeli Companies Law, effective as of May 14, 2011, any director who rendered services to the controlling shareholder or an entity controlled by the controlling shareholder may not be a member of the audit committee. Any person who is not permitted to be a member of the audit committee may not be present in the meetings of the audit committee unless the chairman of the audit committee determines that such person's presence is necessary in order to present a specific matter. However, an employee who is not a controlling shareholder or relative of a controlling shareholder may participate in the audit committee's discussions but not in any vote, and at the request of the audit committee, the secretary of the company and its legal counsel may be present during the meeting.

The responsibilities of the audit committee include identifying irregularities in the management of the company's business and approving related party transactions as required by law. Pursuant to the recent amendment of the Israeli Companies Law, effective as of May 14, 2011, the responsibilities of the audit committee were expanded to include, among others, review of the internal controls of the company, the internal auditor's audit plan and the independent auditor's engagement and compensation. As of September 15, 2011, the audit committee is required to establish and monitor whistleblower procedures. Under Israeli law, an audit committee may not approve an action or a transaction with a controlling shareholder, or with an office holder, unless at the time of approval two external directors are serving as members of the audit committee and at least one of the external directors was present at the meeting in which an approval was granted.

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

Our audit committee consists of three board members who satisfy the respective "independence" requirements of the Securities and Exchange Commission, NASDAQ and Israeli law for audit committee members. Our audit committee is currently composed of Messrs. Shaul Kobrinsky and Jacob Nuss and Ms. Liza Singer. The audit committee meets at least once each quarter. Our audit committee charter is available on our website at [www.magal-s3.com](http://www.magal-s3.com).

#### **Investment Committee**

Our board of directors has established an investment committee, which is responsible for the investment of our cash and our hedging transactions. The investment committee is currently composed of Messrs. Jacob Even-Ezra and Shaul Kobrinsky and Ms. Singer.

#### **Mergers and Acquisitions Committee**

Our board of directors has established a mergers and acquisitions committee, which is responsible for the examination and review of merger and acquisition opportunities and making recommendations to the board of directors with respect to such opportunities. The mergers and acquisitions committee is currently composed of Messrs. Jacob Even-Ezra, Zeev Livne and Shaul Kobrinsky.

#### **Financial Statements Committee**

Pursuant to regulations recently promulgated under the Israeli Companies Law, a public company, such as our company, is required to establish a committee of the board of directors for the review of the financial statements, effective as of the financial statements for the year ended December 31, 2010. The majority of the members of the Financial Statements Committee must be independent directors, as defined in the Israeli Companies Law, all of the members must be able to read and understand financial statements, and at least one of the members must have "financial and accounting expertise," as defined in regulations promulgated under the Israeli companies Law. The chairman of the committee must be an external director. Pursuant to the new regulations, commencing with the financial statements for the year ended December 31, 2010, financial reports of a public company must be brought for discussion and approval by the board of directors only after the Financial Statements Committee has discussed and made recommendations to the board of directors regarding the: (1) valuations and estimates used in connection with the financial statements; (2) internal controls over financial reporting; (3) completeness and appropriateness of the disclosure in the financial statements; (4) accounting policies adopted and accounting treatment applied to material matters; and (5) valuations, including underlying assumptions and estimates, on which data in the financial statements is based. Under the regulations, the audit committee may act also as the Financial Statements Committee if it complies with the requirements of the regulations.

In March 2011, our Board of Directors determined to appoint our Audit Committee to also serve as the Financial Statements Committee.

#### **Rights Offering Committee**

Our Board of Directors has established a committee to oversee the rights offering that we intend to initiate during 2011 and make a recommendation to the board of directors with respect to the terms of the rights offering. The rights offering committee is composed of Mr. J. Perry, the chairman of our board of directors, and Mr. Shaul Kobrinsky and Ms. Liza Singer, our two external directors.

#### **Internal Auditor**

Under the Israeli Companies Law, the board of directors of a public company must appoint an internal auditor nominated by the audit committee. The role of the internal auditor is to examine whether the company's actions comply with the law, integrity and orderly business practice. Under the Israeli Companies Law, the internal auditor may not be an interested party, an office holder, or an affiliate, or a relative of an interested party, office holder or affiliate, nor may the internal auditor be the company's independent accountant or its representative. Mr. Daniel Shapira, Certified Public Accountant (Israel) is our internal auditor.

#### **Directors' Service Contracts**

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

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

##### *Fiduciary Duties of Office Holders*

The Israeli Companies Law codifies the fiduciary duties that "office holders," including directors and executive officers, owe to a company. An "office holder" is defined in the Israeli Companies Law as a director, general manager, chief business manager, deputy general manager, vice general manager, other manager directly subordinate to the general manager or any other person assuming the responsibilities of any of the foregoing positions without regard to such person's title. An office holder's fiduciary duties consist of a duty of care and a fiduciary duty. The duty of care requires an office holder to act at a level of care that a reasonable office holder in the same position would employ under the same circumstances. This includes the duty to utilize reasonable means to obtain (i) information regarding the appropriateness of a given action brought for his approval or performed by him by virtue of his position and (ii) all other information of importance pertaining to the foregoing actions. The fiduciary duty includes (i) avoiding any conflict of interest between the office holder's position in the company and any other position he holds or his personal affairs, (ii) avoiding any competition with the company's business, (iii) avoiding exploiting any business opportunity of the company in order to receive personal gain for the office holder or others, and (iv) disclosing to the company any information or documents relating to the company's affairs that the office holder has received due to his position as an office holder.

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

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

Under the Israeli Companies Law, all arrangements as to compensation of office holders who are not directors require approval by the board of directors, and exculpation, insurance and indemnification of, or an undertaking to, indemnify an office holder who is not a director requires both board of directors and audit committee approval. However, pursuant to recent amendment to the Israeli Companies Law, effective as of May 14, 2011, the arrangements and agreements regarding the terms of employment of officeholders who are not directors will require the approval of the audit committee (or the compensation committee to the extent the company has established such a committee) prior, and in addition, to the approval of the board of directors. However, the approval of the board of directors is not required if the new arrangement only modifies an existing arrangement and the audit committee determines that such modification is not material. The compensation of office holders who are directors must be approved by the audit committee, board of directors and shareholders.

Some transactions, actions and arrangements involving an office holder (or a third party in which an office holder has an interest) must be approved by the board of directors or as otherwise provided for in a company's articles of association, however, a transaction that is adverse to the company's interest may not be approved. In some cases, such a transaction must be approved by the audit committee and by the board of directors itself, and under certain circumstances shareholder approval may also be required. A director who has a personal interest in a transaction that is considered at a meeting of the board of directors or the audit committee may not be present during the board of directors or audit committee discussions and may not vote on the transaction, unless the transaction is not an extraordinary transaction or the majority of the members of the board or the audit committee have a personal interest, as the case may be. In the event the majority of the members of the board of directors or the audit committee have a personal interest, then the approval of the general meeting of shareholders is also required.

*Disclosure of Personal Interests of a Controlling Shareholder; Approval of Transactions with Controlling Shareholders*

The disclosure requirements that apply to an office holder also apply to a transaction in which a controlling shareholder with respect to his or her personal interest in any existing or proposed transaction by us. The Israeli Companies Law provides that an extraordinary transaction with a controlling shareholder or an extraordinary transaction with another person in whom the controlling shareholder has a personal interest or a transaction with a controlling shareholder or his relative regarding terms of service and employment, must be approved by the audit committee, board of directors and shareholders. The shareholder approval for such a transaction must include at least one-third of the shareholders who have no personal interest in the transaction who voted on the matter (not including abstentions). The transaction can be approved by shareholders without this one-third approval if the total shareholdings of those shareholders who have no personal interest and voted against the transaction do not represent more than one percent of the voting rights in the company. However, pursuant to recent amendment to the Israeli Companies Law, effective as of May 14, 2011, the required special majority is increased to a simple majority of the shareholders voted on the matter, excluding the votes of shareholders who have a personal interest in such transaction. This majority requirement will not apply if the total number of shares of disinterested shareholders who vote against the approval of the transaction represent less than 2% of the voting rights in the company.

Under the Companies Regulations (Relief from Related Party Transactions), 5760-2000, promulgated under the Israeli Companies Law, as amended, certain extraordinary transactions between a public company and its controlling shareholder(s) do not require shareholder approval. In addition, under such regulations, directors' compensation and employment arrangements in a public company do not require the approval of the shareholders if both the audit committee and the board of directors agree that such arrangements are solely for the benefit of the company. Also, employment and compensation arrangements for an office holder that is a controlling shareholder of a public company do not require shareholder approval if certain criteria are met. The foregoing exemptions from shareholder approval will not apply if one or more shareholders holding at least 1% of the issued and outstanding share capital of the company or of the company's voting rights, objects to the use of these exemptions provided that such objection is submitted to the company in writing not later than fourteen days from the date of the filing of a report regarding the adoption of such resolution by the company. If such objection is duly and timely submitted, then the transaction or compensation arrangement of the directors will require shareholders' approval as detailed above.



In addition, a private placement of securities requires the approval of the board of directors and shareholders of the company if (i) the private placement will cause a person to become a controlling shareholder or (ii) 20% or more of the company's outstanding share capital prior to the private placement are offered and the payment for which (in whole or in part) is not in cash or registered securities or that is not under market terms, and the private placement will increase the relative holdings of a shareholder that holds 5% or more of the company's outstanding share capital or will cause any person to become a holder of more than 5% of the company's outstanding share capital. Other than as described, under Israeli law private placements require the approval of the board of directors.

The Israeli Companies Law provides that an acquisition of shares in a public company must be made by means of a tender offer if as a result of the acquisition the purchaser would become a 25% or greater shareholder of the company. This rule does not apply if there is already another 25% or greater shareholder of the company. Similarly, the Israeli Companies Law provides that an acquisition of shares in a public company must be made by means of a tender offer if as a result of the acquisition the purchaser would hold greater than a 45% interest in the company, unless there is another shareholder holding more than a 45% interest in the company. These requirements do not apply if, in general, (i) the acquisition was made in a private placement that received shareholder approval, (ii) was from a 25% or greater shareholder of the company which resulted in the acquirer becoming a 25% or greater shareholder of the company, if there is not already a 25% or greater shareholder of the company, or (iii) was from a shareholder holding a 45% interest in the company which resulted in the acquirer becoming a holder of a 45% interest in the company if there is not already a 45% or greater shareholder of the company.

If, as a result of an acquisition of shares, the acquirer will hold more than 90% of a public company's outstanding shares or a class of shares, the acquisition must be made by means of a tender offer for all of the outstanding shares or a class of shares. If less than 5% of the outstanding shares are not tendered in the tender offer, all the shares that the acquirer offered to purchase will be transferred to the acquirer. If more than 5% of the outstanding shares are not tendered in the tender offer, then the acquirer may not acquire shares in the tender offer that will cause his shareholding to exceed 90% of the outstanding shares. The Israeli Companies Law provides for appraisal rights if any shareholder files a request in court within three months following the consummation of a full tender offer. However, pursuant to a recent amendment of the Companies Law, effective as of May 14, 2011, the terms for filing the request for appraisal has been extended to six months. In addition, in the event of a full tender offer, the offeror may determine that any shareholder who accepts the offer will not be entitled to appraisal rights. Such determination will be effective only if the offeror or the company has timely published all the information that is required to be published in connection with such full tender offer pursuant to all applicable laws.

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

*Exculpation of Office Holders.* The Israeli Companies Law provides that an Israeli company cannot exculpate an office holder from liability with respect to a breach of his or her fiduciary duty. If permitted by its articles of association, a company may exculpate in advance an office holder from his or her liability to the company, in whole or in part, with respect to a breach of his or her duty of care. However, a company may not exculpate in advance a director from his or her liability to the company with respect to a breach of his duty of care in the event of distributions.

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

*Indemnification of Office Holders.* Under Israeli law a company may, if permitted by its articles of association, indemnify an office holder for acts performed by the office holder in such capacity for (i) a monetary liability imposed upon the office holder in favor of another person by any court judgment, including a settlement or an arbitration award approved by a court; (ii) reasonable litigation expenses, including attorney's fees, actually incurred by the office holder as a result of an investigation or proceeding instituted against him by a competent authority, provided that such investigation or proceeding concluded without the filing of an indictment against the office holder or the imposition of any monetary liability in lieu of criminal proceedings, or concluded without the filing of an indictment against the office holder and a monetary liability was imposed on him or her in lieu of criminal proceedings with respect to a criminal offense that does not require proof of criminal intent; and (iii) reasonable litigation expenses, including attorneys' fees, actually incurred by the office holder or imposed upon the office holder by a court: in an action, suit or proceeding brought against the office holder by or on behalf of the company or another person, or in connection with a criminal action in which the office holder was acquitted, or in connection with a criminal action in which the office holder was convicted of a criminal offense that does not require proof of criminal intent.

Israeli law provides that a company's articles of association may permit the company to (a) indemnify an office holder retroactively, following a determination to this effect made by the company after the occurrence of the event in respect of which the office holder will be indemnified; and (b) undertake in advance to indemnify an office holder, except that with respect to a monetary liability imposed on the office holder by any judgment, settlement or court-approved arbitration award, the undertaking must be limited to types of occurrences, which, in the opinion of the company's board of directors, are, at the time of the undertaking, foreseeable due to the company's activities and to an amount or standard that the board of directors has determined is reasonable under the circumstances.

*Limitations on Exculpation, Insurance and Indemnification.* The Israeli Companies Law provides that neither a provision of the articles of association permitting the company to enter into a contract to insure the liability of an office holder, nor a provision in the articles of association or a resolution of the board of directors permitting the indemnification of an office holder, nor a provision in the articles of association exculpating an office holder from duty to the company shall be valid, where such insurance, indemnification or exculpation relates to any of the following: (i) a breach by the office holder of his fiduciary duty unless, with respect to insurance coverage or indemnification, the office holder acted in good faith and had a reasonable basis to believe that the act would not prejudice the company; (ii) a breach by the office holder of his duty of care if such breach was committed intentionally or recklessly, unless the breach was committed only negligently; (iii) any act or omission done with the intent to unlawfully yield a personal benefit; or (iv) any fine or forfeiture imposed on the office holder.

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

Our Articles of Association allow us to insure, indemnify and exempt our office holders to the fullest extent permitted by Israeli law. We maintain a directors' and officers' liability insurance policy with a per claim and aggregate coverage limit of \$20 million, including legal costs incurred in Israel. In addition, our audit committee, board of directors and shareholders resolved to indemnify our office holders, pursuant to a standard indemnification agreement that provides for indemnification of an office holder in an amount up to \$5 million. To date, we have provided letters of indemnification to certain of our officers and directors.

Pursuant to the Law for Efficient Enforcement Process in the Securities Authority (Legislation Amendment) 5771-2011, or the Enforcement Law, the Israel Securities Authority, or ISA, may impose fines on public companies, their senior office holders and employees, for the certain actions or omissions stipulated in the Enforcement Law. While almost all of the fineable actions and omissions stipulated do not apply to dual listed companies such as our company, the ISA may impose fines on us or our office holders if we do not make a public filing in Israel of any information or report that was publicly filed with the Securities and Exchange Commission, or if we do not furnish any information that was required by the ISA. Pursuant to the Enforcement Law, a company may not purchase, directly or indirectly, insurance for these proceedings and such insurance if purchased is void. The Enforcement Law further provides that a company or its controlling shareholder may not, directly or indirectly, indemnify the office holders or employee against, or otherwise pay, fines that were imposed on them pursuant to the Enforcement Law. However, under the Enforcement Law, if permitted by a company's articles of association, a company is entitled to purchase insurance and indemnify for payment of damages to any injured person and for expenses incurred by office holders or employees in connection with proceedings conducted against them, including reasonable litigation expenses such as legal fees. A company may undertake to provide such indemnification in advance. In addition, pursuant to a recent amendment to the Companies Law, effective as of May 14, 2011, the ISA shall have similar administrative and enforcement authorities with respect to certain breaches of corporate governance rules that are stipulated by the Israeli Companies Law. The above restrictions and limitations on insurance and indemnification of officeholders apply also to proceedings conducted by the ISA pursuant to the Israeli Companies Law.

#### D. Employees

As of December 31, 2010, we employed 252 full-time employees, of whom 38 were employed in general management and administration, 36 were employed in selling and marketing, 16 were employed in production management, 128 were employed in production, installation and maintenance, and 34 were employed in engineering and research and development. Of such full-time employees, 120 were located in Israel, 10 were in the United States, 77 were in Canada and 45 were in various other countries. As of December 31, 2009, we employed 282 full-time employees, of whom 40 were employed in general management and administration, 36 were employed in selling and marketing, 21 were employed in production management, 145 were employed in production, installation and maintenance, and 40 were employed in engineering and research and development. Of such full-time employees, 152 were located in Israel, 14 were in the United States, 76 were in Canada and 40 were in various other countries.

As of December 31, 2008, we employed 321 full-time employees, of whom 39 were employed in general management and administration, 45 were employed in selling and marketing, 22 were employed in production management, 164 were employed in production, installation and maintenance, and 51 were employed in engineering and research and development. Of such full-time employees, 151 were located in Israel, 29 were in the United States, 89 were in Canada and 52 were in various other countries.

Our relationships with our employees in Israel are governed by Israeli labor legislation and regulations, extension orders of the Israeli Ministry of Labor and personal employment agreements. We are subject to various Israeli labor laws, collective bargaining agreements entered into from time to time between the Manufacturers Association and the Histadrut, as well as collective bargaining arrangements. Such laws, agreements and arrangements cover a wide range of areas, including minimum employment standards, such as working hours, minimum wages, vacation, procedures for dismissing employees, severance pay and pension plans and special issues, such as equal pay for equal work, equal opportunity in employment and employment of youth and army veterans. Certain of our employees are parties to individual employment agreements. We generally provide our employees with benefits and working conditions beyond the required minimums. Each of our subsidiaries provides a benefits package and working conditions which are competitive with other companies in their area of operations. Israeli law requires severance pay upon certain circumstances, including upon the retirement or death of an employee or termination of employment without due cause. Furthermore, Israeli employees and employers are required to pay predetermined sums to the National Insurance Institute, which is similar to the U.S. Social Security Administration, which amounts also include payments for national health insurance.

#### E. Share Ownership.

The following table sets forth certain information regarding the ownership of our ordinary shares by our directors and executive officers as of April 4, 2011.

Name	Number of Ordinary Shares Owned(1)	Percentage of Outstanding Ordinary Shares(2)
Jacob Perry (3)(4)	134,833	1.28%
Eitan Livneh (5)	149,235	1.43%
Hagai Katz	49,000	*
Asaf Even-Ezra (6)	163,926	1.58%
Yehonatan Ben-Hamozeg	33,500	*
Ilan Ovadia	34,000	*
Jacob Even-Ezra (7)	515,945	4.96%
Nathan Kirsh (8)	2,516,267	24.20%
Shaul Kobrinsky	-	-
Zeev Livne	-	-
Jacob Nuss	-	-
Barry Stiefel	5,000	*
Liza Singer	-	-
All directors and executive officers as a group (13 persons)	3,601,706	34.62%

\*Less than 1%

- (1) Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and generally includes voting or investment power with respect to securities. Ordinary shares relating to options or convertible debenture notes currently exercisable or exercisable within 60 days of the date of this table are deemed outstanding for computing the percentage of the person holding such securities but are not deemed outstanding for computing the percentage of any other person. Except as indicated by footnote, the persons named in the table above have sole voting and investment power with respect to all shares shown as beneficially owned by them.
- (2) The percentages shown are based on 10,396,548 ordinary shares issued and outstanding as of April 4, 2011.
- (3) Includes 100,000 ordinary shares issuable upon the exercise of currently exercisable options granted by our company, having an exercise price of \$7.59 per share that expire in August 2013.
- (4) Includes 33,333 ordinary shares issuable upon the exercise of currently exercisable options granted to Mr. Perry by Ki Corporation. Ki Corporation granted Mr. Perry the right to purchase 100,000 shares upon the same terms and conditions that apply to the exercise of the options granted to him under his employment agreement. Mr. Perry has the right to purchase the shares in three equal annual installments commencing on August 20, 2010 at a price of \$7.59 per share. The right to purchase each installment expires after three years.
- (5) Includes 83,336 ordinary shares issuable upon the exercise of currently exercisable options, having an exercise price of \$4.35 per share that expire in August 2014, 20,833 ordinary shares issuable upon the exercise of currently exercisable options, having an exercise price of \$4.35 per share that expire in November 2014, 20,833 ordinary shares issuable upon the exercise of currently exercisable options, having an exercise price of \$4.35 per share that expire in February 2015 and 20,833 ordinary shares issuable upon the exercise of currently exercisable options, having an exercise price of \$4.35 per share that expire in May 2015.
- (6) Includes 24,000 ordinary shares issuable upon the exercise of currently exercisable options, having an exercise price of \$3.53 per share that expire in April 2015 and 24,000 ordinary shares issuable upon the exercise of currently exercisable options, having an exercise price of \$3.53 per share that expire in April 2016. Asaf Even-Ezra is Jacob Even-Ezra's son.
- (7) Includes 77,975 ordinary shares held by a trustee. Jacob Even-Ezra is the father of Asaf Even-Ezra.
- (8) Based upon a Schedule 13D/A filed with the Securities and Exchange Commission on May 17, 2010 and other information available to the company. All of the ordinary shares are held of record by Ki Corporation, a company organized in New Jersey. The Eureka Foundation holds 100% of Ki Corporation. The Eureka Foundation is a Liechtenstein trust controlled by Mr. Kirsh, who also serves as its trustee. Mr. Kirsh may be deemed to have beneficial ownership of the ordinary shares held of record by Mira Mag and Ki Corporation.

## Share Option Plans

### 2003 Israeli Share Option Plan

On October 27, 2003, our board of directors adopted our 2003 Israeli Share Option Plan, or the 2003 Plan, which was approved by our shareholders in July 2004. Under the 2003 Plan, stock options could be granted to our employees, directors, officers and consultants, in accordance with the decision of our board of directors. Our board of directors had the authority to determine the vesting schedule of such options and the exercise price. Under the 2003 Plan, unless determined otherwise by the Board, no option may be exercised before the second anniversary of the date on which it was granted. Pursuant to the 2003 Plan, any options that are cancelled or not exercised within the option period will become available for future grants. Our board of directors has elected to allot options to Israeli employees under Israel's capital gain tax treatment. Pursuant to the provisions of the 2003 Plan, if we issue a stock dividend, the number of shares purchasable by any grantee upon the exercise of options that were granted prior to the issuance of the stock dividend will be correspondingly increased. In May 2008, our board of directors approved an amendment to the 2003 Plan, which was approved by our shareholders in August 2008, pursuant to which the number of ordinary shares available for issuance under the 2003 Plan was increased by 1,000,000 shares and the termination of the 2003 Plan was extended from October 2013 to October 2018.

As of December 31, 2010, options to purchase 1,168,000 ordinary shares were outstanding under the 2003 Plan, exercisable at an average exercise price of \$5.19 per share. No options awarded under the 2003 Plan were exercised during 2010. Following the adoption of our 2010 Israeli Share Option Plan in June 2010, no additional options will be granted under the 2003 Plan.

### 2010 Israeli Share Option Plan

In June 2010, we adopted our 2010 Israeli Share Option Plan, or the 2010 Plan. Under the 2010 Plan, stock options may be periodically granted to our employees, officers, directors and consultants of our company and subsidiaries.

An aggregate 450,575 ordinary shares that remained available for futures option grants under the 2003 Plan as of the date of the adoption of the 2010 Plan and any ordinary shares that become available in the future under the 2003 Plan as a result of expiration, cancellation or relinquishment of any option outstanding under the 2003 Plan will be rolled over to the 2010 Plan. The 2010 Plan has a term of ten years.

The 2010 Plan is designed to allow the grantees to benefit from the tax benefits under Section 102 of the Israeli Income Tax Ordinance [New Version], 1961. Our Board of Directors has resolved that all options that will be granted to Israeli residents under the 2010 Plan will be taxable under the "capital gains route." Pursuant to this route, the profit realized by an employee is taxed as a capital gain (25%) if the options or underlying shares are held by a trustee for at least 24 months from their date of the grant or issuance. Any difference between the exercise price of the options and the average price of the company's shares during the 30 trading days before the date of grant of the options will be treated as ordinary income and will be taxed according to the employee's marginal tax rates plus social contribution. If the underlying shares are sold before the elapse of such period, the profit is re-characterized as ordinary income.

The Board of Directors or a committee of the Board of Directors, the Committee, if appointed, will administer the 2010 Plan. The Board of Directors or the Committee will have the full power and authority to, subject to limitation under the terms and provisions of any applicable law and subject to changes according to the Board's decisions:

- determine the persons who will receive option awards;
- determine the terms and provisions of the respective option agreements (which need not be identical), including, but not limited to, provisions concerning the time and the extent to which the options may be exercised and the nature and duration of restrictions as to the transferability or restrictions constituting substantial risk of forfeiture and to cancel or suspend awards, as necessary;
- determine the purchase price of each share subject to an option;

- designate the type of options;
- alter any restrictions and conditions of any options or shares subject to any options;
- interpret the provisions and supervise the administration of the 2010 Plan;
- accelerate the right of an optionee to exercise in whole or in part, any previously granted option;
- prescribe, amend and rescind rules and regulations relating to the 2010 Plan; and
- make all other determinations deemed necessary or advisable for the administration of the 2010 Plan.

However, the Board of Directors or the Committee may not, without the consent of the optionee, alter or in any way impair the rights of such optionee under any award previously granted.

Options are not assignable or transferable by the optionee. No option or any right with respect to an option may be assignable, transferable or given as collateral or any right with respect to it given to any third party whatsoever, except as specifically allowed under the 2010 Plan, and during the lifetime of the optionee each optionee's rights to purchase shares may only be exercised by the optionee. Generally, an option may be exercised as long as the optionee is employed by, or providing services to, the company or any of its affiliates, to the extent the options have vested.

Options granted under the 2010 Plan may be exercised for cash, however the Board of Directors or the Committee may resolve to allow for a cashless exercise of the options. In the event that we will pay cash dividends, the exercise price of the options will be adjusted to reflect such payment.

As of December 31, 2010, options to purchase 450,575 ordinary shares were outstanding under the 2010 Plan. No options awarded under the 2010 Plan during 2010.

#### ITEM 7. Major Shareholders and Related Party Transactions

##### A. Major Shareholders

The following table sets forth certain information as of April 7, 2011 regarding the beneficial ownership of our ordinary shares, by each person or entity known to us to own beneficially 5.0% or more of our ordinary shares.

Name	Number of Ordinary Shares Beneficially Owned(1)	Percentage of Outstanding Ordinary Shares(2)
Nathan Kirsh (3)	2,516,267	24.2%
Prescott Group Capital Management LLC. (4)	524,927	5.1%
Grace & White, Inc. (5)	521,102	5.1%

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- (1) Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and generally includes voting or investment power with respect to securities. Ordinary shares relating to options or convertible notes currently exercisable or exercisable within 60 days of the date of this table are deemed outstanding for computing the percentage of the person holding such securities but are not deemed outstanding for computing the percentage of any other person. Except as indicated by footnote, the persons named in the table above have sole voting and investment power with respect to all shares shown as beneficially owned by them.
  - (2) The percentages shown are based on 10,396,548 ordinary shares issued and outstanding as of April 7, 2011.
  - (3) Based upon a Schedule 13D/A filed with the Securities and Exchange Commission on May 17, 2010 and other information available to the company. All of the ordinary shares are held of record by Ki Corporation, a company organized in New Jersey. The Euron Foundation holds 100% of Ki Corporation. The Euron Foundation is a Liechtenstein trust controlled by Mr. Kirsh, who also serves as its trustee. Mr. Kirsh may be deemed to have beneficial ownership of the ordinary shares held of record by Mira Mag and Ki Corporation.

- (4) Based solely upon, and qualified in its entirety with reference to, a Schedule 13D filed with the Securities and Exchange Commission on January 28, 2011. The Schedule 13D indicates that Prescott Group Aggressive Small Cap, L.P. and Prescott Group Aggressive Small Cap II, L.P., referred to together as the Small Cap Funds, are the general partners of Prescott Group Aggressive Small Cap Master Fund, G.P., or Prescott Master Fund. Prescott Group Capital Management, L.L.C., or Prescott Capital, serves as the general partner of the Small Cap Funds and may direct the Small Cap Funds, the general partners of Prescott Master Fund, to direct the vote and disposition of the ordinary shares held by the Master Fund. Mr. Frohlich, as the principal of Prescott Capital, may direct the vote and disposition of the ordinary shares held by Prescott Master Fund.
- (5) Based solely upon, and qualified in its entirety with reference to, a Schedule 13G/A filed with the Securities and Exchange Commission on January 31, 2011. The Schedule 13G/A indicates that Grace & White, Inc. is a registered investment adviser.

#### **Significant Changes in the Ownership of Major Shareholders**

On January 10, 2008, Mr. Nathan Kirsh filed a Schedule 13D/A with the SEC reflecting beneficial ownership of 1,913,601, or 18.41% of our ordinary shares. On April 24, 2008, Mr. Nathan Kirsh filed a Schedule 13D/A with the SEC reflecting beneficial ownership of 2,191,162, or 21.08% of our ordinary shares. On April 25, 2008, Mr. Nathan Kirsh filed a Schedule 13D/A with the SEC reflecting beneficial ownership of 2,191,162, or 21.08% of our ordinary shares. On January 16, 2009, Mr. Nathan Kirsh filed a Schedule 13D/A with the SEC reflecting beneficial ownership of 2,516,268, or 24.20% of our ordinary shares. On May 17, 2010, Mr. Nathan Kirsh filed a Schedule 13D/A with the SEC reflecting beneficial ownership of 2,516,267, or 24.20% of our ordinary shares.

On February 11, 2008, Clough Capital Partners, L.P. filed an amendment to the Schedule 13G, on Schedule 13G/A, reflecting beneficial ownership of 712,269 or 6.85% of our ordinary shares. On February 10, 2009, Clough Capital Partners, L.P. filed with the SEC an amendment to the Schedule 13G, on Schedule 13G/A, reflecting beneficial ownership of 770,842 or 7.41% of our ordinary shares. On February 1, 2010, Clough Capital Partners, L.P. filed with the SEC an amendment to the Schedule 13G, on Schedule 13G/A, reflecting beneficial ownership of 738,542 or 7.10% of our ordinary shares. On June 17, 2010, Clough Capital Partners, L.P. filed with the SEC a Schedule 13D reflecting beneficial ownership of 704,042 or 6.8% of our ordinary shares. On March 23, 2011, Clough Capital Partners, L.P. filed with the SEC an amendment to Schedule 13G, on Schedule 13G/A, reflecting that it ceased to beneficially own any of our ordinary shares.

On February 2, 2007, Diker GP, LLC, Diker Management LLC, or Diker Management, Messrs. Charles M. Diker and Mark N. Diker filed a Schedule 13G with the SEC reflecting beneficial ownership of 1,007,601 or 9.70% of our ordinary shares. On February 12, 2008, the foregoing reporting persons filed with the SEC an amendment to the Schedule 13G, on Schedule 13G/A, reflecting beneficial ownership of 1,014,425, or 9.76%, of our ordinary shares. On February 17, 2009, the foregoing reporting persons filed with the SEC an amendment to the Schedule 13G, on Schedule 13G/A, reflecting beneficial ownership of 968,468 or 9.32% of our ordinary shares. On February 16, 2010, the foregoing reporting persons filed with the SEC an amendment to the Schedule 13G, on Schedule 13G/A, reflecting beneficial ownership of 786,854 or 7.57% of our ordinary shares. On June 21, 2010, the foregoing reporting persons filed with the SEC a Schedule 13D reflecting beneficial ownership of 604,495 or 5.8% of our ordinary shares. On February 14, 2011, the foregoing reporting persons filed with the SEC an amendment to the Schedule 13G, on Schedule 13G/A, reflecting beneficial ownership of less than 5% of our ordinary shares.

On February 4, 2008, Grace & White, Inc. filed a Schedule 13G with the SEC reflecting beneficial ownership of 574,254 or 5.52% of our ordinary shares. On February 10, 2009, Grace & White, Inc. filed with the SEC an amendment to the Schedule 13G, on Schedule 13G/A, reflecting beneficial ownership of 596,148 or 5.73% of our ordinary shares. On February 1, 2010, Grace & White, Inc. filed with the SEC an amendment to the Schedule 13G, on Schedule 13G/A, reflecting beneficial ownership of 607,526 or 5.84% of our ordinary shares. On January 31, 2011, Grace & White, Inc. filed with the SEC an amendment to the Schedule 13G, on Schedule 13G/A, reflecting beneficial ownership of 521,102 or 5.01% of our ordinary shares.

On February 14, 2008, Prescott Capital, Prescott Group Aggressive Small Cap, L.P., Prescott Group Aggressive Small Cap II, L.P. and Mr. Phil Frohlich filed a Schedule 13G with the SEC reflecting beneficial ownership of 539,097 or 5.19% of our ordinary shares. On February 10, 2009, the foregoing reporting persons filed with the SEC an amendment to the Schedule 13G, on Schedule 13G/A, reflecting beneficial ownership of 547,127 or 5.3% of our ordinary shares. On June 14, 2010, the foregoing reporting persons filed with the SEC a Schedule 13D reflecting beneficial ownership of 544,427 or 5.2% of our ordinary shares.

#### **Major Shareholders Voting Rights**

The voting rights of our major shareholders do not differ from the voting rights of other holders of our ordinary shares.

#### **Record Holders**

Based on a review of the information provided to us by our transfer agent, as of April 7, 2011, there were 52 holders of record of our ordinary shares, of which 41 record holders holding approximately 80.1% of our ordinary shares had registered addresses in the United States. These numbers are not representative of the number of beneficial holders of our shares nor is it representative of where such beneficial holders reside since many of these ordinary shares were held of record by brokers or other nominees, including CEDE & Co., the nominee for the Depository Trust Company (the central depository for the U.S. brokerage community), which held approximately 79.9% of our outstanding ordinary shares as of such date.

#### **B. Related Party Transactions.**

On January 22, 2008, we entered into a retirement agreement with Mr. Jacob Even-Ezra, who retired from his position as the chairman of our board of directors as of January 1, 2008, based on the terms approved by our shareholders in August 2007. Subsequent to the annual general meeting of our shareholders held in August 2007, our board of directors required that Mr. Even-Ezra's retirement agreement be amended to include a non-compete undertaking. Pursuant to the retirement agreement, as amended, Mr. Even-Ezra has undertaken not to compete with our company for a period of three years following his retirement. In consideration, we agreed to pay Mr. Even-Ezra \$360,000. Such amendment was approved in January 2008 by our audit committee and board of directors without shareholder approval in accordance with the Companies Regulations (Relief from Related Party Transactions) 5760-2000, promulgated under the Israeli Companies Law, since such amendment is solely for the benefit of the our company. In addition, as gratitude for his long term and outstanding efforts to further our business and interests, we agreed to provide to Mr. Even-Ezra with certain benefits and services, the value thereof presently estimated to be \$50,000 per year, for the rest of his life. As of December 31, 2010, the actuarial value of these perquisites is estimated at approximately \$679,000.

On August 21, 2008, we entered into an agreement with Mr. Jacob Perry, in connection with his services as the chairman of our board of directors, which was amended effective as of January 1, 2010 pursuant to the approval of our shareholders at our 2010 annual general meeting. Pursuant to the terms of the agreement, as amended, Mr. Perry agreed to serve as the chairman of our board of directors on a part time basis and has undertaken to devote 50%-60% of his business time and attention to the development of our business. Mr. Perry's service as the chairman of our board of directors is for an unlimited period, however each party may terminate the agreement without cause by giving 90 days' notice to the other party. Mr. Perry is entitled to receive as compensation for his services as chairman of our board of directors a monthly salary of NIS 50,000 (approximately \$14,088). Such compensation is linked to the Israeli consumer price index and is adjusted every six months. As of March 31, 2011, the adjusted monthly salary amounted to NIS 53,305 (approximately \$15,019). In addition, Mr. Perry is entitled to an annual bonus equal to 5% of our company's annual income before taxes, but in any event not more than \$500,000 per year, provided that our senior management is entitled to receive performance bonuses for the given year. In addition, Mr. Perry is entitled to the following benefits: an executive level car, mobile phone, daily newspaper and reimbursement of home communication expenses up to NIS 1,000 a month (approximately \$282) against receipts. However, we will not be obliged to provide such benefits to the extent that such benefits are provided to Mr. Perry by another employer. Currently Mr. Perry's car, mobile phone, 60% of his home communication expenses and a daily newspaper are provided to Mr. Perry by another employer. Mr. Perry is also entitled to receive all customary social benefits such as managers insurance and education fund, such amount will be paid to him or to third parties for his benefit. Mr. Perry was also granted options to purchase 300,000 ordinary shares of our company, exercisable at a price of \$7.59 per share. The options vest in three equal installments of 100,000 ordinary shares each on August 20, 2010, August 20, 2011 and August 20, 2011. Each tranche will expire three years after the applicable vesting date.



On May 13, 2008, Ki Corporation, a company wholly-owned by Mr. Nathan Kirsh, our controlling shareholder, granted to Mr. Jacob Perry, the executive chairman of our Board of Directors, the right to purchase 100,000 shares held by such entity, upon the same terms and conditions that apply to the exercise of the options to purchase 300,000 of our ordinary shares granted to Mr. Perry under his employment agreement. Accordingly, Mr. Perry has the right to purchase the shares in three equal annual installments commencing on August 20, 2010 at a price of \$7.59 per share. The right to purchase each installment expires after three years.

We have entered into retirement agreements with certain of our officers, pursuant to which we made post employment and retirement payments in the aggregate amount of approximately \$0.3 and \$1.9 million for the years ended December 31, 2008 and 2009, respectively. Of such amount, in the year ended December 31, 2009, we paid approximately \$1.5 million to Mr. Izhar Dekel, our former President and chief executive officer, who had been employed by our company and served in various positions from 1984 until February 2009. Such payment includes consideration for a non-compete undertaking as well as severance payments and other retirement related payments in accordance with Mr. Dekel's retirement agreement and Israeli law.

On September 8, 2010, Ki Corporation Limited, a company affiliated with Mr. Nathan Kirsh, our principal shareholder and a director, provided us with a bridge loan in the principal amount of \$10.0 million. The loan agreement provided that if it was not repaid within 180 days, the bridge loan would begin to accrue interest at the rate of LIBOR + 4% per year, calculated from the date of the loan and accumulated on a quarterly basis. However, if the rights offering that we intend to initiate during 2011 occurs within 240 days from the date of the loan, the loan will not bear any interest. Our Audit Committee and Board of Directors believe that the loan is on terms that are favorable to our company, as the market interest rate for similar loans in Israel is approximately 6.7% per year. The loan is due and payable on January 10, 2012, and we have an option to extend the maturity date for an additional 60 days. Any interest will be paid together with, and in the same manner as, the principal, no later than the maturity date. We intend to use part of the proceeds from the rights offering that we intend to initiate during 2011 for the repayment of the bridge loan, which amounts to \$10.0 million as of the date of this annual report. We have undertaken to repay such amount within five business days after the successful completion of the rights offering.

On October 2010, we entered into an agreement with Mr. Nathan Kirsh, our controlling shareholder, for the supply of a perimeter security solution for his private property in France for the aggregate consideration of Euro 233,000 (approximately \$310,000). Our Audit Committee and Board of Directors approved the terms of the transaction.

**C. Interests of Experts and Counsel.**

Not applicable.

**ITEM 8. Financial Information**

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

**Consolidated Financial Statements**

See the consolidated financial statements included under Item 18, "Financial Statements."

**Export Sales**

In the years ended December 31, 2008, 2009 and 2010, the total amount of our revenues from our facilities located outside of Israel to customers outside of Israel was approximately \$35.1 million, \$30.1 million and \$36.9 million, respectively, or 61.5%, 56.7% and 74.3% of our total revenues, respectively. In the years ended December 31, 2008, 2009 and 2010, the total amount of our export revenues from our Israeli facilities to countries outside of Israel was approximately \$9.9 million, \$10.7 million and \$2.9 million, respectively, or 17.4%, 19.6% and 5.9% of our total revenues, respectively.

## **Legal Proceedings**

In May 2005, we entered into an agreement to supply comprehensive security solutions for a sensitive site in Eastern Europe. We commenced the project and delivered some of the equipment and other deliverables to the customer in 2005. In April 2006, the customer informed us that it was canceling the agreement due to errors in the design documents that we had submitted. In addition, the customer did not make payments required under the agreement. We denied all of the allegations and the case was referred to arbitration.

On June 6, 2007, the Court of Arbitration issued its decision in the arbitration and stated that the agreement concluded between us and the customer was void due to legal mistakes made by the customer in the tender process. Based on such decision, we decided to initiate a new legal action against the customer and seek compensation for the damages that we incurred. In March 2010, the Court of Arbitration determined that the customer is liable for certain expenses incurred by us in connection with the negotiation and execution of the agreement due to the customer's wrongful behaviour during the negotiations. In addition, the Court of Arbitration determined that the customer is liable for damages caused to us due to the customer's unjust enrichment resulting from its failure to pay for certain deliveries made by us. The Court of Arbitration's decision is subject to appeal. The scope of damages is subject to proceedings that are currently taking place before the Court of Arbitration.

In addition, we are subject to legal proceedings arising in the normal course of business. Based on the advice of our legal counsel, management believes that these proceedings will not have a material adverse effect on our financial position or results of operations.

## **Dividend Distribution Policy**

We currently intend to retain future earnings for use in our business and do not anticipate paying cash dividends on our ordinary shares in the foreseeable future. Future dividend distributions are subject to the discretion of our board of directors and will depend on a number of factors, including our operating results, future capital resources available for distribution, capital requirements, financial condition, the tax implications of dividend distributions on our income, future prospects and any other factors our board of directors may deem relevant.

The distribution of dividends also may be limited by Israeli law, which permits the distribution of dividends only out of profits (as defined by the Israeli Companies Law) or otherwise upon the permission of the court. "Profits" are defined in the Israeli Companies Law as the balance of surpluses, or the surpluses accumulated over the past two years, whichever is the greater, in accordance with the latest adjusted financial statements, audited or reviewed, prepared by the company, provided that the date in respect of which the statements were prepared is no earlier than six months prior to the date of distribution. "Surplus" means sums included in a company's shareholders' equity originating from the net profit of the company, as determined according to generally accepted accounting principles, and sums other than share capital or premiums that are included in shareholders' equity under generally accepted accounting principles and that the Minister of Justice has prescribed to be considered surplus.

## **B. Significant Changes.**

Since the date of the annual consolidated financial statements included in this annual report, no significant changes have occurred.

**ITEM 9. The Offer and Listing****A. Offer and Listing Details.****Annual Stock Information**

The following table sets forth, for each of the years indicated, the high and low market prices of our ordinary shares on the NASDAQ Global Market and the Tel Aviv Stock Exchange:

	NASDAQ Global Market		Tel Aviv Stock Exchange	
	High	Low	High	Low
2006	\$ 14.20	\$ 8.51	NIS 64.78	NIS 36.10
2007	\$ 12.00	\$ 6.26	NIS 51.00	NIS 23.50
2008	\$ 9.30	\$ 4.61	NIS 32.44	NIS 18.60
2009	\$ 6.40	\$ 3.08	NIS 24.50	NIS 13.00
2010	\$ 4.70	\$ 2.50	NIS 16.86	NIS 9.61

**Quarterly Stock Information**

The following table sets forth, for each of the full financial quarters in the years indicated and any subsequent period, the high and market prices of our ordinary shares on the NASDAQ Global Market and the Tel Aviv Stock Exchange:

	NASDAQ Global Market		Tel Aviv Stock Exchange	
	High	Low	High	Low
<b>2009</b>				
First Quarter	\$ 6.40	\$ 3.79	NIS 24.50	NIS 16.00
Second Quarter	\$ 4.95	\$ 3.80	NIS 19.97	NIS 16.00
Third Quarter	\$ 5.42	\$ 3.63	NIS 20.39	NIS 14.60
Fourth Quarter	\$ 4.55	\$ 3.08	NIS 16.37	NIS 13.00
<b>2010</b>				
First Quarter	\$ 4.70	\$ 3.50	NIS 16.86	NIS 13.70
Second Quarter	\$ 4.00	\$ 2.50	NIS 15.14	NIS 9.61
Third Quarter	\$ 3.28	\$ 2.70	NIS 12.00	NIS 10.00
Fourth Quarter	\$ 3.68	\$ 2.89	NIS 12.50	NIS 10.45

**Monthly Stock Information**

The following table sets forth, for each of the most recent six months, the high and low market prices of our ordinary shares on the NASDAQ Global Market and the Tel Aviv Stock Exchange:

	NASDAQ Global Market		Tel Aviv Stock Exchange	
	High	Low	High	Low
October 2010	\$ 3.56	\$ 3.00	NIS 12.30	NIS 11.15
November 2010	\$ 3.68	\$ 2.89	NIS 12.50	NIS 10.45
December 2010	\$ 3.45	\$ 3.00	NIS 12.39	NIS 10.50
January 2011	\$ 3.29	\$ 2.63	NIS 11.66	NIS 10.18
February 2011	\$ 3.15	\$ 2.80	NIS 11.02	NIS 10.31
March 2010	\$ 3.23	\$ 2.92	NIS 11.41	NIS 10.56

**B. Plan of Distribution.**

Not applicable.

**C. Markets.**

Our ordinary shares have traded on the NASDAQ Global Market under the symbol "MAGS" since our initial public offering in 1993. Our ordinary shares have also traded on the Tel Aviv Stock Exchange under the symbol "MAGS" since July 1, 2001.

**D. Selling Shareholders.**

Not applicable.

**E. Dilution.**

Not applicable.

**F. Expenses of the Issue.**

Not applicable.

**ITEM 10. Additional Information**

**A. Share Capital.**

Not applicable.

**B. Memorandum and Articles of Association.**

**Purposes and Objects of the Company**

We are a public company registered with the Israeli Companies Registrar and have been assigned company number 52-003892-8. Section 2 of our memorandum of association provides, among other things, that we were established for the purposes of acquiring from IAI a plant, known as the Magal Plant, engaged in the development, manufacture, sale and support of alarm devices and dealing in the development, manufacturing and support of security alarm devices and other similar products. In addition, the purpose of our company is to be eligible to perform and act in connection with any right or obligation of whatever kind or nature permissible under Israeli law.

**Board of Directors**

The strategic management of our business (as distinguished from the daily management of our business affairs) is vested in our board of directors, which may exercise all such powers and do all such acts as our company is authorized to exercise and do, and which are not required to be exercised by a resolution of the general meeting of our shareholders. The board of directors may, subject to the provisions of the Israeli Companies Law, delegate some of its powers to committees, each consisting of one or more directors, provided that at least one member of such committee is an external director.

According to the Israeli Companies Law, we may stipulate in our articles of association that the general meeting of shareholders is authorized to assume the responsibilities of the board of directors. In the event the board of directors is unable to act or exercise its powers, the general meeting of shareholders is authorized to exercise the powers of the board of directors, even if the articles of association do not stipulate so. Our board of directors has the power to assume the responsibilities of our chief executive officer if he is unable to act or exercise his powers or if he fails to fulfill the instructions of the board of directors with respect to a specific matter.

Our articles of association do not impose any mandatory retirement or age limit requirements on our directors and our directors are not required to own shares in our company in order to qualify to serve as directors.

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

For a discussion of Israeli law concerning a director's fiduciary duties and the approval of transactions with office holders, see Item 6.C. "Directors, Senior Management and Employees-Board Practices - Approval of Related Party Transactions under Israeli Law."

### **Rights Attached to Shares**

Our authorized share capital consists of NIS 19,748,000 ordinary shares, par value NIS 1.00 each. All our ordinary shares have the same rights, preferences and restrictions, some of which are detailed below. At the general meeting of shareholders, our shareholders may, subject to certain provisions detailed below, create different classes of shares, each class bearing different rights, preferences and restrictions.

The rights attached to the ordinary shares are as follows:

**Dividends Rights.** Holders of ordinary shares are entitled to participate in the payment of dividends in accordance with the amounts paid-up or credited as paid up on the nominal value of such ordinary shares at the time of payment (without taking into account any premium paid thereon). However, under article 13 of our articles of association no shareholder will be entitled to receive any dividends until the shareholder has paid all calls then currently due and payable on each ordinary share held by such shareholder.

The board of directors may declare interim dividends and propose the final dividend with respect to any fiscal year only out of the retained earnings, in accordance with the provisions of the Israeli Companies Law. Declaration of a final dividend requires the approval by ordinary resolution of our shareholders at a general meeting of shareholders. Such resolution may reduce but not increase the dividend amount recommended by the board of directors. Dividends may be paid, in whole or in part, by way of distribution of dividends in kind. See "Item 8A. Financial Information – Consolidated Statements and Other Financial Information – Dividend Distributions Policy."

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

Generally, resolutions are adopted at the general meeting of shareholders by an ordinary resolution, unless the Israeli Companies Law or our articles of association require an extraordinary resolution. An ordinary resolution, such as a resolution approving the declaration of dividends or the appointment of auditors, requires approval by the holders of a simple majority of the shares represented at the meeting, in person or by proxy, and voting on the matter. An extraordinary resolution requires approval by the holders of at least 75% of the shares represented at the meeting, in person or by proxy, and voting on the matter. The primary resolutions required to be adopted by an extraordinary resolution of the general meeting of shareholders are resolutions to:

- amend the memorandum of association or articles of association;
- change the share capital, for example by increasing or canceling the authorized share capital or modifying the rights attached to shares; and
- approve mergers, consolidations or winding up of our company.

Our articles of association do not contain any provisions regarding a classified board of directors or cumulative voting for the election of directors. Pursuant to our articles of association, our directors (except the external directors) are elected at our annual general meeting of shareholders by a vote of the holders of a majority of the voting power represented and voting at such meeting and hold office until the next annual general meeting of shareholders and until their successors have been elected. All the members of our board of directors (except the external directors) may be reelected upon completion of their term of office. For information regarding the election of external directors, see "Item 6C. Directors, Senior Management and Employees – Directors and Senior Management - Board Practices - External and Independent Directors - External Directors."

**Rights to Share in the Company's Profits.** Our shareholders have the right to share in our profits distributed as a dividend or any other permitted distributions. See this Item 10B. "Additional Information – Memorandum and Articles of Association – Rights Attached to Shares – Dividend Rights."

**Liquidation Rights.** Article 111 of our articles of association provides that upon any liquidation, dissolution or winding-up of our company, our remaining assets shall be distributed pro-rata to our ordinary shareholders.

**Redemption.** Under Article 38 of our articles of association, we may issue redeemable stock and redeem the same.

**Capital Calls.** Under our memorandum of association and the Israeli Companies Law, the liability of our shareholders is limited to the par value of the shares held by them.

**Substantial limitations on shareholders.** See Item 6.C. "Directors, Senior Management and Employees-Board Practices-Approval of Related Party Transactions."

#### **Modifications of Share Rights**

The rights attached to a class of shares may be altered by an extraordinary resolution of the general meeting of shareholders, provided the holders of 75% of the issued shares of that class approve such change by the adoption of an extraordinary resolution at a separate meeting of such class, subject to the terms of such class. The provisions of the articles of association pertaining to general meetings of shareholders also apply to a separate meeting of a class of shareholders. Shares which confer preferential or subordinate rights relating to, among other things, dividends, voting, and payment of capital may be created only by an extraordinary resolution of the general meeting of shareholders.

#### **General Meetings of Shareholders**

Under the Israeli Companies Law a company must convene an annual meeting of shareholders at least once every calendar year and within 15 months of the last annual meeting. Depending on the matter to be voted upon, notice of at least 21 days or 35 days prior to the date of the meeting is required. Our board of directors may, in its discretion, convene additional meetings as "special general meetings." In addition, the board must convene a special general meeting upon the demand of two of the directors, 25% of the nominated directors, one or more shareholders having at least 5% of the outstanding share capital and at least 1% of the voting power in the company, or one or more shareholders having at least 5% of the voting power in the company. See this Item 10B. "Additional Information - Memorandum and Articles of Association- Rights Attached to Shares-Voting Rights."

A shareholder present, in person or by proxy, at the commencement of a general meeting of shareholders may not seek the cancellation of any proceedings or resolutions adopted at such general meeting of shareholders on account of any defect in the notice of such meeting relating to the time or the place thereof. Shareholders who are registered in our register of shareholders at the record date may vote at the general meeting of shareholders. The record date is set in the resolution to convene the general meeting of shareholders, provided, however, that such record date must be between 14 to 21 days or, in the event of a vote by ballots, between 28 to 40 days prior the date the general meeting of shareholders is held.

The quorum required for a general meeting of shareholders consists of at least two record shareholders, present in person or by proxy, who hold, in the aggregate, at least one third of the voting power of our outstanding shares. A general meeting of shareholders will be adjourned for lack of a quorum after half an hour from the time appointed for such meeting to the same day in the following week at the same time and place or any other time and place as the board of directors designates in a notice to the shareholders. At such reconvened meeting, if a quorum is not present within half an hour from the time appointed for such meeting, two or more shareholders, present in person or by proxy, will constitute a quorum. The only business that may be considered at an adjourned general meeting of shareholders is the business that might have been lawfully considered at the general meeting of shareholders originally convened and the only resolutions that may be adopted are the resolutions that could have been adopted at the general meeting of shareholders originally convened.

### **Limitations on the Right to Own Our Securities**

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

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

The Israeli Companies Law requires that mergers between Israeli companies be approved by the board of directors and general meeting of shareholders of both parties to the transaction. The approval of the board of directors of both companies is subject to such boards' confirmation that there is no reasonable doubt that after the merger the surviving company will be able to fulfill its obligations towards its creditors. Each company must notify its creditors about the contemplated merger. Under our articles of association, such merger must be approved by a resolution of the shareholders, as explained above. The approval of the merger by the general meetings of shareholders of the companies is also subject to additional approval requirements as specified in the Israeli Companies Law and regulations promulgated thereunder. For purposes of the shareholders approval, the merger shall not be deemed as granted unless the court determines otherwise, if it is not supported by the majority of the shares represented at the general meeting, other than those shares that are held by the other party to the merger or by any shareholder holding 25% or more of the outstanding share capital of the company or the right to appoint 25% or more of the members of the board of directors. See also Item 6C. "Directors, Senior Management and Employees – Board Practices – Approval of Related Party Transactions Under Israeli Law."

The Israeli Companies Law also provides that an acquisition of shares of a public company must be made by means of a special tender offer if as a result of the acquisition the purchaser would become a 25% or greater shareholder of the company and there is no existing 25% or greater shareholder in the company. An acquisition of shares of a public company must also be made by means of a tender offer if as a result of the acquisition the purchaser would become a 45% or greater shareholder of the company and there is no existing 45% or greater shareholder in the company. These requirements do not apply if the acquisition (i) was made through a private placement that received shareholder approval, (ii) was from a 25% shareholder of the company and resulted in the acquirer becoming a 25% shareholder of the company or (iii) was from a 45% shareholder of the company and resulted in the acquirer becoming a 45% shareholder of the company. The special tender offer must be extended to all shareholders but, the offer may include explicit limitations allowing the offeror not to purchase shares representing more than 5% of the voting power attached to the company's outstanding shares, regardless of how many shares are tendered by shareholders. The special tender offer may be effected only if (i) at least 5% of the voting power attached to the company's outstanding shares will be acquired by the offeror and (ii) the number of shares tendered in the offer exceeds the number of shares whose holders objected to the offer.

If, as a result of an acquisition of shares, the acquirer will hold more than 90% of the outstanding shares, the acquisition must be made by means of a tender offer for the entire outstanding shares. In such event, if less than 5% of the outstanding shares are not tendered in the tender offer, all the shares of the company will be deemed as tendered and sold. However, if more than 5% of the outstanding shares are not tendered in the tender offer, then the acquirer may not acquire any shares at all. The law provides for appraisal allowing any shareholder to file a motion to the court within three months following the consummation of a full tender offer. However, pursuant to recent amendment of the Israeli Companies Law, effective as of May 14, 2011, the terms for filing the request for appraisal has been extended to six months. In addition, in the event of a full tender offer, the offeror may determine that any shareholder who accepts the offer will not be entitled to appraisal rights. Such determination shall be effective only if the offeror or the company has timely published all the information that is required to be published in connection with such full tender offer pursuant to all applicable laws.

In addition, the purchase of 25% or more of the outstanding share capital of a company or the purchase of substantial assets of a company requires, under certain conditions, the approval of the Restrictive Practices Authority. Furthermore if the target company has received tax incentives or grants from the Office of the Chief Scientist, changes in ownership may require also the approval of the tax authorities or the Office of the Chief Scientist, as applicable.

## Disclosure of Shareholders' Ownership

The Israeli Securities Law, 5728-1968 and regulations promulgated thereunder contain various provisions regarding the ownership threshold above which shareholders must disclose their share ownership. However, these provisions do not apply to companies, such as ours, whose shares are publicly traded in Israel as well as outside of Israel. As a result of the listing of our ordinary shares on the Tel Aviv Stock Exchange, we are required pursuant to the Israeli Securities Law and the regulations promulgated thereunder to deliver to the Israeli Share Registrar, the Israeli Securities Exchange Commission and the Tel Aviv Stock Exchange, all reports, documents, forms and information received by us from our shareholders regarding their shareholdings, provided that such information was published or required to be published under applicable foreign law.

### C. Material Contracts.

In April 2010, we signed a \$13.5 million contract with SSP for the modernization and upgrade of the indoor security systems of three high-security prisons in Mexico. Nearly half of the project was executed in 2010, and it is expected to be completed during 2011.

In December 2010, we signed a contract with the Port Authority of Kenya valued at \$21.4 million to secure the port of Mombassa. The project is expected to be executed during 2011 and 2012.

### D. Exchange Controls.

Israeli law and regulations do not impose any material foreign exchange restrictions on non-Israeli holders of our ordinary shares. In May 1998, a new "general permit" was issued under the Israeli Currency Control Law, 1978, which removed most of the restrictions that previously existed under such law, and enabled Israeli citizens to freely invest outside of Israel and freely convert Israeli currency into non-Israeli currencies.

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

### E. Taxation.

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

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

#### ISRAELI TAX CONSIDERATIONS

The following is a summary of the material Israeli tax laws applicable to us, and some Israeli Government programs benefiting us. This section also contains a discussion of material Israeli tax consequences concerning the ownership of and disposition of our ordinary shares. This summary does not discuss all the acts of Israeli tax law that may be relevant to a particular investor in light of his or her personal investment circumstances or to some types of investors subject to special treatment under Israeli law. Examples of this kind of investor include residents of Israel or traders in securities who are subject to special tax regimes not covered in this discussion. Since some parts of this discussion are based on new tax legislation that has not yet been subject to judicial or administrative interpretation, we cannot assure you that the appropriate tax authorities or the courts will accept the views expressed in this discussion.



The discussion below should not be construed as legal or professional tax advice and does not cover all possible tax considerations. Potential investors are urged to consult their own tax advisors as to the Israeli or other tax consequences of the purchase, ownership and disposition of our ordinary shares, including in particular, the effect of any foreign, state or local taxes.

## **General Corporate Tax Structure**

Israeli companies are subject to income tax on their worldwide income regardless of the territorial source of such income. Generally, Israeli companies are subject to "corporate tax" on their taxable income. Israeli companies were generally subject to corporate tax at the rate of 25% in 2010, which was reduced to 24% in 2011. The corporate tax rate is scheduled to decrease further as follows: 23% for the 2012 tax year, 22% for the 2013 tax year, 21% for the 2014 tax year, 20% for the 2015 tax year and 18% for the 2016 tax year and thereafter. Capital gains derived after January 1, 2003 (other than gains derived from the sale of listed securities that are taxed at the prevailing corporate tax rates) are generally subject to tax at a rate of 25%. However, the effective tax rate payable by a company that derives income from an "Approved Enterprise," discussed further below, may be considerably less. See "--Tax Benefits under the Law for the Encouragement of Capital Investments, 1959."

## **Israeli Transfer Pricing Regulations**

On November 29, 2006, Income Tax Regulations (Determination of Market Terms), 2006, promulgated under Section 85A of the Israeli Tax Ordinance, came into effect, or the TP Regs. Section 85A of the Tax Ordinance and the TP Regs generally require that all cross-border transactions carried out between related parties be conducted on an arm's length principle basis and will be taxed accordingly. The TP Regs are not expected to have a material effect on us.

## **Tax Benefits for Research and Development**

Israeli tax law allows, under specified conditions, a tax deduction for expenditures, including capital expenditures, in the year incurred relating to scientific research and development projects, if the expenditures are approved by the relevant Israeli Government ministry, determined by the field of research, and the research and development is for the promotion of the company and is carried out by or on behalf of the company seeking such deduction. However, the amount of such deductible expenses shall be reduced by the sum of any funds received through government grants for the finance of such scientific research and development projects. Expenditures not so approved are deductible over a three-year period.

## **Encouragement of Capital Investments Law, 5719-1959**

### *The Investments Law Prior to the 2005 Amendment*

The Law for the Encouragement of Capital Investments, 1959, or the Investments Law, as in effect prior to April 1, 2005 provided that a proposed capital investment in eligible facilities may, upon application to the Investment Center of the Ministry of Industry and Commerce of the State of Israel, be designated as an approved enterprise. The Investment Center based its decision as to whether or not to approve an application, among other things, on the criteria set forth in the Investments Law and regulations, the then prevailing policy of the Investment Center, and the specific objectives and financial criteria of the applicant. Each certificate of approval for an approved enterprise relates to a specific investment program delineated both by its financial scope, including its capital sources, and by its physical characteristics, such as the equipment to be purchased and utilized pursuant to the program.

The Investments Law provides that an approved enterprise is eligible for tax benefits on taxable income derived from its approved enterprise programs. The tax benefits under the Investments Law also apply to income generated by a company from the grant of a usage right with respect to know-how developed by the approved enterprise, income generated from royalties, and income derived from a service which is auxiliary to such usage right or royalties, provided that such income is generated within the approved enterprise's ordinary course of business. If a company has more than one approval enterprise or only a portion of its capital investments are approved, its effective tax rate is the result of a weighted average of the applicable rates. The tax benefits under the Investments Law are not, generally, available with respect to income derived from products manufactured outside of Israel. In addition, the tax benefits available to an approved enterprise are contingent upon the fulfillment of conditions stipulated in the Investments Law and regulations and the criteria set forth in the specific certificate of approval, as described above. In the event that a company does not meet these conditions, it would be required to refund the amount of tax benefits, plus a consumer price index linkage adjustment and interest.

The Investments Law also provides that an approved enterprise is entitled to accelerated depreciation on its property and equipment that are included in an approved enterprise program.

Taxable income of a company derived from an approved enterprise is subject to corporate tax at the maximum rate of 25%, rather than the regular corporate tax rate, for the benefit period. This period is ordinarily seven years commencing with the year in which the approved enterprise first generates taxable income (after the commencement of production), and is limited to 12 years from commencement of production or 14 years from the date of approval, whichever is earlier, referred to as the "Years Limitation."

A company may elect to receive an alternative package of benefits. Under the alternative package of benefits, a company's undistributed income derived from the approved enterprise will be exempt from corporate tax for a period of between two and ten years from the first year the company derives taxable income under the program, depending on the geographic location of the approved enterprise within Israel, and such company will be eligible for a reduced tax rate for the remainder of the benefits period. The Years Limitation does not apply to the exemption period. A company that has elected the alternative package of benefits, such as us, that subsequently pays a dividend out of income derived from the approved enterprise during the tax exemption period will be subject to corporate tax in respect of the gross amount distributed, including any taxes thereon, at the rate which would have been applicable had it not elected the alternative package of benefits, generally 10%-25%, depending on the percentage of the company's ordinary shares held by foreign shareholders. The dividend recipient is subject to withholding tax at the rate of 15% applicable to dividends from approved enterprises, if the dividend is distributed during the tax exemption period or within twelve years thereafter. The company must withhold this tax at source.

A company that has an approved enterprise program is eligible for further tax benefits if it qualifies as a foreign investors' company. A foreign investors' company is a company which more than 25% of its share capital and combined share and loan capital is owned by non-Israeli residents. A company that qualifies as a foreign investors' company and has an approved enterprise program is eligible for tax benefits for a ten-year benefit period. As specified above, depending on the geographic location of the approved enterprise within Israel, income derived from the approved enterprise program may be exempt from tax on its undistributed income for a period of between two to ten years, and will be subject to a reduced tax rate for the remainder of the benefits period. The tax rate for the remainder of the benefits period will be 25%, unless the level of foreign investment exceeds 49%, in which case the tax rate will be 20% if the foreign investment is more than 49% and less than 74%; 15% if more than 74% and less than 90%; and 10% if 90% or more.

Subject to applicable provisions concerning income under the alternative package of benefits, dividends paid by a company are considered to be attributable to income received from the entire company and the company's effective tax rate is the result of a weighted average of the various applicable tax rates, excluding any tax-exempt income. Under the Investments Law, a company that has elected the alternative package of benefits is not obliged to distribute retained profits, and may generally decide from which year's profits to declare dividends. We currently intend to reinvest any income derived from our approved enterprise program and not to distribute such income as a dividend.

The Israeli government may reduce or eliminate tax benefits available to approved enterprise programs in the future. We cannot assure you that our approved program and the benefits thereunder shall continue in the future at its current level or at any level.

Currently, we have two valid expansion programs that were granted approved enterprise status under the Investments Law prior to its amendment.

#### *2005 Amendment to the Investments Law*

An amendment to the Investments Law, which was published on April 1, 2005, or the Amendment, has changed certain provisions of the Investments Law. As a result of the Amendment, a company is no longer obliged to acquire approved enterprise status in order to receive the tax benefits previously available under the alternative benefits provisions, and therefore generally there is no need to apply to the Investment Center for this purpose (approved enterprise status remains mandatory for companies seeking grants). Rather, a company may claim the tax benefits offered by the Investments Law directly in its tax returns, provided that its facilities meet the criteria for tax benefits set out by the Amendment. A company is also granted a right to approach the Israeli Tax Authority for a pre-ruling regarding their eligibility for benefits under the Amendment.

Tax benefits are available under the Amendment to production facilities (or other eligible facilities), which are generally required to derive more than 25% of their business income from export, referred to as a "Benefited Enterprise." In order to receive the tax benefits, the Amendment states that the company must make an investment in the Benefited Enterprise exceeding a certain percentage or a minimum amount specified in the Investments Law. Such investment may be made over a period of no more than three years ending at the end of the year in which the company requested to have the tax benefits apply to the Benefited Enterprise, referred to as the Year of Election. Where the company requests to have the tax benefits apply to an expansion of existing facilities, then only the expansion will be considered a Benefited Enterprise and the company's effective tax rate will be the result of a weighted combination of the applicable rates. In this case, the minimum investment required in order to qualify as a Benefited Enterprise is required to exceed a certain percentage or a minimum amount of the company's production assets before the expansion.

The duration of tax benefits is subject to a limitation of the earlier of seven to ten years from the commencement year, or 12 years from the first day of the Year of Election. The tax benefits granted to a Benefited Enterprise are determined, as applicable to its geographic location within Israel, according to one of the following new tax routes, which may be applicable to us:

- Similar to the currently available alternative route, exemption from corporate tax on undistributed income for a period of two to ten years, depending on the geographic location of the Benefited Enterprise within Israel, and a reduced corporate tax rate of 10% to 25% for the remainder of the benefits period, depending on the level of foreign investment in each year. Benefits may be granted for a term of seven to ten years, depending on the level of foreign investment in the company. If the company pays a dividend out of income derived from the Benefited Enterprise during the tax exemption period, such income will be subject to corporate tax at the applicable rate (10%-25%) with respect to the gross amount of dividend distributed. The company is required to withhold tax at the source at a rate of 15% from any dividends distributed from income derived from the Benefited Enterprise; and
- A special tax route, which enables companies owning facilities in certain geographical locations in Israel to pay corporate tax at the rate of 11.5% on income of the Benefited Enterprise. The benefits period is ten years. Upon payment of dividends, the company is required to withhold tax at source at a rate of 15% for Israeli residents and at a rate of 4% for foreign residents.

Generally, a company that is "Abundant in Foreign Investment," as defined in the Investments Law, is entitled to an extension of the benefits period by an additional five years, depending on the rate of its income that is derived in foreign currency.

The Amendment changes the definition of "foreign investment" in the Investments Law so that the definition now requires a minimal investment of NIS 5 million by foreign investors. Furthermore, such definition now also includes the purchase of shares of a company from another shareholder, provided that the company's outstanding and paid-up share capital exceeds NIS 5 million. Such changes to the aforementioned definition are retroactive from 2003.

The Amendment applies to approved enterprise programs in which the year of election under the Investments Law is 2004 or later, unless such programs received "Approved Enterprise" approval from the Investment Center on or prior to December 31, 2004, in which case the Amendment provides that terms and benefits included in any certificate of approval already granted will remain subject to the provisions of the Investments Law as they were on the date of such approval.

Should we elect to utilize tax benefits under the Amendment to the Investments Law, any such tax exempt profits might be subject to future taxation on the corporate level upon distribution to shareholders by a way of dividend or liquidation. Accordingly, we may be required to recognize deferred tax liability with respect to such tax exempt profits.

A substantial portion of our taxable operating income is derived from our approved enterprise program and we expect that a substantial portion of any taxable operating income that we may realize in the future will be also derived from such program. There is no assurance that our facilities will continue to enjoy such status in the future.

On March 3, 2007, we received a pre-ruling from the Israeli Tax Authority confirming that our most recent development program will be deemed a Benefiting Enterprise under the amended Investments Law. Our income from this program is tax-exempt for a period of two years, and is subject to a reduced tax rate of 10%-25 for a period of five to eight years (depending upon the percentage of foreign ownership of the Company). We have not enjoyed any tax benefits under this program to date.

#### Tax benefits under the 2010 Amendment

In December 2010, the Israeli Parliament passed the Law for Economic Policy for 2011 and 2012 (Amended Legislation), 2011, which prescribes, among other things, amendments in to the Investment Law, effective as of January 1, 2011. According to the amendment, the benefit tracks under the Investment Law were modified and a uniform tax rate will apply to all of the income of an Approved or Privileged Enterprise. Companies may elect to irrevocably implement the amendment (while waiving benefits provided under the Investment Law as currently in effect) and subsequently would be subject to the amended tax rates that are: 2011 and 2011 - 15% (in development area A - 10%), 2013 and 2014 - 12.5% (in development area A - 7%) and in 2015 and thereafter - 12% (in development area A - 6%). Our company is not in development area A. We are currently examining the possible effect of the amendment on our financial statements, if at all, and have not yet decided whether to apply the amendment.

#### **Encouragement of Industry (Taxes) Law, 5729-1969**

Under the Encouragement of Industry (Taxes) Law, 5729-1969, or the Industry Encouragement Law, "Industrial Companies" are entitled to certain corporate tax benefits, including, among others:

- Amortization, under certain conditions, of purchases of know-how and patents and of rights to use a patent and know-how which are used for the development or advancement of the company, over an eight-year period for tax purposes;
- Right to elect, under specified conditions, to file a consolidated tax return with additional related Israeli industrial companies; and
- Accelerated depreciation rates on equipment and buildings; and
- Deductions over a three-year period of expenses in connection with the issuance and listing of shares on a recognized stock market.

Eligibility for benefits under the Industry Encouragement Law is not subject to the prior approval of any governmental authority. Under the Industry Encouragement Law, an "Industrial Company" is a company resident in Israel, at least 90% of the income of which, in any tax year, determined in Israeli currency, exclusive of income from government loans, capital gains, interest and dividends, is derived from an "Industrial Enterprise" owned by it. An "Industrial Enterprise" is an enterprise owned by an Industrial Company, whose major activity in a given tax year is industrial production activity.

We believe that we currently qualify as an industrial company as defined by the Industry Encouragement Law. We cannot assure you that we will continue to qualify as an industrial company or that the benefits described above will be available to us in the future.

#### Encouragement of Industrial Research and Development Law, 5744-1984

Under the Encouragement of Industrial Research and Development Law, 5744-1984, or the Research Law, research and development programs that meet specified criteria and are approved by a governmental committee of the Office of the Chief Scientist of the Israeli Ministry of Industry, Trade and Labor, or the OCS, are eligible for grants between 20%-50% of certain of the project's expenditures, as determined by the research committee of the OCS. In exchange, the recipient of such grants is required to pay the OCS royalties from the revenues derived from products incorporating technology developed within the framework of the approved research and development program or derived from such program (including ancillary services in connection with such program), usually up to 100% of the U.S. dollar-linked value of the total grants received in respect of such program, plus LIBOR interest.

The terms of the Israeli government participation also require that products developed with government grants be manufactured in Israel. However, under regulations promulgated under the Research Law, upon the approval of the OCS, some of the manufacturing volume may be performed outside Israel, provided that the grant recipient pays royalties at an increased rate, up to 300% of the received grant, depending on the percentage of manufacturing being transferred abroad. The Research Law also provides that know-how developed under an approved research and development program may not be transferred to third parties in Israel without the prior approval of the research committee of the OCS. The Research Law further provides that the know-how developed under an approved research and development program may not be transferred to any third parties outside Israel. No approval is required for the sale or export of any products resulting from such research and development.

In June 2005, an amendment to the Research Law became effective, which amendment was intended to make the Research Law more compatible with the global business environment by, among other things, relaxing restrictions on the transfer of manufacturing rights outside Israel and on the transfer of OCS funded know-how outside of Israel. The amendment permits the OCS, among other things, to approve the transfer of manufacturing rights outside Israel in exchange for an import of different manufacturing into Israel as a substitute, in lieu of demanding the recipient to pay increased royalties as described above. The amendment further permits, under certain circumstances and subject to the OCS's prior approval, the transfer outside Israel of know-how that has been funded by OCS, generally in the following cases: (a) the grant recipient pays to the OCS a portion of the consideration paid for such funded know-how (according to certain formulas), (b) the grant recipient receives know-how from a third party in exchange for its funded know-how, or (c) such transfer of funded know-how arises in connection with certain types of cooperation in research and development activities.

The Research Law imposes reporting requirements with respect to certain changes in the ownership of a grant recipient. The law requires the grant recipient and its controlling shareholders and interested parties to notify the OCS and obtaining the approval of the OCS for any change in control of the recipient or a change in the holdings of the means of control of the recipient that results in a foreign resident becoming an interested party directly in the recipient and requires the new interested party to undertake to the OCS to comply with the Research Law. In addition, the rules of the OCS may require prior approval of the OCS or additional information or representations in respect of certain of such events. For this purpose, "control" is defined as the ability to direct the activities of a company other than any ability arising solely from serving as an officer or director of the company. A person is presumed to have control if such person holds 50% or more of the means of control of a company. "Means of control" refers to voting rights or the right to appoint directors or the chief executive officer. An "interested party" of a company includes a holder of 5% or more of its outstanding share capital or voting rights, its chief executive officer and directors, someone who has the right to appoint its chief executive officer or at least one director, and a company with respect to which any of the foregoing interested parties owns 25% or more of the outstanding share capital or voting rights or has the right to appoint 25% or more of the directors. Accordingly, any foreign resident who acquires 5% or more of our ordinary shares will be required to notify the OCS that it has become an interested party and to sign an undertaking to comply with the Research Law.

The Israeli authorities have indicated that the government may reduce or abolish grants from the OCS in the future. Even if these grants are maintained, we cannot assure you that we will receive OCS grants in the future. In addition, each application to the OCS is reviewed separately, and grants are based on the program approved by the research committee. Generally, expenditures supported under other incentive programs of the State of Israel are not eligible for grants from the OCS.

### **Taxation under Inflationary Conditions**

The Income Tax (Inflationary Adjustments) Law, 5745-1985, generally referred to as the Inflationary Adjustments Law, represents an attempt to overcome the problems presented to a traditional tax system by an economy undergoing rapid inflation. The Inflationary Adjustments Law is highly complex. Its features which are material to us can be described as follows:

- There is a special tax adjustment for the preservation of equity whereby some corporate assets are classified broadly into fixed assets and non-fixed assets.
- Where a company's equity, as defined in such law, exceeds the depreciated cost of fixed assets, a deduction from taxable income that takes into account the effect of the applicable annual rate of inflation on such excess is allowed up to a ceiling of 70% of taxable income in any single tax year, with the unused portion permitted to be carried forward on a linked basis. If the depreciated cost of fixed assets exceeds a company's equity, then such excess multiplied by the applicable annual rate of inflation is added to taxable income.
- Subject to specified limitations, depreciation deductions on fixed assets and losses carried forward are adjusted for inflation based on the increase in the Israeli consumer price index.

The Inflationary Adjustments Law was abolished, effective as of January 1 2008, and subject to transitional provisions and special provisions to prevent a distortion in the tax calculations. In February 2008, the Knesset passed an amendment to the Income Tax (Inflationary Adjustments) Law, 1985, which limits the scope of the law with effect from 2008 and thereafter. From 2008, the results for tax purposes will be measured in nominal values, excluding certain adjustments for changes in the Israeli consumer price index carried out in the period up to December 31, 2007. The amended law includes, among other things, the elimination of the inflationary additions and deductions and the additional deduction for depreciation with effect from 2008.

### **Capital Gains Tax on Sales of Our Ordinary Shares by Foreign Holders**

Under income tax regulations foreign residents of Israel, who sell shares of an Israeli company publicly traded on a recognized stock exchange outside of Israel, will be exempt from tax subject to the satisfaction of all following conditions:

- The capital gain is not attributable to a permanent establishment in Israel.
- The shares were purchased after the first initial public offering on the recognized stock exchange outside of Israel.
- The provisions of the Income Tax Law (Inflationary Adjustments), 1985 do not apply to such gain

However, non-Israeli corporations will not be entitled to the foregoing exemptions if an Israeli resident (i) has a controlling interest of 25% or more in such non-Israeli corporation, or (ii) is the beneficiary of or is entitled to 25% or more of the revenues or profits of such non-Israeli corporation, whether directly or indirectly.

Under the U.S.-Israel Tax Treaty, the sale, exchange or disposition of our ordinary shares by a shareholder who is a U.S. resident (for purposes of the U.S.-Israel Tax Treaty) holding the ordinary shares as a capital asset is exempt from Israeli capital gains tax unless either (i) the shareholder holds, directly or indirectly, shares representing 10% or more of our voting capital during any part of the 12-month period preceding such sale, exchange or disposition or (ii) the capital gains arising from such sale are attributable to a permanent establishment of the shareholder located in Israel. However, under the U.S.-Israel Tax Treaty, such U.S. resident (for purposes of the U.S.-Israel Tax Treaty) would be permitted to claim a credit for such taxes against the U.S. federal income tax imposed with respect to such sale, exchange or disposition, subject to the limitations in U.S. laws applicable to foreign tax credits. The Treaty does not relate to U.S. state or local taxes.

### **Taxation of Foreign Holders of Shares**

Foreign residents of Israel are subject to income tax on income accrued or derived from sources in Israel. Such sources of income include passive income such as dividends, royalties and interest, as well as non-passive income from services rendered in Israel. On distributions of dividends after January 1, 2006 other than bonus shares or stock dividends, income tax at the rate of 20% will be withheld on dividends distributed to Israeli individual shareholders or to foreign residents, unless a different rate is provided in a treaty between Israel and the shareholder's country of residence. With respect to a person who is a "substantial shareholder" at the time receiving the dividend or on any date in the twelve months preceding it, the applicable tax rate is 25%. A "substantial shareholder" is generally a person who alone or together with such person's relative or another person who collaborates with such person on a permanent basis, holds, directly or indirectly, at least 10% of any of the "means of control" of the corporation. "Means of control" generally include the right to vote, receive profits, nominate a director or an officer, receive assets upon liquidation, or order someone who holds any of the aforesaid rights how to act, and all regardless of the source of such right. Under the U.S.-Israel Tax Treaty, the maximum rate of tax withheld in Israel on dividends paid to a holder of our ordinary shares who is a U.S. resident (for purposes of the U.S.-Israel Tax Treaty) is 25%. However, generally, the maximum rate of withholding tax on dividends, not generated by our approved enterprise, that are paid to a U.S. corporation holding 10% or more of our outstanding voting capital throughout the tax year in which the dividend is distributed as well as the previous tax year, is 12.5%. Furthermore, dividends paid from income derived from our approved enterprise are subject, under certain conditions, to withholding at the rate of 15%. We cannot assure you that we will designate the profits that are being distributed in a way that will reduce shareholders' tax liability.

A non-resident of Israel who receives dividends from which tax was withheld is generally exempt from the duty to file returns in Israel in respect of such income, provided such income was not derived from a business conducted in Israel by the taxpayer, and the taxpayer has no other taxable sources of income in Israel.

In some instances where our shareholders may be liable for Israeli tax on the sale of their ordinary shares, the payment of the consideration may be subject to the withholding of Israeli tax at source.

#### **Controlled Foreign Corporation**

In general, and subject to the provisions of all relevant legislation, an Israeli resident who holds, directly or indirectly, 10% or more of the rights in a foreign corporation whose shares are not publicly traded, in which more than 50% of the rights are held directly or indirectly by Israeli residents, and a majority of whose income in a tax year is considered passive income (generally referred to as a Controlled Foreign Corporation), is liable for tax on the portion of his or her income attributed to holdings in such corporation, as if such income was distributed to him or her as a dividend.

#### **UNITED STATES FEDERAL INCOME TAX CONSEQUENCES**

The following is a summary of certain material U.S. federal income tax consequences that apply to U.S. Holders who hold ordinary shares as capital assets. This summary is based on the United States Internal Revenue Code of 1986, as amended (the "Code"), Treasury regulations promulgated thereunder, judicial and administrative interpretations thereof, and the U.S.-Israel Tax Treaty, all as in effect on the date hereof and all of which are subject to change either prospectively or retroactively. This summary does not address all tax considerations that may be relevant with respect to an investment in ordinary shares. This summary does not discuss all the tax consequences that may be relevant to a U.S. Holder in light of such holder's particular circumstances or U.S. Holders subject to special rules, including persons that are non-U.S. Holders, broker-dealers, financial institutions, certain insurance companies, investors liable for alternative minimum tax, tax-exempt organizations, regulated investment companies, taxpayers whose functional currency is not the U.S. dollar, persons who hold the ordinary shares through partnerships or other pass-through entities, persons who acquired their ordinary shares through the exercise or cancellation of employee stock options or otherwise as compensation for services, investors that actually or constructively own 10 percent or more of our voting shares, and investors holding ordinary shares as part of a straddle or appreciated financial position or as part of a hedging or conversion transaction.

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

This summary does not address the effect of any U.S. federal taxation other than U.S. federal income taxation. In addition, this summary does not include any discussion of state, local or foreign taxation.

This summary is not a legal opinion and cannot be used for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code or applicable U.S. state or local laws. You are urged to consult your tax advisors regarding the foreign and United States federal, state and local tax considerations of an investment in ordinary shares.

For purposes of this summary, the term "U.S. Holder" means an individual who is a citizen or, for U.S. federal income tax purposes, a resident of the United States, a corporation or other entity taxable as a corporation created or organized in or under the laws of the United States or any political subdivision thereof, an estate whose income is subject to U.S. federal income tax regardless of its source, or a trust that (a) is subject to the primary supervision of a court within the United States and the control of one or more U.S. persons or (b) has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person.

#### *Taxation of Dividends*

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

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

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

Subject to certain limitations, "qualified dividend income" received by a noncorporate U.S. Holder in tax years beginning on or before December 31, 2011 will be subject to tax at a reduced maximum tax rate of 15 percent. Distributions taxable as dividends paid on the ordinary shares should qualify for the 15 percent rate provided that either: (i) we are entitled to benefits under the income tax treaty between the United States and Israel (the "Treaty") or (ii) the ordinary shares are readily tradable on an established securities market in the United States and certain other requirements are met. We believe that we are entitled to benefits under the Treaty and that the ordinary shares currently are readily tradable on an established securities market in the United States. However, no assurance can be given that the ordinary shares will remain readily tradable. The rate reduction does not apply unless certain holding period requirements are satisfied. With respect to the ordinary shares, the U.S. Holder must have held such shares for at least 61 days during the 121-day period beginning 60 days before the ex-dividend date. The rate reduction also does not apply to dividends received from a passive foreign investment company, see discussion below, or in respect of certain hedged positions or in certain other situations. The legislation enacting the reduced tax rate contains special rules for computing the foreign tax credit limitation of a taxpayer who receives dividends subject to the reduced tax rate. U.S. Holders of ordinary shares should consult their own tax advisors regarding the effect of these rules in their particular circumstances.



#### *Disposition of Ordinary Shares*

If you sell or otherwise dispose of ordinary shares, you will recognize gain or loss for U.S. federal income tax purposes in an amount equal to the difference between the amount realized on the sale or other disposition and your adjusted tax basis in the ordinary shares. Subject to the discussion below under the heading "Passive Foreign Investment Companies," such gain or loss generally will be capital gain or loss and will be long-term capital gain or loss if you have held the ordinary shares for more than one year at the time of the sale or other disposition. In general, any gain that you recognize on the sale or other disposition of ordinary shares will be U.S.-source for purposes of the foreign tax credit limitation; losses will generally be allocated against U.S. source income. Deduction of capital losses is subject to certain limitations under the Code.

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

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

#### *Passive Foreign Investment Companies*

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

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

If we are treated as a PFIC for any taxable year, dividends would not qualify for the reduced maximum tax rate, discussed above, you would be required to file an annual return on IRS Form 8621, and, unless you elect either to treat your investment in ordinary shares as an investment in a "qualified electing fund," or a QEF election, or to "mark to market" your ordinary shares, as described below:

- you would be required to allocate income recognized upon receiving certain dividends or gain recognized upon the disposition of ordinary shares ratably over the holding period for such ordinary shares,
- the amount allocated to each year during which we are considered a PFIC other than the year of the dividend payment or disposition would be subject to tax at the highest individual or corporate tax rate, as the case may be, in effect for that year and an interest charge would be imposed with respect to the resulting tax liability allocated to each such year, and
- the amount allocated to the current taxable year and any taxable year before we became a PFIC would be taxable as ordinary income in the current year.

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

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

#### *Backup Withholding and Information Reporting*

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

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

Any U.S. holder who holds 10% or more in vote or value of our ordinary shares will be subject to certain additional United States information reporting requirements.

#### **F. Dividends and Paying Agents.**

Not applicable.

#### **G. Statements by Experts.**

Not applicable.

#### **H. Documents on Display.**

We are subject to certain of the reporting requirements of the Securities and Exchange Act of 1934, as amended, or the Exchange Act, as applicable to "foreign private issuers" as defined in Rule 3b-4 under the Exchange Act. As a foreign private issuer, we are exempt from certain provisions of the Exchange Act. Accordingly, our proxy solicitations are not subject to the disclosure and procedural requirements of Regulation 14A under the Exchange Act, and transactions in our equity securities by our officers and directors are exempt from reporting and the "short-swing" profit recovery provisions contained in Section 16 of the Exchange Act. In addition, we are not required under the Exchange Act to file periodic reports and financial statements as frequently or as promptly as U.S. companies whose securities are registered under the Exchange Act. However, we file with the Securities and Exchange Commission an annual report on Form 20-F containing financial statements audited by an independent accounting firm. We also submit to the Securities and Exchange Commission reports on Form 6-K containing (among other things) press releases and unaudited financial information. We post our annual report on Form 20-F on our website ([www.magal-s3.com](http://www.magal-s3.com)) promptly following the filing of our annual report with the Securities and Exchange Commission. The information on our website is not incorporated by reference into this annual report.

This annual report and the exhibits thereto and any other document we file pursuant to the Exchange Act may be inspected without charge and copied at prescribed rates at the Securities and Exchange Commission public reference room at 100 F Street, N.E., Room 1580, Washington, D.C. 20549. You may obtain information on the operation of the Securities and Exchange Commission's public reference room in Washington, D.C. by calling the Securities and Exchange Commission at 1-800-SEC-0330. The Exchange Act file number for our Securities and Exchange Commission filings is 000-21388.

The Securities and Exchange Commission maintains a website at [www.sec.gov](http://www.sec.gov) that contains reports, proxy and information statements, and other information regarding registrants that make electronic filings with the Securities and Exchange Commission using its EDGAR (Electronic Data Gathering, Analysis, and Retrieval) system.

The documents concerning our company that are referred to in this annual report may also be inspected at our executive offices in Israel.

In addition, since we are also listed on the Tel Aviv Stock Exchange, we submit copies of all our filings with the SEC to the Israeli Securities Authority and Tel Aviv Stock Exchange. Such copies can be retrieved electronically through the Tel Aviv Stock Exchange's internet messaging system ([www.maya.tase.co.il](http://www.maya.tase.co.il)) and through the MAGNA distribution site of the Israeli Securities Authority ([www.magna.isa.gov.il](http://www.magna.isa.gov.il)).

**I. Subsidiary Information.**

Not applicable.

**ITEM 11. Quantitative and Qualitative Disclosures about Market Risk**

We are exposed to a variety of risks, including changes in interest rates and foreign currency fluctuations.

**Interest Rate Risk**

Our exposure to market risk for changes in interest rates is related to our long-term and short-term loans. Our financial expenses are sensitive to the LIBOR and prime interest rates, since our short-term loans bear prime-based interest rates and of our \$0.6 million in long-term loans, \$0.5 million bears LIBOR interest rate and \$0.1 million bear prime-based interest rates.

The table below presents principal amounts and related weighted average interest rates by date of maturity for our loans:

**Interest Rate Sensitivity**  
**Principal Amount by Expected Maturity Date and Weighted Average Interest Rate**

(U.S. dollars in thousands)

Liabilities	2011	2012	2013	2014	Total	Fair Value at December 31, 2010
Short-term loans	\$ 9,327	-	-	-	\$ 9,327	\$ 9,327
Weighted average interest rate (%)	5.5				5.5	
Long-term loans	\$ 503	\$ 23	\$ 27	-	\$ 553	\$ 553
Weighted average interest rate (%)	1	3	3	-	1.15	-

**Foreign Currency Exchange Risk**

We sell most of our products in North America, Europe and Israel. Our revenues are primarily denominated in U.S. dollars, Euros and NIS, while a portion of our expenses, primarily labor expenses, is incurred in NIS and Canadian Dollars. Additionally, certain assets, especially trade receivables, as well as part of our liabilities are denominated in NIS. As a result, fluctuations in rates of exchange between the U.S. dollar and non-U.S. dollar currencies may affect our operating results and financial condition. The dollar cost of our operations in Israel may be adversely affected by the appreciation of the NIS against the U.S. dollar. In addition, the value of our non-U.S. dollar revenues could be adversely affected by the depreciation of the U.S. dollar against such currencies. In 2008, 2009 and 2010, the NIS appreciated by approximately 1.1%, 0.7% and 6.0%, respectively, against the U.S. dollar, which had an adverse effect on our results of operations. In 2008 and 2010, the Euro depreciated against the U.S. dollar by 5.3% and 7.4%, respectively, while in 2009 the Euro appreciated against the U.S. dollar by 3.5%.

In addition, the U.S. dollar cost of our operations in Canada is influenced by the exchange rate between the U.S. dollar and the Canadian dollar. In 2008, the Canadian dollar depreciated against the U.S. dollar by approximately 19.7%, while in 2009 and 2010 the Canadian dollar appreciated against the U.S. dollar by 16.6% and 4.9%, respectively.

During the years ended December 31, 2008, 2009 and 2010, foreign currency fluctuations had an adverse impact on our results of operations and we recorded foreign exchange losses, net of \$246,000, \$1,138,000 and \$199,000, respectively. We cannot assure you that in the future our results of operations may not be materially adversely affected by currency fluctuations.

To protect against the change in the forecasted foreign currency cash flows of certain sale arrangements resulting from changes in the exchange rate, from time to time we have entered into forward contracts to hedge portions of our forecasted revenue and unbilled accounts receivable denominated in foreign currencies. We have designated the forward instruments as cash flow hedges for accounting purposes. In 2009 and 2010 we had no forward contracts.

For derivative instruments designated as cash flow hedges (i.e., hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings in the same line item associated with the forecasted transaction in the same period or periods during which the hedged transaction affects earnings.

We recorded \$291,000, \$0 and \$0 of financial expenses related to forward contracts transactions in 2008, 2009 and 2010, respectively.

**ITEM 12. Description of Securities Other Than Equity Securities**

Not applicable.

## PART II

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

Not applicable.

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

Not applicable.

### ITEM 15. Controls and Procedures

#### Disclosure Controls and Procedures

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

#### Management's Report on Internal Control over Financial Reporting

Our management, including our chief executive officer and chief financial officer, is responsible for establishing and maintaining adequate internal control over financial reporting, as defined under Exchange Act Rules 13a-15(f) and 15d-15(f). Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States. Internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets, (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with appropriate authorizations; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2010. In conducting its assessment of internal control over financial reporting, management based its evaluation on the framework in "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations, or the COSO, of the Treadway Commission. Based on that assessment, our management has concluded that our internal control over financial reporting was effective as of December 31, 2010.

#### Changes in Internal Control over Financial Reporting

During the period covered by this Annual Report on Form 20-F, no changes in our internal control over financial reporting have occurred that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### ITEM 16A. Audit Committee Financial Expert

Our board of directors has determined that Ms. Liza Singer, an external and independent director, meets the definition of an audit committee financial expert, as defined by rules of the Securities and Exchange Commission. For a brief description of Ms. Singer's relevant experience, see Item 6.A. "Directors, Senior Management and Employees - Directors and Senior Management."

**ITEM 16B. Code of Ethics**

On April 11, 2010, we adopted an amended and restated code of ethics that revised the provisions of our previous code of ethics. The amended and restated code of ethics applies to our chief executive officer and all senior financial officers of our company, including our chief financial officer, chief accounting officer or controller, and persons performing similar functions. The amended and restated code of ethics reflects our growing emphasis on international operations and better addresses issues related with such activities by providing clear instructions in connection with commercial international activities. The code of ethics is publicly available on our website at [www.magal-s3.com](http://www.magal-s3.com). Written copies are available upon request. If we make any substantive amendment to the code of ethics or grant any waivers, including any implicit waiver, from a provision of the code of ethics, we will disclose the nature of such amendment or waiver on our website.

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

**Independent Public Accountant Fees and Services**

The following table sets forth, for each of the years indicated, the fees billed by our principal independent registered public accounting firm, Kost Forer Gabbay & Kasierer. All of such fees were pre-approved by our Audit Committee.

Services Rendered	Year Ended December 31	
	2009	2010
Audit (1)	\$ 570,000	\$ 369,000
Tax (2)	101,000	45,000
Other (3)	43,000	43,000
Total	\$ 714,000	\$ 457,000

- (1) Audit fees are for audit services for each of the years shown in the table, including fees associated with the annual audit (including audit of our internal control over financial reporting), consultations on various accounting issues and audit services provided in connection with other statutory or regulatory filings.
- (2) Tax fees are for professional services rendered by our auditors for tax compliance, tax planning and tax advice on actual or contemplated transactions, tax consulting associated to international taxation, tax assessment deliberation, transfer pricing and withholding tax assessments.
- (3) Other fees primarily relate to out of pocket reimbursement of expenses, primarily traveling expenses of our auditors. In 2009, other fees also include fees for due diligence performed in connection with a contemplated acquisition. In 2010, these fees also relate to fees associated with our proposed rights offering.

**Pre-Approval Policies and Procedures**

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

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

Not applicable.

**ITEM 16E. Purchase of Equity Securities by the Issuer and Affiliated Purchasers**

Neither we nor any affiliated purchaser has purchased any of our securities during 2010.

**ITEM 16F. Changes In Registrant's Certifying Accountant**

None.

**ITEM 16G. Corporate Governance**

Under NASDAQ Listing Rule 5615(a)(3), foreign private issuers, such as our company, are permitted to follow certain home country corporate governance practices instead of certain provisions of NASDAQ Listing Rules. A foreign private issuer that elects to follow a home country practice instead of any of such NASDAQ requirements must submit to NASDAQ in advance a written statement from an independent counsel in such issuer's home country certifying that the issuer's practices are not prohibited by the home country's laws.

On July 7, 2005, we notified NASDAQ that we do not comply with the following NASDAQ requirements, and instead follow Israeli law and practice in respect of such requirements:

- the requirement regarding the process of nominating directors. Instead, we follow Israeli law and practice in accordance with which our directors are recommended by our board of directors for election by our shareholders. See Item 6.C. "Directors, Senior Management and Employees - Board Practices - Election of Directors."
- the requirement regarding the compensation of our chief executive officer and all other executive officers. Instead, we follow Israeli law and practice in accordance with which our board of directors must approve all compensation arrangements for our chief executive officer and all compensation arrangements for officers are subject to the chief executive officer's approval. See Item 6.C. "Directors, Senior Management and Employees - Compensation."
- the requirement that our independent directors have regularly scheduled meetings at which only independent directors are present. Under Israeli law independent directors are not required to hold executive sessions.

In addition, on June 30, 2006, we provided NASDAQ with a notice of non-compliance with respect to the requirement to maintain a majority of independent directors, as defined under NASDAQ Listing Rules. Instead, under Israeli law and practice we are required to appoint at least two external directors, within the meaning of the Israeli Companies Law, to our board of directors.

**PART III**

**ITEM 17. Financial Statements**

We have elected to furnish financial statements and related information specified in Item 18.

**ITEM 18. Financial Statements**

The financial statements required by this item are found at the end of this annual report, beginning on page F-1.

**Consolidated Financial Statements**

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**ITEM 19. Exhibits**

<u>Exhibit No.</u>	<u>Description</u>
1.1	Memorandum of Association of the Registrant <sup>(1)</sup>
1.2	Articles of Association of the Registrant <sup>(2)</sup>
2.1	Specimen Share Certificate for Ordinary Share <sup>(3)</sup>
2.2	Registrant's 2003 Israeli Share Option Plan <sup>(4)</sup>
2.3	Registrant's 2010 Israeli Share Option Plan
2.4	Amended and Restated Term Sheet between the Registrant and Nathan Kirsh, originally entered into on July 20, 2010 and amended on September 6, 2010, and further amended on November 3, 2010 <sup>(5)</sup>
4.1	Agreement between the Kenya Port Authority and the Registrant for the Plant Design, Supply, Delivery, Installation and Commissioning of an Integrated Security System dated December 10, 2010
8.1	List of Subsidiaries of the Registrant
12.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act, as amended
12.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act, as amended



- 13.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 13.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 15.1 Consent of Kost Forer Gabbay & Kasierer
- 15.2 Consent of Salles, Sáinz - Grant Thornton, S. C. (relating to Senstar Stellar Latin America, S. A. de C.V.)
- 

- (1) Filed as an exhibit to our Registration Statement on Form F-1 (File No. 33-57438), filed with the Securities and Exchange Commission on January 26, 1993, as amended, and incorporated herein by reference.
- (2) Filed as an exhibit to our Registration Statement on Form F-1 (No. 33-57438), filed with the Securities and Exchange Commission on January 26, 1993, as amended, and incorporated herein by reference, as amended by an amendment filed as an exhibit to our Registration Statement on Form S-8 (File No. 333-6246), filed with the Commission on January 7, 1997 and incorporated herein by reference, and as further amended by an amendment filed as an exhibit to our Annual Report on Form 20-F for the fiscal year ended December 31, 2000, filed with the Securities and Exchange Commission on June 29, 2001 and incorporated herein by reference.
- (3) Filed as an exhibit to our Registration Statement on Form 8-A, filed with the Securities and Exchange Commission on March 18, 1993, as amended, and incorporated herein by reference.
- (4) Filed as Exhibit 4.3 to the Registrant's Registration Statement on Form S-8 (File No. 333-127340), filed with the Securities and Exchange Commission on August 9, 2005, and incorporated herein by reference.
- (5) Filed as Exhibit 4.9 to the Registrant's Registration Statement on Form F-1 (File No. 333-171320), filed with the Securities and Exchange Commission on December 21, 2010, and incorporated herein by reference.

MAGAL SECURITY SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2010

IN U.S. DOLLARS

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

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

**MAGAL SECURITY SYSTEMS LTD.**

We have audited the accompanying consolidated balance sheets of Magal Security Systems Ltd. and its subsidiaries ("the Company") as of December 31, 2009 and 2010, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2010. 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.

In 2008, we did not audit the financial statements of a certain subsidiary, whose revenues constitute approximately 4.9% of total consolidated revenues for the year ended December 31, 2008. The financial statements of this company were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to amounts included for this subsidiary, is based solely on the report of the other auditors.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits and the report of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2009 and 2010, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2010, in conformity with U.S. generally accepted accounting principles.

Tel-Aviv, Israel  
April 11, 2011

/s/ Kost Forer Gabbay & Kasierer  
KOST FORER GABBAY & KASIERER  
A Member of Ernst & Young Global

## CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	December 31,	
	2009	2010
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 11,869	\$ 16,596
Short-term bank deposits	1,807	-
Restricted deposit	172	2,692
Trade receivables (net of allowance for doubtful accounts of \$ 911 and \$ 919 at December 31, 2009 and 2010, respectively)	12,328	15,106
Unbilled accounts receivable	5,892	2,927
Other accounts receivable and prepaid expenses (Note 4)	1,401	2,417
Deferred income taxes (Note 15)	272	474
Inventories (Note 5)	10,912	10,340
<b>Total current assets</b>	<b>44,653</b>	<b>50,552</b>
<b>LONG-TERM INVESTMENTS AND RECEIVABLES:</b>		
Long-term trade receivables	1,753	1,568
Long-term loan (Note 12i)	200	-
Long-term restricted deposits	40	2,196
Severance pay fund	2,476	2,148
<b>Total long-term investments and receivables</b>	<b>4,469</b>	<b>5,912</b>
<b>PROPERTY AND EQUIPMENT, NET (Note 6)</b>	<b>9,178</b>	<b>6,794</b>
<b>OTHER INTANGIBLE ASSETS, NET (Note 7)</b>	<b>269</b>	<b>213</b>
<b>GOODWILL (Note 2l)</b>	<b>2,053</b>	<b>2,026</b>
<b>ASSETS ATTRIBUTED TO DISCONTINUED OPERATIONS (Note 16)</b>	<b>28</b>	<b>-</b>
<b>Total assets</b>	<b>\$ 60,650</b>	<b>\$ 65,497</b>

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

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands (except share and per share data)

	December 31,	
	2009	2010
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Short-term bank credit (Note 9)	\$ 8,234	\$ 9,327
Current maturities of long-term bank debt (Note 11)	1,824	503
Trade payables	4,018	3,937
Customer advances	2,330	2,428
Other accounts payable and accrued expenses (Note 10)	7,601	7,745
<b>Total</b> current liabilities	<b>24,007</b>	<b>23,940</b>
<b>LONG-TERM LIABILITIES:</b>		
Long-term bank debt (Note 11)	548	50
Loan from related party (Note 1d)	-	9,907
Deferred income taxes (Note 15)	179	190
Accrued severance pay	3,562	3,394
<b>Total</b> long-term liabilities	<b>4,289</b>	<b>13,541</b>
LIABILITIES ATTRIBUTED TO DISCONTINUED OPERATIONS (Note 16)	45	-
<b>COMMITMENTS AND CONTINGENT LIABILITIES (Note 12)</b>		
<b>SHAREHOLDERS' EQUITY (Note 13):</b>		
Share capital -		
Ordinary shares of NIS 1 par value -		
Authorized: 19,748,000 shares at December 31, 2009 and 2010; Issued and outstanding: 10,396,548 shares at December 31, 2009 and 2010	3,225	3,225
Additional paid-in capital	48,741	49,971
Accumulated other comprehensive income	3,849	5,075
Foreign currency translation adjustments (Company's stand alone financial statements)	3,890	3,400
Accumulated deficit	(27,450)	(33,655)
<b>Total</b> Magal shareholders' equity	<b>32,255</b>	<b>28,016</b>
Non controlling interest	54	-
<b>Total</b> shareholders' equity	<b>32,309</b>	<b>28,016</b>
<b>Total</b> liabilities and shareholders' equity	<b>\$ 60,650</b>	<b>\$ 65,497</b>

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

CONSOLIDATED STATEMENTS OF OPERATIONS

U.S. dollars in thousands (except per share data)

	Year ended December 31,		
	2008	2009	2010
Revenues	\$ 57,105	\$ 54,518	\$ 49,699
Cost of revenues	37,559	33,404	31,400
Gross profit	19,546	21,114	18,299
Operating expenses:			
Research and development	5,556	5,059	4,105
Selling and marketing	12,953	10,820	11,261
General and administrative	10,243	8,100	7,593
Impairment of goodwill and other intangible assets (Note 16,7b)	2,772	-	-
Post employment and termination benefits (Note 2t)	2,582	-	-
Total operating expenses	34,106	23,979	22,959
Operating loss	(14,560)	(2,865)	(4,660)
Financial expenses, net (Note 19)	1,314	1,568	967
Loss before income taxes	(15,874)	(4,433)	(5,627)
Income taxes (Note 15)	3,066	864	602
Loss from continuing operations	(18,940)	(5,297)	(6,229)
Income (loss) from discontinued operations, net (Note 16)	(13,662)	4,216	-
Loss	(32,602)	(1,081)	(6,229)
Less: loss (income ) attributable to non-controlling interest	-	(54)	24
Loss attributable to Magal shareholders	\$ (32,602)	\$ (1,135)	\$ (6,205)
Basic and diluted loss per share from continuing operations	\$ (1.82)	\$ (0.52)	\$ (0.60)
Basic and diluted net earnings (loss) per share from discontinued operations	(1.32)	0.41	-
Basic loss per share (Note 14)	\$ (3.14)	\$ (0.11)	\$ (0.60)

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

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. dollars in thousands (except share data)

	<u>Number of shares</u>	<u>Ordinary shares</u>	<u>Additional paid-in capital</u>	<u>Accumulated other comprehensive income (loss)</u>	<u>Foreign currency translation adjustment - the Company</u>	<u>Retained earnings (accumulated deficit)</u>	<u>Non- controlling interest</u>	<u>Total comprehensive income (loss)</u>	<u>Total shareholders' equity</u>
Balance as of January 1, 2008	10,396,548	\$ 3,225	\$ 47,806	\$ 5,671	\$ 2,589	\$ 6,287	\$ -	\$ -	\$ 65,578
Stock-based compensation	-	-	237	-	-	-	-	-	237
Comprehensive income (loss):									
Loss	-	-	-	-	-	(32,602)	-	\$ (32,602)	(32,602)
Realized loss from available- for-sale securities	-	-	-	151	-	-	-	151	151
Foreign currency translation adjustments	-	-	-	(3,350)	704	-	-	(3,350)	(2,646)
Total comprehensive loss								<u>\$ (35,801)</u>	
Balance as of December 31, 2008	10,396,548	3,225	48,043	2,472	3,293	(26,315)	-	-	30,718
Stock-based compensation	-	-	542	-	-	-	-	-	542
Stock-based compensation – granted by related party	-	-	156	-	-	-	-	-	156
Comprehensive income (loss):									
Loss	-	-	-	-	-	(1,135)	54	\$ (1,081)	(1,081)
Realized foreign currency translation adjustments from sale of subsidiary	-	-	-	(789)	-	-	-	(789)	(789)
Foreign currency translation adjustments	-	-	-	2,166	597	-	-	2,166	2,763
Total comprehensive income								<u>\$ 296</u>	
Balance as of December 31, 2009	<u>10,396,548</u>	<u>\$ 3,225</u>	<u>\$ 48,741</u>	<u>\$ 3,849</u>	<u>\$ 3,890</u>	<u>\$ (27,450)</u>	<u>\$ 54</u>		<u>\$ 32,309</u>

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

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. dollars in thousands (except share data)

	<u>Number of shares</u>	<u>Ordinary shares</u>	<u>Additional paid-in capital</u>	<u>Accumulated other comprehensive income (loss)</u>	<u>Foreign currency translation - the Company</u>	<u>Retained earnings (accumulated deficit)</u>	<u>Non- controlling interest</u>	<u>Total comprehensive income (loss)</u>	<u>Total shareholders' equity</u>
Balance as of December 31, 2009	10,396,548	\$ 3,225	\$ 48,741	\$ 3,849	\$ 3,890	\$ (27,450)	\$ 54		\$ 32,309
Stock-based compensation	-	-	833	-	-	-	-	-	833
Stock-based compensation – granted by related party	-	-	100	-	-	-	-	-	100
Capital fund on loan granted by a related party	-	-	297	-	-	-	-	-	297
Purchase of non-controlling interests	-	-	-	-	-	-	(30)	-	(30)
Comprehensive income (loss):									
Loss	-	-	-	-	-	(6,205)	(24)	\$ (6,229)	(6,229)
Foreign currency translation adjustments	-	-	-	1,226	(490)	-	-	1,226	736
Total comprehensive income								\$ (5,003)	
Balance as of December 31, 2010	<u>10,396,548</u>	<u>\$ 3,225</u>	<u>\$ 49,971</u>	<u>\$ 5,075</u>	<u>\$ 3,400</u>	<u>\$ (33,655)</u>	<u>\$ -</u>		<u>\$ 28,016</u>

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



CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2008	2009	2010
<b>Cash flows from operating activities:</b>			
Loss	\$ (32,602)	\$ (1,081)	\$ (6,229)
Adjustments required to reconcile loss to net cash provided by operating activities:			
Loss (income) from discontinued operations	13,662	(4,216)	-
Depreciation and amortization	1,191	1,204	1,062
Impairment of goodwill and other intangible assets	2,772	-	-
Loss (gain) on sale of property and equipment	(9)	268	48
Decrease (increase) in accrued interest and exchange differences on marketable securities, short-term and long-term bank deposits and long-term loans	1,696	2	(510)
Write off of long term loan	550	319	206
Stock based compensation	237	698	933
Losses (gains) on forward contract, net	291	-	-
Decrease (increase) in trade receivables, net	10,595	3,889	(2,809)
Decrease (increase) in unbilled accounts receivable	(1,201)	(582)	3,161
Decrease (increase) in other accounts receivable and prepaid expenses	276	1,984	(960)
Decrease (increase) in deferred income taxes	2,359	793	(168)
Decrease in inventories	1,951	3,888	995
Decrease in long-term trade receivables	216	95	282
Decrease in trade payables	(1,618)	(899)	(258)
Increase (decrease) in other accounts payable and accrued expenses	(409)	(1,640)	187
Increase (decrease) in customer advances	1,202	551	(7)
Accrued severance pay, net	(66)	378	87
Net cash provided by (used in) continuing operations	1,093	5,651	(3,980)
Net cash provided by (used in) discontinued operations	(378)	120	(17)
Net cash provided by (used in) operating activities	715	5,771	(3,997)

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2008	2009	2010
<b>Cash flows from investing activities:</b>			
Purchase of short-term deposits	(1,412)	-	-
Proceeds from sale of short-term bank deposits	11,100	1,316	1,857
Escrow deposit	-	920	-
Investment in long-term bank deposits and restricted deposit	-	(13)	(5,149)
Purchase of marketable securities	(1,968)	-	-
Proceeds from sale of marketable securities	3,802	918	-
Investment in long-term loan	(187)	-	-
Release of restricted deposit	-	-	483
Proceeds from sale of property and equipment	25	64	2,080
Purchase of property and equipment	(1,411)	(2,025)	(363)
Investment in know-how and patents	(29)	(27)	(24)
Proceeds from sale of subsidiary (a)	-	2,850	-
Net cash provided by (used in) continuing activities	9,920	4,003	(1,116)
Net cash provided by discontinued operations	(3,281)	(15)	-
Net cash provided by (used in) investing activities	6,639	3,988	(1,116)
<b>Cash flows from financing activities:</b>			
Short-term bank credit, net	7,113	(14,553)	536
Proceeds from long-term bank loans	-	97	-
Principal payment of long-term bank loans	(4,303)	(829)	(1,827)
Proceeds from related party loan	-	-	10,000
Net cash provided by (used in) continuing operations	2,810	(15,285)	8,709
Net cash provided by (used in) discontinued operations	(145)	771	-
Net cash provided by (used in) financing activities	2,665	(14,514)	8,709
Effect of exchange rate changes on cash and cash equivalents	(2,389)	(211)	1,131
Increase (decrease) in cash and cash equivalents	7,630	(4,966)	4,727
Cash and cash equivalents at the beginning of the year	9,205	16,835	11,869
Cash and cash equivalents at the end of the year	\$ 16,835	\$ 11,869	\$ 16,596

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2008	2009	2010
<b>Supplemental disclosures of cash flows activities:</b>			
Cash paid during the year for:			
Interest	\$ 1,686	\$ 881	\$ 463
Income taxes	\$ 1,286	\$ 431	\$ 389
Sale of marketable security to a former shareholder of subsidiary	\$ 4,410	\$ -	\$ -
<b>(a) Proceeds from Sale of Subsidiary</b>			
Working capital, net		\$ (3,227)	
Property and equipment		339	
Accrued severance pay		(418)	
Customer related intangible assets		2,614	
Deferred taxes		(715)	
Capital gain		4,257	
		<u>\$ 2,850</u>	

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

NOTE 1:- GENERAL

- a. Magal Security Systems Ltd. ("the Parent Company") and its subsidiaries (together - "the Company") are engaged in the development, manufacture, marketing and sale of complex computerized security systems used to automatically detect and deter human intrusion for both civilian and military markets. The Company's systems are used in more than 75 countries around the world.

As for major customer data, see Note 18b.

- b. The Company has obtained shareholder approval to file a registration statement with the U.S. Securities and Exchange Commission with respect to a rights offering to be made to holders of the Company's ordinary shares, which are traded on the NASDAQ Global Market and the Tel-Aviv Stock Exchange, for a total amount of \$ 15,000. Shareholders who fully exercise their basic subscription rights will be entitled to subscribe for additional rights that remain unsubscribed as a result of any unexercised basic subscription rights. In addition, Mr. Nathan Kirsh, the Company's controlling shareholder and a director, has undertaken to exercise, directly or through entities owned by him, his basic subscription rights in full and his over-subscription rights in full, up to the total rights offering amount of \$ 15,000.

- c. In order to comply with the Israeli Companies Law, prior to the rights offering the Company must complete a private placement of 150,000 of its Ordinary shares to Ki Corporation Limited ("Ki Corporation"), a company owned by Mr. Nathan Kirsh. Such private placement will be made at an initial price per share equal to the closing price of the Company's Ordinary shares on the NASDAQ Global Market on the date preceding the private placement. Upon the effective date of the rights offering, the price per share paid by Ki Corporation will be adjusted to the higher of the price per share in the rights offering and the closing price of the Ordinary shares on the NASDAQ Global Market on the date preceding the effective date of the rights offering. The private placement consideration to be received from Ki Corporation Limited will be paid to the Company by means of a partial offset against the outstanding principal amount due Ki Corporation under the bridge loan that it provided to the Company on September 8, 2010.

- d. On September 8, 2010, Ki Corporation provided the Company with a \$ 10,000 bridge loan. The loan agreement provided that if it is not repaid within 180 days, the bridge loan would then accrue interest at the rate of LIBOR + 4% per year, calculated from the date of the loan and to be accumulated on a quarterly basis. However, if the rights offering that Company intends to initiate during 2011 occurs within 240 days from the date of the loan, the loan will not bear any interest. The Company has undertaken to repay the bridge loan within five business days after the successful completion of the rights offering.

The term of the loan ends on January 10, 2012, after which the Company will retain an option to extend the loan for a further 60 days.

The principal at the amount of \$ 10,000 and the interest will be paid at the end of the term of the loan. The principal and the interest will be paid in the same manner.

The loan was recorded at fair value in the amount of \$ 9,703 using an effective interest rate of 6.7%. The difference between consideration received and the fair value of the loan was recorded in the statement of changes in shareholders' equity.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

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

a. Use of estimates:

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

b. Financial statements in U.S. dollars:

The Parent Company's revenues are generated in NIS, U.S. dollars and Euros. In addition, most of the Parent Company's costs are incurred in NIS. The Parent Company's management believes that the NIS is the primary currency of the economic environment in which the Parent Company operates.

In accordance with U.S. Securities and Exchange Commission Regulation S-X, Rule 3-20, the Company has determined its reporting currency to be the U. S. dollar. The measurement process of Rule 3-20 is conceptually consistent with that of ASC 830.

Therefore, the functional currency of the Company is the NIS and its reporting currency is the U.S. dollar. The functional currency of the Company's foreign subsidiaries is the local currency in which each subsidiary operates.

ASC 830 " Foreign Currency Matters" sets the standards for translating foreign currency financial statements of consolidated subsidiaries. The first step in the translation process is to identify the functional currency for each entity included in the financial statements. The accounts of each entity are then measured in its functional currency. All transaction gains and losses from the measurement of monetary balance sheet items are reflected in the statement of operations as financial income or expenses, as appropriate.

After the measurement process is complete the financial statements are translated into the reporting currency, which is the U.S. dollar, using the current rate method. Equity accounts are translated using historical exchange rates. All other balance sheet accounts are translated using the exchange rates in effect at the balance sheet date. Statement of operations amounts have been translated using the average exchange rate for the year. The resulting translation adjustments are reported as a component of shareholders' equity in accumulated other comprehensive income (loss).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

c. Principles of consolidation:

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

On January 1, 2009, the Company adopted an amendment to ASC 810, "Consolidation." According to the amendment, a non-controlling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as a separate component of equity in the consolidated financial statements. As such, changes in the parent's ownership interest with no change of control are treated as equity transactions, rather than step acquisitions or dilution gains or losses. The amendment also clarifies that losses of partially owned consolidated subsidiaries shall continue to be allocated to the non-controlling interests even when their investment was already reduced to zero.

d. Cash equivalents:

Cash equivalents are short-term highly liquid investments that are readily convertible into cash with original maturities of three months or less at the date acquired.

e. Marketable securities:

The Company accounts for investments in debt securities in accordance with ASC 320 Investments - Debt and Equity Securities. Management determines the appropriate classification of its investments in debt securities at the time of purchase and reevaluates such determinations at each balance sheet date. The debt securities are classified as "available-for-sale" since the Company does not have the intent to hold the securities to maturity, and are stated at fair value. Available-for-sale securities are carried at fair value with unrealized gains and losses reported net of tax in accumulated "other comprehensive income" as a separate component of shareholders equity. Realized gains and losses on sales of investments, as determined on a specific identification basis, are included in financial income, net, together with accretion (amortization) of discount (premium), and interest.

The Company recognizes an impairment charge when a decline in the fair value of its investments below the cost basis is judged to be other-than-temporary.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

In 2009, the Company adopted an amendment to ASC 320-10 that changed the impairment and presentation model for its available-for-sale debt securities. Under the amended impairment model, an other-than-temporary impairment ("OTTI") loss is recognized in earnings, based on the entire difference between the fair value and the amortized carrying amount, if the entity has the intent to sell the debt security, or if it is more likely than not that it will be required to sell the debt security before recovery of its amortized cost basis. However, if an entity does not expect to sell and it is not more likely than not that it will be required to sell a debt security, it will still need to evaluate expected cash flows to be received and determine if a credit loss exists. In the event of a credit loss, only the amount of impairment associated with the credit loss is recognized currently in earnings. Amounts relating to factors other than credit losses are recorded in other comprehensive income.

The initial application of the amendment to ASC 320-10 did not result in any cumulative effect for the Company. During 2009 the Company sold all its remaining securities.

f. Short-term and long-term bank deposits:

Short-term bank deposits are deposits with maturities of more than three months and less than one year, and are presented at their cost.

A bank deposit with a maturity of more than one year is included in long-term bank deposits, and presented at cost.

g. Inventories:

Inventories are stated at the lower of cost or market value. The Company periodically evaluates the quantities on hand relative to historical and projected sales volumes, current and historical selling prices and contractual obligations to maintain certain levels of parts. Based on these evaluations, inventory write-offs are provided to cover risks arising from slow-moving items, discontinued products, excess inventories, market prices lower than cost and adjusted revenue forecasts.

Cost is determined as follows:

Raw materials, parts and supplies: using the "first-in, first-out" method.

Work in progress and finished products: on the basis of direct manufacturing costs with the addition of allocable indirect cost, representing allocable operating overhead expenses and manufacturing costs.

During 2008, 2009 and 2010, the Company recorded inventory write-offs from continued operations in the amounts of \$ 2,041, \$ 1,391 and \$ 309, respectively. Such write-offs were included in cost of revenues.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

h. Long-term trade receivables:

Long-term trade and other receivables with long term payment terms are recorded at their estimated present values.

i. Property and equipment:

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

	%
Buildings	3 – 4
Machinery and equipment	10 - 33 (mainly 10%)
Motor vehicles	15
Promotional displays	25 – 50
Office furniture and equipment	6 – 33
Leasehold improvements	By the shorter of the term of the lease or the useful life of the assets

j. Intangible assets:

Intangible assets are amortized over their useful lives using a method of amortization that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used up, in accordance with ASC 350 Intangibles - Goodwill and Other.

Know-how is amortized over five to ten years, patents are amortized over a period of ten years and technology is amortized over eight years.

k. Impairment of long-lived assets:

The Company's long-lived assets and certain identifiable intangibles are reviewed for impairment in accordance with ASC 360 Property, Plant, and Equipment whenever events or changes in circumstances indicate that the carrying amount of a group of assets may not be recoverable. Recoverability of a group of assets to be held and used is measured by a comparison of the carrying amount of the group to the future undiscounted cash flows expected to be generated by the group. If such group of assets is considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds their fair value. In 2009 and 2010, the Company did not record any impairment charges attributable to long-lived assets. In 2008, the Company recorded an impairment charge of \$ 2,043 (of which \$ 1,692 was classified as discontinued operations) attributable to such intangible assets.



NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Effective 2009, as required by ASC 820, "Fair Value Measurements and Disclosures," the Company applies assumptions that market place participants would consider in determining the fair value of its long lived assets (including finite lived intangible assets).

1. Goodwill:

Goodwill has been recorded as a result of past acquisitions and represents excess of the costs over the net fair value of the assets of the businesses acquired.

Goodwill is allocated to one Reporting Unit within the Perimeter Products segment.

The Company follows ASC 350, "Intangibles – Goodwill and Other."

ASC 350 requires goodwill to be tested for impairment, at the reporting unit level, at least annually or between annual tests in certain circumstances, and written down when impaired, rather than being amortized. The Company performs its goodwill annual impairment test at December 31 of each year, or more often if indicators of impairment are present.

ASC 350 prescribes a two phase process for impairment testing of goodwill. The first phase screens for impairment, while the second phase (if necessary) measures impairment. In the first phase of impairment testing, goodwill attributable to each of the reporting units is tested for impairment by comparing the fair value of each reporting unit with its carrying value. If the carrying value of the reporting unit exceeds its fair value, the second phase is then performed. The second phase of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. Fair value is determined using discounted cash flows, based on the income approach, as the Company believes that this approach best approximates the reporting unit's fair value at this time. Significant estimates used in the methodologies include estimates of future cash flows, future short-term and long-term growth rates and weighted average cost of capital for each of the reporting units.

The material assumptions used for the income approach for 2010 were five years of projected net cash flows, a Weighted Average Cost of Capital (WACC) rate of 15.5% and a long-term growth rate of 1%. The Company considered historical rates and current market conditions when determining the discount and growth rates to use in its analyses. If these estimates or their related assumptions change in the future, the Company may be required to record impairment charges for its goodwill.

Effective 2010, as required by ASC 820, "Fair Value Measurements and disclosures," the Company applies assumptions that marketplace participants would consider in determining the fair value of its reporting unit.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

For 2009 and 2010, the Company did not record any impairment charges. In 2008, the Company recorded an impairment charge in the amount of \$ 10,844 (of which \$ 8,423 was classified as discontinued operations).

m. Revenue recognition:

The Company generates its revenues mainly from (1) installation of comprehensive security systems for which revenues are generated from long-term fixed price contracts; (2) sales of security products; and (3) services and maintenance, which are performed either on a fixed-price basis or as time-and-materials based contracts.

Revenues from installation of comprehensive security systems are generated from fixed-price contracts according to which the time between the signing of the contract and the final customer acceptance is usually over one year. Such contracts require significant customization for each customer's specific needs and, as such, revenues from this type of contract are recognized in accordance with ASC 605-35 Revenue Recognition -Construction-Type and Production-Type Projects," using contract accounting on a percentage of completion method. Accounting for long-term contracts using the percentage-of-completion method stipulates that revenue and expense are recognized throughout the life of the contract, even though the project is not completed and the purchaser does not have possession of the project. Percentage of completion is calculated based on the "Input Method."

Project costs include materials purchased to produce the system, related labor and overhead expenses and subcontractor's costs. The percentage to completion is measured by monitoring costs and efforts devoted using records of actual costs incurred to date in the project compared to the total estimated project requirement, which corresponds to the costs related to earned revenues. The amounts of revenues recognized are based on the total fees under the agreements and the percentage to completion achieved. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are first determined, in the amount of the estimated loss on the entire contract.

Estimated gross profit or loss from long-term contracts may change due to changes in estimates resulting from differences between actual performance and original forecasts. Such changes in estimated gross profit are recorded in results of operations when they are reasonably determinable by management, on a cumulative catch-up basis.

The Company believes that the use of the percentage of completion method is appropriate as the Company has the ability to make reasonably dependable estimates of the extent of progress towards completion, contract revenues and contract costs. In addition, contracts executed include provisions that clearly specify the enforceable rights regarding services to be provided and received by the parties to the contracts, the consideration to be exchanged and the manner and the terms of settlement, including in cases of termination for convenience. In all cases the Company expects to perform its contractual obligations and its customers are expected to satisfy their obligations under the contract.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Fees are payable upon completion of agreed upon milestones and subject to customer acceptance. Amounts of revenues recognized in advance of contractual billing are recorded as unbilled accounts receivable. The period between most instances of advanced recognition of revenues and the customers' billing generally ranges between one to six months.

The Company sells security products to customers according to customer orders without installation work. The customers do not have a right to return the products. Revenues from security product sales are recognized in accordance with Staff Accounting Bulletin ("SAB") No. 104, "Revenue Recognition in Financial Statements," when delivery has occurred, persuasive evidence of an agreement exists, the vendor's fee is fixed or determinable, no further obligation exists and collectability is probable.

Services and maintenance are performed under either fixed-price based or time-and-materials based contracts. Under fixed-price contracts, the Company agrees to perform certain work for a fixed price. Under time-and-materials contracts, the Company is reimbursed for labor hours at negotiated hourly billing rates and for materials. Such service contracts are not in the scope of ASC 605-35, and accordingly, related revenues are recognized in accordance with SAB No. 104, as those services are performed or over the term of the related agreements provided that, an evidence of an arrangement has been obtained, fees are fixed and determinable and collectability is reasonably assured.

Deferred revenue includes unearned amounts under installation services, service contracts and maintenance agreements.

n. Accounting for stock-based compensation:

The Company accounts for stock-based compensation in accordance with ASC 718 Compensation-Stock Compensation.

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

The Company recognizes compensation expenses for the value of its awards, which have graded vesting, based on the accelerated attribution method over the vesting period, net of estimated forfeitures. Estimated forfeitures are based on actual historical pre-vesting forfeitures.

During the years ended December 31, 2008, 2009 and 2010, the Company recognized stock-based compensation expenses related to employee stock options in the amounts of \$ 237, \$ 542 and \$ 833, respectively. In 2009 and 2010, the Company recognized additional stock-based compensation expenses of \$ 156 and \$ 100, respectively, related to a transaction between two of the Company's related parties, see Note 17d.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company estimates the fair value of stock options granted under ASC 718 using the Binomial model. The Binomial model for option pricing requires a number of assumptions, of which the most significant are the suboptimal exercise factor and expected stock price volatility. The suboptimal exercise factor is estimated using historical option exercise information. The suboptimal exercise factor is the ratio by which the stock price must increase over the exercise price before employees are expected to exercise their stock options. Expected volatility is based upon actual historical stock price movements and was calculated as of the grant dates for different periods, since the Binomial model can be used for different expected volatilities for different periods. The risk-free interest rate is based on the yield from U.S. Treasury zero-coupon bonds with an equivalent term to the contractual term of the options. The expected term of options granted is derived from the output of the option valuation model and represents the period of time that options granted are expected to be outstanding. Estimated forfeitures are based on actual historical pre-vesting forfeitures.

The following assumptions were used in the Binomial option pricing model for 2008, 2009 (no options were granted in 2010).

	2008	2009
Dividend yield	0%	0%
Expected volatility	28%-69%	34%-62%
Risk-free interest	0.36%-3.39%	0.27%-3.14%
Contractual term	1-7 years	4-9 years
Forfeiture rate	0%	0%
Suboptimal exercise multiple	1-2	1.5

o. Research and development costs:

Research and development costs incurred in the process of developing product improvements or new products, are charged to expenses as incurred.

p. Warranty costs:

The Company provides a warranty for up to 26 months at no extra charge. The Company estimates the costs that may be incurred under its warranty and records a liability in the amount of such costs at the time product revenue is recognized in accordance with ASC 460, "Guarantees" and ASC 450 "Contingencies." Factors that affect the Company's warranty liability include the number of units, historical and anticipated rates of warranty claims and cost per claim. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary. The provision for warranty as of December 31, 2009 and 2010 was \$ 492 and \$ 607, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

q. Net earnings (loss) per share:

Basic net earnings (loss) per share are computed based on the weighted average number of Ordinary shares outstanding during each year. Diluted net earnings (loss) per share is computed based on the weighted average number of Ordinary shares outstanding during each year, plus dilutive potential Ordinary shares considered outstanding during the year, in accordance with ASC 260 "Earnings Per Share."

r. Concentrations of credit risk:

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, marketable securities, short-term and long-term bank deposits, trade receivables, unbilled accounts receivable, long-term trade receivables and long-term loans.

Of the Company's cash and cash equivalents and short-term, restricted and long-term bank deposits at December 31, 2010, \$ 14,696 is invested in major Israeli and U.S. banks, and approximately \$ 6,787 is invested in other banks, mainly with Deutsche Bank, RBC Royal Bank and Fianzas Atlas. Cash and cash equivalents in the United States may be in excess of insured limits and are not insured in other jurisdictions. Generally these deposits may be redeemed upon demand and therefore, bear low risk.

The short-term and long-term trade receivables of the Company, as well as the unbilled accounts receivable, are primarily derived from sales to large and solid organizations and governmental authorities located mainly in Israel, the United States, Canada, Mexico, and Europe. The Company performs ongoing credit evaluations of its customers and to date has not experienced any material losses. An allowance for doubtful accounts is determined with respect to those amounts that the Company has determined to be doubtful of collection and in accordance with an aging policy. As of December 31, 2010, the Company's allowance for doubtful accounts amounted to \$ 919. During the years ended December 31, 2008, 2009 and 2010, the Company recorded \$ 755 (additional \$ 468 under discontinued operations), \$ (153) and \$ 601 of expenses (income) related to doubtful accounts, respectively. In certain circumstances, the Company may require letters of credit, other collateral or additional guarantees.

A loan granted to a third party is secured by a personal guarantee of the beneficial owner of the third party; however, management anticipates difficulties in the full repayment of the loan, (see Note 12i).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company has no significant off-balance sheet concentrations of credit risk, such as foreign exchange contracts or foreign hedging arrangements, except derivative instruments, which are detailed in paragraph w. below.

s. Income taxes:

The Company accounts for income taxes in accordance with ASC 740 "Income Taxes." This ASC prescribes the use of the liability method whereby deferred tax assets and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company provides a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

Effective January 1, 2007, the Company adopted an amendment to ASC 740 Income Taxes. The amendment clarifies the accounting for uncertainties in income taxes by establishing minimum standards for the recognition and measurement of tax positions taken or expected to be taken in a tax return. Under the requirements of ASC 740, the Company must review all of its tax positions and make a determination as to whether its position is more-likely-than-not to be sustained upon examination by regulatory authorities. If a tax position meets the more-likely-than-not standard, then the related tax benefit is measured based on a cumulative probability analysis of the amount that is more-likely-than-not to be realized upon ultimate settlement or disposition of the underlying issue.

In 2008, 2009 and 2010, the Company recorded tax expenses (benefits) of \$ (59) and \$ (165) and 88, respectively.

t. Severance pay:

The Company's liability for its Israeli employees severance pay is calculated pursuant to Israel's Severance Pay Law based on the most recent salary of the employees multiplied by the number of years of employment, as of the balance sheet date (the "Shut Down" method). Employees are entitled to one month's salary for each year of employment or a portion thereof. The Company's liability for its employees in Israel is fully provided by monthly deposits with insurance policies and by an accrual. The value of these policies is recorded as an asset in the Company's balance sheet.

The deposited funds include profits accumulated up to balance sheet date. The deposited funds may be withdrawn only upon the fulfillment of the obligation pursuant to Israel's Severance Pay Law or labor agreements. The value of the deposited funds is based on the cash surrendered value of these policies, and includes immaterial profits.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

On December 31, 2007, the former Chairman of the Company's Board of Directors, (hereinafter - the retired Chairman) retired from his position. Pursuant to his retirement agreement, the retired Chairman will be entitled to receive certain perquisites from the Company for the rest of his life. As of December 31, 2010, the actuarial value of these perquisites is estimated to be approximately \$ 679. This provision was included as part of accrued severance pay.

On November 10, 2008, the Company's former President and chief executive officer (hereinafter - the retired CEO) resigned. The retirement agreement entered into with the retired CEO amounted to \$ 1,645, including consideration for a non-compete undertaking as well as severance payments and other retirement related payments in accordance with the retired CEO's retirement agreement and Israeli law. In addition, in 2008, certain senior employees were entitled to termination benefits in the aggregate amount of \$ 881 related to their respective retirement from the Company. In connection with such terminations, the Company recorded an expense of \$ 2,526. As of December 31, 2010, all the expenses were paid.

Severance expenses for the years ended December 31, 2008, 2009 and 2010, amounted to approximately \$ 3,091, \$ 1,402 and \$ 724, respectively.

The Company has entered into an agreement with some of the employees implementing Section 14 of the Severance Pay Law and the General Approval of the Labor Minister dated June 30, 1998, issued in accordance with the said Section 14, mandating that upon termination of such employees' employment, all the amounts accrued in their insurance policies shall be released to them. The severance pay liabilities and deposits covered by these plans are not reflected in the balance sheet as the severance pay risks have been irrevocably transferred to the severance funds.

u. Fair value of financial instruments:

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

- (i) The carrying amounts of cash and cash equivalents, marketable securities, short-term bank deposits, trade receivables, unbilled accounts receivable, short-term bank credit and trade payables approximate their fair value due to the short-term maturity of such instruments.
- (ii) The carrying amount of the Company's long-term trade receivables and long-term bank deposits approximate their fair value. The fair value was estimated using discounted cash flows analysis, based on the Company's investment rates for similar type of investment arrangements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

(iii) The carrying amounts of the Company's long-term debt are estimated by discounting the future cash flows using current interest rates for loans of similar terms and maturities. As of December 31, 2010, there was no material difference in the fair value of the Company's long-term borrowing compared to their carrying amount.

v. Advertising expenses:

Advertising costs are expensed as incurred. Advertising expenses for the years ended December 31, 2008, 2009 and 2010, were \$ 334, \$ 145 and \$ 137, respectively.

w. Derivative instruments:

ASC 815, "Derivatives and Hedging" qualifies as part of a hedging relationship and further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument, based upon the exposure being hedged.

In 2008, the Company had forward contracts in order to hedge portions of its forecasted revenue and unbilled accounts receivable denominated in Euros, Polish Zlotys, U.S. dollars and Canadian dollars. The Company did not designate the forward instruments as hedges for accounting purpose and thus, all changes in the fair value of these derivatives were recorded in financial expenses for the year ended December 31, 2008. The Company did not enter into any derivative transactions during 2009 and 2010. As a result, the Company recorded \$29 in financial expenses related to forward contracts in 2008. In 2009 and 2010, the Company had no financial expenses related to forward contracts.

x. Fair value measurements:

ASC 820 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. As a basis for considering such assumptions, ASC 820 establishes a three tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

- Level 1 - Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 - Include other inputs that are directly or indirectly observable in the marketplace.
- Level 3 - Unobservable inputs which are supported by little or no market activity.



NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

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

During 2008, the Company measured the fair value of marketable securities based on quoted prices (unadjusted). In 2009 and 2010, the Company did not have any assets or liabilities measured at fair value on a recurring or nonrecurring basis.

y. Non-controlling interest.

The Company established a new Spanish subsidiary in September 2009, which was 76% owned by the Company and 24% owned by a local partner. The non-controlling interest relating to the new Spanish subsidiary was not material in 2009 and 2010. As of December 31, 2010, the Company changed the engagement terms with the local partner pursuant to a new employment agreement with the Spanish subsidiary. In return for the new arrangement, the local partner gave up his ownership rights and as of December 31, 2010, the Company owns 100% of the Spanish subsidiary.

z. Impact of recently issued Accounting Standards still not effective for the Company:

1. In October 2009, the FASB issued an update to ASC 605-25, "Revenue Recognition – Multiple-Element Arrangements", that provides amendments to the criteria for separating consideration in multiple-deliverable arrangements to:

- a) Provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated and how the consideration should be allocated;
- b) Require an entity to allocate revenue in an arrangement using estimated selling prices ("ESP") of deliverables if a vendor does not have vendor-specific objective evidence of selling price ("VSOE") or third-party evidence of selling price ("TPE");
- c) Eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method; and
- d) Require expanded disclosures of qualitative and quantitative information regarding application of the multiple-deliverable revenue arrangement guidance.

The mandatory adoption date is January 1, 2011. The Company does not expect the adoption have material impact on its financial condition or result of operation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

2. In February 2010, the FASB issued amendments to certain recognition and disclosure requirements of subsequent events codified in ASC 855, "Subsequent Events." This update removes the requirement to disclose the date through which subsequent events were evaluated in both originally issued and reissued financial statements for "SEC Filers." The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.
3. In January 2010, the FASB issued ASU 2010-06, updating the "Fair Value Measurements Disclosures" codified in ASC 820. This update requires (a) an entity to disclose separately the amounts of significant transfers in and out of Levels 1 and 2 fair value measurements and to describe the reasons for the transfers; and (b) information about purchases, sales, issuances and settlements to be presented separately (i.e. present the activity on a gross basis rather than net) in the reconciliation for fair value measurements using significant unobservable inputs (Level 3 inputs). This update clarifies existing disclosure requirements for the level of disaggregation used for classes of assets and liabilities measured at fair value, and require disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements using Level 2 and Level 3 inputs. As applicable to the Company, this update became effective in these annual financial statements and the adoption did not have a material impact on the consolidated financial statements.

The gross presentation of the Level 3 rollforward information will be effective for fiscal years beginning after December 15, 2010.

**NOTE 3:- MARKETABLE SECURITIES**

The Company invests in marketable debt securities, which are classified as available-for-sale investments.

During 2008, an other-than-temporary impairment of the marketable securities in the amount of \$ 315 was recorded in financial expense. In 2009, all the Company's available-for-sale securities were sold at a gain of \$ 58.

In 2009, no other-than-temporary impairment was recorded in earnings.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 4:- OTHER ACCOUNTS RECEIVABLE AND PREPAID EXPENSES

	December 31,	
	2009	2010
Government authorities	\$ 578	\$ 806
Employees	92	33
Prepaid expenses	496	747
Advances to suppliers	134	683
Others	101	148
	<u>\$ 1,401</u>	<u>\$ 2,417</u>

NOTE 5:- INVENTORIES

	December 31,	
	2009	2010
Raw materials	\$ 3,301	\$ 3,146
Work in progress	2,661	1,998
Finished products	4,950	5,196
	<u>\$ 10,912</u>	<u>\$ 10,340</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 6:- PROPERTY AND EQUIPMENT

a. Composition:

	December 31,	
	2009	2010
<b>Cost:</b>		
Land and buildings	\$ 10,800	\$ 8,257
Machinery and equipment	6,386	6,759
Motor vehicles	1,173	1,155
Promotional displays	1,886	2,064
Office furniture and equipment	2,883	3,242
Leasehold improvements	120	59
	<u>23,248</u>	<u>21,536</u>
<b>Accumulated depreciation:</b>		
Buildings	3,806	3,431
Machinery and equipment	5,584	6,026
Motor vehicles	730	798
Promotional displays	1,735	1,928
Office furniture and equipment	2,195	2,536
Leasehold improvements	20	23
	<u>14,070</u>	<u>14,742</u>
Property and equipment, net	<u>\$ 9,178</u>	<u>\$ 6,794</u>

b. Depreciation expenses amounted to \$ 989, \$ 1,012 and \$ 970 for the years ended December 31, 2008, 2009 and 2010, respectively.

c. For charges, see Note 12h.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 7:- OTHER INTANGIBLE ASSETS, NET

a. Composition:

	December 31,	
	2009	2010
<b>Cost:</b>		
Know-how	\$ 1,070	\$ 1,138
Patents	3,253	3,436
Technology	366	12
	<u>4,689</u>	<u>4,586</u>
<b>Accumulated amortization:</b>		
Know-how	1,023	1,138
Patents	3,031	3,226
Technology	366	9
	<u>4,420</u>	<u>4,373</u>
Other intangibles, net	<u>\$ 269</u>	<u>\$ 213</u>

b. Amortization expenses related to intangible assets amounted to \$ 553, \$ 192 and \$ 92 for the years ended December 31, 2008, 2009 and 2010, respectively.

The amortization expenses include impairment of know-how in the amount of \$ 351 for the year ended December 31, 2008.

c. Estimated amortization of intangible assets for the years ended:

<u>December 31,</u>	
2011	\$ 43
2012	41
2013	38
2014 and thereafter	<u>91</u>
	<u>\$ 213</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 8:- GOODWILL

Goodwill relates to one reporting unit that resides within the perimeter segment.

Changes in the carrying amount of goodwill for the years ended December 31, 2010 and 2009 are as follows:

As of January 1, 2009	\$ 1,874
Foreign currency translation adjustments	<u>179</u>
As of December 31, 2009	2,053
Foreign currency translation adjustments	<u>(27)</u>
As of December 31, 2010	<u>\$ 2,026</u>

The Company determined the fair value of the reporting unit using the income approach. The material assumptions used for the income approach for 2010 were five years of projected net cash flows, a discount rate of 15.5% and a long-term growth rate of 1.0%. The Company considered historical rates and current market conditions when determining the discount and growth rates to use in its analyses. If these estimates or their related assumptions change in the future, the Company may be required to record impairment charges for its goodwill.

NOTE 9:- SHORT-TERM BANK CREDIT

a. Classified by currency, linkage terms and interest rates:

	Interest rate		December 31,	
	2009	2010	2009	2010
	%			
In or linked to NIS	4.75	5.5	\$ 7,709	\$ 9,327
In or linked to Canadian dollar	2.75	-	<u>525</u>	<u>-</u>
			<u>\$ 8,234</u>	<u>\$ 9,327</u>
Weighted average interest rates at the end of the year	4.62	5.5		

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 9:- SHORT-TERM BANK CREDIT (Cont.)

b. Credit lines

	December 31,	
	2009	2010
Short-term bank credit	\$ 8,234	\$ 9,327
Long-term bank credit	2,372	553
Performance guarantees	4,572	7,246
	<u>15,178</u>	<u>17,126</u>
Unutilized credit lines approximate	<u>12,069</u>	<u>5,173</u>
Total authorized credit lines approximate	<u>\$ 27,247</u>	<u>22,299</u>

c. The Company's Canadian subsidiary has undertaken to maintain general covenants and the following financial ratios and terms in respect of its outstanding credit lines: a quick ratio of not less than 1.25; a ratio of total liabilities to tangible net worth of not greater than 0.75; and tangible net worth of at least \$ 10 million. As of December 31, 2010, the Company's subsidiary was in compliance with the ratios and terms.

d. For charges, see Note 12h.

NOTE 10:- OTHER ACCOUNTS PAYABLE AND ACCRUED EXPENSES

	December 31,	
	2009	2010
Employees and payroll accruals	\$ 2,565	\$ 2,648
Accrued expenses	4,260	3,690
Deferred revenues	153	390
Government authorities	278	249
Income tax payable	260	479
Others	85	289
	<u>\$ 7,601</u>	<u>\$ 7,745</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 11:- LONG-TERM BANK DEBT

- a. Classified by currency, linkage terms and interest rates:

	Linkage terms	Interest rate		December 31,	
		2009	2010	2009	2010
		%			
Bank loans	U.S. \$	0.87	0.87	\$ 1,120	\$ 480
Bank loan	NIS	2	3	89	73
Mortgage payable	U.S. \$	5.45	-	1,163	-
				2,372	553
Less - current maturities				1,824	503
				\$ 548	\$ 50
Weighted average interest rates at the end of the year		3.16	1.15		

- b. As of December 31, 2010, the aggregate annual maturities of the long-term loans are as follows:

2011	\$ 503
2012	23
2013	27
	\$ 553

- c. As for charges, see Note 12h.

NOTE 12:- COMMITMENTS AND CONTINGENT LIABILITIES

- a. Royalty commitments to the Office of the Chief Scientist of the Israeli Ministry of Industry and Trade ("OCS"):

Under the research and development agreements between the Company and the OCS and pursuant to applicable laws, the Company is required to pay royalties at the rate of 3%-4.5% of revenues derived from sales of products developed with funds provided by the OCS and ancillary services, up to an amount equal to 100% of the OCS research and development grants received, linked to the U.S. dollars plus interest on the unpaid amount received based on the 12-month LIBOR rate applicable to U.S. dollar deposits. The obligation to pay these royalties is contingent on actual sales of the products and in the absence of such sales no payment is required.



NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

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

Royalties paid to the OCS amounted to \$ 125, \$ 172 and \$ 0 for the years ended December 31, 2008, 2009 and 2010, respectively. As of December 31, 2010, the Company had remaining contingent obligations to pay royalties in the amount of approximately \$ 1,212.

b. Royalty commitments to a third party:

During 2002, the Company entered into a development agreement for planning, developing and manufacturing a security system with a third party. Under the agreement, the Company agreed to pay the third party royalty fees based on a defined formula. Under this agreement, the Company also committed to purchase a certain volume of products at a minimum amount of approximately \$ 300 over 2.5 years after achievement of certain milestones. As of December 31, 2010, royalty commitments under the agreement amounted to \$ 52.

c. In September 2006, the Company signed a non-exclusive agreement with a third party for the rights to use certain intangible assets such as know-how and patents for the production, sale and marketing of a perimeter security system based on fiber-optic lines that is used mainly to protect marine sites. The contract period was two years and the Company had the right to extend the contract for an additional five years. In September 2008, management extended the option. The consideration for the license is \$ 548, payable in 24 monthly installments. In addition, the Company agreed to pay royalties based on a defined formula.

In addition, the parties have signed an unlimited agreement that grants the Company the rights to provide maintenance and support for the systems previously sold by the third party. The Company agreed to pay royalties based on a defined formula. No royalties were paid or accrued as of December 31, 2010.

d. Lease commitments:

The Company rents certain of its facilities and some of its motor vehicles under various operating lease agreements, which expire on various dates, the latest of which is in 2024.

Future minimum lease payments under non-cancelable operating lease agreements are as follows:

2011	\$ 822
2012	568
2013	295
2014	132
2015 and there after	<u>1,058</u>
	<u>\$ 2,875</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

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

Total rent expenses for the years ended December 31, 2008, 2009 and 2010 were approximately \$ 813, \$ 806 and \$ 924, respectively.

e. Guarantees:

As of December 31, 2010, the Company obtained bank performance guarantees and advance payment guarantees and bid bond guarantees from several banks, mainly in Israel, in the aggregate amount of \$ 7,246.

f. Restricted deposit:

In connection with two projects in South America and Africa, the Company required to maintain restricted deposit in order to guarantee the Company performance under these projects. The deposits for the two projects in the amount of \$ 2,530 and \$ 2,140, respectively, bear interest at rate of 4.29% and 1% respectively and will be released to the Company after meeting predetermined milestones.

g. Legal proceedings:

In May 2005, the Company entered into an agreement to supply comprehensive security solutions for a sensitive site in Eastern Europe. The Company commenced the project and delivered some of the equipment and other deliverables to the customer in 2005. In April 2006, the customer informed the Company that it was canceling the agreement due to errors in the design documents that the Company submitted. In addition, the customer did not make payments required under the agreement. The Company denied all of the allegations and the case was referred to arbitration.

On June 6, 2007, the Court of Arbitration issued its decision in the arbitration and stated that the agreement concluded between the Company and the customer was void due to legal mistakes made by the customer in the tender process. Based on such decision, the Company decided to initiate a new legal action against the customer seeking compensation for the damages incurred. In March 2010, the Court of Arbitration determined that the customer is liable for certain expenses incurred by the Company in connection with the negotiation and execution of the agreement due to the customer's wrongful behaviour during the negotiations. In addition, the Court of Arbitration determined that the customer is liable for damages caused to the Company due to the customer's unjust enrichment resulting from the non-payment for certain deliveries made by the Company. The scope of damages is subject to proceedings that are currently taking place before the Court of Arbitration.

In addition, the Company is subject to legal proceedings arising in the normal course of business. Based on the advice of legal counsel, management believes that these proceedings will not have a material adverse effect on the Company's financial position or results of operations.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

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

h. Charges:

As collateral for all of the Company liabilities to banks:

In January 2010, the Company approved a new credit arrangement and created in favor of the Banks a first degree fixed charge over its unissued share capital and its goodwill and a first degree floating charge over its factory, business, and all of its assets and rights. Upon the creation of the said fixed and floating charges the pledge arrangement was terminated.

i. In October 2006, the Company signed an agreement with a third party who consults, markets and implements projects in the security field. Pursuant to the agreement, during the first 12 months ("the agreement period"), the parties agreed to cooperate in the development of the business of the third party.

The Company granted a loan to the third party in the amount of \$ 600. The Company also agreed to provide the third party with additional monthly amounts to fund its activities during the agreement period, not to exceed \$ 23 per month. The loan and the monthly amounts will bear an annual interest rate of 5% and will be repaid in October 2011.

The Company received an option to purchase all of the assets of the third party's business, exercisable during the agreement period ("the option") until October 2008. The Company was obligated to exercise the option if the third party met certain milestones. The exercise price of the option was comprised of the outstanding loan and the monthly amounts mentioned above and an additional \$ 400 in cash. The option expired in October 2008 without being exercised.

The Company evaluates the anticipated repayment of the loan annually. Due to unanticipated difficulties in the implementation of the projects and based on ASC 310-10-35-3, "Loan Impairment," management estimated that as of December 31, 2010, the repayment of the loan is not probable, and therefore set a provision for the entire loan amount. The Company recorded expenses of \$550, \$ 319 and \$ 206 for the years ended December 31, 2008, 2009 and 2010, respectively, related to such provision.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

**NOTE 13:- SHAREHOLDERS' EQUITY**

- a. Pertinent rights and privileges conferred by Ordinary shares:

The Ordinary shares of the Company are listed on the NASDAQ Global Market and on the Tel-Aviv Stock Exchange. The Ordinary shares confer upon their holders the right to receive notice to participate and vote in the general meetings of the Company and the right to receive dividends, if declared.

- b. Stock Option Plan:

On October 27, 2003, the Company's Board of Directors approved the 2003 Israeli Share Option Plan ("the 2003 Plan"). Under the 2003 Plan, stock options may be periodically granted to employees, directors, officers and consultants of the Company or its subsidiaries in accordance with the decision of the Board of Directors of the Company (or a committee appointed by it). The Board of Directors also has the authority to determine the vesting schedule and exercise price of options granted under the 2003 Plan.

The 2003 Plan is effective for ten years and will terminate in October 2013. Any options that are cancelled or forfeited before expiration become available for future grant.

In May 2008, the Board of Directors approved an amendment to the 2003 Plan, which was approved by the shareholders in August 2008, which increased the number of Ordinary shares available for issuance under the 2003 Plan increased by an additional 1,000,000 options and the termination of the 2003 Plan was extended from October 2013 to October 2018.

On June 23, 2010, the Company's Annual General Meeting approved the 2010 Israeli Share Option Plan, or the 2010 Plan, which authorizes the grant of options to employees, officers, directors and consultants of our company and subsidiaries. The ordinary shares that remain available for futures option grants under the 2003 Plan as of the date of the adoption of the 2010 Plan and any ordinary shares that become available in the future under the 2003 Plan as a result of expiration, cancellation or relinquishment of any option currently outstanding under the 2003 Plan will be rolled over to the 2010 Plan. Following the adoption of the 2010 Plan, no additional options will be granted under the 2003 Plan. The 2010 Plan has a term of ten years.

As of December 31, 2010, 450,575 Ordinary shares were available for future option grants under the 2010 Plan.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 13:- SHAREHOLDERS' EQUITY (Cont.)

A summary of employee option activity under the Company's stock option plans as of December 31, 2010 and changes during the year ended December 31, 2010 are as follows:

	<u>Number of options</u>	<u>Weighted- average exercise price</u>	<u>Weighted- average remaining contractual life (in months)</u>	<u>Aggregate intrinsic value (in thousands)</u>
Outstanding at January 1, 2010	1,447,200	\$ 5.54	55.4	\$ 68
Granted				
Exercised				
Forfeited	(279,200)	\$ 7.02	-	
Outstanding at December 31, 2010	<u>1,168,000</u>	<u>\$ 5.19</u>	<u>49.1</u>	<u>-</u>
Vested and expected to vest at December 31, 2010	<u>1,168,000</u>	<u>\$ 5.19</u>	<u>49.1</u>	<u>-</u>
Exercisable at December 31, 2010	<u>461,669</u>	<u>\$ 5.64</u>	<u>35.3</u>	<u>-</u>

The weighted-average grant-date fair value of options granted during the years ended December 31, 2008 and 2009 was \$ 2.84 and \$ 1.41, respectively. No options were granted during 2010. The aggregate intrinsic value in the table above represents the total intrinsic value (the difference between the Company's closing stock price on the last trading day of the fourth quarter of fiscal 2010 and the exercise price, multiplied by the number of in-the-money options). This amount changes based on the fair market value of the Company's stock. The total intrinsic value of options exercised for the year ended December 31, 2010 was \$ 0, as none of the options were exercised in the aforementioned period. As of December 31, 2010, there were approximately \$ 550 of total unrecognized compensation costs related to non-vested share-based compensation arrangements granted under the Company's stock option plans and \$ 74 related to option granted to related parties (see Note 17d). This cost is expected to be recognized over a period of 2.92 years.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 13:- SHAREHOLDERS' EQUITY (Cont.)

The options outstanding as of December 31, 2010 are follows:

Options outstanding as of December 31, 2010	Exercise price	Weighted average remaining contractual life (In months)	Options exercisable as of December 31, 2010
100,000	\$ 8.22	19.50	100,000
300,000	\$ 7.59	43.67	100,000
98,000	\$ 4.09	45.83	24,500
250,000	\$ 4.35	52.07	104,169
320,000	\$ 3.53	62.65	99,000
100,000	\$ 3.48	47.11	34,000
<u>1,168,000</u>	<u>\$ 5.64</u>	<u>35.30</u>	<u>461,669</u>

c. Dividends:

Dividends, if any, will be declared and paid in U.S. dollars. Dividends paid to shareholders in Israel will be converted into NIS on the basis of the exchange rate prevailing at the date of payment. The Company has determined that it will not distribute dividends out of tax-exempt profits.

NOTE 14:- BASIC AND DILUTED NET EARNINGS PER SHARE

	Year ended December 31,		
	2008	2009	2010
Numerator:			
Loss from continuing operations	\$ (18,940)	\$ (5,297)	\$ (6,229)
Income (loss) on discontinued operations	(13,662)	4,216	-
Loss	<u>\$ (32,602)</u>	<u>\$ (1,081)</u>	<u>\$ (6,229)</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 14:- BASIC AND DILUTED NET EARNINGS PER SHARE (Cont.)

	Year ended December 31,		
	2008	2009	2010
Denominator:			
Denominator for basic net earnings per share weighted-average number of shares outstanding	10,396,548	10,396,548	10,396,548
Effect of diluting securities:			
Employee stock options	-	2,076	-
Denominator for diluted net earnings per share - adjusted weighted average shares and assumed exercises	<u>10,396,548</u>	<u>10,398,624</u>	<u>10,396,548</u>
Basic loss per share from continuing operations	\$ (1.82)	\$ (0.52)	\$ (0.6)
Basic net earnings (loss) per share from discontinued operations	(1.32)	0.41	-
Basic net earnings (loss) per share	<u>\$ (3.14)</u>	<u>\$ (0.11)</u>	<u>\$ (0.6)</u>
Diluted loss per share from continuing operations	\$ (1.82)	\$ (0.52)	\$ (0.6)
Diluted net earnings (loss) per share from discontinued operations	(1.32)	0.41	-
Diluted net earnings (loss) per share	<u>\$ (3.14)</u>	<u>\$ (0.11)</u>	<u>\$ (0.6)</u>

NOTE 15:- TAXES ON INCOME

- a. Tax benefits in Israel under the Law for the Encouragement of Capital Investments, 1959 ("the Law"):

The Company has been granted the status of an "Approved Enterprise" under the Law. Currently, there is expansion program under which the Company is entitled to tax benefits:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

NOTE 15:- TAXES ON INCOME (Cont.)

On August 13, 2002, a program of the Company was granted the status of an "Approved Enterprise". The Company elected to enjoy the "alternative benefits" track - waiver of grants in return for tax exemption - and, accordingly, the Company's income from this program is tax-exempt for a period of two years and is subject to a reduced tax rate of 10%-25% for a period of five to eight years (depending upon the percentage of foreign ownership of the Company). The benefit period for this program began in 2003 and will terminate in 2012.

The period of tax benefits detailed above is subject to limits of the earlier of 12 years from the commencement of production or 14 years from receiving the approval ("the years' limitation"). Please note that the years' limitation does not apply to the exemption period.

An amendment to the Law, which was published effective as of April 1, 2005 ("the Amendment"), changed certain provisions of the Law. As a result of the Amendment, a company is no longer obliged to implement an Approved Enterprise status in order to receive the tax benefits previously available under the Alternative Benefits provisions, and therefore there is no need to apply to the Investment Center for this purpose (Approved Enterprise status remains mandatory for companies seeking grants). Rather, a company may claim the tax benefits offered by the Investment Law directly in its tax returns, provided that its facilities meet the criteria for tax benefits set out by the Amendment. A company is also entitled to approach the Israeli Tax Authority for a pre-ruling regarding their eligibility for benefits under the Amendment.

Tax benefits are available under the Amendment to production facilities (or other eligible facilities), which are generally required to derive more than 25% of their business income from export (referred to as a Beneficiary Enterprise). In order to receive the tax benefits, the Amendment states that a company must make an investment in the Beneficiary Enterprise exceeding a minimum amount specified in the Law. Such investment may be made over a period of no more than three years ending at the end of the year in which a company requested to have the tax benefits apply to the Beneficiary Enterprise ("the Year of Election").

Where a company requests to have the tax benefits apply to an expansion of existing facilities, then only the expansion will be considered a Beneficiary Enterprise and the company's effective tax rate will be the result of a weighted combination of the applicable rates. In such case, the minimum investment required in order to qualify as a Beneficiary Enterprise is required to exceed a certain percentage of the company's production assets before the expansion. The duration of tax benefits is subject to a limitation of the earlier of seven years from the Commencement Year (the Commencement Year is defined as the later of (a) the first tax year in which a company had derived income for tax purposes from the Beneficiary Enterprise or (b) the year in which a company requested to have the tax benefits apply to the Beneficiary Enterprise - Year of Election) or 12 years from the first day of the Year of Election.



NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

NOTE 15:- TAXES ON INCOME (Cont.)

In December 2010, the "Knesset" (Israeli Parliament) passed the Law for Economic Policy for 2011 and 2012 (Amended Legislation), 2011, which prescribes, among others, amendments in the Law for the Encouragement of Capital Investments, 1959 ("The Law"). The amendment became effective as of January 1, 2011. According to the amendment, the benefit tracks in the Law were modified and a flat tax rate applies to the Company's entire preferred income. The Company will be able to opt to apply (the waiver is non-recourse) the amendment and from then on it will be subject to the amended tax rates that are: 2011 and 2012 - 15% (in development area A - 10%, 2013 and 2014 - 12.5% (in development area A - 7%) and in 2015 and thereafter - 12% (in development area A - 6%).

- b. On March 3, 2007, the Company received a pre-ruling from the Israeli Tax Authority for its request for a Beneficiary Enterprise, regarding eligibility for benefits under the Amendment. The Company's income from this program is tax-exempt for a period of two years and is subject to a reduced tax rate of 10%-25% for a period of five to eight years (depending upon the percentage of foreign ownership of the Company). The Company has not yet obtained any tax benefits from this program.

Income from sources other than an "Approved Enterprise" during the benefit period was subject to tax at regular rate of 25% in 2010 (see e. below).

By virtue of the Law, the Company is entitled to claim accelerated depreciation on equipment used by the "Approved Enterprise" during five tax years.

Since the Company is operating under approval for an Approved Enterprise and since part of its taxable income is not entitled to tax benefits under the Law and is taxed at regular rates (25% in 2010), its effective tax rate is the result of a weighted combination of the various applicable rates and tax-exemptions. The computation is made for income derived from each program on the basis of formulas determined in the law and in the approvals.

The tax-exempt income attributable to the "Approved Enterprises" can be distributed to shareholders without subjecting the Company to taxes only upon the complete liquidation of the Company. If the retained tax-exempt income is distributed in a manner other than in the complete liquidation of the Company, it would be taxed at the corporate tax rate applicable to such profits as if the Company had not chosen the alternative tax benefits (currently - 15%).

The Company's Board of Directors has decided that its policy is not to declare dividends out of such tax-exempt income. Accordingly, no deferred income taxes have been provided on income attributable to the Company's "Approved Enterprises" and "Beneficiary Enterprise," as such retained earnings are essentially permanent in duration.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

NOTE 15:- TAXES ON INCOME (Cont.)

- c. Measurement of taxable income under the Income Tax (Inflationary Adjustments) Law, 1985:

Under the Income Tax (Inflationary Adjustments) Law, 1985, results for tax purposes are measured in real terms, in accordance with the changes in the Israeli Consumer Price Index ("Israeli CPI"). Accordingly, until 2002, results for tax purposes were measured in terms of earnings in NIS after certain adjustments for increases in the Israeli CPI. Commencing in taxable year 2003 through 2006, the Company elected to measure its taxable income and file its tax returns under the Israeli Income Tax Regulations (Principles Regarding the Management of Books of Account of Foreign Invested Companies and Certain Partnerships and the Determination of Their Taxable Income), 1986. Such an election obligated the Company for three years. Accordingly, commencing in the 2003 tax year, results for tax purposes are measured in terms of earnings in U. S. dollars.

Changes in the tax laws applicable to the Company:

In February 2008, the "Knesset" (Israeli Parliament) passed an amendment to the Income Tax (Inflationary Adjustments) Law, 1985, which limits the scope of the law with effect from 2008 and thereafter. From 2008, the results for tax purposes will be measured in nominal values, excluding certain adjustments for changes in the Israeli CPI carried out in the period up to December 31, 2007. The amended law includes, among other things, the elimination of the inflationary additions and deductions and the additional deduction for depreciation with effect from 2008.

- d. Tax benefits (in Israel) under the Law for the Encouragement of Industry (Taxes), 1969:

The Company is an "industrial company" as defined by this law and, as such, is entitled to certain tax benefits including accelerated depreciation, deduction of the purchase price of patents and know-how and deduction of public offering expenses.

- e. Tax rates:

1. Tax rates applicable to the income of the Company:

Taxable income of the Company is subject to tax at the rate of 27% in 2008, 26% in 2009 and 25% in 2010.

In July 2009, the Israeli Parliament (the Knesset) passed the Economic Efficiency Law (Amended Legislation for Implementing the Economic Plan for 2009 and 2010), 2009, which prescribes, among other things, an additional gradual reduction in the Israeli corporate tax rate starting from 2011 to the following tax rates: 2011 - 24%, 2012 - 23%, 2013 - 22%, 2014 - 21%, 2015 - 20%, 2016 and thereafter - 18%.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

NOTE 15:- TAXES ON INCOME (Cont.)

2. The tax rates of the Company's subsidiaries range between 16%-40%. In December 2007, the tax rate in Germany was reduced to 30% from 38%. The tax reduction is effective beginning January 1, 2008. Deferred taxes have been adjusted accordingly.

f. Income taxes on non-Israeli subsidiaries:

Non-Israeli subsidiaries are taxed according to the tax laws in their respective country of domicile.

Israeli income taxes and foreign withholding taxes were not provided for undistributed earnings of the Company's foreign subsidiaries.. The Company's board of directors has determined that the Company will not distribute any amounts of its undistributed earnings as dividends. The Company intends to reinvest these earnings indefinitely in its foreign subsidiaries. Accordingly, no deferred income taxes have been provided. If these earnings were distributed to Israel in the form of dividends or otherwise, the Company would be subject to additional Israeli income taxes (subject to an adjustment for foreign tax credits) and foreign withholding taxes.

g. Israeli Transfer Pricing Regulations:

On November 29, 2006, Income Tax Regulations (Determination of Market Terms), 2006, promulgated under Section 85A of the Tax Ordinance, came into effect ("TP Regulations"). Section 85A of the Tax Ordinance and the TP Regulations generally requires that all cross-border transactions carried out between related parties be conducted on an arm's length principle basis and be taxed accordingly. The TP Regulations did not have a material effect on the Company.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 15:- TAXES ON INCOME (Cont.)

h. Reconciliation between the theoretical tax expense, assuming all income is taxed at the Israeli statutory rate, and the actual tax expense, is as follows:

	Year ended December 31,		
	2008	2009	2010
Loss from continuing continued operations before taxes as reported in the statements of operations	\$ (15,874)	\$ (4,433)	\$ (5,627)
Tax rate	27%	26%	25%
Theoretical tax benefit	\$ (4,286)	\$ (1,153)	\$ (1,407)
Increase (decrease) in taxes:			
Non-deductible items	194	467	335
Temporary differences on current year losses for which valuation allowance was provided	7,293	925	1,909
Realization of carry forward tax losses for which valuation allowance was provided	-	(129)	(383)
Deferred taxes on carry forward losses recognized in prior years against which valuation allowance was provided this year	-	*) 677	-
Reduction and tax rate differences in subsidiaries	(90)	(20)	107
Taxes in respect of prior years	48	(70)	103
Other	(93)	167	(62)
Taxes on income in the statements of operations	\$ 3,066	\$ 864	\$ 602

\*) The Company recorded in 2009 valuation allowance in the amount of \$ 677 relating to deferred tax on losses created in prior years by our subsidiary in Canada due to the uncertainty of their future realization.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 15:- TAXES ON INCOME (Cont.)

- i. Taxes on income (tax benefit) included in the statements of operations:

	Year ended December 31,		
	2008	2009	2010
<b>Current:</b>			
Foreign	\$ 659	\$ 141	\$ 667
<b>Deferred:</b>			
Domestic	2,357	-	-
Foreign	2	793	(168)
<b>Taxes in respect of prior years:</b>			
Domestic	48	(16)	107
Foreign	-	(54)	(4)
<b>Total taxes on income</b>	<b>\$ 3,066</b>	<b>\$ 864</b>	<b>\$ 602</b>

- j. Deferred income taxes:

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

	December 31,	
	2009	2010
<b>Deferred tax assets:</b>		
Operating loss carry forwards	\$ 6,948	\$ 8,048
Reserves and tax allowances	3,433	3,685
<b>Total deferred taxes before valuation allowance</b>	<b>10,381</b>	<b>11,733</b>
Valuation allowance	(10,109)	(11,259)
<b>Net deferred tax assets</b>	<b>272</b>	<b>474</b>
<b>Deferred tax liabilities</b>		
Intangible assets	179	190
<b>Net deferred tax assets (liabilities)</b>	<b>\$ 93</b>	<b>\$ 284</b>
Domestic	\$ -	\$ -
Foreign	93	284
	<b>\$ 93</b>	<b>\$ 284</b>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 15:- TAXES ON INCOME (Cont.)

- k. The domestic and foreign components of loss before taxes are as follows:

	Year ended December 31,		
	2008	2009	2010
Domestic	\$ (13,199)	\$ (4,330)	\$ (7,874)
Foreign	(2,675)	(103)	2,247
	<u>\$ (15,874)</u>	<u>\$ (4,433)</u>	<u>\$ (5,627)</u>

- l. Net operating carry forward tax losses:

The Company has estimated total available carry forward tax losses of \$ 24,801 to offset against future taxable income. As of December 31, 2010, the Company recorded a full valuation allowance on these carry forward tax losses due to the uncertainty of their future realization.

The Company's subsidiaries have estimated total available carry forward tax losses of \$ 9,206, which may be used to offset against future taxable income, for periods ranging between 12 to 20 years. As of December 31, 2010, the Company recorded a full valuation allowance for its subsidiaries' carry forward tax losses due to the uncertainty of their future realization.

Utilization of U.S. net operating losses may be subject to a substantial annual limitation due to the "change in ownership" provisions of the Internal Revenue Code of 1986 and similar state provisions. The annual limitation may result in the expiration of net operating losses before utilization.

- m. In December 2007, the Company finalized with the Israeli Tax Authority the tax assessment with respect to the years 2001-2004.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 15:- TAXES ON INCOME (Cont.)

n. Uncertain tax provisions:

As of December 31, 2009 and 2010 balances in respect to ASC 740 Income Taxes amounted to \$ 140 and \$ 243, respectively.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	December 31,	
	2009	2010
Balance at the beginning of the year	\$ 294	\$ 140
Additions based on tax positions taken during a prior period	-	189
Reduction related to tax positions taken during a prior period	(133)	(100)
Reductions related to settlement of tax matters	(33)	
Foreign currency translation adjustments	12	14
Balance at the end of the year	<u>\$ 140</u>	<u>\$ 243</u>

NOTE 16:- DISCONTINUED OPERATIONS

a. On August 31, 2007, the Company entered into an agreement to purchase all of the shares of a European company engaged in the installation and integration of security systems (hereinafter - the European subsidiary), in consideration for 9,300 Euros (approximately \$13,600), of which 5,500 Euros were paid in 2008 as contingent consideration.

The acquisition was accounted for using the purchase method of accounting as determined in ASC 805, "Business Combinations" and, accordingly, the purchase price was allocated to the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 16:- DISCONTINUED OPERATIONS (Cont.)

In 2008, following the annual goodwill impairment test, the Company determined that the fair value of its European subsidiary had decreased and, as a result, recorded a goodwill impairment charge of \$ 8,423 (including \$ 3,300 of funds prepaid on account of future earn-out payments), which was allocated to the Projects segment. In addition, the Company determined that customer-related intangible assets of the European subsidiary in the amount of \$ 1,692 that were recorded on the acquisition had been impaired and, as a result, recorded an impairment charge attributed to such intangible assets.

In September 2009, the Company resolved to discontinue the operation of the European subsidiary. The subsidiary was sold in December 2009 in consideration of 2,900 Euro (approximately \$ 4,200). In addition, the remaining escrow amount of approximately 620 Euros was released back to the Company.

Accordingly, the operating results and the cash flows for 2007, 2008 and 2009, as well as the capital gain of approximately \$4,300 resulting from the sale, were classified as discontinued operations, in accordance with ASC 205-20 "Discontinued Operations."

The following are the results of the operations of the European subsidiary for the year ended December 2008. The operating results of the European subsidiary during 2009 were immaterial

	<u>Year ended December 31, 2008</u>
Revenues	\$ 13,250
Cost of revenues	<u>13,232</u>
Gross profit	<u>18</u>
Operating expenses:	
Sales and marketing	4,864
General and administrative	<u>9,409</u>
Operating income (loss)	(14,255)
Financial expense, net	(692)
Tax benefit	<u>(1,682)</u>
Net income (loss)	<u>\$ (13,265)</u>

As of December 31, 2009, there are no balance sheet items related to the operations of the European subsidiary.



NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 17:- BALANCES AND TRANSACTIONS WITH RELATED PARTIES

- a. Sales to related parties:

	Year ended December 31,		
	2008	2009	2010
Sales to a related party	\$ -	\$ -	\$ 107
Loan from a related party	\$ -	\$ -	\$ 9,703
Interest expenses	\$ -	\$ -	\$ 195

- b. In October 2010, the Company entered into agreement with its principal shareholder to install a perimeter security system project at one of his premises in Europe. The work started in December 2010 and is expected to be finalized during the first half of 2011. As of December 31, 2010, there is an advance payment balance of \$ 172 related to such project.
- c. On September 8, 2010, Ki Corporation provided the Company with a \$ 10,000 bridge loan. The loan agreement provided that if it is not repaid within 180 days, the bridge loan would begin to accrue interest at the rate of LIBOR + 4% per year, calculated from the date of the loan and accumulated on a quarterly basis. However, if the rights offering that the Company intends to initiate during 2011 occurs within 240 days from the date of the loan, the loan will not bear any interest. The Company has undertaken to repay the bridge loan within five business days after the successful completion of the rights offering. The term of the loan ends on January 10, 2012, after which the Company will retain an option to extend the loan for a further 60 days.

The principal at the amount of \$10,000 and the interest will be paid at the end of the term of the loan. The principal and the interest will be paid in the same manner.

The loan was recorded at fair value in the amount of \$ 9,703 using an effective interest rate of 6.7%. The difference between the consideration received and the fair value of the loan was recorded in the statement of changes in shareholders' equity. During 2010, the Company recorded interest expense of \$ 195 with respect to such loan. As of December 31, 2010, the loan fair value and accumulated interest amounted to \$ 9,907.

- d. In May 2008, one of the Company's major shareholders granted to the executive chairman of the Board of Directions the right to purchase 100,000 shares, subject to the same terms and conditions that apply to the exercise of the options the executive chairman received from the Company pursuant to his employment agreement. The employment agreement was approved in the Company's annual shareholders' meeting on August 20, 2008 and consequently, the chairman of the Board of Directors has the right to purchase the shares in three equal installments commencing on August 20, 2010 at a price of \$ 7.59 per share. The right to purchase each installment expires after three years. The Company recorded \$ 100 in deferred stock compensation expense with respect to this in 2010.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

**NOTE 17:- BALANCES AND TRANSACTIONS WITH RELATED PARTIES (Cont.)**

- e. On December 31, 2007, the Company's Chairman retired from his position. Pursuant to his retirement agreement as amended, the retired Chairman undertook not to compete with the Company for a period of three years following his retirement. In consideration, the Company agreed to pay the retired Chairman a onetime payment of \$ 360 payable within three months. In addition, the Chairman is entitled to receive certain perquisites from the Company for the rest of his life. The liability as of December 31, 2010 and the special post-benefit expense related to the retirement agreement amounted to \$ 679.

**NOTE 18:- SEGMENT INFORMATION**

The Company adopted ASC 280, "Segment Reporting." The Company operates in two major reportable segments, which represent the Company's operating segments as follows:

1. Perimeter security systems - The Company's line of perimeter security systems consists of the following: Microprocessor-based central control units, taut wire perimeter intrusion detection systems, INNO fences, vibration detection systems, field disturbance sensors, and other.
2. Security turnkey projects - The Company executes turnkey projects based on the Company's security management system and acts as an integrator.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 18:- SEGMENT INFORMATION (Cont.)

a. The following data present the revenues, expenditures, assets and other operating data of the Company's operating segments:

	Year ended December 31,											
	2008				2009				2010			
	Perimeter	Projects	Eliminations	Total	Perimeter	Projects	Eliminations	Total	Perimeter	Projects	Eliminations	Total
Revenues	\$ 41,378	\$ 15,727	\$ -	\$ 57,105	\$ 39,102	\$ 15,416	\$ -	\$ 54,518	\$ 33,248	\$ 17,249	\$ (798)	\$ 49,699
Depreciation and amortization	\$ 782	\$ 409	\$ -	\$ 1,191	\$ 1,166	\$ 38	\$ -	\$ 1,204	\$ 945	\$ 117	\$ -	\$ 1,062
Impairment of Goodwill and Other intangible assets	\$ 2,772	\$ -	\$ -	\$ 2,772	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Operating income (loss), before financial expenses and taxes on income	\$ (9,330)	\$ (5,230)	\$ -	\$ (14,560)	\$ (1,053)	\$ (1,812)	\$ -	\$ (2,865)	\$ (1,641)	\$ (2,716)	\$ (303)	\$ (4,660)
Financial expenses, net				1,314				1,568				967
Taxes on income (tax benefit)				3,066				864				602
Income (loss) from discontinued operations, net				(13,662)				4,216				-
Net income (loss)				\$ (32,602)				\$ (1,081)				\$ (6,229)

	December 31,								
	2008			2009			2010		
	Perimeter	Projects	Total	Perimeter	Projects	Total	Perimeter	Projects	Total
Total long-lived assets	\$ 9,580	\$ 3,623	\$ 13,203	\$ 10,590	\$ 910	\$ 11,500	\$ 8,240	\$ 793	\$ 9,033

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 18:- SEGMENT INFORMATION (Cont.)

- b. Major customer data (percentage of total revenues):

	Year ended December 31,		
	2008	2009	2010
Customer A	10.8%	19.6%	13.4%
Customer B	-	-	11.4%

- c. Geographical information:

The following is a summary of revenues within geographic areas based on end customer's location and long-lived assets:

	Year ended December 31,		
	2008	2009	2010
1. Revenues:			
Israel	\$ 12,097	\$ 12,968	\$ 9,838
Europe	15,603	10,808	9,787
North America	15,648	13,763	15,393
South and Latin America	4,542	3,986	9,958
Others	9,215	12,993	4,723
	<u>\$ 57,105</u>	<u>\$ 54,518</u>	<u>\$ 49,699</u>
2. Long-lived assets:			
Israel	\$ 3,148	\$ 4,230	\$ 4,065
Europe	3,954	1,174	1,082
USA	2,610	2,262	39
Canada	3,309	3,590	3,620
Others	182	244	227
	<u>\$ 13,203</u>	<u>\$ 11,500</u>	<u>\$ 9,033</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 19:- SELECTED STATEMENTS OF INCOME DATA

Financial expenses:

	Year ended December 31,		
	2008	2009	2010
<b>Financial expenses:</b>			
Interest on long-term debt	\$ (170)	\$ (93)	\$ (11)
Interest on short-term bank credit	(922)	(879)	(744)
Interest on a related party loan	-	-	(195)
Forward contracts losses	(291)	-	-
Foreign exchange losses	(875)	(1,378)	(517)
Marketable securities losses	(442)	-	-
	<u>(2,700)</u>	<u>(2,350)</u>	<u>(1,467)</u>
<b>Financial income:</b>			
Interest on short-term and long-term bank deposits, structured notes and marketable securities	757	484	182
Marketable securities gain	-	58	-
Foreign exchange gains	629	240	318
	<u>1,386</u>	<u>782</u>	<u>500</u>
	<u>\$ (1,314)</u>	<u>\$ (1,568)</u>	<u>\$ (967)</u>

NOTE 20:- SUBSEQUENT EVENTS

On January 23, 2011, the Israeli Tax Authorities issued a NIS 2.3 million (approximately \$ 686,000) tax assessment related to the Company's 2005-2006 tax years. Based on the advice of its tax advisors, the Company believed that its probable that it will not have to pay this amount and that it will be settled by means of an offset against some of the Company's carry forward tax losses for which the Company has recorded a full valuation allowance. Accordingly, the Company expects that the tax assessment will not have a material affect on its position or results of operations.

Salles Sainz

# Grant Thornton

## Report of Independent Registered Public Accounting Firm

To the Shareholders' of

Senstar Stellar Latin America, S. A. de C.V.:

We have audited the accompanying balances sheets of SENSTAR STELLAR LATIN AMERICA, S.A. DE C.V. (incorporated in Mexico), as of December 31, 2008 and 2007, and the related statements of operations, changes in shareholders' equity, and cash flows for each of the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the 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 audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the translated financial statements referred to above present fairly, in all material respects, the financial position of Senstar Stellar Latin America, S.A. de C.V. as of December 31, 2008 and 2007, and the related statements of operations, changes in shareholders' equity and cash flows for each of the years then ended in conformity with the accounting principles generally accepted in the United States of America.

SALLES, SAINZ - GRANT THORNTON, S.C.



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By: Hector Bautista C.P.A.

Mexico City, Mexico  
March 27, 2009

**SCHEDULE OF VALUATION AND QUALIFYING ACCOUNTS**  
(U.S. dollars in thousands)

	<u>Balance at beginning of period</u>	<u>Provision for doubtful accounts</u>	<u>Offsets against receivables balances for which allowance was provided in previous years</u>	<u>Translation adjustments</u>	<u>Balance at end of period</u>
Year ended December 31, 2010:					
Allowance for doubtful debts	\$ 911	\$ 601	\$ (610)	\$ 17	\$ 919
Year ended December 31, 2009:					
Allowance for doubtful debts (1)	\$ 1,506	\$ (153)	\$ -	\$ 2	\$ 911
Year ended December 31, 2008:					
Allowance for doubtful debts	\$ 343	\$ 1,223	\$ -	\$ (60)	\$ 1,506

(1) In September 2009, our Board of Directors resolved to discontinue the operations of the European integration subsidiary that we acquired in September 2007. The subsidiary was sold in December 2009. In connection with the acquisition, the buyer assumed \$444,000 of doubtful accounts of the subsidiary.

**SIGNATURE**

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

MAGAL SECURITY SYSTEMS LTD.

By: /s/ Eitan Livneh

Name: Eitan Livneh

Title: President and Chief Executive Officer

Date: April 11, 2011



**MAGAL SECURITY SYSTEMS LTD.  
THE 2010 INCENTIVE OPTION SCHEME**

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## DEFINITIONS

For purposes of the Incentive Option Scheme and related documents, including without limited, the Grant Notification Letter, the following definitions shall apply:

- (a) **"Board"** - the Board of Directors of the Company.
- (b) **"Cause"** – any of the following:
  - (i) conviction of any felony involving moral turpitude or affecting the Company or any of its affiliates;
  - (ii) any refusal to carry out a reasonable directive of the chief executive officer, the Board or the Grantee's direct supervisor, which involves the business of the Company or any of its affiliates and was capable of being lawfully performed;
  - (iii) embezzlement of funds of the Company or any of its affiliates;
  - (iv) any breach of the Grantee's fiduciary duties or duties of care of the Company or any of its affiliates; including without limitation disclosure of confidential information of the Company or any of its affiliates;
  - (v) any conduct (other than conduct in good faith), including without limitation, any act or omission, reasonably determined by the Board to be materially detrimental to the Company or any of its affiliates; and/or
  - (vi) if such term is or may be defined under the Grantee's employment agreement, service agreement or any other engagement agreement with the Company or any of its affiliates then the circumstances included in such definition shall be added; and/or
  - (vii) Any circumstances resulting in the Grantees' employment with the Company and/or any of its affiliates being, or may be, terminated without severance pay under any applicable law or agreement.

For the avoidance of any doubt, it is hereby clarified that in any event of conflict between the definition of the term "Cause" in this Scheme and the definition of the term "Cause" in a certain employment agreement, the definition in this Scheme shall prevail in connection with the Option, with the Grant Notification Letter and with this Scheme.

- (c) **"Chairman"** - the chairman of the Committee and if no such Committee is appointed the Chairman of the Board.
- (d) **"Committee"** or the **"Compensation Committee"**- a share option compensation committee appointed by the Board, which shall consist of no fewer than two members of the Board. If no such committee is appointed, then all the authorities of the Committee under the Scheme shall be vested in the Board.
- (e) **"Company"** – Magal Security Systems Ltd., an Israeli company.
- (f) **"Date of Grant"** - the date of grant of an Option, as determined by the Board or the Committee and set forth in the Grantee's Grant Notification Letter.
- (g) **"Distribution Date"** - the date the Company shall declare on the distribution of a share dividend and/or a cash dividend and/or subscription rights, as the case may be, and as detailed in Section 8 of the Scheme.

- (h) **"Employee"** - a person who is employed by the Company or any affiliate.
  - (i) **"Expiration Date"** - the date upon which an Option shall expire, as set forth in Section 7.2 of the Scheme.
  - (j) **"Fair Market Value"** - as of any date, the value of a Share determined as follows:
    - (i) As long as the Shares are listed on any established Share exchange or a national market system, including without limitation the Tel-Aviv Securities Exchange, the NASDAQ National Market System, or the NASDAQ SmallCap Market of the NASDAQ Share Market, the Fair Market Value shall be the closing sales price for such Shares (or the closing bid, if no sales were reported), as quoted on such exchange or system for the last market trading day prior to time of determination, as reported in the Wall Street Journal, or such other source as the Board deems reliable;
    - (ii) If the Shares are regularly quoted by a recognized securities dealer but selling prices are not reported, the Fair Market Value shall be the mean between the high bid and low asked prices for the Shares on the last market trading day prior to the day of determination, or;
    - (iii) In the absence of an established market for the Shares, the Fair Market Value thereof shall be determined in good faith by the Board.
  - (k) **"Grantee"** - a person who receives or holds an Option under the Scheme.
  - (l) **"Grant Notification Letter"** - a document to be signed between the Company and a Grantee that sets out, and inform the Grantee of, the terms and conditions of the grant of an Option.
  - (m) **"Non-Employee"** - a director, consultant, advisor, service provider of the Company or any affiliate, or any other person who is not an Employee.
  - (n) **"Option"** - an option to purchase one or more Shares of the Company pursuant to the Scheme.
  - (o) **"Purchase Price"** or the **"Exercise Price"** - the price for each Share (as such term is defined below) subject to an Option.
  - (p) **"Scheme"** - this 2010 Incentive Option Scheme.
  - (q) **"Share"** - the ordinary shares, NIS 1.00 par value each, of the Company.
  - (r) **"Successor Company"** - any entity the Company is merged to or is acquired by, in which the Company is not the surviving entity.
  - (s) **"Transaction"** –
    - (i) merger, acquisition or reorganization of the Company with one or more other entities in which the Company is not the surviving entity;
    - (ii) any transaction resulting in the shareholders of the Company immediately prior to the closing of such transaction, being the holders of 50% or less of the voting rights of the Company;
    - (iii) a sale of all or substantially all of the assets of the Company.
  - (t) **"Vested Option"** - any Option, which has already been vested according to the Vesting Dates.
  - (u) **"Vesting Dates"** - as determined by the Board or by the Committee, the date as of which the Grantee shall be entitled to exercise the Options or part of the Options, as set forth in Section 10 of the Scheme and in the Grantee's Grant Notification Letter.
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## THE SCHEME

This scheme, as amended from time to time, shall be known as Magal Security Systems Ltd. 2010 Incentive Option Scheme.

### **1. PURPOSE OF THE SCHEME**

The Scheme is intended to provide an incentive to retain, in the employ of the Company and its affiliates, persons of training, experience, and ability, to attract new employees, directors, consultants, service providers and any other entity which the Board shall decide their services are considered valuable to the Company, to encourage the sense of proprietorship of such persons, and to stimulate the active interest of such persons in the development and financial success of the Company by providing them with opportunities to purchase shares in the Company, pursuant to the Scheme.

Incentives under the Scheme shall only be issued to Grantees subject to the applicable law in their respective country of residence for tax purposes or any other purposes, as the case may be.

### **2. ADMINISTRATION OF THE SCHEME**

2.1 The Board shall have the power to administer the Scheme either directly or upon the recommendation of the Committee, all as provided by applicable law and in the Company's Articles of Association. Notwithstanding the above, the Board shall automatically have residual authority (i) if no Committee shall be constituted; (ii) if such Committee shall cease to operate for any reason; (iii) with respect to the rights not delegated by the Board to the Committee; or (iv) if, and to the extent, in accordance with Israeli Law the Committee is not permitted to administer the Scheme.

2.2 The Committee shall select one of its members as its Chairman and shall hold its meetings at such times and places as the Chairman shall determine. The Committee shall keep records of its meetings and shall make such rules and regulations for the conduct of its business as it shall deem advisable.

2.3 The Board and/or the Committee, if applicable subject to the approval of the Board, to the extent required under applicable law (and subject further to applicable laws) shall have the full power and authority to:

- (i) designate participants;
- (ii) determine the terms and provisions of the respective Grant Notification Letters, including, but not limited to, the number of Options to be granted to each Grantee, the number of Shares to be covered by each Option, provisions concerning the time and the extent to which the Options may be exercised and the nature and duration of restrictions as to the transferability or restrictions constituting substantial risk of forfeiture and to cancel or suspend awards, as necessary;
- (iii) determine the Fair Market Value of the Shares covered by each Option;
- (iv) make an election as to the type of Approved 102 Option;

(v) designate the type of Options;  
(vi) alter any restrictions and conditions of any Options or Shares subject to any Options; (vii) interpret the provisions and supervise the administration of the Scheme;  
(viii) accelerate the right of a Grantee to exercise in whole or in part, any previously granted Option;  
(ix) determine the Purchase Price of the Option;  
(x) prescribe, amend and rescind rules and regulations relating to the Scheme; and  
(xi) make all other determinations deemed necessary or advisable for the administration of the Scheme.

- 2.4 The Board or the Committee shall have the authority to grant, at its discretion, to the holder of an outstanding Option, in exchange for the surrender and cancellation of such Option, a new Option having a purchase price equal to, lower than or higher than the Purchase Price of the original Option so surrendered and canceled and containing such other terms and conditions, or to change the Purchase Price as the Board or the Committee may prescribe in accordance with the provisions of the Scheme.
- 2.5 Subject to the Company's Articles of Association, all decisions and elections made by the Board or the Committee pursuant to the provisions of the Scheme shall be made by a majority of its members.. Any decision reduced to writing shall be executed in accordance with the provisions of the Company's Articles of Association, as the same may be in effect from time to time.
- 2.6 The interpretation and construction by the Committee of any provision of the Scheme or of any Grant Notification Letter thereunder shall be final and conclusive unless otherwise determined by the Board.
- 2.7 Subject to the Company's Articles of Association and the Company's decision, and to all approvals legally required, including, but not limited to the provisions of any applicable law, each member of the Board or the Committee shall be indemnified and held harmless by the Company against any cost or expense (including counsel fees) reasonably incurred by him, or any liability (including any sum paid in settlement of a claim with the approval of the Company) arising out of any act or omission to act in connection with the Scheme unless arising out of such member's own fraud or bad faith, to the extent permitted by applicable law. Such indemnification shall be in addition to any rights of indemnification the member may have as a director or otherwise under the Company's Articles of Association, any agreement, any vote of shareholders or disinterested directors, insurance policy or otherwise.

### **3. DESIGNATION OF PARTICIPANTS**

The persons eligible for participation in the Scheme as Grantees shall include any Employees and/or Non-Employees of the Company or of any affiliate.

The grant of an Option hereunder shall neither entitle the Grantee to participate nor disqualify the Grantee from participating in, any other grant of Options pursuant to the Scheme or any other option or share plan of the Company or any of its affiliates.

#### 4. SHARES RESERVED FOR THE SCHEME; RESTRICTION THEREON

- 4.1 The Company has reserved five hundred and ten thousand and five hundred and seventy five (510,575) authorized but unissued Shares, for the purposes of the Scheme and for the purposes of any other share option plans which may be adopted by the Company in the future, subject to adjustment as set forth in Section 8 below. Any Shares which remain unissued and which are not subject to the outstanding Options at the termination of the Scheme shall cease to be reserved for the purpose of the Scheme, but until termination of the Scheme the Company shall at all times reserve sufficient number of Shares to meet the requirements of the Scheme. Should any Option for any reason expire or be canceled prior to its exercise or relinquishment in full, the Shares subject to such Option may again be subjected to an Option under the Scheme or under the Company's other share option plans.
- 4.2 Each Option granted pursuant to the Scheme, shall be evidenced by a written Grant Notification Letter between the Company and the Grantee, in such form as the Board or the Committee shall from time to time approve. Each Grant Notification Letter shall state, among other matters, the number of Shares to which the Option relates, the type of Option granted thereunder, the Vesting Dates, the Purchase Price per share, the Expiration Date and such other terms and conditions as the Committee or the Board in its discretion may prescribe, provided that they are consistent with this Scheme.

#### 5. PURCHASE PRICE

- 5.1 The Purchase Price of each Share subject to an Option shall be determined by the Board in its sole and absolute discretion in accordance with applicable law, unless such authority is delegated to the Committee. Each Grant Notification Letter will contain the Purchase Price determined for each Grantee and/or each portions of the Options so granted.
- 5.2 Without derogating from the above and in addition thereto, the Purchase Price of each Share subject to an Option shall be payable upon the exercise of an Option in the following acceptable forms of payment:
- (i) cash, check or wire transfer;
  - (ii) at the discretion of the Committee, through delivery of Share (including other Share subject to the Options being exercised) having a Fair Market Value equal as of the date of exercise to the Purchase Price of the Share purchased and acquired upon the exercise of the Option, or by a different form of cashless exercise method through a third party broker as approved by the Committee;
  - (iii) Notwithstanding the above, the Board may, in its sole discretion, allow for cashless exercise of the Options. If the Board so permitted, the applicable Notice of Grant shall provide that the Grantee shall be entitled, at his or her own discretion instruct the Company in writing, as part of the exercise notice, that the payment for the Options will be made through "cashless exercise" mechanism (the "Cashless Notice"). In the event that the Grantee has elected to submit the Cashless Notice then the Grantee shall be entitled to receive a certificate for the number of Shares equal to the quotient obtained by dividing  $(A-B) \cdot (N)$  by  $(A) \cdot (V)$ ,  
where:  
(A) = the average of the closing (or closing bid, if so reported) prices per Share on the five (5) Trading Days preceding the date of such election;  
(B) = the Purchase Price;  
(N) = the number of shares issuable upon exercise of the Options in accordance with the terms of this Agreement; and  
(V) = the nominal value of the share (currently NIS1.00).

5.3 The Purchase Price shall be denominated in US Dollars.

## 6. ADJUSTMENTS

Upon the occurrence of any of the following described events, Grantee's rights to purchase Shares under the Scheme shall be adjusted as hereafter provided:

- 6.1 In the event of Transaction, the unexercised Options then outstanding under the Scheme shall be assumed or substituted for an appropriate number of shares of each class of shares or other securities of the Successor Company (or a parent or subsidiary of the Successor Company) as were distributed to the shareholders of the Company in connection and with respect to the Transaction. In the case of such assumption and/or substitution of Options, appropriate adjustments shall be made to the Purchase Price so as to reflect such action and all other terms and conditions of the Grant Notification Letters shall remain unchanged, including but not limited to the vesting schedule, all subject to the determination of the Committee or the Board, which determination shall be in their sole discretion and final. The Company shall notify the Grantee of the Transaction in such form and method as it deems applicable at least ten (10) days prior to the effective date of such Transaction.
- 6.2 Notwithstanding the above and subject to any applicable law, the Board or the Committee shall have full power and authority to determine that in certain Grant Notification Letters there shall be a clause instructing that, if in any such Transaction as described in Section 6.1 above, the Successor Company (or parent or subsidiary of the Successor Company) does not agree to assume or substitute for the Options, the Vesting Dates shall be accelerated so that any unvested Option or any portion thereof shall be immediately vested as of the date which is ten (10) days prior to the effective date of the Transaction.
- 6.3 For the purposes of Section 6.1 above, an Option shall be considered assumed or substituted if, following the Transaction, the Option confers the right to purchase or receive, for each Share underlying an Option immediately prior to the Transaction, the consideration (whether shares, options, cash, or other securities or property) received in the Transaction by holders of shares held on the effective date of the Transaction (and if such holders were offered a choice of consideration, the type of consideration chosen by the holders of a majority of the outstanding shares); provided, however, that if such consideration received in the Transaction is not solely ordinary shares (or their equivalent) of the Successor Company or its parent or subsidiary, the Committee may, with the consent of the Successor Company, provide for the consideration to be received upon the exercise of the Option to be solely ordinary shares (or their equivalent) of the Successor Company or its parent or subsidiary equal in Fair Market Value to the per Share consideration received by holders of a majority of the outstanding shares in the Transaction; and provided further that the Committee may determine, in its discretion, that in lieu of such assumption or substitution of Options for options of the Successor Company or its parent or subsidiary, such Options will be substituted for any other type of asset or property including cash which is fair under the circumstances.

- 6.4 The Board or the Committee shall have full power and authority to determine that in certain Grant Notification Letters there shall be a clause instructing that, if the Company is voluntarily liquidated or dissolved while unexercised Options remain outstanding under the Scheme, the Company shall immediately notify all unexercised Option holders of such liquidation, and the Option holders shall then have ten (10) days to exercise any unexercised Vested Option held by them at that time, in accordance with the exercise procedure set forth herein. Upon the expiration of such ten (10) days period, all remaining outstanding Options will terminate immediately.
- 6.5 If the outstanding shares of the Company shall at any time be changed or exchanged by, share split, combination or exchange of shares, recapitalization, spin-off or any other like event by or of the Company, and as often as the same shall occur, then the number, class and kind of the Shares subject to the Scheme or subject to any Options therefore granted, and the Purchase Prices, shall be appropriately and equitably adjusted so as to maintain the proportionate number of Shares without changing the aggregate Purchase Price. Upon happening of any of the foregoing, the class and aggregate number of Shares issuable pursuant to the Scheme (as set forth in Section 6 hereof), in respect of which Options have not yet been exercised, shall be appropriately adjusted, all as will be determined by the Board whose determination shall be final.
- 6.6 Notwithstanding anything mentioned above, in addition thereto and subject to the following, upon declaration of a share dividend (bonus shares) to the Company's shareholders, in the event that the Distribution Date of such share dividend shall occur prior to the exercise of the Options by the Grantee, the Grantee's rights with respect to such Options shall be reserved so that immediately following the Distribution Date the number of shares to be realized from the exercise of the Options (the: "**Exercised Shares**") shall be equitably adjusted as to the class and number of Exercised Shares to reflect the increase in the Exercised Shares the Grantee would have been entitled to, should the Options have been exercised prior to the Distribution Date.

Any of the foregoing shall also apply to any share additionally added to the Exercised Shares.

For the avoidance of any doubt, the number, class and kind of the Exercised Shares shall be adjusted only with respect to any declaration of share dividend as set out in this section.



6.7 In the event of declaration of cash dividend, should the Distribution Date be prior to the exercise date of an Option including any unvested Options, then the original Purchase Price of an Option shall be reduced as follows:

Immediately after the Distribution Date the ratio (the: “**Dividend Ratio**”) shall be calculated between the Company’s share price as quoted on any established share exchange or a national market system as adjusted to the distribution of the cash dividend (the: “**X Dividend**”) and the closing share price at the end of the Distribution Date.

The original Purchase Price of an Option shall be multiplied by the Dividend Ratio at the Distribution Date resulting in the new Purchase Price of an Option.

The original Purchase Price shall also be adjusted with respect to any other events that may be deemed to be a distribution as such term is defined under the applicable law, based on the above description.

6.9 Notwithstanding anything to the contrary mentioned above, subject to this Section 6, the Grantee shall not be entitled to receive portion of shares, and the number of shares allocated to the Grantee pursuant to any adjustments made pursuant to this Section 6, shall be rounded as to nearest whole number of share and the provisions of this Scheme shall apply accordingly. The resolution of the Committee and the Board with respect to such rounding shall be final.

6.10 Anything herein to the contrary notwithstanding, if prior to the completion of the IPO all or substantially all of the shares of the Company are to be sold, or in case of a Transaction, all or substantially all of the shares of the Company are to be exchanged for securities of another Company, then each Grantee shall be obliged to sell or exchange, as the case may be, any Shares such Grantee purchased under the Scheme, in accordance with the instructions issued by the Board in connection with the Transaction, whose determination shall be final.

6.11 In the event that the Company’s Shares shall be registered for trading in any public market, the Grantee acknowledges that Grantee’s rights to sell the Shares may be subject to certain limitations (including a lock-up period) as will be requested by the Company or its underwriters, and the Grantee unconditionally agrees and accepts any such limitations.

## 7. TERM AND EXERCISE OF OPTIONS

7.1 Options shall be exercised by the Grantee by giving written notice to the Company and/or to any third party designated by the Company (the: “**Representative**”), in such form and method as may be determined by the Company, which exercise shall be effective upon receipt of such notice by the Company and/or the Representative and the payment of the Purchase Price at the Company’s or the Representative’s principal office. The notice shall specify the number of Shares with respect to which the Option is being exercised.

7.2 Options, to the extent not previously exercised, shall terminate forthwith upon the earlier of: (i) the date set forth in the Grant Notification Letter; and (ii) the expiration of any extended period in any of the events set forth in Section 7.5 below.

7.3 The Options may be exercised by the Grantee in whole at any time or in part from time to time, to the extent that the Options become vested and exercisable, prior to the Expiration Date, and provided that, subject to the provisions of Section 7.5 below, the Grantee is employed by or providing services to the Company or any of its affiliates, at all times during the period beginning with the granting of the Option and ending upon the date of exercise.

- 7.4 Subject to the provisions of Section 7.5 below, in the event of termination of Grantee's employment or services, with the Company or any of its affiliates, all Options granted to such Grantee will immediately expire. A notice of termination of employment or service shall be deemed to constitute termination of employment or service. For the avoidance of doubt, in case of such termination of employment or service, the unvested portion of the Grantee's Option shall not vest and shall not become exercisable and the Grantee shall have no claim against the Company and/or its affiliate that his/her Options were prevented from continuing to vest as of such termination. Notwithstanding anything to the contrary mentioned above, a Grantee shall not cease to be an Employee only due to the transfer of such Employee's employment among the Company and its affiliates.
- 7.5 Notwithstanding anything to the contrary hereinabove and unless otherwise determined in the Grantee's Grant Notification Letter, an Option may be exercised after the date of termination of Grantee's employment or service with the Company or any affiliates during an additional period of time beyond the date of such termination, but only with respect to the number of Vested Options at the time of such termination according to the Vesting Dates, if:
- (i) termination is without Cause, in which event any Vested Option still in force and unexpired may be exercised within a period of ninety (90) days after the date of such termination or other period as determined in the applicable employment or service agreement of such Grantee; or-
  - (ii) termination is the result of death or disability of the Grantee, in which event any Vested Option still in force and unexpired may be exercised within a period of twelve (12) months after the date of such termination; or -
  - (iii) prior to the date of such termination, the Committee may authorize an extension of the terms of all or part of the Vested Options beyond the date of such termination for a period not to exceed the period during which the Options by their terms would otherwise have been exercisable.

For avoidance of any doubt, if termination of employment or service is for Cause, any outstanding unexercised Option (whether vested or non-vested), will immediately expire and terminate, and the Grantee shall not have any right in connection to such outstanding Options.

- 7.6 Any form of Grant Notification Letter authorized by the Scheme may contain such other provisions as the Committee may, from time to time, deem advisable.
- 7.7 The Options and any underlying Shares are extraordinary, one-time benefits granted to the Grantee and are not and shall not be deemed a salary component for any purpose whatsoever, including in connection with calculating severance compensation under applicable law.

7.8 Neither the Grantee nor any other person, as the case may be, shall have any claim to be granted any Options, and there is no obligation by the Company for uniformity of treatment of Grantees or their beneficiaries (if applicable). The terms and conditions of the Options granted under this Scheme and any of the Board's determinations and interpretations with respect thereto need not be the same with respect to each Grantee (whether or not such Grantees are similarly situated).

**8. VESTING OF OPTIONS**

8.1 Subject to the provisions of the Scheme, each Option shall vest in accordance with the Vesting Dates and for the number of Shares as shall be provided in the Grant Notification Letter. However, no Option shall be exercisable after the Expiration Date.

8.2 An Option may be subject to such other terms and conditions on the time or times when it may be exercised, as the Committee may deem appropriate. The vesting provisions of individual Options may vary.

**9. DIVIDENDS**

Notwithstanding anything mentioned above, and in addition thereto, with respect to all Shares (but excluding, for avoidance of any doubt, any unexercised Options) allocated or issued upon the exercise of Options purchased by the Grantee and held by the Grantee or by the Trustee, as the case may be, the Grantee shall be entitled to receive dividends in accordance with the quantity of such Shares, subject to the provisions of the Company's Articles of Association (and all amendments thereto) and subject to any applicable taxation on distribution of dividends.

**10. PURCHASE FOR INVESTMENT**

The Company's obligation to issue or allocate Shares upon exercise of an Option granted under the Scheme is expressly conditioned upon:

- (i) the Company's completion of any registration or other qualifications of such Shares under all applicable laws, rules and regulations, or;
- (ii) representations and undertakings by the Grantee (or his legal representative, heir or legatee, in the event of the Grantee's death) to assure that the sale of the Shares complies with any registration exemption requirements which the Company in its sole discretion shall deem necessary or advisable.

Such required representations and undertakings may include representations and agreements that such Grantee (or his legal representative, heir, or legatee):

- (i) is purchasing such Shares for investment and not with any present intention of selling or otherwise disposing thereof; and;
- (ii) agrees to have placed upon the face and reverse of any certificates evidencing such Shares a legend setting forth (a) any representations and undertakings which such Grantee has given to the Company or a reference thereto, and (b) that, prior to effecting any sale or other disposition of any such Shares, the Grantee must furnish to the Company an opinion of counsel, satisfactory to the Company, that such sale or disposition will not violate the applicable laws, rules and regulations of the United States or any other state having jurisdiction over the Company and the Grantee.

**11. RESTRICTIONS ON ASSIGNABILITY AND SALE OF OPTIONS**

No Option or any right with respect thereto, purchasable hereunder, whether fully paid or not, shall be assignable, transferable or given as collateral or any right with respect to it given to any third party whatsoever, other than by will or by laws of decent and distribution, or as specifically otherwise allowed under the Scheme, except as specifically allowed under the Scheme, and during the lifetime of the Grantee each and all of such Grantee's rights to purchase Shares hereunder shall be exercisable only by the Grantee.

Any such action made directly or indirectly, for an immediate validation or for a future one, shall be void.

**12. EFFECTIVE DATE, DURATION, AMENDMENTS OR TERMINATION OF THE SCHEME**

- 12.1 The Scheme shall be effective as of the day it was adopted by the Board and shall terminate at the end of ten (10) years from such day of adoption (the: "**Termination Date**").
- 12.2 The Company shall obtain the approval of the Company's shareholders for the adoption of this Scheme and/or the Annexes thereto, or for any amendment to this Scheme and/or the Annexes thereto, if shareholders' approval is required under any applicable law including without limitation the U.S. securities law or the securities laws of other jurisdiction applicable to Options granted to Grantees under this Scheme and/or the Annexes thereto, or if shareholders' approval is required by any authority or by any governmental agencies or national securities exchanges including without limitation the U.S. Securities and Exchange Commission.
- 12.3 The Board may at any time, subject to the provisions of Section 12.2 above and all applicable law, amend, alter, suspend or terminate the Scheme, provided, however, that
- (i) the Board may not extend the term of the Scheme specified in Section 13.1 above and;
  - (ii) no amendment, alteration, suspension or termination of the Scheme shall impair the rights of any Grantee, unless mutually agreed otherwise by the Grantee and the Company, which agreement must be in writing and signed by the Grantee and the Company.

Earlier termination of the Scheme prior to the Termination Date shall not affect the Board's ability to exercise the powers granted to it hereunder with respect to Options granted under the Scheme prior to the date of such earlier termination.

**13. GOVERNMENT REGULATIONS**

The Scheme, and the granting and exercise of Options hereunder, and the obligation of the Company to sell and deliver Shares under such Options, shall be subject to all applicable laws, rules, and regulations, whether of the State of Israel or of the United States or any other State having jurisdiction over the Company and the Grantee, including the registration of the Shares under the United States Securities Act of 1933, and the Ordinance and to such approvals by any governmental agencies or national securities exchanges as may be required. Nothing herein shall be deemed to require the Company to register the Shares under the securities laws of any jurisdiction.

**14. CONTINUANCE OF EMPLOYMENT OR HIRED SERVICES**

Neither the Scheme nor the Grant Notification Letter with the Grantee shall impose any obligation on the Company or an Affiliate thereof, to continue to hold any Grantee in its employ or service, and nothing in the Scheme or in any Option granted pursuant thereto shall confer upon any Grantee any right to continue in the employ or service of the Company or an Affiliate thereof or restrict the right of the Company or an Affiliate thereof to terminate such employment or service at any time.

**15. GOVERNING LAW & JURISDICTION**

The Scheme shall be governed by and construed and enforced in accordance with the laws of the State of Israel applicable to contracts made and to be performed therein, without giving effect to the principles of conflict of laws. The competent courts of Tel-Aviv, Israel shall have sole jurisdiction in any matters pertaining to the Scheme.

**16. TAX CONSEQUENCES**

16.1 Any tax consequences to any Grantee arising from the grant or exercise of any Option, from the payment for Shares covered thereby or from any other event or act (of the Company and/or its affiliates, or the Grantee) hereunder shall be borne solely by the Grantee. The Company and/or its affiliates shall withhold taxes according to the requirements under the applicable laws, rules, and regulations, including withholding taxes at source. Furthermore, the Grantee shall agree to indemnify the Company and/or its affiliates and hold them harmless against and from any and all liability for any such tax or interest or penalty thereon, including without limitation, liabilities relating to the necessity to withhold, or to have withheld, any such tax from any payment made to the Grantee.

16.2 The Company shall not be required to release any Share certificate to a Grantee until all required payments have been fully made.

**17. NON-EXCLUSIVITY OF THE SCHEME**

The adoption of the Scheme by the Board shall not be construed as amending, modifying or rescinding any previously approved incentive arrangements or as creating any limitations on the power of the Board to adopt such other incentive arrangements as it may deem desirable, including, without limitation, the granting of Options otherwise than under the Scheme, and such arrangements may be either applicable generally or only in specific cases.

For the avoidance of doubt, prior grant of options to Grantees of the Company under their employment agreements, and not in the framework of any previous option scheme, shall not be deemed an approved incentive arrangement for the purpose of this Section.

**18. MULTIPLE AGREEMENTS**

The terms of each Option may differ from other Options granted under the Scheme at the same time, or at any other time. The Board may also grant more than one Option to a given Grantee during the term of the Scheme, either in addition to, or in substitution for, one or more Options previously granted to that Grantee.

**19. RULES PARTICULAR TO SPECIFIC COUNTRIES**

Notwithstanding anything herein to the contrary, the terms and conditions of the Scheme may be adjusted with respect to a particular country by means of an addendum to the Scheme in the form of an annex (the: "**Annex**"), and to the extent that the terms and conditions set forth in the Annex conflict with any provisions of the Scheme, the provisions of the Annex shall govern. Terms and conditions set forth in the Annex shall apply only to Options issued to Grantees under the jurisdiction of the specific country that is subject of the Annex and shall not apply to Options issued to any other Grantee. The adoption of any such Annex shall be subject to the approval of the Board and if required the approval of the shareholders of the Company.

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**ANNEX A - ISRAEL**  
**TO THE 2010 MAGAL SECURITY SYSTEMS LTD. INCENTIVE OPTION SCHEME**

**DEFINITIONS**

For purposes of this Annex and the Grant Notification Letter, the following definitions shall apply:

- (a) **"Affiliate"** - any "employing company" within the meaning of Section 102(a) of the Ordinance.
- (b) **"Approved 102 Option"** - an Option granted pursuant to Section 102(b) of the Ordinance and held in trust by a Trustee for the benefit of the Grantee.
- (c) **"Capital Gain Option (CGO)"** - an Approved 102 Option elected and designated by the Company to qualify under the capital gain tax treatment in accordance with the provisions of Section 102(b)(2) of the Ordinance.
- (d) **"Controlling Shareholder"** - shall have the meaning ascribed to it in Section 32(9) of the Ordinance.
- (e) **"Employee"** - a person who is employed by the Company or its Affiliates, including an individual who is serving as a director or an office holder, but excluding any Controlling Shareholder, all as determined in Section 102 of the Ordinance.
- (f) **"ITA"** - the Israeli Tax Authorities.
- (g) **"Non-Employee"** - a consultant, adviser, service provider, Controlling Shareholder or any other person who is not an Employee.
- (h) **"Ordinary Income Option (OIO)"** - an Approved 102 Option elected and designated by the Company to qualify under the ordinary income tax treatment in accordance with the provisions of Section 102(b)(1) of the Ordinance.
- (i) **"102 Option"** - any Option granted to Employees pursuant to Section 102 of the Ordinance.
- (j) **"3(i) Option"** - an Option granted pursuant to Section 3(i) of the Ordinance to any person who is a Non-Employee.
- (k) **"Ordinance"** - the Israeli Income Tax Ordinance [New Version] 1961 as now in effect or as hereafter amended.
- (l) **"Section 102"** - Section 102 of the Ordinance and any regulations, rules, orders or procedures promulgated thereunder as now in effect or as hereafter amended.

- (m) **“Trustee”** - any individual appointed by the Company to serve as a trustee and approved by the ITA, all in accordance with the provisions of Section 102(a) of the Ordinance.
- (n) **“Unapproved 102 Option”** - an Option granted pursuant to Section 102(c) of the Ordinance and not held in trust by a Trustee.

For the avoidance of any doubt, it is hereby clarified that any capitalized terms not specifically defined in this Annex shall be construed according to the interpretation given to it in the Scheme.

#### ANNEX A - ISRAEL

##### **1. GENERAL**

- 1.1. This Annex (the: **“Annex”**) shall apply only to Grantees who are residents of the state of Israel at the Date of Grant or those who are deemed to be residents of the state of Israel for the payment of tax at the Date of Grant. The provisions specified hereunder shall form an integral part of the 2010 Incentive Option Scheme of Magal Security Systems Ltd. (hereinafter: the **“Scheme”**), which applies to the issuance of options to purchase Shares of Magal Security Systems Ltd. (hereinafter: the **“Company”**). According to the Scheme, options to purchase the Company’s Shares may be issued to employees, directors, consultants and service provides of the Company or its affiliates.
- 1.2. This Annex is effective with respect to Options granted following Amendment no. 132 of the Ordinance, which entered into effect on January 1, 2003.
- 1.3. This Annex is to be read as a continuation of the Scheme and only modifies options granted to Israeli Grantees so that they comply with the requirements set by the Israeli law in general, and in particular with the provisions of Section 102 (as specified herein), as may be amended or replaced from time to time. For the avoidance of doubt, this Annex does not add to or modify the Scheme in respect of any other category of Grantees.
- 1.4. The Scheme and this Annex are complimentary to each other and shall be deemed as one. In any case of contradiction, whether explicit or implied, between the provisions of this Annex and the Scheme, the provisions set out in the Annex shall prevail.

##### **2. ISSUANCE OF OPTIONS**

- 2.1. The persons eligible for participation in the Scheme as Grantees shall include any Employees and/or Non-Employees of the Company or of any Affiliate; provided, however, that (i) Employees may only be granted 102 Options; and (ii) Non-Employees and/or Controlling Shareholders may only be granted 3(i) Options.



- 2.2 The Company may designate Options granted to Employees pursuant to Section 102 as Unapproved 102 Options or Approved 102 Options.
- 2.3 The grant of Approved 102 Options shall be made under this Annex adopted by the Board, and shall be conditioned upon the approval of this Annex by the ITA.
- 2.4 Approved 102 Options may either be classified as Capital Gain Options (“CGOs”) or Ordinary Income Options (“OIOs”).
- 2.5 No Approved 102 Options may be granted under this Annex to any eligible Employee, unless and until, the Company’s election of the type of Approved 102 Options as CGO or OIO granted to Employees (the: “**Election**”), is appropriately filed with the ITA. Such Election shall become effective beginning the first date of grant of an Approved 102 Option under this Annex and shall remain in effect at least until the end of the year following the year during which the Company first granted Approved 102 Options. The Election shall obligate the Company to grant *only* the type of Approved 102 Option it has elected, and shall apply to all Grantees who were granted Approved 102 Options during the period indicated herein, all in accordance with the provisions of Section 102(g) of the Ordinance. For the avoidance of doubt, such Election shall not prevent the Company from granting Unapproved 102 Options simultaneously.
- 2.6 All Approved 102 Options must be held in trust by a Trustee, as described in Section 3 below.
- 2.7 For the avoidance of doubt, the designation of Unapproved 102 Options and Approved 102 Options shall be subject to the terms and conditions set forth in Section 102.

**3. TRUSTEE**

- 3.1 Approved 102 Options which shall be granted under this Annex and/or any Shares allocated or issued upon exercise of such Approved 102 Options and/or other shares received subsequently following any realization of rights, including without limitation bonus shares, shall be allocated or issued to the Trustee and held for the benefit of the Grantees for such period of time as required by Section 102 or any regulations, rules or orders or procedures promulgated thereunder (the: “**Holding Period**”). In the case the requirements for Approved 102 Options are not met, then the Approved 102 Options may be regarded as Unapproved 102 Options, all in accordance with the provisions of Section 102.
- 3.2 Notwithstanding anything to the contrary, the Trustee shall not release any Shares allocated or issued upon exercise of Approved 102 Options prior to the full payment of the Grantee’s tax liabilities arising from Approved 102 Options which were granted to him and/or any Shares allocated or issued upon exercise of such Options.

- 3.3 With respect to any Approved 102 Option, subject to the provisions of Section 102 and any rules or regulation or orders or procedures promulgated thereunder, a Grantee shall not sell or release from trust any Share received upon the exercise of an Approved 102 Option and/or any share received subsequently following any realization of rights, including without limitation, bonus shares, until the lapse of the Holding Period required under Section 102 of the Ordinance. Notwithstanding the above, if any such sale or release occurs during the Holding Period, the sanctions under Section 102 of the Ordinance and under any rules or regulation or orders or procedures promulgated thereunder shall apply to and shall be borne by such Grantee.
- 3.4 Upon receipt of Approved 102 Option, the Grantee will sign an undertaking in which he or she will give his or her consent to the grant of the Option under Section 102, and will undertake to comply with the terms of Section 102 and the trust agreement between the Company and the Trustee.

#### **4. THE OPTIONS**

The terms and conditions, upon which the Options shall be issued and exercised, shall be as specified in the Grant Notification Letter to be executed pursuant to the Scheme and to this Annex. Each Grant Notification Letter shall state, inter alia, the number of Shares to which the Option relates, the type of Option granted thereunder (whether a CGO, OIO, Unapproved 102 Option or a 3(i) Option), the vesting provisions and the Purchase Price.

#### **5. FAIR MARKET VALUE**

Without derogating from the definition of "Fair Market Value" enclosed in the Scheme and solely for the purpose of determining the tax liability pursuant to Section 102(b)(3) of the Ordinance, if at the date of grant the Company's shares are listed on any established stock exchange or a national market system or if the Company's shares will be registered for trading within ninety (90) days following the date of grant of the CGOs, the fair market value of the Shares at the date of grant shall be determined in accordance with the average value of the Company's shares on the thirty (30) trading days preceding the date of grant or on the thirty (30) trading days following the date of registration for trading, as the case may be.

#### **6. EXERCISE OF OPTIONS**

- 6.1 Options shall be exercised by the Grantee by giving a written notice to the Company and/or to any third party designated by the Company (the: "**Representative**"), in such form and method as may be determined by the Company and, when applicable, by the Trustee, in accordance with the requirements of Section 102, which exercise shall be effective upon receipt of such notice by the Company and/or the Representative and the payment of the Purchase Price for the number of Shares with respect to which the option is being exercised, at the Company's or the Representative's principal office. The notice shall specify the number of Shares with respect to which the option is being exercised.
- 6.2 Without derogating from Section 4.2 of the Scheme, and in addition thereto, with respect to Approved 102 Options, any shares of Common Stock allocated or issued upon the exercise of an Approved 102 Option, shall be voted in accordance with the provisions of Section 102 and any rules, regulations or orders promulgated thereunder.

**7. ASSIGNABILITY AND SALE OF OPTIONS**

7.1 Notwithstanding any other provision of the Scheme, no Option or any right with respect thereto, purchasable hereunder, whether fully paid or not, shall be assignable, transferable or given as collateral or any right with respect to them given to any third party whatsoever, and during the lifetime of the Grantee each and all of such Grantee's rights to purchase Shares hereunder shall be exercisable only by the Grantee.

Any such action made directly or indirectly, for an immediate validation or for a future one, shall be void.

7.2 As long as Options or Shares purchased pursuant to thereto are held by the Trustee on behalf of the Grantee, all rights of the Grantee over the shares are personal, can not be transferred, assigned, pledged or mortgaged, other than by will or laws of descent and distribution.

**8. INTEGRATION OF SECTION 102 AND TAX ASSESSING OFFICER'S PERMIT**

8.1 With regards to Approved 102 Options, the provisions of the Scheme and/or the Annex and/or the Grant Notification Letter shall be subject to the provisions of Section 102 and the Tax Assessing Officer's permit, and the said provisions and permit shall be deemed an integral part of the Scheme and of the Annex and of the Grant Notification Letter.

8.2 Any provision of Section 102 and/or the said permit which is necessary in order to receive and/or to keep any tax benefit pursuant to Section 102, which is not expressly specified in the Scheme or the Annex or the Grant Notification Letter, shall be considered binding upon the Company and the Grantees.

**9. DIVIDEND**

Subject to the Company's Articles of Association, with respect to all Shares (but excluding, for avoidance of any doubt, any unexercised options) allocated or issued upon the exercise of Options and held by the Grantee or by the Trustee as the case may be, the Grantee shall be entitled to receive dividends in accordance with the quantity of such shares, and subject to any applicable taxation on distribution of dividends, and when applicable subject to the provisions of Section 102 and the rules, regulations or orders promulgated thereunder.

**10. TAX CONSEQUENCES**

10.1 Any tax consequences arising from the grant or exercise of any Option, from the payment for Shares covered thereby or from any other event or act (of the Company, and/or its Affiliates, and the Trustee or the Grantee), hereunder, shall be borne solely by the Grantee. The Company and/or its Affiliates, and/or the Trustee shall withhold taxes according to the requirements under the applicable laws, rules, and regulations, including withholding taxes at source. Furthermore, the Grantee shall agree to indemnify the Company and/or its Affiliates and/or the Trustee and hold them harmless against and from any and all liability for any such tax or interest or penalty thereon, including without limitation, liabilities relating to the necessity to withhold, or to have withheld, any such tax from any payment made to the Grantee.

- 10.2 The Company and/or, when applicable, the Trustee shall not be required to release any share certificate to a Grantee until all required payments have been fully made.
- 10.3 With respect to Unapproved 102 Option, if the Grantee ceases to be employed by the Company or any Affiliate, the Grantee shall extend to the Company and/or its Affiliate a security or guarantee for the payment of tax due at the time of sale of Shares, all in accordance with the provisions of Section 102 and the rules, regulation or orders promulgated thereunder.

**11. GOVERNING LAW & JURISDICTION**

This Annex shall be governed by and construed and enforced in accordance with the laws of the State of Israel applicable to contracts made and to be performed therein, without giving effect to the principles of conflict of laws. The competent courts of Tel-Aviv, Israel shall have sole jurisdiction in any matters pertaining to this Annex.

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**Contract for the Plant Design, Supply, Delivery, Installation and  
Commissioning of an Integrated Security System**

**Between**

**Kenya Ports Authority**

**and**

**M/S Magal Security Systems Ltd.**

**Dated: 10<sup>th</sup> December, 2010**



## Contract Agreement

THIS AGREEMENT is made the 10<sup>th</sup> day of December, 2010

BETWEEN

(1) Kenya Ports Authority, a corporation incorporated under the laws of Kenya and having its principal place of business at Mombasa, Kenya (hereinafter called "the Employer"), and (2) M/s Magal Security Systems Ltd a corporation incorporated under the laws of Israel and having its principal place of business at Yehud, Israel (hereinafter called "the Contractor").

WHEREAS the Employer desires to engage the Contractor to Design, Supply, Deliver, Instal and Commission the Integrated Security System, "the Facilities", and the Contractor has agreed to such engagement upon and subject to the terms and conditions hereinafter appearing.

NOW IT IS HEREBY AGREED as follows:

**Article 1.  
Contract  
Documents**

1.1 Contract Documents (Reference GC Clause 2)

The following documents shall constitute the Contract between the Employer and the Contractor, and each shall be read and construed as an integral part of the Contract:

- a) This Contract Agreement and the Appendices hereto 1 – Terms and Procedures of Payment, 5 - List of Major Items of Plant and Installation Services and List of Approved Subcontractors, 7 - List of Documents for Approval or Review and 8 - Functional Guarantees.
- b) Letter of Bid submitted by the Contractor
- c) Clarification Letter dated 6<sup>th</sup> January 2010 (wrongly dated 6<sup>th</sup> January 2009)
- d) Addenda 1 to 4 issued by the Employer
- e) Particular Conditions
- f) General Conditions
- g) Priced Bills of Materials
- h) Technical Specifications
- I) Drawings
- j) Contractor's Bid submission
- k) Bidding document ICB No KPA/028/2009-10 MD issued on 1<sup>st</sup> October 2009 excluding the Instructions to Bidders



**Article 2.  
Contract Price  
and Terms of  
Payment**

1.2 Order of Precedence (Reference GC Clause 2)

In the event of any ambiguity or conflict between the Contract Documents listed above, the order of precedence shall be the order in which the Contract Documents are listed in Article 1.1 (Contract Documents) above.

1.3 Definitions (Reference GC Clause 1)

Capitalized words and phrases used herein shall have the same meanings as are ascribed to them in the General Conditions.

2.1 Contract Price (Reference GC Clause 12)

The Employer hereby agrees to pay to the Contractor the Contract Price in consideration of the performance by the Contractor of its obligations hereunder. The Contract Price shall be the aggregate of: USD 21,395,501.60 as specified in the Award Letter and or such other sums as may be determined in accordance with the terms and conditions of the Contract.

2.2 Terms of Payment (Reference GC Clause 13)

The terms and procedures of payment according to which the Employer will reimburse the Contractor are given in the Appendix (Terms and Procedures of Payment) hereto.

**Payment Procedures**

The procedures to be followed in applying for certification and making payments shall be as follows:

**Monthly Payment Certificate**

The Contractor shall submit to the Project Manager, in the manner required by the Project Manager after the end of each month a statement showing the estimated total value of installation services properly executed and materials or goods for permanent works brought to Site up to the end of the previous month. The Contractor shall amend or correct his estimate as directed by the Project Manager and the latter shall not accept it until he is satisfied that it is fair and reasonable. With respect to the said materials and goods, no payment for them shall be made unless:-

- (i) The materials are in accordance with the contract specifications;
- (ii) The materials have been delivered to Site and are properly stored and protected against loss, damage or deterioration;



- (iii) The Contractor's record of the requirements, orders, receipts and use of materials are kept in a form approved by the Project Manager, and such records are available for inspection by the Project Manager;
- (iv) The Contractor has submitted a statement of his cost of acquiring and delivering the materials and goods to the Site, together with such documents as may be required for the purpose of evidencing such cost;
- (v) The materials are to be used within a reasonable time.

The Contractor will be paid on the certificate of the Project Manager the amount due to him on account of the estimated total value of the installation services executed up to the end of the previous month together with such amount (not exceeding 75% of the invoice value) as the Project Manager may consider proper on account of materials and goods for permanent Work delivered by the Contractor on Site.

Within 14 days after receiving a statement from the Contractor as aforesaid, and subject to the Contractor having made such further amendments and corrections as the Project Manager may require, the Project Manager shall issue a Certificate of Payment to the Employer showing the amount due, with a copy to the Contractor.

The Project Manager shall not unreasonably withhold certifying a Monthly Payment Certificate and where there is a dispute regarding an item for payment, the Project Manager may delete this disputed item from the Monthly Payment Certificate and certify the remainder for payment provided the said payment is in accordance with the preceding paragraph.

**Article 3.**  
**Effective Date**

3.1 Effective Date (Reference GC Clause 1)

The Effective Date from which the Time for Completion of the Facilities shall be counted is the date when all of the following conditions have been fulfilled:

- (a) This Contract Agreement has been duly executed for and on behalf of the Employer and the Contractor;
- (b) The Contractor has submitted to the Employer the performance security and the advance payment guarantee;

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- (c) The Employer has paid the Contractor the advance payment
- (d) The Contractor has been advised that the documentary credit referred to in Article 2.2 above has been issued in its favor.

Each party shall use its best efforts to fulfill the above conditions for which it is responsible as soon as practicable.

- 3.2 If the conditions listed under 3.1 are not fulfilled within two (2) months from the date of this Contract notification because of reasons not attributable to the Contractor, the Parties shall discuss and agree on an equitable adjustment to the Contract Price and the Time for Completion and/or other relevant conditions of the Contract.

**Article 4.  
Communications**

- 4.1 The address of the Employer for notice purposes, pursuant to GC 4.1 is:

Attention: Procurement & Supplies Manager,  
Street Address: P. O. Box 95009 - 80104,  
Floor/Room number: Block 3, 4th Floor, Kipevu,  
City: Mombasa  
Country: Kenya  
Telephone: +254 41 2112999  
Facsimile number: +254 41 2311867

- 4.2 The address of the Contractor for notice purposes, pursuant to GC 4.1 is: M/s Magal Security Systems Ltd

17 Altatel Street, Yehud Industrial Zone  
Israel 56100  
Tel: +972 3 539 1444  
Facsimile: +972 3 536 6245

[www.magal-s31.com](http://www.magal-s31.com)

**Article 5. Appendices**

- 5.1 The Appendices listed in the attached List of Appendices shall be deemed to form an integral part of this Contract Agreement.
- 5.2 Reference in the Contract to any Appendix shall mean the Appendices attached hereto, and the Contract shall be read and construed accordingly.



IN WITNESS WHEREOF the Employer and the Contractor have caused this Agreement to be duly executed by their duly authorized representatives the day and year first above written.

Signed by, for and on behalf of the Employer



[Signature]

Name: Gichiri Ndua

Designation: Managing Director



in the presence of

[Signature]

Name: Muhomani Galere

Designation: Corporation Secretary

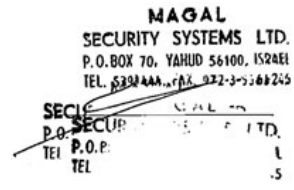
Signed by, for and on behalf of the Contractor



[Signature]

Name: Eitan Livneh

Designation: President & CEO



Name: Jacob Perry

Designation: Chairman of the Board



in the presence of

Name: Raphael Nezer

Designation: Vice President Sales

## General Conditions (GC)

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## General Conditions

### Contract and Interpretation

#### 1. Definitions

1.1 The following words and expressions shall have the meanings hereby assigned to them:

“Contract” means the Contract Agreement entered into between the Employer and the Contractor, together with the Contract Documents referred to therein; they shall constitute the Contract, and the term “the Contract” shall in all such documents be construed accordingly.

“Contract Documents” means the documents listed in Article 1.1 (Contract Documents) of the Contract Agreement (including any amendments thereto).

“GC” means the General Conditions hereof.

“PC” means the Particular Conditions.

“day” means calendar day.

“year” means 365 days.

“month” means calendar month.

“Party” means the Employer or the Contractor, as the context requires, and “Parties” means both of them.

“Employer” means the person **named as such in the PC** and includes the legal successors or permitted assigns of the Employer.

“Project Manager” means the person appointed by the Employer in the manner provided in GC Sub-Clause 18.1 (Project Manager) hereof and **named as such in the PC** to perform the duties delegated by the Employer.

“Contractor” means the person(s) whose bid to perform the Contract has been accepted by the Employer and is named as Contractor in the Contract Agreement, and includes the legal successors or permitted assigns of the Contractor.

“Contractor’s Representative” means any person nominated by the Contractor and approved by the Employer in the manner provided in GC Sub-Clause 18.2 (Contractor’s Representative and Construction Manager) hereof to perform the duties delegated by the Contractor.



“Construction Manager” means the person appointed by the Contractor’s Representative in the manner provided in GC Sub-Clause 18.2.4.

“Subcontractor,” including manufacturers, means any person to whom execution of any part of the Facilities, including preparation of any design or supply of any Plant, is sub-contracted directly or indirectly by the contractor, and includes its legal successors or permitted assigns.

“Dispute Board” (DB) means the person or persons named as such in the PC appointed by agreement between the Employer and the Contractor to make a decision with respect to any dispute or difference between the Employer and the Contractor referred to him or her by the Parties pursuant to GC Sub-Clause 47.1 (Dispute Board) hereof.

“The Bank” means the financing institution **named in the PC**.

“Contract Price” means the sum specified in Article 2.1 (Contract Price) of the Contract Agreement, subject to such additions and adjustments thereto or deductions therefrom, as may be made pursuant to the Contract.

“Facilities” means the Plant to be supplied and installed, as well as all the Installation Services to be carried out by the Contractor under the Contract.

“Plant” means permanent plant, equipment, machinery, apparatus, materials, articles and things of all kinds to be provided and incorporated in the Facilities by the Contractor under the Contract (including the spare parts to be supplied by the Contractor under GC Sub-Clause 8.3 hereof), but does not include Contractor’s Equipment.

“Installation Services” means all those services ancillary to the supply of the Plant for the Facilities, to be provided by the Contractor under the Contract, such as transportation and provision of marine or other similar insurance, inspection, expediting, site preparation works (including the provision and use of Contractor’s Equipment and the supply of all construction materials required), installation, testing, pre-commissioning, commissioning, operations, maintenance, the provision of operations and maintenance manuals, training, etc... as the case may require.

“Contractor’s Equipment” means all facilities, equipment, machinery, tools, apparatus, appliances or things of every kind required in or for installation, completion and maintenance of Facilities that are to be provided by the Contractor, but does not include Plant, or other things intended to form or forming part of the Facilities.

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“Country of Origin” means the countries and territories eligible under the rules of the Bank as further **elaborated in the PC**.

“Site” means the land and other places upon which the Facilities are to be installed, and such other land or places as may be specified in the Contract as forming part of the Site.

“Effective Date” means the date of fulfillment of all conditions stated in Article 3 (Effective Date) of the Contract Agreement, from which the Time for Completion shall be counted.

“Time for Completion” means the time within which Completion of the Facilities as a whole (or of a part of the Facilities where a separate Time for Completion of such part has been prescribed) is to be attained, as referred to in GC Clause 9 and in accordance with the relevant provisions of the Contract.

“Completion” means that the Facilities (or a specific part thereof where specific parts are specified in the Contract) have been completed operationally and structurally and put in a tight and clean condition, that all work in respect of Pre-commissioning of the Facilities or such specific part thereof has been completed, and that the Facilities or specific part thereof are ready for Commissioning as provided in GC Clause 25 (Completion) hereof.

“Pre-commissioning” means the testing, checking and other requirements specified in the Employer’s Requirements that are to be carried out by the Contractor in preparation for Commissioning as provided in GC Clause 25 (Completion) hereof.

“Commissioning” means operation of the Facilities or any part thereof by the Contractor following Completion, which operation is to be carried out by the Contractor as provided in GC Sub-Clause 26.1 (Commissioning) hereof, for the purpose of carrying out Guarantee Test(s).

“Guarantee Test(s)” means the test(s) specified in the Employer’s Requirements to be carried out to ascertain whether the Facilities or a specified part thereof is able to attain the Functional Guarantees specified in the Appendix to the Contract Agreement titled Functional Guarantees, in accordance with the provisions of GC Sub-Clause 26.2 (Guarantee Test) hereof.

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“Operational Acceptance” means the acceptance by the Employer of the Facilities (or any part of the Facilities where the Contract provides for acceptance of the Facilities in parts), which certifies the Contractor’s fulfillment of the Contract in respect of Functional Guarantees of the Facilities (or the relevant part thereof) in accordance with the provisions of GC Clause 29 (Functional Guarantees) hereof and shall include deemed acceptance in accordance with GC Clause 26 (Commissioning and Operational Acceptance) hereof.

“Defect Liability Period” means the period of validity of the warranties given by the Contractor commencing at Completion of the Facilities or a part thereof, during which the Contractor is responsible for defects with respect to the Facilities (or the relevant part thereof) as provided in GC Clause 28 (Defect Liability) hereof.

**2. Contract Documents**

2.1 Subject to Article 1.2 (Order of Precedence) of the Contract Agreement, all documents forming part of the Contract (and all parts thereof) are intended to be correlative, complementary and mutually explanatory. The Contract shall be read as a whole.

**3. Interpretation**

3.1 In the Contract, except where the context requires otherwise:

- (a) words indicating one gender include all genders;
- (b) words indicating the singular also include the plural and words indicating the plural also include the singular;
- (c) provisions including the word “agree,” “agreed,” or “agreement” require the agreement to be recorded in writing;
- (d) the word “tender” is synonymous with “bid,” “tenderer,” with “bidder,” and “tender documents” with “bidding documents,” and
- (e) “written” or “in writing” means hand-written, type-written, printed or electronically made, and resulting in a permanent record.

The marginal words and other headings shall not be taken into consideration in the interpretation of these Conditions.

3.2 Incoterms

Unless inconsistent with any provision of the Contract, the meaning of any trade term and the rights and obligations of Parties thereunder shall be as prescribed by *Incoterms*.

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Incoterms means international rules for interpreting trade terms published by the International Chamber of Commerce (latest edition), 38 Cours Albert le<sup>e</sup>, 75008 Paris, France.

3.4 Entire Agreement

Subject to GC Sub-Clause 17.4 hereof, the Contract constitutes the entire agreement between the Employer and Contractor with respect to the subject matter of Contract and supersedes all communications, negotiations and agreements (whether written or oral) of Parties with respect thereto made prior to the date of Contract.

3.5 Amendment

No amendment or other variation of the Contract shall be effective unless it is in writing, is dated, expressly refers to the Contract, and is signed by a duly authorized representative of each Party hereto.

3.6 Independent Contractor

The Contractor shall be an independent contractor performing the Contract. The Contract does not create any agency, partnership, joint venture or other joint relationship between the Parties hereto. Subject to the provisions of the Contract, the Contractor shall be solely responsible for the manner in which the Contract is performed. All employees, representatives or Subcontractors engaged by the Contractor in connection with the performance of the Contract shall be under the complete control of the Contractor and shall not be deemed to be employees of the Employer, and nothing contained in the Contract or in any subcontract awarded by the Contractor shall be construed to create any contractual relationship between any such employees, representatives or Subcontractors and the Employer.

3.7 Non-Waiver

3.7.1 Subject to GC Sub-Clause 3.7.2 below, no relaxation, forbearance, delay or indulgence by either Party in enforcing any of the terms and conditions of the Contract or the granting of time by either Party to the other shall prejudice, affect or restrict the rights of that Party under the Contract, nor shall any waiver by either Party of any breach of Contract operate as waiver of any subsequent or continuing breach of Contract.

3.7.2 Any waiver of a Party's rights, powers or remedies under the Contract must be in writing, must be dated and signed by an authorized representative of the Party granting such waiver, and must specify the right and the extent to which it is being waived.



3.8 Severability

If any provision or condition of the Contract is prohibited or rendered invalid or unenforceable, such prohibition, invalidity or unenforceability shall not affect the validity or enforceability of any other provisions and conditions of the Contract.

3.9 Country of Origin

“Origin” means the place where the plant and component parts thereof are mined, grown, produced or manufactured, and from which the services are provided. Plant components are produced when, through manufacturing, processing, or substantial or major assembling of components, a commercially recognized product results that is substantially in its basic characteristics or in purpose or utility from its components.

4. **Communications**

4.1 Wherever these Conditions provide for the giving or issuing of approvals, certificates, consents, determinations, notices, requests and discharges, these communications shall be:

- (a) in writing and delivered against receipt; and
- (b) delivered, sent or transmitted to the address for the recipient’s communications as stated in the Contract Agreement.

When a certificate is issued to a Party, the certifier shall send a copy to the other Party. When a notice is issued to a Party, by the other Party or the Project Manager, a copy shall be sent to the Project Manager or the other Party, as the case may be.

5. **Law and Language**

5.1 The Contract shall be governed by and interpreted in accordance with laws of the country **specified in the PC.**

5.2 The ruling language of the Contract shall be that **stated in the PC.**

5.3 The language for communications shall be the ruling language unless otherwise **stated in the PC.**

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**6. Fraud and Corruption**

6.1 The Bank requires that Borrowers (including beneficiaries of Bank loans), as well as Contractors, Subcontractors, manufacturers, and Consultants under Bank-financed contracts, observe the highest standard of ethics during the procurement and execution of such contracts. In pursuit of this policy, the Bank:

- (i) "corrupt practice" is the offering, giving, receiving or soliciting, directly or indirectly, of anything of value to influence improperly the actions of another party;
- (ii) "fraudulent practice"<sup>2</sup> is any act or omission, including a misrepresentation, that knowingly or recklessly misleads, or attempts to mislead, a party to obtain a financial or other benefit or to avoid an obligation;
- (iii) "collusive practice"<sup>3</sup> is an arrangement between two or more parties designed to achieve an improper purpose, including to influence improperly the actions of another party;
- (iv) "coercive practice"<sup>4</sup> is impairing or harming, or threatening to impair or harm, directly or indirectly, any party or the property of the party to influence improperly the actions of a party;
- (v) "obstructive practice" is
  - (aa) deliberately destroying, falsifying, altering or concealing of evidence material to the investigation or making false statements to investigators in order to materially impede a Bank investigation into allegations of a corrupt, fraudulent, coercive or collusive practice; and/or threatening, harassing or intimidating any party to prevent it from disclosing its knowledge of matters relevant to the investigation or from pursuing the investigation, or
  - (bb) acts intended to materially impede the exercise of the Bank's inspection and audit rights provided for under Sub-Clause 9.8.

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1 "another party" refers to a public official acting in relation to the procurement process or contract execution]. In this context, "public official" includes World Bank staff and employees of other organizations taking or reviewing procurement decisions.

2 a "party" refers to a public official; the terms "benefit" and "obligation" relate to the procurement process or contract execution; and the "act or omission" is intended to influence the procurement process or contract execution.

3 "parties" refers to participants in the procurement process (including public officials) attempting to establish bid prices at artificial, non competitive levels.

4 a "party" refers to a participant in the procurement process or contract execution.



7. **Inspections  
and Audit by the  
Bank**

7.1 The Contractor shall permit the Bank and/or persons appointed by the Bank to inspect the Site and/or the accounts and records of the Contractor and its subcontractors relating to the performance of the Contract, and to have such accounts and records audited by auditors appointed by the Bank if required by the Bank. The Contractor's attention is drawn to Sub-Clause 15.6 [Corrupt or Fraudulent Practices] which provides, inter alia, that acts intended to materially impede the exercise of the Bank's inspection and audit rights provided for under Sub-Clause 1.15 constitute a prohibited practice subject to contract termination (as well as to a determination of ineligibility under the Procurement Guidelines).



## Subject Matter of Contract

- 8. Scope of Facilities**
- 8.1 Unless otherwise expressly limited in the Employer's Requirements, the Contractor's obligations cover the provision of all Plant and the performance of all Installation Services required for the design, and the manufacture (including procurement, quality assurance, construction, installation, associated civil works, Pre-commissioning and delivery) of the Plant, and the installation, completion and commissioning of the Facilities in accordance with the plans, procedures, specifications, drawings, codes and any other documents as specified in the Section, Employer's Requirements. Such specifications include, but are not limited to, the provision of supervision and engineering services; the supply of labor, materials, equipment, spare parts (as specified in GC Sub-Clause 8.3 below) and accessories; Contractor's Equipment; construction utilities and supplies; temporary materials, structures and facilities; transportation (including, without limitation, unloading and hauling to, from and at the Site); and storage, except for those supplies, works and services that will be provided or performed by the Employer, as set forth in the Appendix to the Contract Agreement titled Scope of Works and Supply by the Employer.
- 8.2 The Contractor shall, unless specifically excluded in the Contract, perform all such work and/or supply all such items and materials not specifically mentioned in the Contract but that can be reasonably inferred from the Contract as being required for attaining Completion of the Facilities as if such work and/or items and materials were expressly mentioned in the Contract.
- 9. Time for Commencement and Completion**
- 9.1 The Contractor shall commence work on the Facilities within the period **specified in the PC** and without prejudice to GC Sub-Clause 27.2 hereof, the Contractor shall thereafter proceed with the Facilities in accordance with the time schedule specified in the Appendix to the Contract Agreement titled Time Schedule.
- 9.2 The Contractor shall attain Completion of the Facilities or of a part where a separate time for Completion of such part is specified in the Contract, within the time **stated in the PC** or within such extended time to which the Contractor shall be entitled under GC Clause 41 hereof.
- 10. Contractor's Responsibilities**
- 10.1 The Contractor shall design, manufacture including associated purchases and/or subcontracting, install and complete the Facilities in accordance with the Contract. When completed, the Facilities should be fit for the purposes for which they are intended as defined in the Contract.



- 10.2 The Contractor confirms that it has entered into this Contract on the basis of a proper examination of the data relating to the Facilities including any data as to boring tests provided by the Employer, and on the basis of information that the Contractor could have obtained from a visual inspection of the Site if access thereto was available and of other data readily available to it relating to the Facilities as of the date twenty-eight (28) days prior to bid submission. The Contractor acknowledges that any failure to acquaint itself with all such data and information shall not relieve its responsibility for properly estimating the difficulty or cost of successfully performing the Facilities.
- 10.3 The Contractor shall acquire and pay for all permits, approvals and/or licenses from all local, state or national government authorities or public service undertakings in the country where the Site is located which such authorities or undertakings require the Contractor to obtain in its name and which are necessary for the performance of the Contract, including, without limitation, visas for the Contractor's and Subcontractor's personnel and entry permits for all imported Contractor's Equipment. The Contractor shall acquire all other permits, approvals and/or licenses that are not the responsibility of the Employer under GC Sub-Clause 11.3 hereof and that are necessary for the performance of the Contract.
- 10.4 The Contractor shall comply with all laws in force in the county where the Facilities are to be implemented. The laws will include all local, state, national or other laws that affect the performance of the Contract and bind upon the Contractor. The Contractor shall indemnify and hold harmless the Employer from and against any and all liabilities, damages, claims, fines, penalties and expenses of whatever nature arising or resulting from the violation of such laws by the Contractor or its personnel, including the Subcontractors and their personnel, but without prejudice to GC Sub-Clause 11.1 hereof.
- 10.5 Any Plant and Installation Services that will be incorporated in or be required for the Facilities and other supplies shall have their origin as specified under GC Clause 1 (Country of Origin). Any subcontractors retained by the Contractor shall be from a country as specified in GC Clause 1 (Country of Origin).



- 10.6 The Contractor shall permit the Bank to inspect the Contractor's accounts and records relating to the performance of the Contractor and to have them audited by auditors appointed by the Bank, if so required by the Bank.
- 10.7 If the Contractor is a joint venture, or association (JVA) of two or more persons, all such persons shall be jointly and severally bound to the Employer for the fulfillment of the provisions of the Contract, unless otherwise specified in the PC, and shall designate one of such persons to act as a leader with authority to bind the JVA. The composition or the constitution of the JVA shall not be altered without the prior consent of the Employer.
- 10.8 The Contractor shall permit the Bank and/or persons appointed by the Bank to inspect the Site and/or the accounts and records of the Contractor and its sub-contractors relating to the performance of the Contract, and to have such accounts and records audited by auditors appointed by the Bank if required by the Bank. The Contractor's attention is drawn to Sub-Clause 6.1 which provides, inter alia, that acts intended to materially impede the exercise of the Bank's inspection and audit rights provided for under Sub-Clause 10.8 constitute a prohibited practice subject to contract termination (as well as to a determination of ineligibility under the Procurement Guidelines).
- 11.1 All information and/or data to be supplied by the Employer as described in the Appendix to the Contract Agreement titled Scope of Works and Supply by the Employer, shall be deemed to be accurate, except when the Employer expressly states otherwise.
- 11.2 The Employer shall be responsible for acquiring and providing legal and physical possession of the Site and access thereto, and for providing possession of and access to all other areas reasonably required for the proper execution of the Contract, including all requisite rights of way, as specified in the Appendix to the Contract Agreement titled Scope of Works and Supply by the Employer. The Employer shall give full possession of and accord all rights of access thereto on or before the date(s) specified in that Appendix.
- 11.3 The Employer shall acquire and pay for all permits, approvals and/or licenses from all local, state or national government authorities or public service undertakings in the country where the Site is located which (a) such authorities or undertakings require the Employer to obtain in the Employer's name, (b) are necessary for the execution of the Contract, including those required for the performance by both the Contractor and the Employer of their respective obligations under the Contract, and (c) are specified in the Appendix (Scope of Works and Supply by the Employer).

**11. Employer's Responsibilities**

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- 11.4 If requested by the Contractor, the Employer shall use its best endeavors to assist the Contractor in obtaining in a timely and expeditious manner all permits, approvals and/or licenses necessary for the execution of the Contract from all local, state or national government authorities or public service undertakings that such authorities or undertakings require the Contractor or Subcontractors or the personnel of the Contractor or Subcontractors, as the case may be, to obtain.
- 11.5 Unless otherwise specified in the Contract or agreed upon by the Employer and the Contractor, the Employer shall provide sufficient, properly qualified operating and maintenance personnel; shall supply and make available all raw materials, utilities, lubricants, chemicals, catalysts, other materials and facilities; and shall perform all work and services of whatsoever nature, including those required by the Contractor to properly carry out Pre-commissioning, Commissioning and Guarantee Tests, all in accordance with the provisions of the Appendix to the Contract Agreement titled Scope of Works and Supply by the Employer, at or before the time specified in the program furnished by the Contractor under GC Sub-Clause 19.2 hereof and in the manner thereupon specified or as otherwise agreed upon by the Employer and the Contractor.
- 11.6 The Employer shall be responsible for the continued operation of the Facilities after Completion, in accordance with GC Sub-Clause 25.8, and shall be responsible for facilitating the Guarantee Test(s) for the Facilities, in accordance with GC Sub-Clause 26.2.
- 11.7 All costs and expenses involved in the performance of the obligations under this GC Clause 11 shall be the responsibility of the Employer, save those to be incurred by the Contractor with respect to the performance of Guarantee Tests, in accordance with GC Sub-Clause 26.2.
- 11.8 In the event that the Employer shall be in breach of any of his obligations under this Clause, the additional cost incurred by the Contractor in consequence thereof shall be agreed upon by both Parties and added to the Contract Price.

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## Payment

- 12. Contract Price**
- 12.1 The Contract Price shall be as specified in Article 2 (Contract Price and Terms of Payment) of the Contract Agreement.
- 12.2 Unless an adjustment clause is provided for in the PC, the Contract Price shall be a firm lump sum not subject to any alteration, except in the event of a Change in the Facilities or as otherwise provided in the Contract.
- 12.3 Subject to GC Sub-Clauses 10.2, 11.1 and 36 hereof, the Contractor shall be deemed to have satisfied itself as to the correctness and sufficiency of the Contract Price, which shall, except as otherwise provided for in the Contract, cover all its obligations under the Contract.
- 13. Terms of Payment**
- 13.1 The Contract Price shall be paid as specified in Article 2 (Contract Price and Terms of Payment) of the Contract Agreement and in the Appendix to the Contract Agreement titled Terms and Procedures of Payment, which also outlines the procedures to be followed in making application for and processing payments.
- 13.2 No payment made by the Employer herein shall be deemed to constitute acceptance by the Employer of the Facilities or any part(s) thereof.
- 13.3 In the event that the Employer fails to make any payment by its respective due date or within the period set forth in the Contract, the Employer shall pay to the Contractor interest on the amount of such delayed payment at the rate(s) shown in the Appendix to the Contract Agreement titled Terms and Procedures of Payment, for the period of delay until payment has been made in full, whether before or after judgment or arbitrage award.
- 13.4 The currency or currencies in which payments are made to the Contractor under this Contract shall be specified in the Appendix to the Contract Agreement titled Terms and Procedures of Payment, subject to the general principle that payments will be made in the currency or currencies in which the Contract Price has been stated in the Contractor's bid.
- 14. Securities**
- 14.1 Issuance of Securities
- The Contractor shall provide the securities specified below in favor of the Employer at the times, and in the amount, manner and form specified below.

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14.2 Advance Payment Security

- 14.2.1 The Contractor shall, within twenty-eight (28) days of the notification of contract award, provide a security in an amount equal to the advance payment calculated in accordance with the Appendix to the Contract Agreement titled Terms and Procedures of Payment, and in the same currency or currencies.
- 14.2.2 The security shall be in the form provided in the bidding documents or in another form acceptable to the Employer. The amount of the security shall be reduced in proportion to the value of the Facilities executed by and paid to the Contractor from time to time, and shall automatically become null and void when the full amount of the advance payment has been recovered by the Employer. The security shall be returned to the Contractor immediately after its expiration.

14.3 Performance Security

- 14.3.1 The Contractor shall, within twenty-eight (28) days of the notification of contract award, provide a security for the due performance of the Contract in the amount **specified in the PC**.
- 14.3.2 The performance security shall be denominated in the currency or currencies of the Contract, or in a freely convertible currency acceptable to the Employer, and shall be in the form provided in Section IX, Contract Forms, corresponding to the type of bank guarantee stipulated by the Employer in the PC, or in another form acceptable to the Employer.
- 14.3.3 Unless otherwise **specified in the PC**, the security shall be reduced by half on the date of the Operational Acceptance. The Security shall become null and void, or shall be reduced pro rata to the Contract Price of a part of the Facilities for which a separate Time for Completion is provided, five hundred and forty (540) days after Completion of the Facilities or three hundred and sixty five (365) days after Operational Acceptance of the Facilities, whichever occurs first; provided, however, that if the Defects Liability Period has been extended on any part of the Facilities pursuant to GC Sub-Clause 28.8 hereof, the Contractor shall issue an additional security in an amount proportionate to the Contract Price of that part. The security shall be returned to the Contractor immediately after its expiration, provided, however, that if the Contractor, pursuant to GC Sub-Clause 28.10, is liable for an extended defect liability obligation, the performance security shall be extended for the period specified in the PC pursuant to GC Sub-Clause 28.10 and up to the amount specified in the PC.

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14.3.4 The Employer shall not make a claim under the Performance Security, except for amounts to which the Employer is entitled under the Contract. The Employer shall indemnify and hold the Contractor harmless against and from all damages, losses and expenses (including legal fees and expenses) resulting from a claim under the Performance Security to the extent to which the Employer was not entitled to make the claim.

**15. Taxes and Duties**

15.1 Except as otherwise specifically provided in the Contract, the Contractor shall bear and pay all taxes, duties, levies and charges assessed on the Contractor, its Subcontractors or their employees by all municipal, state or national government authorities in connection with the Facilities in and outside of the country where the Site is located.

15.2 Notwithstanding GC Sub-Clause 15.1 above, the Employer shall bear and promptly pay

(a) all customs and import duties for the Plant specified in Price Schedule No. 1; and

(b) other domestic taxes such as, sales tax and value added tax (VAT) on the Plant specified in Price Schedules No. 1 and No. 2 and that is to be incorporated into the Facilities, and on the finished goods, imposed by the law of the country where the Site is located.

15.3 If any tax exemptions, reductions, allowances or privileges may be available to the Contractor in the country where the Site is located, the Employer shall use its best endeavors to enable the Contractor to benefit from any such tax savings to the maximum allowable extent.

15.4 For the purpose of the Contract, it is agreed that the Contract Price specified in Article 2 (Contract Price and Terms of Payment) of the Contract Agreement is based on the taxes, duties, levies and charges prevailing at the date twenty-eight (28) days prior to the date of bid submission in the country where the Site is located (hereinafter called "Tax" in this GC Sub-Clause 15.4). If any rates of Tax are increased or decreased, a new Tax is introduced, an existing Tax is abolished, or any change in interpretation or application of any Tax occurs in the course of the performance of Contract, which was or will be assessed on the Contractor, Subcontractors or their employees in connection with performance of the Contract, an equitable adjustment of the Contract Price shall be made to fully take into account any such change by addition to the Contract Price or deduction therefrom, as the case may be, in accordance with GC Clause 37 hereof.

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## Intellectual Property

- 16. License/Use of Technical Information** (a) 16.1 For the operation and maintenance of the Plant, the Contractor hereby grants a non-exclusive and non-transferable license (without the right to sub-license) to the Employer under the patents, utility models or other industrial property rights owned by the Contractor or by a third Party from whom the Contractor has received the right to grant licenses thereunder, and shall also grant to the Employer a non-exclusive and non-transferable right (without the right to sub-license) to use the know-how and other technical information disclosed to the Employer under the Contract. Nothing contained herein shall be construed as transferring ownership of any patent, utility model, trademark, design, copyright, know-how or other intellectual property right from the Contractor or any third Party to the Employer.
- 16.2 The copyright in all drawings, documents and other materials containing data and information furnished to the Employer by the Contractor herein shall remain vested in the Contractor or, if they are furnished to the Employer directly or through the Contractor by any third Party, including suppliers of materials, the copyright in such materials shall remain vested in such third Party.
- 17. Confidential Information** 17.1 The Employer and the Contractor shall keep confidential and shall not, without the written consent of the other Party hereto, divulge to any third Party any documents, data or other information furnished directly or indirectly by the other Party hereto in connection with the Contract, whether such information has been furnished prior to, during or following termination of the Contract. Notwithstanding the above, the Contractor may furnish to its Subcontractor(s) such documents, data and other information it receives from the Employer to the extent required for the Subcontractor(s) to perform its work under the Contract, in which event the Contractor shall obtain from such Subcontractor(s) an undertaking of confidentiality similar to that imposed on the Contractor under this GC Clause 17.

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- 17.2 The Employer shall not use such documents, data and other information received from the Contractor for any purpose other than the operation and maintenance of the Facilities. Similarly, the Contractor shall not use such documents, data and other information received from the Employer for any purpose other than the design, procurement of Plant, construction or such other work and services as are required for the performance of the Contract.
- 17.3 The obligation of a Party under GC Sub-Clauses 16.1 and 16.2 above, however, shall not apply to that information which
- (a) now or hereafter enters the public domain through no fault of that Party
  - (b) can be proven to have been possessed by that Party at the time of disclosure and which was not previously obtained, directly or indirectly, from the other Party hereto
  - (c) otherwise lawfully becomes available to that Party from a third Party that has no obligation of confidentiality.
- 17.4 The above provisions of this GC Clause 17 shall not in any way modify any undertaking of confidentiality given by either of the Parties hereto prior to the date of the Contract in respect of the Facilities or any part thereof.
- 17.5 The provisions of this GC Clause 17 shall survive termination, for whatever reason, of the Contract.

#### **Execution of the Facilities**

#### **18. Representatives**

18.1 Project Manager

If the Project Manager is not named in the Contract, then within fourteen (14) days of the Effective Date, the Employer shall appoint and notify the Contractor in writing of the name of the Project Manager. The Employer may from time to time appoint some other person as the Project Manager in place of the person previously so appointed, and shall give a notice of the name of such other person to the Contractor without delay. No such appointment shall be made at such a time or in such a manner as to impede the progress of work on the Facilities. Such appointment shall only take effect upon receipt of such notice by the Contractor. The Project Manager shall represent and act for the Employer at all times during the performance of the Contract. All notices, instructions, orders, certificates, approvals and all other communications under the Contract shall be given by the Project Manager, except as herein otherwise provided.

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All notices, instructions, information and other communications given by the Contractor to the Employer under the Contract shall be given to the Project Manager, except as herein otherwise provided.

18.2 Contractor's Representative & Construction Manager

18.2.1 If the Contractor's Representative is not named in the Contract, then within fourteen (14) days of the Effective Date, the Contractor shall appoint the Contractor's Representative and shall request the Employer in writing to approve the person so appointed. If the Employer makes no objection to the appointment within fourteen (14) days, the Contractor's Representative shall be deemed to have been approved. If the Employer objects to the appointment within fourteen (14) days giving the reason therefore, then the Contractor shall appoint a replacement within fourteen (14) days of such objection, and the foregoing provisions of this GC Sub-Clause 18.2.1 shall apply thereto.

18.2.2 The Contractor's Representative shall represent and act for the Contractor at all times during the performance of the Contract and shall give to the Project Manager all the Contractor's notices, instructions, information and all other communications under the Contract.

All notices, instructions, information and all other communications given by the Employer or the Project Manager to the Contractor under the Contract shall be given to the Contractor's Representative or, in its absence, its deputy, except as herein otherwise provided.

The Contractor shall not revoke the appointment of the Contractor's Representative without the Employer's prior written consent, which shall not be unreasonably withheld. If the Employer consents thereto, the Contractor shall appoint some other person as the Contractor's Representative, pursuant to the procedure set out in GC Sub-Clause 18.2.1.

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- 18.2.3 The Contractor's Representative may, subject to the approval of the Employer which shall not be unreasonably withheld, at any time delegate to any person any of the powers, functions and authorities vested in him or her. Any such delegation may be revoked at any time. Any such delegation or revocation shall be subject to a prior notice signed by the Contractor's Representative, and shall specify the powers, functions and authorities thereby delegated or revoked. No such delegation or revocation shall take effect unless and until a copy thereof has been delivered to the
- Any act or exercise by any person of powers, functions and Employer and the Project Manager authorities so delegated to him or her in accordance with this GC Sub-Clause 18.2.3 shall be deemed to be an act or exercise by the Contractor's Representative.
- 18.2.4 From the commencement of installation of the Facilities at the Site until Completion, the Contractor's Representative shall appoint a suitable person as the Construction Manager. The Construction Manager shall supervise all work done at the Site by the Contractor and shall be present at the Site throughout normal working hours except when on leave, sick or absent for reasons connected with the proper performance of the Contract. Whenever the Construction Manager is absent from the Site, a suitable person shall be appointed to act as the Construction Manager's deputy.
- 18.2.5 The Employer may by notice to the Contractor object to any representative or person employed by the Contractor in the execution of the Contract who, in the reasonable opinion of the Employer, may behave inappropriately, may be incompetent or negligent, or may commit a serious breach of the Site regulations provided under GC Sub-Clause 23.3. The Employer shall provide evidence of the same, whereupon the Contractor shall remove such person from the Facilities.
- 18.2.6 If any representative or person employed by the Contractor is removed in accordance with GC Sub-Clause 18.2.5, the Contractor shall, where required, promptly appoint a replacement.



**19. Work Program**

19.1 Contractor's Organization

The Contractor shall supply to the Employer and the Project Manager a chart showing the proposed organization to be established by the Contractor for carrying out work on the Facilities within twenty-one (21) days of the Effective Date. The chart shall include the identities of the key personnel and the curricula vitae of such key personnel to be employed shall be supplied together with the chart. The Contractor shall promptly inform the Employer and the Project Manager in writing of any revision or alteration of such an organization chart.

19.2 Program of Performance

Within twenty-eight (28) days after the Effective Date, the Contractor shall submit to the Project Manager a detailed program of performance of the Contract, made in a form acceptable to the Project Manager and showing the sequence in which it proposes to design, manufacture, transport, assemble, install and pre-commission the Facilities, as well as the date by which the Contractor reasonably requires that the Employer shall have fulfilled its obligations under the Contract so as to enable the Contractor to execute the Contract in accordance with the program and to achieve Completion, Commissioning and Acceptance of the Facilities in accordance with the Contract. The program so submitted by the Contractor shall accord with the Time Schedule included in the Appendix to the Contract Agreement titled Time Schedule, and any other dates and periods specified in the Contract. The Contractor shall update and revise the program as and when appropriate or when required by the Project Manager, but without modification in the Times for Completion specified in the PC pursuant to Sub-Clause 9.2 and any extension granted in accordance with GC Clause 41, and shall submit all such revisions to the Project Manager.

19.3 Progress Report

The Contractor shall monitor progress of all the activities specified in the program referred to in GC Sub-Clause 19.2 above, and supply a progress report to the Project Manager every month.

The progress report shall be in a form acceptable to the Project Manager and shall indicate: (a) percentage completion achieved compared with the planned percentage completion for each activity; and (b) where any activity is behind the program, giving comments and likely consequences and stating the corrective action being taken.

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19.4 Progress of Performance

If at any time the Contractor's actual progress falls behind the program referred to in GC Sub-Clause 19.2, or it becomes apparent that it will so fall behind, the Contractor shall, at the request of the Employer or the Project Manager, prepare and submit to the Project Manager a revised program, taking into account the prevailing circumstances, and shall notify the Project Manager of the steps being taken to expedite progress so as to attain Completion of the Facilities within the Time for Completion under GC Sub-Clause 9.2, any extension thereof entitled under GC Sub-Clause 41.1, or any extended period as may otherwise be agreed upon between the Employer and the Contractor.

19.5 Procedures

The Contract shall be executed in accordance with the Contract Documents including the procedures given in the Forms and Procedures of the Employer's Requirements.

The Contractor may execute the Contract in accordance with its own standard project execution plans and procedures to the extent that they do not conflict with the provisions contained in the Contract.

**20. Subcontracting**

20.1 The Appendix to the Contract Agreement titled List of Major Items of Plant and Installation Services and List of Approved Subcontractors, specifies major items of supply or services and a list of approved Subcontractors against each item, including manufacturers. Insofar as no Subcontractors are listed against any such item, the Contractor shall prepare a list of Subcontractors for such item for inclusion in such list. The Contractor may from time to time propose any addition to or deletion from any such list. The Contractor shall submit any such list or any modification thereto to the Employer for its approval in sufficient time so as not to impede the progress of work on the Facilities. Such approval by the Employer for any of the Subcontractors shall not relieve the Contractor from any of its obligations, duties or responsibilities under the Contract.

20.2 The Contractor shall select and employ its Subcontractors for such major items from those listed in the lists referred to in GC Sub-Clause 20.1.

20.3 For items or parts of the Facilities not specified in the Appendix to the Contract Agreement titled List of Major Items of Plant and Installation Services and List of Approved Subcontractors, the Contractor may employ such Subcontractors as it may select, at its discretion.

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- 20.4 Each sub-contract shall include provisions which would entitle the Employer to require the sub-contract to be assigned to the Employer under GC 20.5 (if and when applicable), or in event of termination by the Employer under GC 43.2.
- 20.5 If a sub-contractor's obligations extend beyond the expiry date of the relevant Defects Liability Period and the Project Manager, prior to that date, instructs the Contractor to assign the benefits of such obligations to the Employer, then the Contractor shall do so.

**21. Design and Engineering**

21.1 Specifications and Drawings

21.1.1 The Contractor shall execute the basic and detailed design and the engineering work in compliance with the provisions of the Contract, or where not so specified, in accordance with good engineering practice.

The Contractor shall be responsible for any discrepancies, errors or omissions in the specifications, drawings and other technical documents that it has prepared, whether such specifications, drawings and other documents have been approved by the Project Manager or not, provided that such discrepancies, errors or omissions are not because of inaccurate information furnished in writing to the Contractor by or on behalf of the Employer.

21.1.2 The Contractor shall be entitled to disclaim responsibility for any design, data, drawing, specification or other document, or any modification thereof provided or designated by or on behalf of the Employer, by giving a notice of such disclaimer to the Project Manager.

21.2 Codes and Standards

Wherever references are made in the Contract to codes and standards in accordance with which the Contract shall be executed, the edition or the revised version of such codes and standards current at the date twenty-eight (28) days prior to date of bid submission shall apply unless otherwise specified. During Contract execution, any changes in such codes and standards shall be applied subject to approval by the Employer and shall be treated in accordance with GC Clause 40.

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21.3 Approval Review of Technical Documents by Project Manager

21.3.1 The Contractor shall prepare or cause its Subcontractors to prepare, and furnish to the Project Manager the documents listed in the Appendix to the Contract Agreement titled List of Documents for Approval or Review, for its approval or review as specified and in accordance with the requirements of GC Sub-Clause 19.2 (Program of Performance).

Any part of the Facilities covered by or related to the documents to be approved by the Project Manager shall be executed only after the Project Manager's approval thereof.

GC Sub-clauses 21.3.2 through 21.3.7 shall apply to those documents requiring the Project Manager's approval, but not to those furnished to the Project Manager for its review only.

21.3.2 Within fourteen (14) days after receipt by the Project Manager of any document requiring the Project Manager's approval in accordance with GC Sub-Clause 21.3.1, the Project Manager shall either return one copy thereof to the Contractor with its approval endorsed thereon or shall notify the Contractor in writing of its disapproval thereof and the reasons therefore and the modifications that the Project Manager proposes.

If the Project Manager fails to take such action within the said fourteen (14) days, then the said document shall be deemed to have been approved by the Project Manager.

21.3.3 The Project Manager shall not disapprove any document, except on the grounds that the document does not comply with the Contract or that it is contrary to good engineering practice.

21.3.4 If the Project Manager disapproves the document, the Contractor shall modify the document and resubmit it for the Project Manager's approval in accordance with GC Sub-Clause 21.3.2. If the Project Manager approves the document subject to modification(s), the Contractor shall make the required modification(s), whereupon the document shall be deemed to have been approved.

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- 21.3.5 If any dispute or difference occurs between the Employer and the Contractor in connection with or arising out of the disapproval by the Project Manager of any document and/or any modification(s) thereto that cannot be settled between the Parties within a reasonable period, then such dispute or difference may be referred to a Dispute Board for determination in accordance with GC Sub-Clause 47.1 hereof. If such dispute or difference is referred to a Dispute Board, the Project Manager shall give instructions as to whether and if so, how, performance of the Contract is to proceed. The Contractor shall proceed with the Contract in accordance with the Project Manager's instructions, provided that if the Dispute Board upholds the Contractor's view on the dispute and if the Employer has not given notice under GC Sub-Clause 47.3 hereof, then the Contractor shall be reimbursed by the Employer for any additional costs incurred by reason of such instructions and shall be relieved of such responsibility or liability in connection with the dispute and the execution of the instructions as the Dispute Board shall decide, and the Time for Completion shall be extended accordingly.
- 21.3.6 The Project Manager's approval, with or without modification of the document furnished by the Contractor, shall not relieve the Contractor of any responsibility or liability imposed upon it by any provisions of the Contract except to the extent that any subsequent failure results from modifications required by the Project Manager.
- 21.3.7 The Contractor shall not depart from any approved document unless the Contractor has first submitted to the Project Manager an amended document and obtained the Project Manager's approval thereof, pursuant to the provisions of this GC Sub-Clause 21.3.
- If the Project Manager requests any change in any already approved document and/or in any document based thereon, the provisions of GC Clause 40 shall apply to such request.

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22. Procurement

22.1 Plant

Subject to GC Sub-Clause 15.2, the Contractor shall procure and transport all Plant in an expeditious and orderly manner to the Site.

22.2 Employer-Supplied Plant

If the Appendix to the Contract Agreement titled Scope of Works and Supply by the Employer, provides that the Employer shall furnish any specific items to the Contractor, the following provisions shall apply:

22.2.1 The Employer shall, at its own risk and expense, transport each item to the place on or near the Site as agreed upon by the Parties and make such item available to the Contractor at the time specified in the program furnished by the Contractor, pursuant to GC Sub-clause 19.2, unless otherwise mutually agreed.

22.2.2 Upon receipt of such item, the Contractor shall inspect the same visually and notify the Project Manager of any detected shortage, defect or default. The Employer shall immediately remedy any shortage, defect or default, or the Contractor shall, if practicable and possible, at the request of the Employer, remedy such shortage, defect or default at the Employer's cost and expense. After inspection, such item shall fall under the care, custody and control of the Contractor. The provision of this GC Sub-Clause 22.2.2 shall apply to any item supplied to remedy any such shortage or default or to substitute for any defective item, or shall apply to defective items that have been repaired.

22.2.3 The foregoing responsibilities of the Contractor and its obligations of care, custody and control shall not relieve the Employer of liability for any undetected shortage, defect or default, nor place the Contractor under any liability for any such shortage, defect or default whether under GC Clause 28 or under any other provision of Contract.

22.3 Transportation

22.3.1 The Contractor shall at its own risk and expense transport all the materials and the Contractor's Equipment to the Site by the mode of transport that the Contractor judges most suitable under all the circumstances.

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- 22.3.2 Unless otherwise provided in the Contract, the Contractor shall be entitled to select any safe mode of transport operated by any person to carry the materials and the Contractor's Equipment.
- 22.3.3 Upon dispatch of each shipment of materials and the Contractor's Equipment, the Contractor shall notify the Employer by telex, cable, facsimile or electronic means, of the description of the materials and of the Contractor's Equipment, the point and means of dispatch, and the estimated time and point of arrival in the country where the Site is located, if applicable, and at the Site. The Contractor shall furnish the Employer with relevant shipping documents to be agreed upon between the Parties.
- 22.3.4 The Contractor shall be responsible for obtaining, if necessary, approvals from the authorities for transportation of the materials and the Contractor's Equipment to the Site. The Employer shall use its best endeavors in a timely and expeditious manner to assist the Contractor in obtaining such approvals, if requested by the Contractor. The Contractor shall indemnify and hold harmless the Employer from and against any claim for damage to roads, bridges or any other traffic facilities that may be caused by the transport of the materials and the Contractor's Equipment to the Site.

22.4 Customs Clearance

The Contractor shall, at its own expense, handle all imported materials and Contractor's Equipment at the point(s) of import and shall handle any formalities for customs clearance, subject to the Employer's obligations under GC Sub-Clause 15.2, provided that if applicable laws or regulations require any application or act to be made by or in the name of the Employer, the Employer shall take all necessary steps to comply with such laws or regulations. In the event of delays in customs clearance that are not the fault of the Contractor, the Contractor shall be entitled to an extension in the Time for Completion, pursuant to GC Clause 41.

**23. Installation**

23.1 Setting Out/Supervision

- 23.1.1 Bench Mark: The Contractor shall be responsible for the true and proper setting-out of the Facilities in relation to bench marks, reference marks and lines provided to it in writing by or on behalf of the Employer.

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If, at any time during the progress of installation of the Facilities, any error shall appear in the position, level or alignment of the Facilities, the Contractor shall forthwith notify the Project Manager of such error and, at its own expense, immediately rectify such error to the reasonable satisfaction of the Project Manager. If such error is based on incorrect data provided in writing by or on behalf of the Employer, the expense of rectifying the same shall be borne by the Employer.

23.1.2 Contractor's Supervision: The Contractor shall give or provide all necessary superintendence during the installation of the Facilities, and the Construction Manager or its deputy shall be constantly on the Site to provide full-time superintendence of the installation. The Contractor shall provide and employ only technical personnel who are skilled and experienced in their respective callings and supervisory staff who are competent to adequately supervise the work at hand.

23.2 Labor:

23.2.1 Engagement of Staff and Labor

Except as otherwise stated in the Specification, the Contractor shall make arrangements for the engagement of all staff and labor, local or otherwise, and for their payment, housing, feeding and transport.

The Contractor shall provide and employ on the Site in the installation of the Facilities such skilled, semi-skilled and unskilled labor as is necessary for the proper and timely execution of the Contract. The Contractor is encouraged to use local labor that has the necessary skills.

The Contractor shall be responsible for obtaining all necessary permit(s) and/or visa(s) from the appropriate authorities for the entry of all labor and personnel to be employed on the Site into the country where the Site is located. The Employer will, if requested by the Contractor, use his best endeavors in a timely and expeditious manner to assist the Contractor in obtaining any local, state, national or government permission required for bringing in the Contractor's personnel.

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The Contractor shall at its own expense provide the means of repatriation to all of its and its Subcontractor's personnel employed on the Contract at the Site to the place where they were recruited or to their domicile. It shall also provide suitable temporary maintenance of all such persons from the cessation of their employment on the Contract to the date programmed for their departure. In the event that the Contractor defaults in providing such means of transportation and temporary maintenance, the Employer may provide the same to such personnel and recover the cost of doing so from the Contractor.

23.2.2 Persons in the Service of Employer

The Contractor shall not recruit, or attempt to recruit, staff and labor from amongst the Employer's Personnel.

23.2.3 Labor Laws

The Contractor shall comply with all the relevant labor Laws applicable to the Contractor's Personnel, including Laws relating to their employment, health, safety, welfare, immigration and emigration, and shall allow them all their legal rights.

The Contractor shall at all times during the progress of the Contract use its best endeavors to prevent any unlawful, riotous or disorderly conduct or behavior by or amongst its employees and the labor of its Subcontractors.

The Contractor shall, in all dealings with its labor and the labor of its Subcontractors currently employed on or connected with the Contract, pay due regard to all recognized festivals, official holidays, religious or other customs and all local laws and regulations pertaining to the employment of labor.

23.2.4 Rates of Wages and Conditions of Labor

The Contractor shall pay rates of wages, and observe conditions of labor, which are not lower than those established for the trade or industry where the work is carried out. If no established rates or conditions are applicable, the Contractor shall pay rates of wages and observe conditions which are not lower than the general level of wages and conditions observed locally by employers whose trade or industry is similar to that of the Contractor.





The Contractor shall inform the Contractor's Personnel about their liability to pay personal income taxes in the Country in respect of such of their salaries, wages and allowances as are chargeable under the Laws for the time being in force, and the Contractor shall perform such duties in regard to such deductions thereof as may be imposed on him by such Laws.

23.2.5 Working Hours

No work shall be carried out on the Site on locally recognized days of rest, or outside the normal working hours **stated in the PC**, unless:

- (a) otherwise stated in the Contract,
- (b) the Project Manager gives consent, or
- (c) the work is unavoidable, or necessary for the protection of life or property or for the safety of the Works, in which case the Contractor shall immediately advise the Project Manager.

If and when the Contractor considers it necessary to carry out work at night or on public holidays so as to meet the Time for Completion and requests the Project Manager's consent thereto, the Project Manager shall not unreasonably withhold such consent.

This Sub-clause shall not apply to any work which is customarily carried out by rotary or double-shifts.

23.2.6 Facilities for Staff and Labor

Except as otherwise stated in the Specification, the Contractor shall provide and maintain all necessary accommodation and welfare facilities for the Contractor's Personnel. The Contractor shall also provide facilities for the Employer's Personnel as stated in the Specification.

The Contractor shall not permit any of the Contractor's Personnel to maintain any temporary or permanent living quarters within the structures forming part of the Permanent Works.

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23.2.7 Health and Safety

The Contractor shall at all times take all reasonable precautions to maintain the health and safety of the Contractor's Personnel. In collaboration with local health authorities, the Contractor shall ensure that medical staff, first aid facilities, sick bay and ambulance service are available at all times at the Site and at any accommodation for Contractor's and Employer's Personnel, and that suitable arrangements are made for all necessary welfare and hygiene requirements and for the prevention of epidemics.

The Contractor shall appoint an accident prevention officer at the Site, responsible for maintaining safety and protection against accidents. This person shall be qualified for this responsibility, and shall have the authority to issue instructions and take protective measures to prevent accidents. Throughout the performance of the Contract, the Contractor shall provide whatever is required by this person to exercise this responsibility and authority.

The Contractor shall send to the Project Manager, details of any accident as soon as practicable after its occurrence. The Contractor shall maintain records and make reports concerning health, safety and welfare of persons, and damage to property, as the Engineer may reasonably require.

The Contractor shall throughout the contract (including the Defects Notification Period): (i) conduct Information, Education and Consultation Communication (IEC) campaigns, at least every other month, addressed to all the Site staff and labor (including all the Contractor's employees, all Sub-Contractors and Employer's and Project Manager's' employees, and all truck drivers and crew making deliveries to Site for construction activities) and to the immediate local communities, concerning the risks, dangers and impact, and appropriate avoidance behavior with respect to of Sexually Transmitted Diseases (STD)—or Sexually Transmitted Infections (STI) in general and HIV/AIDS in particular; (ii) provide male or female condoms for all Site staff and labor as appropriate; and (iii) provide for STI and HIV/AIDS screening, diagnosis, counseling and referral to a dedicated national STI and HIV/AIDS program, (unless otherwise agreed) of all Site staff and labor.

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The Contractor shall include in the program to be submitted for the execution of the Facilities under Sub- Clause 18.2 an alleviation program for Site staff and labor and their families in respect of Sexually Transmitted Infections (STI) and Sexually Transmitted Diseases (STD) including HIV/AIDS. The STI, STD and HIV/AIDS alleviation program shall indicate when, how and at what cost the Contractor plans to satisfy the requirements of this Sub-clause and the related specification. For each component, the program shall detail the resources to be provided or utilized and any related sub-contracting proposed. The program shall also include provision of a detailed cost estimate with supporting documentation. Payment to the Contractor for preparation and implementation this program shall not exceed the Provisional Sum dedicated for this purpose.

23.2.8 Funeral Arrangements

In the event of the death of any of the Contractor's personnel or accompanying members of their families, the Contractor shall be responsible for making the appropriate arrangements for their return or burial, unless otherwise **specified in the PC**.

23.2.9 Records of Contractor's Personnel

The Contractor shall keep accurate records of the Contractor's personnel, including the number of each class of Contractor's Personnel on the Site and the names, ages, genders, hours worked and wages paid to all workers. These records shall be summarized on a monthly basis in a form approved by the Project Manager and shall be available for inspection by the Project Manager until the Contractor has completed all work.

23.2.10 Supply of Foodstuffs

The Contractor shall arrange for the provision of a sufficient supply of suitable food as may be stated in the Specification at reasonable prices for the Contractor's Personnel for the purposes of or in connection with the Contract.

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23.2.11 Supply of Water

The Contractor shall, having regard to local conditions, provide on the Site an adequate supply of drinking and other water for the use of the Contractor's Personnel.

23.2.12 Measures against Insect and Pest Nuisance

The Contractor shall at all times take the necessary precautions to protect the Contractor's Personnel employed on the Site from insect and pest nuisance, and to reduce their danger to health. The Contractor shall comply with all the regulations of the local health authorities, including use of appropriate insecticide.

23.2.13 Alcoholic Liquor or Drugs

The Contractor shall not, otherwise than in accordance with the Laws of the Country, import, sell, give barter or otherwise dispose of any alcoholic liquor or drugs, or permit or allow importation, sale, gift barter or disposal by Contractor's Personnel.

23.2.14 Arms and Ammunition

The Contractor shall not give, batter, or otherwise dispose of, to any person, any arms or ammunition of any kind, or allow Contractor's Personnel to do so.

23.2.15 Prohibition of All Forms of Forced or Compulsory Labor

The contractor shall not employ "forced or compulsory labor" in any form. "Forced or compulsory labor" consists of all work or service, not voluntarily performed, that is extracted from an individual under threat of force or penalty.

23.2.16 Prohibition of Harmful Child Labor

The Contractor shall not employ any child to perform any work that is economically exploitative, or is likely to be hazardous to, or to interfere with, the child's education, or to be harmful to the child's health or physical, mental, spiritual, moral, or social development.

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23.3 Contractor's Equipment

23.3.1 All Contractor's Equipment brought by the Contractor onto the Site shall be deemed to be intended to be used exclusively for the execution of the Contract. The Contractor shall not remove the same from the Site without the Project Manager's consent that such Contractor's Equipment is no longer required for the execution of the Contract.

23.3.2 Unless otherwise specified in the Contract, upon completion of the Facilities, the Contractor shall remove from the Site all Equipment brought by the Contractor onto the Site and any surplus materials remaining thereon.

23.3.3 The Employer will, if requested, use its best endeavors to assist the Contractor in obtaining any local, state or national government permission required by the Contractor for the export of the Contractor's Equipment imported by the Contractor for use in the execution of the Contract that is no longer required for the execution of the Contract.

23.4 Site Regulations and Safety

The Employer and the Contractor shall establish Site regulations setting out the rules to be observed in the execution of the Contract at the Site and shall comply therewith. The Contractor shall prepare and submit to the Employer, with a copy to the Project Manager, proposed Site regulations for the Employer's approval, which approval shall not be unreasonably withheld.

Such Site regulations shall include, but shall not be limited to, rules in respect of security, safety of the Facilities, gate control, sanitation, medical care, and fire prevention.

23.5 Opportunities for Other Contractors

23.5.1 The Contractor shall, upon written request from the Employer or the Project Manager, give all reasonable opportunities for carrying out the work to any other contractors employed by the Employer on or near the Site.

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- 23.5.2 If the Contractor, upon written request from the Employer or the Project Manager, makes available to other contractors any roads or ways the maintenance for which the Contractor is responsible, permits the use by such other contractors of the Contractor's Equipment, or provides any other service of whatsoever nature for such other contractors, the Employer shall fully compensate the Contractor for any loss or damage caused or occasioned by such other contractors in respect of any such use or service, and shall pay to the Contractor reasonable remuneration for the use of such equipment or the provision of such services.
- 23.5.3 The Contractor shall also so arrange to perform its work as to minimize, to the extent possible, interference with the work of other contractors. The Project Manager shall determine the resolution of any difference or conflict that may arise between the Contractor and other contractors and the workers of the Employer in regard to their work.
- 23.5.4 The Contractor shall notify the Project Manager promptly of any defects in the other contractors' work that come to its notice, and that could affect the Contractor's work. The Project Manager shall determine the corrective measures, if any, required to rectify the situation after inspection of the Facilities. Decisions made by the Project Manager shall be binding on the Contractor.

23.6 Emergency Work

If, by reason of an emergency arising in connection with and during the execution of the Contract, any protective or remedial work is necessary as a matter of urgency to prevent damage to the Facilities, the Contractor shall immediately carry out such work.

If the Contractor is unable or unwilling to do such work immediately, the Employer may do or cause such work to be done as the Employer may determine is necessary in order to prevent damage to the Facilities. In such event the Employer shall, as soon as practicable after the occurrence of any such emergency, notify the Contractor in writing of such emergency, the work done and the reasons therefor. If the work done or caused to be done by the Employer is work that the Contractor was liable to do at its own expense under the Contract, the reasonable costs incurred by the Employer in connection therewith shall be paid by the Contractor to the Employer. Otherwise, the cost of such remedial work shall be borne by the Employer.

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23.7 Site Clearance

23.7.1 Site Clearance in Course of Performance: In the course of carrying out the Contract, the Contractor shall keep the Site reasonably free from all unnecessary obstruction, store or remove any surplus materials, clear away any wreckage, rubbish or temporary works from the Site, and remove any Contractor's Equipment no longer required for execution of the Contract.

23.7.2 Clearance of Site after Completion: After Completion of all parts of the Facilities, the Contractor shall clear away and remove all wreckage, rubbish and debris of any kind from the Site, and shall leave the Site and Facilities in a clean and safe condition.

23.8 Watching and Lighting

The Contractor shall provide and maintain at its own expense all lighting, fencing, and watching when and where necessary for the proper execution and the protection of the Facilities, or for the safety of the owners and occupiers of adjacent property and for the safety of the public.

**24. Test and Inspection**

24.1 The Contractor shall at its own expense carry out at the place of manufacture and/or on the Site all such tests and/or inspections of the Plant and any part of the Facilities as are specified in the Contract.

24.2 The Employer and the Project Manager or their designated representatives shall be entitled to attend the aforesaid test and/or inspection, provided that the Employer shall bear all costs and expenses incurred in connection with such attendance including, but not limited to, all traveling and board and lodging expenses.

24.3 Whenever the Contractor is ready to carry out any such test and/or inspection, the Contractor shall give a reasonable advance notice of such test and/or inspection and of the place and time thereof to the Project Manager. The Contractor shall obtain from any relevant third Party or manufacturer any necessary permission or consent to enable the Employer and the Project Manager or their designated representatives to attend the test and/or inspection.

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- 24.4 The Contractor shall provide the Project Manager with a certified report of the results of any such test and/or inspection.
- If the Employer or Project Manager or their designated representatives fails to attend the test and/or inspection, or if it is agreed between the Parties that such persons shall not do so, then the Contractor may proceed with the test and/or inspection in the absence of such persons, and may provide the Project Manager with a certified report of the results thereof.
- 24.5 The Project Manager may require the Contractor to carry out any test and/or inspection not required by the Contract, provided that the Contractor's reasonable costs and expenses incurred in the carrying out of such test and/or inspection shall be added to the Contract Price. Further, if such test and/or inspection impede the progress of work on the Facilities and/or the Contractor's performance of its other obligations under the Contract, due allowance will be made in respect of the Time for Completion and the other obligations so affected.
- 24.6 If any Plant or any part of the Facilities fails to pass any test and/or inspection, the Contractor shall either rectify or replace such Plant or part of the Facilities and shall repeat the test and/or inspection upon giving a notice under GC Sub-Clause 24.3.
- 24.7 If any dispute or difference of opinion shall arise between the Parties in connection with or arising out of the test and/or inspection of the Plant or part of the Facilities that cannot be settled between the Parties within a reasonable period of time, it may be referred to an Dispute Board for determination in accordance with GC Sub-Clause 6.1.
- 24.8 The Contractor shall afford the Employer and the Project Manager, at the Employer's expense, access at any reasonable time to any place where the Plant are being manufactured or the Facilities are being installed, in order to inspect the progress and the manner of manufacture or installation, provided that the Project Manager shall give the Contractor a reasonable prior notice.

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- 24.9 The Contractor agrees that neither the execution of a test and/or inspection of Plant or any part of the Facilities, nor the attendance by the Employer or the Project Manager, nor the issue of any test certificate pursuant to GC Sub-Clause 24.4, shall release the Contractor from any other responsibilities under the Contract.
- 24.10 No part of the Facilities or foundations shall be covered up on the Site without the Contractor carrying out any test and/or inspection required under the Contract. The Contractor shall give a reasonable notice to the Project Manager whenever any such parts of the Facilities or foundations are ready or about to be ready for test and/or inspection; such test and/or inspection and notice thereof shall be subject to the requirements of the Contract.
- 24.11 The Contractor shall uncover any part of the Facilities or foundations, or shall make openings in or through the same as the Project Manager may from time to time require at the Site, and shall reinstate and make good such part or parts.
- If any parts of the Facilities or foundations have been covered up at the Site after compliance with the requirement of GC Sub-Clause 24.10 and are found to be executed in accordance with the Contract, the expenses of uncovering, making openings in or through, reinstating, and making good the same shall be borne by the Employer, and the Time for Completion shall be reasonably adjusted to the extent that the Contractor has thereby been delayed or impeded in the performance of any of its obligations under the Contract.

**25. Completion of the Facilities**

- 25.1 As soon as the Facilities or any part thereof has, in the opinion of the Contractor, been completed operationally and structurally and put in a tight and clean condition as specified in the Employer's Requirements, excluding minor items not materially affecting the operation or safety of the Facilities, the Contractor shall so notify the Employer in writing.
- 25.2 Within seven (7) days after receipt of the notice from the Contractor under GC Sub-Clause 25.1, the Employer shall supply the operating and maintenance personnel specified in the Appendix to the Contract Agreement titled Scope of Works and Supply by the Employer for Precommissioning of the Facilities or any part thereof.
- Pursuant to the Appendix to the Contract Agreement titled Scope of Works and Supply by the Employer, the Employer shall also provide, within the said seven (7) day period, the raw materials, utilities, lubricants, chemicals, catalysts, facilities, services and other matters required for Precommissioning of the Facilities or any part thereof.

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- 25.3 As soon as reasonably practicable after the operating and maintenance personnel have been supplied by the Employer and the raw materials, utilities, lubricants, chemicals, catalysts, facilities, services and other matters have been provided by the Employer in accordance with GC Sub-Clause 24.2, the Contractor shall commence Precommissioning of the Facilities or the relevant part thereof in preparation for Commissioning, subject to GC Sub-Clause 26.5.
- 25.4 As soon as all works in respect of Precommissioning are completed and, in the opinion of the Contractor, the Facilities or any part thereof is ready for Commissioning, the Contractor shall so notify the Project Manager in writing.
- 25.5 The Project Manager shall, within fourteen (14) days after receipt of the Contractor's notice under GC Sub-Clause 25.4, either issue a Completion Certificate in the form specified in the Employer's Requirements (Forms and Procedures), stating that the Facilities or that part thereof have reached Completion as of the date of the Contractor's notice under GC Sub-Clause 25.4, or notify the Contractor in writing of any defects and/or deficiencies.

If the Project Manager notifies the Contractor of any defects and/or deficiencies, the Contractor shall then correct such defects and/or deficiencies, and shall repeat the procedure described in GC Sub-Clause 25.4.

If the Project Manager is satisfied that the Facilities or that part thereof have reached Completion, the Project Manager shall, within seven (7) days after receipt of the Contractor's repeated notice, issue a Completion Certificate stating that the Facilities or that part thereof have reached Completion as of the date of the Contractor's repeated notice.

If the Project Manager is not so satisfied, then it shall notify the Contractor in writing of any defects and/or deficiencies within seven (7) days after receipt of the Contractor's repeated notice, and the above procedure shall be repeated.

- 25.6 If the Project Manager fails to issue the Completion Certificate and fails to inform the Contractor of any defects and/or deficiencies within fourteen (14) days after receipt of the Contractor's notice under GC Sub-Clause 25.4 or within seven (7) days after receipt of the Contractor's repeated notice under GC Sub-Clause 25.5, or if the Employer makes use of the Facilities or part thereof, then the Facilities or that part thereof shall be deemed to have reached Completion as of the date of the Contractor's notice or repeated notice, or as of the Employer's use of the Facilities, as the case may be.

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26. **Commissioning and Operational Acceptance**

- 25.7 As soon as possible after Completion, the Contractor shall complete all outstanding minor items so that the Facilities are fully in accordance with the requirements of the Contract, failing which the Employer will undertake such completion and deduct the costs thereof from any monies owing to the Contractor.
- 25.8 Upon Completion, the Employer shall be responsible for the care and custody of the Facilities or the relevant part thereof, together with the risk of loss or damage thereto, and shall thereafter take over the Facilities or the relevant part thereof.
- 26.1 Commissioning
- 26.1.1 Commissioning of the Facilities or any part thereof shall be commenced by the Contractor immediately after issue of the completion Certificate by the project Manager, pursuant to GC Sub-Clause 25.5, or immediately after the date of the deemed Completion, under GC Sub-Clause 25.6.
- 26.1.2 The Employer shall supply the operating and maintenance personnel and all raw materials, utilities, lubricants, chemicals, catalysts, facilities, services and other matters required for Commissioning.
- 26.1.3 In accordance with the requirements of the Contract, the Contractor's and Project Manager's advisory personnel shall attend the Commissioning, including the Guarantee Test, and shall advise and assist the Employer.
- 26.2 Guarantee Test
- 26.2.1 Subject to GC Sub-Clause 26.5, the Guarantee Test and repeats thereof shall be conducted by the Contractor during Commissioning of the Facilities or the relevant part thereof to ascertain whether the Facilities or the relevant part can attain the Functional Guarantees specified in the Appendix to the Contract Agreement titled Functional Guarantees. The Employer shall promptly provide the Contractor with such information as the Contractor may reasonably require in relation to the conduct and results of the Guarantee Test and any repeats thereof.

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26.2.2 If for reasons not attributable to the Contractor, the Guarantee Test of the Facilities or the relevant part thereof cannot be successfully completed within the period from the date of Completion **specified in the PC** or any other period agreed upon by the Employer and the Contractor, the Contractor shall be deemed to have fulfilled its obligations with respect to the Functional Guarantees, and GC Sub-Clauses 29.2 and 29.3 shall not apply.

26.3 Operational Acceptance

26.3.1 Subject to GC Sub-clause 26.4 below, Operational Acceptance shall occur in respect of the Facilities or any part thereof when

- (a) the Guarantee Test has been successfully completed and the Functional Guarantees are met; or
- (b) the Guarantee Test has not been successfully completed or has not been carried out for reasons not attributable to the Contractor within the period from the date of Completion specified in the PC pursuant to GC Sub-Clause 26.2.2 above or any other period agreed upon by the Employer and the Contractor; or
- (c) the Contractor has paid the liquidated damages specified in GC Sub-Clause 29.3 hereof; and
- (d) any minor items mentioned in GC Sub-Clause 25.7 hereof relevant to the Facilities or that part thereof have been completed.

26.3.2 At any time after any of the events set out in GC Sub-Clause 26.3.1 have occurred, the contractor may give a notice to the Project Manager requesting the issue of an Operational Acceptance Certificate in the form provided in the Employer's Requirements (Forms and Procedures) in respect of the Facilities or the part thereof specified in such notice as of the date of such notice.

26.3.3 The Project Manager shall, after consultation with the Employer, and within seven (7) days after receipt of the Contractor's notice, issue an Operational Acceptance Certificate.

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26.3.4 If within seven (7) days after receipt of the Contractor's notice, the Project Manager fails to issue the Operational Acceptance Certificate or fails to inform the Contractor in writing of the justifiable reasons why the Project Manager has not issued the Operational Acceptance Certificate, the Facilities or the relevant part thereof shall be deemed to have been accepted as of the date of the Contractor's said notice.

26.4 Partial Acceptance

26.4.1 If the Contract specifies that Completion and Commissioning shall be carried out in respect of parts of the Facilities, the provisions relating to Completion and Commissioning including the Guarantee Test shall apply to each such part of the Facilities individually, and the Operational Acceptance Certificate shall be issued accordingly for each such part of the Facilities.

26.4.2 If a part of the Facilities comprises facilities such as buildings, for which no Commissioning or Guarantee Test is required, then the Project Manager shall issue the Operational Acceptance Certificate for such facility when it attains Completion, provided that the Contractor shall thereafter complete any outstanding minor items that are listed in the Operational Acceptance Certificate.

26.5 Delayed Pre-commissioning and/or Guarantee Test

26.5.1 In the event that the Contractor is unable to proceed with the Pre-commissioning of the Facilities pursuant to Sub-Clause 25.3, or with the Guarantee Test pursuant to Sub-Clause 26.2, for reasons attributable to the Employer either on account of non availability of other facilities under the responsibilities of other contractor(s), or for reasons beyond the Contractor's control, the provisions leading to "deemed" completion of activities such as Completion, pursuant to GC Sub-Clause 25.6, and Operational Acceptance, pursuant to GC Sub-Clause 26.3.4, and Contractor's obligations regarding Defect Liability Period, pursuant to GC Sub-Clause 28.2, Functional Guarantee, pursuant to GC Clause 29, and Care of Facilities, pursuant to GC Clause 33, and GC Clause 421.1, Suspension, shall not apply. In this case, the following provisions shall apply.

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- 26.5.2 When the Contractor is notified by the Project Manager that he will be unable to proceed with the activities and obligations pursuant to above Sub-Clause 14.1, the Contractor shall be entitled to the following:
- (a) the Time of Completion shall be extended for the period of suspension without imposition of liquidated damages pursuant to GC Sub-Clause 27.2;
  - (b) payments due to the Contractor in accordance with the provision specified in the Appendix to the Contract Agreement titled Terms and Procedures of Payment, which would not have been payable in normal circumstances due to non-completion of the subject activities, shall be released to the Contractor against submission of a security in the form of a bank guarantee of equivalent amount acceptable to the Employer, and which shall become null and void when the Contractor will have complied with its obligations regarding those payments, subject to the provision of Sub-Clause 26.5.3 below;
  - (c) the expenses towards the above security and extension of other securities under the contract, of which validity needs to be extended, shall be reimbursed to the Contractor by the Employer;
  - (d) the additional charges towards the care of the Facilities pursuant to GC Sub-Clause 33.1 shall be reimbursed to the Contractor by the Employer for the period between the notification mentioned above and the notification mentioned in Sub-Clause 26.5.4 below. The provision of GC Sub-Clause 34.2 shall apply to the Facilities during the same period.
- 26.5.3 In the event that the period of suspension under above Sub-Clause 26.5.1 actually exceeds one hundred eighty (180) days, the Employer and Contractor shall mutually agree to any additional compensation payable to the Contractor.



26.5.4 When the Contractor is notified by the Project Manager that the plant is ready for Pre-commissioning, the Contractor shall proceed without delay in performing Pre-commissioning in accordance with Clause 25.

### Guarantees and Liabilities

**27. Completion  
Time Guarantee**

27.1 The Contractor guarantees that it shall attain Completion of the Facilities (or a part for which a separate time for completion is specified) within the Time for Completion specified in the PC pursuant to GC Sub-Clause 9.2, or within such extended time to which the Contractor shall be entitled under GC Clause 41 hereof.

27.2 If the Contractor fails to attain Completion of the Facilities or any part thereof within the Time for Completion or any extension thereof under GC Clause 41 due to reasons attributable to the Contractor, the Contractor shall pay to the Employer liquidated damages in the amount **specified in the PC** as a percentage rate of the Contract Price or the relevant part thereof. The aggregate amount of such liquidated damages shall in no event exceed the amount **specified as "Maximum" in the PC** as a percentage rate of the Contract Price. Once the "Maximum" is reached, the Employer may consider termination of the Contract, pursuant to GC Sub-Clause 43.2.2.

Such payment shall completely satisfy the Contractor's obligation to attain Completion of the Facilities or the relevant part thereof within the Time for Completion or any extension thereof under GC Clause 41. The Contractor shall have no further liability whatsoever to the Employer in respect thereof.

However, the payment of liquidated damages shall not in any way relieve the Contractor from any of its obligations to complete the Facilities or from any other obligations and liabilities of the Contractor under the Contract.

Save for liquidated damages payable under this GC Sub-Clause 27.2, the failure by the Contractor to attain any milestone or other act, matter or thing by any date specified in the Appendix to the Contract Agreement titled Time Schedule, and/or other program of work prepared pursuant to GC Sub-Clause 19.2 shall not render the Contractor liable for any loss or damage thereby suffered by the Employer.

27.3 If the Contractor attains Completion of the Facilities or any part thereof before the Time for Completion or any extension thereof under GC Clause 41, the Employer shall pay to the Contractor a bonus in the amount **specified in the PC**. The aggregate amount of such bonus shall in no event exceed the amount **specified as "Maximum" in the PC**.

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**28. Defect Liability**

28.1 The Contractor warrants that the Facilities or any part thereof shall be free from defects in the design, engineering, materials and workmanship of the Plant supplied and of the work executed.

28.2 The Defect Liability Period shall be five hundred and forty (540) days from the date of Completion of the Facilities (or any part thereof) or one year from the date of Operational Acceptance of the Facilities (or any part thereof), whichever first occurs, unless specified otherwise in the PC pursuant to GC Sub-clause 28.10.

If during the Defect Liability Period any defect should be found in the design, engineering, materials and workmanship of the Plant supplied or of the work executed by the Contractor, the Contractor shall promptly, in consultation and agreement with the Employer regarding appropriate remedying of the defects, and at its cost, repair, replace or otherwise make good as the Contractor shall determine at its discretion, such defect as well as any damage to the Facilities caused by such defect. The Contractor shall not be responsible for the repair, replacement or making good of any defect or of any damage to the Facilities arising out of or resulting from any of the following causes:

- (a) improper operation or maintenance of the Facilities by the Employer;
- (b) operation of the Facilities outside specifications provided in the Contract; or
- (c) normal wear and tear.

28.3 The Contractor's obligations under this GC Clause 28 shall not apply to:

- (a) any materials that are supplied by the Employer under GC Sub-Clause 22.2, are normally consumed in operation, or have a normal life shorter than the Defect Liability Period stated herein;
- (b) any designs, specifications or other data designed, supplied or specified by or on behalf of the Employer or any matters for which the Contractor has disclaimed responsibility herein; or

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(c) any other materials supplied or any other work executed by or on behalf of the Employer, except for the work executed by the Employer under GC Sub-clause 28.7.

28.4 The Employer shall give the Contractor a notice stating the nature of any such defect together with all available evidence thereof, promptly following the discovery thereof. The Employer shall afford all reasonable opportunity for the Contractor to inspect any such defect.

28.5 The Employer shall afford the Contractor all necessary access to the Facilities and the Site to enable the Contractor to perform its obligations under this GC Clause 28.

The Contractor may, with the consent of the Employer, remove from the Site any Plant or any part of the Facilities that are defective if the nature of the defect, and/or any damage to the Facilities caused by the defect, is such that repairs cannot be expeditiously carried out at the Site.

28.6 If the repair, replacement or making good is of such a character that it may affect the efficiency of the Facilities or any part thereof, the Employer may give to the Contractor a notice requiring that tests of the defective part of the Facilities shall be made by the Contractor immediately upon completion of such remedial work, whereupon the Contractor shall carry out such tests.

If such part fails the tests, the Contractor shall carry out further repair, replacement or making good, as the case may be, until that part of the Facilities passes such tests. The tests shall be agreed upon by the Employer and the Contractor.

28.7 If the Contractor fails to commence the work necessary to remedy such defect or any damage to the Facilities caused by such defect within a reasonable time (which shall in no event be considered to be less than fifteen (15) days), the Employer may, following notice to the Contractor, proceed to do such work, and the reasonable costs incurred by the Employer in connection therewith shall be paid to the Employer by the Contractor or may be deducted by the Employer from any monies due the Contractor or claimed under the Performance Security.

28.8 If the Facilities or any part thereof cannot be used by reason of such defect and/or making good of such defect, the Defect Liability Period of the Facilities or such part, as the case may be, shall be extended by a period equal to the period during which the Facilities or such part cannot be used by the Employer because of any of the aforesaid reasons.

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- 28.9 Except as provided in GC Clauses 28 and 34, the Contractor shall be under no liability whatsoever and howsoever arising, and whether under the Contract or at law, in respect of defects in the Facilities or any part thereof, the Plant, design or engineering or work executed that appear after Completion of the Facilities or any part thereof, except where such defects are the result of the gross negligence, fraud, or criminal or willful action of the Contractor.
- 28.10 In addition, any such component of the Facilities, and during the period of time as may be **specified in the PC**, shall be subject to an extended defect liability period. Such obligation of the Contractor shall be in addition to the defect liability period specified under GC Sub-Clause 28.2.
- 29. Functional Guarantees**
- 29.1 The Contractor guarantees that during the Guarantee Test, the Facilities and all parts thereof shall attain the Functional Guarantees specified in the Appendix to the Contract Agreement titled Functional Guarantees, subject to and upon the conditions therein specified.
- 29.2 If, for reasons attributable to the Contractor, the minimum level of the Functional Guarantees specified in the Appendix to the Contract Agreement titled Functional Guarantees, are not met either in whole or in part, the Contractor shall at its cost and expense make such changes, modifications and/or additions to the Plant or any part thereof as may be necessary to meet at least the minimum level of such Guarantees. The Contractor shall notify the Employer upon completion of the necessary changes, modifications and/or additions, and shall request the Employer to repeat the Guarantee Test until the minimum level of the Guarantees has been met. If the Contractor eventually fails to meet the minimum level of Functional Guarantees, the Employer may consider termination of the Contract, pursuant to GC Sub-Clause 43.2.2.
- 29.3 If, for reasons attributable to the Contractor, the Functional Guarantees specified in the Appendix to the Contract Agreement titled Functional Guarantees, are not attained either in whole or in part, but the minimum level of the Functional Guarantees specified in the said Appendix to the Contract Agreement is met, the Contractor shall, at the Contractor's option, either

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- (a) make such changes, modifications and/or additions to the Facilities or any part thereof that are necessary to attain the Functional Guarantees at its cost and expense, and shall request the Employer to repeat the Guarantee Test or
- (b) pay liquidated damages to the Employer in respect of the failure to meet the Functional Guarantees in accordance with the provisions in the Appendix to the Contract Agreement titled Functional Guarantees.

29.4 The payment of liquidated damages under GC Sub-Clause 29.3, up to the limitation of liability specified in the Appendix to the Contract Agreement titled Functional Guarantees, shall completely satisfy the Contractor's guarantees under GC Sub-Clause 29.3, and the contractor shall have no further liability whatsoever to the Employer in respect thereof. Upon the payment of such liquidated damages by the Contractor, the Project Manager shall issue the Operational Acceptance Certificate for the Facilities or any part thereof in respect of which the liquidated damages have been so paid.

**30. Patent Indemnity**

30.1 The Contractor shall, subject to the Employer's compliance with GC Sub-Clause 30.2, indemnify and hold harmless the Employer and its employees and officers from and against any and all suits, actions or administrative proceedings, claims, demands, losses, damages, costs, and expenses of whatsoever nature, including attorney's fees and expenses, which the Employer may suffer as a result of any infringement or alleged infringement of any patent, utility model, registered design, trademark, copyright or other intellectual property right registered or otherwise existing at the date of the Contract by reason of: (a) the installation of the Facilities by the Contractor or the use of the Facilities in the country where the Site is located; and (b) the sale of the products produced by the Facilities in any country.

Such indemnity shall not cover any use of the Facilities or any part thereof other than for the purpose indicated by or to be reasonably inferred from the Contract, any infringement resulting from the use of the Facilities or any part thereof, or any products produced thereby in association or combination with any other equipment, plant or materials not supplied by the Contractor, pursuant to the Contract Agreement.

30.2 If any proceedings are brought or any claim is made against the Employer arising out of the matters referred to in GC Sub-Clause 30.1, the Employer shall promptly give the Contractor a notice thereof, and the Contractor may at its own expense and in the Employer's name conduct such proceedings or claim and any negotiations for the settlement of any such proceedings or claim.



If the Contractor fails to notify the Employer within twenty-eight (28) days after receipt of such notice that it intends to conduct any such proceedings or claim, then the Employer shall be free to conduct the same on its own behalf. Unless the Contractor has so failed to notify the Employer within the twenty-eight (28) day period, the Employer shall make no admission that may be prejudicial to the defense of any such proceedings or claim.

The Employer shall, at the Contractor's request, afford all available assistance to the Contractor in conducting such proceedings or claim, and shall be reimbursed by the Contractor for all reasonable expenses incurred in so doing.

30.3 The Employer shall indemnify and hold harmless the Contractor and its employees, officers and Subcontractors from and against any and all suits, actions or administrative proceedings, claims, demands, losses, damages, costs, and expenses of whatsoever nature, including attorney's fees and expenses, which the Contractor may suffer as a result of any infringement or alleged infringement of any patent, utility model, registered design, trademark, copyright or other intellectual property right registered or otherwise existing at the date of the Contract arising out of or in connection with any design, data, drawing, specification, or other documents or materials provided or designed by or on behalf of the Employer.

**31. Limitation of Liability**

31.1 Except in cases of criminal negligence or willful misconduct,

- (a) neither Party shall be liable to the other Party, whether in contract, tort, or otherwise, for any indirect or consequential loss or damage, loss of use, loss of production, or loss of profits or interest costs, which may be suffered by the other Party in connection with the Contract, other than specifically provided as any obligation of the Party in the Contract, and
- (b) the aggregate liability of the Contractor to the Employer, whether under the Contract, in tort or otherwise, shall not exceed the amount resulting from the application of the multiplier specified in the PC, to the Contract Price or, if a multiplier is not so specified, the total Contract Price, provided that this limitation shall not apply to the cost of repairing or replacing defective equipment, or to any obligation of the Contractor to indemnify the Employer with respect to patent infringement.

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**Risk Distribution**

- 32. Transfer of Ownership**

  - 32.1 Ownership of the Plant (including spare parts) to be imported into the country where the Site is located shall be transferred to the Employer upon loading on to the mode of transport to be used to convey the Plant from the country of origin to that country.
  - 32.2 Ownership of the Plant (including spare parts) procured in the country where the Site is located shall be transferred to the Employer when the Plant are brought on to the Site.
  - 32.3 Ownership of the Contractor's Equipment used by the Contractor and its Subcontractors in connection with the Contract shall remain with the Contractor or its Subcontractors.
  - 32.4 Ownership of any Plant in excess of the requirements for the Facilities shall revert to the Contractor upon Completion of the Facilities or at such earlier time when the Employer and the Contractor agree that the Plant in question are no longer required for the Facilities.
  - 32.5 Notwithstanding the transfer of ownership of the Plant, the responsibility for care and custody thereof together with the risk of loss or damage thereto shall remain with the Contractor pursuant to GC Clause 33 (Care of Facilities) hereof until Completion of the Facilities or the part thereof in which such Plant are incorporated.
  
- 33. Care of Facilities**

  - 33.1 The Contractor shall be responsible for the care and custody of the Facilities or any part thereof until the date of Completion of the Facilities pursuant to GC Clause 25 or, where the Contract provides for Completion of the Facilities in parts, until the date of Completion of the relevant part, and shall make good at its own cost any loss or damage that may occur to the Facilities or the relevant part thereof from any cause whatsoever during such period. The Contractor shall also be responsible for any loss or damage to the Facilities caused by the Contractor or its Subcontractors in the course of any work carried out, pursuant to GC Clause 28. Notwithstanding the foregoing, the Contractor shall not be liable for any loss or damage to the Facilities or that past thereof caused by reason of any of the matters specified or referred to in paragraphs (a), (b) and (c) of GC Sub-Clauses 33.2 and 39.1.

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- 33.2 If any loss or damage occurs to the Facilities or any part thereof or to the Contractor's temporary facilities by reason of
- (a) insofar as they relate to the country where the Site is located, nuclear reaction, nuclear radiation, radioactive contamination, pressure wave caused by aircraft or other aerial objects, or any other occurrences that an experienced contractor could not reasonably foresee, or if reasonably foreseeable could not reasonably make provision for or insure against, insofar as such risks are not normally insurable on the insurance market and are mentioned in the general exclusions of the policy of insurance, including War Risks and Political Risks, taken out under GC Clause 35 hereof; or
  - (b) any use or occupation by the Employer or any third Party other than a Subcontractor, authorized by the Employer of any part of the Facilities; or
  - (c) any use of or reliance upon any design, data or specification provided or designated by or on behalf of the Employer, or any such matter for which the Contractor has disclaimed responsibility herein,
- the Employer shall pay to the Contractor all sums payable in respect of the Facilities executed, notwithstanding that the same be lost, destroyed or damaged, and will pay to the Contractor the replacement value of all temporary facilities and all parts thereof lost, destroyed or damaged. If the Employer requests the Contractor in writing to make good any loss or damage to the Facilities thereby occasioned, the Contractor shall make good the same at the cost of the Employer in accordance with GC Clause 40. If the Employer does not request the Contractor in writing to make good any loss or damage to the Facilities thereby occasioned, the Employer shall either request a change in accordance with GC Clause 40, excluding the performance of that part of the Facilities thereby lost, destroyed or damaged, or, where the loss or damage affects a substantial part of the Facilities, the Employer shall terminate the Contract pursuant to GC Sub-Clause 43.1 hereof.
- 33.3 The Contractor shall be liable for any loss of or damage to any Contractor's Equipment, or any other property of the Contractor used or intended to be used for purposes of the Facilities, except (i) as mentioned in GC Sub-Clause 33.2 with respect to the Contractor's temporary facilities, and (ii) where such loss or damage arises by reason of any of the matters specified in GC Sub-Clauses 33.2 (b) and (c) and 39.1.
- 33.4 With respect to any loss or damage caused to the Facilities or any part thereof or to the Contractor's Equipment by reason of any of the matters specified in GC Sub-Clause 39.1, the provisions of GC Sub-Clause 39.3 shall apply.

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**34. Loss of or Damage to Property; Accident or Injury to Workers; Indemnification**

- 34.1 Subject to GC Sub-Clause 34.3, the Contractor shall indemnify and hold harmless the Employer and its employees and officers from and against any and all suits, actions or administrative proceedings, claims, demands, losses, damages, costs, and expenses of whatsoever nature, including attorney's fees and expenses, in respect of the death or injury of any person or loss of or damage to any property other than the Facilities whether accepted or not, arising in connection with the supply and installation of the Facilities and by reason of the negligence of the Contractor or its Subcontractors, or their employees, officers or agents, except any injury, death or property damage caused by the negligence of the Employer, its contractors, employees, officers or agents.
- 34.2 If any proceedings are brought or any claim is made against the Employer that might subject the Contractor to liability under GC Sub-Clause 34.1, the Employer shall promptly give the Contractor a notice thereof and the Contractor may at its own expense and in the Employer's name conduct such proceedings or claim and any negotiations for the settlement of any such proceedings or claim.
- If the Contractor fails to notify the Employer within twenty-eight (28) days after receipt of such notice that it intends to conduct any such proceedings or claim, then the Employer shall be free to conduct the same on its own behalf. Unless the Contractor has so failed to notify the Employer within the twenty-eight (28) day period, the Employer shall make no admission that may be prejudicial to the defense of any such proceedings or claim.
- The Employer shall, at the Contractor's request, afford all available assistance to the Contractor in conducting such proceedings or claim, and shall be reimbursed by the Contractor for all reasonable expenses incurred in so doing.
- 34.3 The Employer shall indemnify and hold harmless the Contractor and its employees, officers and Subcontractors from any liability for loss of or damage to property of the Employer, other than the Facilities not yet taken over, that is caused by fire, explosion or any other perils, in excess of the amount recoverable from insurances procured under GC Clause 35, provided that such fire, explosion or other perils were not caused by any act or failure of the Contractor.
- 34.4 The Party entitled to the benefit of an indemnity under this GC Clause 34 shall take all reasonable measures to mitigate any loss or damage which has occurred. If the Party fails to take such measures, the other Party's liabilities shall be correspondingly reduced.

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35. Insurance

35.1 To the extent specified in the Appendix to the Contract Agreement titled Insurance Requirements, the Contractor shall at its expense take out and maintain in effect, or cause to be taken out and maintained in effect, during the performance of the Contract, the insurances set forth below in the sums and with the deductibles and other conditions specified in the said Appendix. The identity of the insurers and the form of the policies shall be subject to the approval of the Employer, who should not unreasonably withhold such approval.

(a) Cargo Insurance During Transport

Covering loss or damage occurring while in transit from the Contractor's or Subcontractor's works or stores until arrival at the Site, to the Plant (including spare parts therefor) and to the Contractor's Equipment.

(b) Installation All Risks Insurance

Covering physical loss or damage to the Facilities at the Site, occurring prior to Completion of the Facilities, with an extended maintenance coverage for the Contractor's liability in respect of any loss or damage occurring during the Defect Liability Period while the Contractor is on the Site for the purpose of performing its obligations during the Defect Liability Period.

(c) Third Party Liability Insurance

Covering bodily injury or death suffered by third Parties including the Employer's personnel, and loss of or damage to property occurring in connection with the supply and installation of the Facilities.

(d) Automobile Liability Insurance

Covering use of all vehicles used by the Contractor or its Subcontractors, whether or not owned by them, in connection with the execution of the Contract.

(e) Workers' Compensation

In accordance with the statutory requirements applicable in any country where the Contract or any part thereof is executed.

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(f) Employer's Liability

In accordance with the statutory requirements applicable in any country where the Contract or any part thereof is executed.

(g) Other Insurances

Such other insurances as may be specifically agreed upon by the Parties hereto as listed in the Appendix to the Contract Agreement titled Insurance Requirements.

- 35.2 The Employer shall be named as co-insured under all insurance policies taken out by the Contractor pursuant to GC Sub-Clause 35.1, except for the Third Party Liability, Workers' Compensation, and Employer's Liability Insurances, and the Contractor's Subcontractors shall be named as co-insureds under all insurance policies taken out by the Contractor pursuant to GC Sub-Clause 35.1 except for the Cargo Insurance During Transport, Workers' Compensation and Employer's Liability Insurances. All insurer's rights of subrogation against such co-insureds for losses or claims arising out of the performance of the Contract shall be waived under such policies.
- 35.3 The Contractor shall, in accordance with the provisions of the Appendix to the Contract Agreement titled Insurance Requirements, deliver to the Employer certificates of insurance or copies of the insurance policies as evidence that the required policies are in full force and effect. The certificates shall provide that no less than twenty-one (21) days' notice shall be given to the Employer by insurers prior to cancellation or material modification of a policy.
- 35.4 The Contractor shall ensure that, where applicable, its Subcontractor(s) shall take out and maintain in effect adequate insurance policies for their personnel and vehicles and for work executed by them under the Contract, unless such Subcontractors are covered by the policies taken out by the Contractor.
- 35.5 The Employer shall at its expense take out and maintain in effect during the performance of the Contract those insurances specified in the Appendix to the Contract Agreement titled Insurance Requirements, in the sums and with the deductibles and other conditions specified in the said Appendix. The Contractor and the Contractor's Subcontractors shall be named as co-insureds under all such policies. All insurers' rights of subrogation against such co-insureds for losses or claims arising out of the performance of the Contract shall be waived under such policies. The Employer shall deliver to the Contractor satisfactory evidence that the required insurances are in full force and effect. The policies shall provide that not less than twenty-one (21) days' notice shall be given to the Contractor by all insurers prior to any cancellation or material modification of the policies. If so requested by the Contractor, the Employer shall provide copies of the policies taken out by the Employer under this GC Sub-Clause 35.5.

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- 35.6 If the Contractor fails to take out and/or maintain in effect the insurances referred to in GC Sub-Clause 35.1, the Employer may take out and maintain in effect any such insurances and may from time to time deduct from any amount due the Contractor under the Contract any premium that the Employer shall have paid to the insurer, or may otherwise recover such amount as a debt due from the Contractor. If the Employer fails to take out and/or maintain in effect the insurances referred to in GC 35.5, the Contractor may take out and maintain in effect any such insurances and may from time to time deduct from any amount due the Employer under the Contract any premium that the Contractor shall have paid to the insurer, or may otherwise recover such amount as a debt due from the Employer. If the Contractor fails to or is unable to take out and maintain in effect any such insurances, the Contractor shall nevertheless have no liability or responsibility towards the Employer, and the Contractor shall have full recourse against the Employer for any and all liabilities of the Employer herein.
- 35.7 Unless otherwise provided in the Contract, the Contractor shall prepare and conduct all and any claims made under the policies effected by it pursuant to this GC Clause 35, and all monies payable by any insurers shall be paid to the Contractor. The Employer shall give to the Contractor all such reasonable assistance as may be required by the Contractor. With respect to insurance claims in which the Employer's interest is involved, the Contractor shall not give any release or make any compromise with the insurer without the prior written consent of the Employer. With respect to insurance claims in which the Contractor's interest is involved, the Employer shall not give any release or make any compromise with the insurer without the prior written consent of the Contractor.
36. **Unforeseen Conditions**
- 36.1 If, during the execution of the Contract, the Contractor shall encounter on the Site any physical conditions other than climatic conditions, or artificial obstructions that could not have been reasonably foreseen prior to the date of the Contract Agreement by an experienced contractor on the basis of reasonable examination of the data relating to the Facilities including any data as to boring tests, provided by the Employer, and on the basis of information that it could have obtained from a visual inspection of the Site if access thereto was available, or other data readily available to it relating to the Facilities, and if the Contractor determines that it will in consequence of such conditions or obstructions incur additional cost and expense or require additional time to perform its obligations under the Contract that would not have been required if such physical conditions or artificial obstructions had not been encountered, the Contractor shall promptly, and before performing additional work or using additional Plant or Contractor's Equipment, notify the Project Manager in writing of



- (a) the physical conditions or artificial obstructions on the Site that could not have been reasonably foreseen;
- (b) the additional work and/or Plant and/or Contractor's Equipment required, including the steps which the Contractor will or proposes to take to overcome such conditions or obstructions;
- (c) the extent of the anticipated delay; and
- (d) the additional cost and expense that the Contractor is likely to incur.

On receiving any notice from the Contractor under this GC Sub-Clause 36.1, the Project Manager shall promptly consult with the Employer and Contractor and decide upon the actions to be taken to overcome the physical conditions or artificial obstructions encountered. Following such consultations, the Project Manager shall instruct the Contractor, with a copy to the Employer, of the actions to be taken.

- 36.2 Any reasonable additional cost and expense incurred by the Contractor in following the instructions from the Project Manager to overcome such physical conditions or artificial obstructions referred to in GC Sub-Clause 36.1 shall be paid by the Employer to the Contractor as an addition to the Contract Price.
- 36.3 If the Contractor is delayed or impeded in the performance of the Contract because of any such physical conditions or artificial obstructions referred to in GC Sub-Clause 36.1, the Time for Completion shall be extended in accordance with GC Clause 41.

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**37. Change in Laws and Regulations**

37.1 If, after the date twenty-eight (28) days prior to the date of Bid submission, in the country where the Site is located, any law, regulation, ordinance, order or by-law having the force of law is enacted, promulgated, abrogated or changed which shall be deemed to include any change in interpretation or application by the competent authorities, that subsequently affects the costs and expenses of the Contractor and/or the Time for Completion, the Contract Price shall be correspondingly increased or decreased, and/or the Time for Completion shall be reasonably adjusted to the extent that the Contractor has thereby been affected in the performance of any of its obligations under the Contract. Notwithstanding the foregoing, such additional or reduced costs shall not be separately paid or credited if the same has already been accounted for in the price adjustment provisions where applicable, in accordance with the PC pursuant to GC Sub-Clause 12.2.

**38. Force Majeure**

38.1 "Force Majeure" shall mean any event beyond the reasonable control of the Employer or of the Contractor, as the case may be, and which is unavoidable notwithstanding the reasonable care of the Party affected, and shall include, without limitation, the following:

- (a) war, hostilities or warlike operations whether a state of war be declared or not, invasion, act of foreign enemy and civil war
- (b) rebellion, revolution, insurrection, mutiny, usurpation of civil or military government, conspiracy, riot, civil commotion and terrorist acts
- (c) confiscation, nationalization, mobilization, commandeering or requisition by or under the order of any government or de jure or de facto authority or ruler or any other act or failure to act of any local state or national government authority
- (d) strike, sabotage, lockout, embargo, impost restriction, port congestion, lack of usual means of public transportation and communication, industrial dispute, shipwreck, shortage or restriction of power supply, epidemics, quarantine and plague
- (e) earthquake, landslide, volcanic activity, fire, flood or inundation, tidal wave, typhoon or cyclone, hurricane, storm, lightning, or other inclement weather condition, nuclear and pressure waves or other natural or physical disaster

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- (f) shortage of labor, materials or utilities where caused by circumstances that are themselves Force Majeure.
- 38.2 If either Party is prevented, hindered or delayed from or in performing any of its obligations under the Contract by an event of Force Majeure, then it shall notify the other in writing of the occurrence of such event and the circumstances thereof within fourteen (14) days after the occurrence of such event.
- 38.3 The Party who has given such notice shall be excused from the performance or punctual performance of its obligations under the Contract for so long as the relevant event of Force Majeure continues and to the extent that such Party's performance is prevented, hindered or delayed. The Time for Completion shall be extended in accordance with GC Clause 41.
- 38.4 The Party or Parties affected by the event of Force Majeure shall use reasonable efforts to mitigate the effect thereof upon its or their performance of the Contract and to fulfill its or their obligations under the Contract, but without prejudice to either Party's right to terminate the Contract under GC Sub-Clauses 38.6 and 39.5.
- 38.5 No delay or nonperformance by either Party hereto caused by the occurrence of any event of Force Majeure shall
- (a) constitute a default or breach of the Contract, or
  - (b) give rise to any claim for damages or additional cost or expense occasioned thereby, subject to GC Sub-Clauses 33.2, 39.3 and 39.4
- if and to the extent that such delay or nonperformance is caused by the occurrence of an event of Force Majeure.
- 38.6 If the performance of the Contract is substantially prevented, hindered or delayed for a single period of more than sixty (60) days or an aggregate period of more than one hundred and twenty (120) days on account of one or more events of Force Majeure during the currency of the Contract, the Parties will attempt to develop a mutually satisfactory solution, failing which either Party may terminate the Contract by giving a notice to the other, but without prejudice to either Party's right to terminate the Contract under GC Sub-Clause 39.5.
- 38.7 In the event of termination pursuant to GC Sub-Clause 38.6, the rights and obligations of the Employer and the Contractor shall be as specified in GC Sub-Clauses 43.1.2 and 43.1.3.

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**39. War Risks**

- 38.8 Notwithstanding GC Sub-Clause 38.5, Force Majeure shall not apply to any obligation of the Employer to make payments to the Contractor herein.
- 39.1 "War Risks" shall mean any event specified in paragraphs (a) and (b) of GC Sub-Clause 38.1 and any explosion or impact of any mine, bomb, shell, grenade or other projectile, missile, munitions or explosive of war, occurring or existing in or near the country (or countries) where the Site is located.
- 39.2 Notwithstanding anything contained in the Contract, the Contractor shall have no liability whatsoever for or with respect to
- (a) destruction of or damage to Facilities, Plant, or any part thereof;
  - (b) destruction of or damage to property of the Employer or any third Party; or
  - (c) injury or loss of life
- if such destruction, damage, injury or loss of life is caused by any War Risks, and the Employer shall indemnify and hold the Contractor harmless from and against any and all claims, liabilities, actions, lawsuits, damages, costs, charges or expenses arising in consequence of or in connection with the same.
- 39.3 If the Facilities or any Plant or Contractor's Equipment or any other property of the Contractor used or intended to be used for the purposes of the Facilities shall sustain destruction or damage by reason of any War Risks, the Employer shall pay the Contractor for
- (a) any part of the Facilities or the Plant so destroyed or damaged to the extent not already paid for by the Employer  
and so far as may be required by the Employer, and as may be necessary for completion of the Facilities
  - (b) replacing or making good any Contractor's Equipment or other property of the Contractor so destroyed or damaged
  - (c) replacing or making good any such destruction or damage to the Facilities or the Plant or any part thereof.
- If the Employer does not require the Contractor to replace or make good any such destruction or damage to the Facilities, the Employer shall either request a change in accordance with GC Clause 40, excluding the performance of that part of the Facilities thereby destroyed or damaged or, where the loss, destruction or damage affects a substantial part of the Facilities, shall terminate the Contract, pursuant to GC Sub-Clause 43.1.

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If the Employer requires the Contractor to replace or make good on any such destruction or damage to the Facilities, the Time for Completion shall be extended in accordance with GC 41.

- 39.4 Notwithstanding anything contained in the Contract, the Employer shall pay the Contractor for any increased costs or incidentals to the execution of the Contract that are in any way attributable to, consequent on, resulting from, or in any way connected with any War Risks, provided that the Contractor shall as soon as practicable notify the Employer in writing of any such increased cost.
- 39.5 If during the performance of the Contract any War Risks shall occur that financially or otherwise materially affect the execution of the Contract by the Contractor, the Contractor shall use its reasonable efforts to execute the Contract with due and proper consideration given to the safety of its and its Subcontractors' personnel engaged in the work on the Facilities, provided, however, that if the execution of the work on the Facilities becomes impossible or is substantially prevented for a single period of more than sixty (60) days or an aggregate period of more than one hundred and twenty (120) days on account of any War Risks, the Parties will attempt to develop a mutually satisfactory solution, failing which either Party may terminate the Contract by giving a notice to the other.
- 39.6 In the event of termination pursuant to GC Sub-Clauses 39.3 or 39.5, the rights and obligations of the Employer and the Contractor shall be specified in GC Sub-Clauses 43.1.2 and 43.1.3.

#### **Change in Contract Elements**

**40. Change in the Facilities**

40.1 Introducing a Change

- 40.1.1 Subject to GC Sub-Clauses 40.2.5 and 40.2.7, the Employer shall have the right to propose, and subsequently require, that the Project Manager order the Contractor from time to time during the performance of the Contract to make any change, modification, addition or deletion to, in or from the Facilities hereinafter called "Change", provided that such Change falls within the general scope of the Facilities and does not constitute unrelated work and that it is technically practicable, taking into account both the state of advancement of the Facilities and the technical compatibility of the Change envisaged with the nature of the Facilities as specified in the Contract.

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- 40.1.2 The Contractor may from time to time during its performance of the Contract propose to the Employer with a copy to the Project Manager, any Change that the Contractor considers necessary or desirable to improve the quality, efficiency or safety of the Facilities. The Employer may at its discretion approve or reject any Change proposed by the Contractor, provided that the Employer shall approve any Change proposed by the Contractor to ensure the safety of the Facilities.
- 40.1.3 Notwithstanding GC Sub-Clauses 40.1.1 and 40.1.2, no change made necessary because of any default of the Contractor in the performance of its obligations under the Contract shall be deemed to be a Change, and such change shall not result in any adjustment of the Contract Price or the Time for Completion.
- 40.1.4 The procedure on how to proceed with and execute Changes is specified in GC Sub-Clauses 40.2 and 40.3, and further details and forms are provided in the Employer's Requirements (Forms and Procedures).

40.2 Changes Originating from Employer

- 40.2.1 If the Employer proposes a Change pursuant to GC Sub-Clause 40.1.1, it shall send to the Contractor a "Request for Change Proposal," requiring the Contractor to prepare and furnish to the Project Manager as soon as reasonably practicable a "Change Proposal," which shall include the following:
- (a) brief description of the Change
  - (b) effect on the Time for Completion
  - (c) estimated cost of the Change
  - (d) effect on Functional Guarantees (if any)
  - (e) effect on the Facilities
  - (f) effect on any other provisions of the Contract.
- 40.2.2 Prior to preparing and submitting the "Change Proposal," the Contractor shall submit to the Project Manager an "Estimate for Change Proposal," which shall be an estimate of the cost of preparing and submitting the Change Proposal.

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Upon receipt of the Contractor's Estimate for Change Proposal, the Employer shall do one of the following:

- (a) accept the Contractor's estimate with instructions to the Contractor to proceed with the preparation of the Change Proposal
- (b) advise the Contractor of any part of its Estimate for Change Proposal that is unacceptable and request the Contractor to review its estimate
- (c) advise the Contractor that the Employer does not intend to proceed with the Change.

40.2.3 Upon receipt of the Employer's instruction to proceed under GC Sub-Clause 40.2.2 (a), the Contractor shall, with proper expedition, proceed with the preparation of the Change Proposal, in accordance with GC Sub-Clause 40.2.1.

40.2.4 The pricing of any Change shall, as far as practicable, be calculated in accordance with the rates and prices included in the Contract. If such rates and prices are inequitable, the Parties thereto shall agree on specific rates for the valuation of the Change.

40.2.5 If before or during the preparation of the Change Proposal it becomes apparent that the aggregate effect of compliance therewith and with all other Change Orders that have already become binding upon the Contractor under this GC Clause 40 would be to increase or decrease the Contract Price as originally set forth in Article 2 (Contract Price) of the Contract Agreement by more than fifteen percent (15%), the Contractor may give a written notice of objection thereto prior to furnishing the Change Proposal as aforesaid. If the Employer accepts the Contractor's objection, the Employer shall withdraw the proposed Change and shall notify the Contractor in writing thereof.

The Contractor's failure to so object shall neither affect its right to object to any subsequent requested Changes or Change Orders herein, nor affect its right to take into account, when making such subsequent objection, the percentage increase or decrease in the Contract Price that any Change not objected to by the Contractor represents.

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40.2.6 Upon receipt of the Change Proposal, the Employer and the Contractor shall mutually agree upon all matters therein contained. Within fourteen (14) days after such agreement, the Employer shall, if it intends to proceed with the Change, issue the Contractor with a Change Order.

If the Employer is unable to reach a decision within fourteen (14) days, it shall notify the Contractor with details of when the Contractor can expect a decision.

If the Employer decides not to proceed with the Change for whatever reason, it shall, within the said period of fourteen (14) days, notify the Contractor accordingly. Under such circumstances, the Contractor shall be entitled to reimbursement of all costs reasonably incurred by it in the preparation of the Change Proposal, provided that these do not exceed the amount given by the Contractor in its Estimate for Change Proposal submitted in accordance with GC Sub-Clause 40.2.2.

40.2.7 If the Employer and the Contractor cannot reach agreement on the price for the Change, an equitable adjustment to the Time for Completion, or any other matters identified in the Change Proposal, the Employer may nevertheless instruct the Contractor to proceed with the Change by issue of a "Pending Agreement Change Order."

Upon receipt of a Pending Agreement Change Order, the Contractor shall immediately proceed with effecting the Changes covered by such Order. The Parties shall thereafter attempt to reach agreement on the outstanding issues under the Change Proposal.

If the Parties cannot reach agreement within sixty (60) days from the date of issue of the Pending Agreement Change Order, then the matter may be referred to the Dispute Board in accordance with the provisions of GC Sub-clause 47.1.

40.3 Changes Originating from Contractor

40.3.1 If the Contractor proposes a Change pursuant to GC Sub- Clause 40.1.2, the Contractor shall submit to the Project Manager a written "Application for Change Proposal," giving reasons for the proposed Change and including the information specified in GC Sub-Clause 40.2.1.

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Upon receipt of the Application for Change Proposal, the Parties shall follow the procedures outlined in GC Sub-Clauses 40.2.6 and 40.2.7. However, should the Employer choose not to proceed, the Contractor shall not be entitled to recover the costs of preparing the Application for Change Proposal.

**41. Extension of Time for Completion**

41.1

The Time(s) for Completion specified in the PC pursuant to GC Sub-Clause 8.2 shall be extended if the Contractor is delayed or impeded in the performance of any of its obligations under the Contract by reason of any of the following:

- (a) any Change in the Facilities as provided in GC Clause 40
- (b) any occurrence of Force Majeure as provided in GC Clause 38, unforeseen conditions as provided in GC Clause 36, or other occurrence of any of the matters specified or referred to in paragraphs (a), (b) and (c) of GC Sub-Clause 33.2
- (c) any suspension order given by the Employer under GC Clause 41 hereof or reduction in the rate of progress pursuant to GC Sub-Clause 42.2 or
- (d) any changes in laws and regulations as provided in GC Clause 37 or
- (e) any default or breach of the Contract by the Employer, Appendix to the Contract Agreement titled, or any activity, act or omission of the Employer, or the Project Manager, or any other contractors employed by the Employer, or
- (f) any delay on the part of a sub-contractor, provided such delay is due to a cause for which the Contractor himself would have been entitled to an extension of time under this sub-clause, or
- (g) delays attributable to the Employer or caused by customs, or
- (h) any other matter specifically mentioned in the Contract

by such period as shall be fair and reasonable in all the circumstances and as shall fairly reflect the delay or impediment sustained by the Contractor.

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41.2 Except where otherwise specifically provided in the Contract, the Contractor shall submit to the Project Manager a notice of a claim for an extension of the Time for Completion, together with particulars of the event or circumstance justifying such extension as soon as reasonably practicable after the commencement of such event or circumstance. As soon as reasonably practicable after receipt of such notice and supporting particulars of the claim, the Employer and the Contractor shall agree upon the period of such extension. In the event that the Contractor does not accept the Employer's estimate of a fair and reasonable time extension, the Contractor shall be entitled to refer the matter to a Dispute Board, pursuant to GC Sub-Clause 47.1.

41.3 The Contractor shall at all times use its reasonable efforts to minimize any delay in the performance of its obligations under the Contract.

41.4 In all cases where the Contractor has given a notice of a claim for an extension of time under GC 41.2, the Contractor shall consult with the Project Manager in order to determine the steps (if any) which can be taken to overcome or minimize the actual or anticipated delay. The Contractor shall there after comply with all reasonable instructions which the Project Manager shall give in order to minimize such delay. If compliance with such instructions shall cause the Contractor to incur extra costs and the Contractor is entitled to an extension of time under GC 41.1, the amount of such extra costs shall be added to the Contract Price.

**42. Suspension**

42.1 The Employer may request the Project Manager, by notice to the Contractor, to order the Contractor to suspend performance of any or all of its obligations under the Contract. Such notice shall specify the obligation of which performance is to be suspended, the effective date of the suspension and the reasons therefor. The Contractor shall thereupon suspend performance of such obligation, except those obligations necessary for the care or preservation of the Facilities, until ordered in writing to resume such performance by the Project Manager.

If, by virtue of a suspension order given by the Project Manager, other than by reason of the Contractor's default or breach of the Contract, the Contractor's performance of any of its obligations is suspended for an aggregate period of more than ninety (90) days, then at any time thereafter and provided that at that time such performance is still suspended, the Contractor may give a notice to the Project Manager requiring that the Employer shall, within twenty-eight (28) days of receipt of the notice, order the resumption of such performance or request and subsequently order a change in accordance with GC Clause 40, excluding the performance of the suspended obligations from the Contract.

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If the Employer fails to do so within such period, the Contractor may, by a further notice to the Project Manager, elect to treat the suspension, where it affects a part only of the Facilities, as a deletion of such part in accordance with GC Clause 40 or, where it affects the whole of the Facilities, as termination of the Contract under GC Sub-Clause 43.1.

42.2 If

- (a) the Employer has failed to pay the Contractor any sum due under the Contract within the specified period, has failed to approve any invoice or supporting documents without just cause pursuant to the Appendix to the Contract Agreement titled Terms and Procedures of Payment, or commits a substantial breach of the Contract, the Contractor may give a notice to the Employer that requires payment of such sum, with interest thereon as stipulated in GC Sub-Clause 13.3, requires approval of such invoice or supporting documents, or specifies the breach and requires the Employer to remedy the same, as the case may be. If the Employer fails to pay such sum together with such interest, fails to approve such invoice or supporting documents or give its reasons for withholding such approval, or fails to remedy the breach or take steps to remedy the breach within fourteen (14) days after receipt of the Contractor's notice or
- (b) the Contractor is unable to carry out any of its obligations under the Contract for any reason attributable to the Employer, including but not limited to the Employer's failure to provide possession of or access to the Site or other areas in accordance with GC Sub-Clause 11.2, or failure to obtain any governmental permit necessary for the execution and/or completion of the Facilities,

then the Contractor may by fourteen (14) days' notice to the Employer suspend performance of all or any of its obligations under the Contract, or reduce the rate of progress.

42.3 If the Contractor's performance of its obligations is suspended or the rate of progress is reduced pursuant to this GC Clause 42, then the Time for Completion shall be extended in accordance with GC Sub-Clause 41.1, and any and all additional costs or expenses incurred by the Contractor as a result of such suspension or reduction shall be paid by the Employer to the Contractor in addition to the Contract Price, except in the case of suspension or reduction in the rate of progress by reason of the Contractor's default or breach of the Contract.

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42.4 During the period of suspension, the Contractor shall not remove from the Site any Plant, any part of the Facilities or any Contractor's Equipment, without the prior written consent of the Employer.

**43. Termination**

43.1 Termination for Employer's Convenience

43.1.1 The Employer may at any time terminate the Contract for any reason by giving the Contractor a notice of termination that refers to this GC Sub-Clause 43.1.

43.1.2 Upon receipt of the notice of termination under GC Sub-Clause 43.1.1, the Contractor shall either immediately or upon the date specified in the notice of termination

- (a) cease all further work, except for such work as the Employer may specify in the notice of termination for the sole purpose of protecting that part of the Facilities already executed, or any work required to leave the Site in a clean and safe condition
- (b) terminate all subcontracts, except those to be assigned to the Employer pursuant to paragraph (d) (ii) below
- (c) remove all Contractor's Equipment from the Site, repatriate the Contractor's and its Subcontractors' personnel from the Site, remove from the Site any wreckage, rubbish and debris of any kind, and leave the whole of the Site in a clean and safe condition, and
- (d) subject to the payment specified in GC Sub-Clause 43.1.3,
  - (i) deliver to the Employer the parts of the Facilities executed by the Contractor up to the date of termination
  - (ii) to the extent legally possible, assign to the Employer all right, title and benefit of the Contractor to the Facilities and to the Plant as of the date of termination, and, as may be required by the Employer, in any subcontracts concluded between the Contractor and its Subcontractors; and

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(iii) deliver to the Employer all non-proprietary drawings, specifications and other documents prepared by the Contractor or its Subcontractors as at the date of termination in connection with the Facilities.

43.1.3 In the event of termination of the Contract under GC Sub-Clause 43.1.1, the Employer shall pay to the Contractor the following amounts:

- (a) the Contract Price, properly attributable to the parts of the Facilities executed by the Contractor as of the date of termination
- (b) the costs reasonably incurred by the Contractor in the removal of the Contractor's Equipment from the Site and in the repatriation of the Contractor's and its Subcontractors' personnel
- (c) any amounts to be paid by the Contractor to its Subcontractors in connection with the termination of any subcontracts, including any cancellation charges
- (d) costs incurred by the Contractor in protecting the Facilities and leaving the Site in a clean and safe condition pursuant to paragraph (a) of GC Sub-Clause 43.1.2
- (e) the cost of satisfying all other obligations, commitments and claims that the Contractor may in good faith have undertaken with third Parties in connection with the Contract and that are not covered by paragraphs (a) through (d) above.

43.2 Termination for Contractor's Default

43.2.1 The Employer, without prejudice to any other rights or remedies it may possess, may terminate the Contract forthwith in the following circumstances by giving a notice of termination and its reasons therefor to the Contractor, referring to this GC Sub-Clause 43.2:

- (a) if the Contractor becomes bankrupt or insolvent, has a receiving order issued against it, compounds with its creditors, or, if the Contractor is a corporation, a resolution is passed or order is made for its winding up, other than a voluntary liquidation for the purposes of amalgamation or reconstruction, a receiver is appointed over any part of its undertaking or assets, or if the Contractor takes or suffers any other analogous action in consequence of debt

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- (b) if the Contractor assigns or transfers the Contract or any right or interest therein in violation of the provision of GC Clause 44.
- (c) if the Contractor, in the judgment of the Employer has engaged in corrupt, collusive, coercive, or fraudulent practices, as defined in GC Clause 6, in competing for or in executing the Contract.

43.2.2 If the Contractor

- (a) has abandoned or repudiated the Contract
- (b) has without valid reason failed to commence work on the Facilities promptly or has suspended, other than pursuant to GC Sub-Clause 42.2, the progress of Contract performance for more than twenty-eight (28) days after receiving a written instruction from the Employer to proceed
- (c) persistently fails to execute the Contract in accordance with the Contract or persistently neglects to carry out its obligations under the Contract without just cause
- (d) refuses or is unable to provide sufficient materials, services or labor to execute and complete the Facilities in the manner specified in the program furnished under GC Sub-Clause 19.2 at rates of progress that give reasonable assurance to the Employer that the Contractor can attain Completion of the Facilities by the Time for Completion as extended,

then the Employer may, without prejudice to any other rights it may possess under the Contract, give a notice to the Contractor stating the nature of the default and requiring the Contractor to remedy the same. If the Contractor fails to remedy or to take steps to remedy the same within fourteen (14) days of its receipt of such notice, then the Employer may terminate the Contract forthwith by giving a notice of termination to the Contractor that refers to this GC Sub-Clause 43.2.

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- 43.2.3 Upon receipt of the notice of termination under GC Sub-Clauses 43.2.1 or 43.2.2, the Contractor shall, either immediately or upon such date as is specified in the notice of termination,
- (a) cease all further work, except for such work as the Employer may specify in the notice of termination for the sole purpose of protecting that part of the Facilities already executed, or any work required to leave the Site in a clean and safe condition
  - (b) terminate all subcontracts, except those to be assigned to the Employer pursuant to paragraph (d) below
  - (c) deliver to the Employer the parts of the Facilities executed by the Contractor up to the date of termination
  - (d) to the extent legally possible, assign to the Employer all right, title and benefit of the Contractor to the Facilities and to the Plant as of the date of termination, and, as may be required by the Employer, in any subcontracts concluded between the Contractor and its Subcontractors
  - (e) deliver to the Employer all drawings, specifications and other documents prepared by the Contractor or its Subcontractors as of the date of termination in connection with the Facilities.
- 43.2.4 The Employer may enter upon the Site, expel the Contractor, and complete the Facilities itself or by employing any third Party. The Employer may, to the exclusion of any right of the Contractor over the same, take over and use with the payment of a fair rental rate to the Contractor, with all the maintenance costs to the account of the Employer and with an indemnification by the Employer for all liability including damage or injury to persons arising out of the Employer's use of such equipment, any Contractor's Equipment owned by the Contractor and on the Site in connection with the Facilities for such reasonable period as the Employer considers expedient for the supply and installation of the Facilities.

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Upon completion of the Facilities or at such earlier date as the Employer thinks appropriate, the Employer shall give notice to the Contractor that such Contractor's Equipment will be returned to the Contractor at or near the Site and shall return such Contractor's Equipment to the Contractor in accordance with such notice. The Contractor shall thereafter without delay and at its cost remove or arrange removal of the same from the Site.

43.2.5 Subject to GC Sub-Clause 43.2.6, the Contractor shall be entitled to be paid the Contract Price attributable to the Facilities executed as of the date of termination, the value of any unused or partially used Plant on the Site, and the costs, if any, incurred in protecting the Facilities and in leaving the Site in a clean and safe condition pursuant to paragraph (a) of GC Sub-Clause 43.2.3. Any sums due the Employer from the Contractor accruing prior to the date of termination shall be deducted from the amount to be paid to the Contractor under this Contract.

43.2.6 If the Employer completes the Facilities, the cost of completing the Facilities by the Employer shall be determined.

If the sum that the Contractor is entitled to be paid, pursuant to GC Sub-Clause 43.2.5, plus the reasonable costs incurred by the Employer in completing the Facilities, exceeds the Contract Price, the Contractor shall be liable for such excess.

If such excess is greater than the sums due the Contractor under GC Sub-Clause 43.2.5, the Contractor shall pay the balance to the Employer, and if such excess is less than the sums due the Contractor under GC Sub-Clause 43.2.5, the Employer shall pay the balance to the Contractor.

The Employer and the Contractor shall agree, in writing, on the computation described above and the manner in which any sums shall be paid.

43.3 Termination by the Contractor

43.3.1 If

- (a) the Employer has failed to pay the Contractor any sum due under the Contract within the specified period, has failed to approve any invoice or supporting documents without just cause pursuant to the Appendix to the Contract Agreement titled Terms and Procedures of Payment, or commits a substantial breach of the Contract, the Contractor may give a notice to the Employer that requires payment of such sum, with interest thereon as stipulated in GC Sub-Clause 13.3, requires approval of such invoice or supporting documents, or specifies the breach and requires the Employer to remedy the same, as the case may be. If the Employer fails to pay such sum together with such interest, fails to approve such invoice or supporting documents or give its reasons for withholding such approval, fails to remedy the breach or take steps to remedy the breach within fourteen (14) days after receipt of the Contractor's notice, or

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(b) the Contractor is unable to carry out any of its obligations under the Contract for any reason attributable to the Employer, including but not limited to the Employer's failure to provide possession of or access to the Site or other areas or failure to obtain any governmental permit necessary for the execution and/or completion of the Facilities,

then the Contractor may give a notice to the Employer thereof, and if the Employer has failed to pay the outstanding sum, to approve the invoice or supporting documents, to give its reasons for withholding such approval, or to remedy the breach within twenty-eight (28) days of such notice, or if the Contractor is still unable to carry out any of its obligations under the Contract for any reason attributable to the Employer within twenty-eight (28) days of the said notice, the Contractor may by a further notice to the Employer referring to this GC Sub-Clause 43.3.1, forthwith terminate the contract.

43.3.2 The Contractor may terminate the Contract forthwith by giving a notice to the Employer to that effect, referring to this GC Sub-Clause 43.3.2, if the Employer becomes bankrupt or insolvent, has a receiving order issued against it, compounds with its creditors, or, being a corporation, if a resolution is passed or order is made for its winding up (other than a voluntary liquidation for the purposes of amalgamation or reconstruction), a receiver is appointed over any part of its undertaking or assets, or if the Employer takes or suffers any other analogous action in consequence of debt.

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- 43.3.3 If the Contract is terminated under GC Sub-Clauses 42.3.1 or 42.3.2, then the Contractor shall immediately
- (a) cease all further work, except for such work as may be necessary for the purpose of protecting that part of the Facilities already executed, or any work required to leave the Site in a clean and safe condition
  - (b) terminate all subcontracts, except those to be assigned to the Employer pursuant to paragraph (d) (ii)
  - (c) remove all Contractor's Equipment from the Site and repatriate the Contractor's and its Subcontractors' personnel from the Site, and
  - (d) subject to the payment specified in GC Sub-Clause 43.3.4,
    - (i) deliver to the Employer the parts of the Facilities executed by the Contractor up to the date of termination
    - (ii) to the extent legally possible, assign to the Employer all right, title and benefit of the Contractor to the Facilities and to the Plant as of the date of termination, and, as may be required by the Employer, in any subcontracts concluded between the Contractor and its Subcontractors, and
    - (iii) deliver to the Employer all drawings, specifications and other documents prepared by the Contractor or its Subcontractors as of the date of termination in connection with the Facilities.
- 43.3.4 If the Contract is terminated under GC Sub-Clauses 43.3.1 or 43.3.2, the Employer shall pay to the Contractor all payments specified in GC Sub-Clause 43.1.3, and reasonable compensation for all loss, except for loss of profit, or damage sustained by the Contractor arising out of, in connection with or in consequence of such termination.
- 43.3.5 Termination by the Contractor pursuant to this GC Sub-Clause 43.3 is without prejudice to any other rights or remedies of the Contractor that may be exercised in lieu of or in addition to rights conferred by GC Sub-Clause 43.3.

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- 43.4 In this GC Clause 43, the expression "Facilities executed" shall include all work executed, Installation Services provided, and all Plant acquired, or subject to a legally binding obligation to purchase, by the Contractor and used or intended to be used for the purpose of the Facilities, up to and including the date of termination.
- 43.5 In this GC Clause 43, in calculating any monies due from the Employer to the Contractor, account shall be taken of any sum previously paid by the Employer to the Contractor under the Contract, including any advance payment paid pursuant to the Appendix to the Contract Agreement titled Terms and Procedures of Payment.
- 44. Assignment** 44.1 Neither the Employer nor the Contractor shall, without the express prior written consent of the other Party, which consent shall not be unreasonably withheld, assign to any third Party the Contract or any part thereof, or any right, benefit, obligation or interest therein or thereunder, except that the Contractor shall be entitled to assign either absolutely or by way of charge any monies due and payable to it or that may become due and payable to it under the Contract.
- 44. Export Restrictions** 44.1 Notwithstanding any obligation under the Contract to complete all export formalities, any export restrictions attributable to the Employer, to the country of the Employer or to the use of the Plant and Installation Services to be supplied which arise from trade regulations from a country supplying those Plant and Installation Services, and which substantially impede the Contractor from meeting its obligations under the Contract, shall release the Contractor from the obligation to provide deliveries or services, always provided, however, that the Contractor can demonstrate to the satisfaction of the Employer and of the Bank that it has completed all formalities in a timely manner, including applying for permits, authorizations and licenses necessary for the export of the Plant and Installation Services under the terms of the Contract. Termination of the Contract on this basis shall be for the Employer's convenience pursuant to Sub-Clause 43.1.

#### **Claims, Disputes and Arbitration**

- 46. Contractor's Claims** 46.1 If the Contractor considers himself to be entitled to any extension of the Time for Completion and/or any additional payment, under any Clause of these Conditions or otherwise in connection with the Contract, the Contractor shall submit a notice to the Project Manager, describing the event or circumstance giving rise to the claim. The notice shall be given as soon as practicable, and not later than 28 days after the Contractor became aware, or should have become aware, of the event or circumstance.



If the Contractor fails to give notice of a claim within such period of 28 days, the Time for Completion shall not be extended, the Contractor shall not be entitled to additional payment, and the Employer shall be discharged from all liability in connection with the claim. Otherwise, the following provisions of this Sub-Clause shall apply.

The Contractor shall also submit any other notices which are required by the Contract, and supporting particulars for the claim, all as relevant to such event or circumstance.

The Contractor shall keep such contemporary records as may be necessary to substantiate any claim, either on the Site or at another location acceptable to the Project Manager. Without admitting the Employer's liability, the Project Manager may, after receiving any notice under this Sub-Clause, monitor the record-keeping and/or instruct the Contractor to keep further contemporary records. The Contractor shall permit the Project Manager to inspect all these records, and shall (if instructed) submit copies to the Project Manager.

Within 42 days after the Contractor became aware (or should have become aware) of the event or circumstance giving rise to the claim, or within such other period as may be proposed by the Contractor and approved by the Project Manager, the Contractor shall send to the Project Manager a fully detailed claim which includes full supporting particulars of the basis of the claim and of the extension of time and/or additional payment claimed. If the event or circumstance giving rise to the claim has a continuing effect:

- (a) this fully detailed claim shall be considered as interim;
- (b) the Contractor shall send further interim claims at monthly intervals, giving the accumulated delay and/or amount claimed, and such further particulars as the Project Manager may reasonably require; and
- (c) the Contractor shall send a final claim within 28 days after the end of the effects resulting from the event or circumstance, or within such other period as may be proposed by the Contractor and approved by the Project Manager.

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Within 42 days after receiving a claim or any further particulars supporting a previous claim, or within such other period as may be proposed by the Project Manager and approved by the Contractor, the Project Manager shall respond with approval, or with disapproval and detailed comments. He may also request any necessary further particulars, but shall nevertheless give his response on the principles of the claim within such time.

Each Payment Certificate shall include such amounts for any claim as have been reasonably substantiated as due under the relevant provision of the Contract. Unless and until the particulars supplied are sufficient to substantiate the whole of the claim, the Contractor shall only be entitled to payment for such part of the claim as he has been able to substantiate.

The Project Manager shall agree with the Contractor or estimate: (i) the extension (if any) of the Time for Completion (before or after its expiry) in accordance with GC Clause 40, and/or (ii) the additional payment (if any) to which the Contractor is entitled under the Contract.

The requirements of this Sub-Clause are in addition to those of any other Sub-Clause which may apply to a claim. If the Contractor fails to comply with this or another Sub-Clause in relation to any claim, any extension of time and/or additional payment shall take account of the extent (if any) to which the failure has prevented or prejudiced proper investigation of the claim, unless the claim is excluded under the second paragraph of this Sub-Clause.

In the event that the Contractor and the Employer cannot agree on any matter relating to a claim, either Party may refer the matter to the Dispute Board pursuant to GC 47 hereof.

**47. Disputes and Arbitration**

47.1 Appointment of the Dispute Board

Disputes shall be referred to a DB for decision in accordance with GC Sub-Clause 47.3. The Parties shall appoint a DB by the date stated in the PC.

The DB shall comprise, as stated in the PC, either one or three suitably qualified persons ("the members"), each of whom shall be fluent in the language for communication defined in the Contract and shall be a professional experienced in the type of activities involved in the performance of the Contract and with the interpretation of contractual documents. If the number is not so stated and the Parties do not agree otherwise, the DB shall comprise three persons, one of whom shall serve as chairman.

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If the Parties have not jointly appointed the DB 21 days before the date stated in the PC and the DB is to comprise three persons, each Party shall nominate one member for the approval of the other Party. The first two members shall recommend and the Parties shall agree upon the third member, who shall act as chairman.

However, if a list of potential members is included in the PC, the members shall be selected from those on the list, other than anyone who is unable or unwilling to accept appointment to the DB.

The agreement between the Parties and either the sole member or each of the three members shall incorporate by reference the General Conditions of Dispute Board Agreement contained in the Appendix to these General Conditions, with such amendments as are agreed between them.

The terms of the remuneration of either the sole member or each of the three members, including the remuneration of any expert whom the DB consults, shall be mutually agreed upon by the Parties when agreeing the terms of appointment of the member or such expert (as the case may be). Each Party shall be responsible for paying one-half of this remuneration.

If a member declines to act or is unable to act as a result of death, disability, resignation or termination of appointment, a replacement shall be appointed in the same manner as the replaced person was required to have been nominated or agreed upon, as described in this Sub-Clause.

The appointment of any member may be terminated by mutual agreement of both Parties, but not by the Employer or the Contractor acting alone. Unless otherwise agreed by both Parties, the appointment of the DB (including each member) shall expire when the Operational Acceptance Certificate has been issued in accordance with GC Sub-Clause 26.3.

47.2 Failure to Agree on the Composition of the Dispute Board

If any of the following conditions apply, namely:

- (a) the Parties fail to agree upon the appointment of the sole member of the DB by the date stated in the first paragraph of GC Sub-Clause 47.1,





either Party fails to nominate a member (for approval by the other Party) of a DB of three persons by such date,

the Parties fail to agree upon the appointment of the third member (to act as chairman) of the DB by such date, or

the Parties fail to agree upon the appointment of a replacement person within 42 days after the date on which the sole member or one of the three members declines to act or is unable to act as a result of death, disability, resignation or termination of appointment,

then the appointing entity or official **named in the PC** shall, upon the request of either or both of the Parties and after due consultation with both Parties, appoint this member of the DB. This appointment shall be final and conclusive. Each Party shall be responsible for paying one-half of the remuneration of the appointing entity or official.

47.3 Obtaining Dispute Board's Decision

If a dispute (of any kind whatsoever) arises between the Parties in connection with the performance of the Contract, including any dispute as to any certificate, determination, instruction, opinion or valuation of the Project Manager, either Party may refer the dispute in writing to the DB for its decision, with copies to the other Party and the Project Manager. Such reference shall state that it is given under this Sub-Clause.

For a DB of three persons, the DB shall be deemed to have received such reference on the date when it is received by the chairman of the DB.

Both Parties shall promptly make available to the DB all such additional information, further access to the Site, and appropriate facilities, as the DB may require for the purposes of making a decision on such dispute. The DB shall be deemed to be not acting as arbitrator(s).

Within 84 days after receiving such reference, or within such other period as may be proposed by the DB and approved by both Parties, the DB shall give its decision, which shall be reasoned and shall state that it is given under this Sub-Clause. The decision shall be binding on both Parties, who shall promptly give effect to it unless and until it shall be revised in an amicable settlement or an arbitral award as described below. Unless the Contract has already been abandoned, repudiated or terminated, the Contractor shall continue with the performance of the Facilities in accordance with the Contract.

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If either Party is dissatisfied with the DB's decision, then either Party may, within 28 days after receiving the decision, give notice to the other Party of its dissatisfaction and intention to commence arbitration. If the DB fails to give its decision within the period of 84 days (or as otherwise approved) after receiving such reference, then either Party may, within 28 days after this period has expired, give notice to the other Party of its dissatisfaction and intention to commence arbitration.

In either event, this notice of dissatisfaction shall state that it is given under this Sub-clause, and shall set out the matter in dispute and the reason(s) for dissatisfaction. Except as stated in GC Sub-Clauses 47.6 and 47.7, neither Party shall be entitled to commence arbitration of a dispute unless a notice of dissatisfaction has been given in accordance with this Sub-Clause.

If the DB has given its decision as to a matter in dispute to both Parties, and no notice of dissatisfaction has been given by either Party within 28 days after it received the DB's decision, then the decision shall become final and binding upon both Parties.

47.4 Amicable Settlement

Where notice of dissatisfaction has been given under GC Sub-Clause 47.3 above, both Parties shall attempt to settle the dispute amicably before the commencement of arbitration. However, unless both Parties agree otherwise, arbitration may be commenced on or after the fifty-sixth day after the day on which notice of dissatisfaction and intention to commence arbitration was given, even if no attempt at amicable settlement has been made.

47.5 Arbitration

Unless **indicated otherwise in the PC**, any dispute not settled amicably and in respect of which the DB's decision (if any) has not become final and binding shall be finally settled by arbitration. Unless otherwise agreed by both Parties, arbitration shall be conducted as follows:

(a) For contracts with foreign contractors:

- (i) international arbitration with proceedings administered by the international arbitration institution **appointed in the PC**, in accordance with the rules of arbitration of the appointed institution;



- (ii) the place of arbitration shall be the city where the headquarters of the appointed arbitration institution is located or such other place selected in accordance with the applicable arbitration rules; and
  - (iii) the arbitration shall be conducted in the language for communications defined in Sub-Clause 5.3; and
- (b) For contracts with domestic contractors, arbitration with proceedings conducted in accordance with the laws of the Employer's country.

The arbitrator(s) shall have full power to open up, review and revise any certificate, determination, instruction, opinion or valuation of the Project Manager, and any decision of the DB, relevant to the dispute. Nothing shall disqualify the Project Manager from being called as a witness and giving evidence before the arbitrator(s) on any matter whatsoever relevant to the dispute.

Neither Party shall be limited in the proceedings before the arbitrator(s) to the evidence or arguments previously put before the DB to obtain its decision, or to the reasons for dissatisfaction given in its notice of dissatisfaction. Any decision of the DB shall be admissible in evidence in the arbitration.

Arbitration may be commenced prior to or after completion of the Works. The obligations of the Parties, the Project Manager and the DB shall not be altered by reason of any arbitration being conducted during the progress of the Works.

47.6 Failure to Comply with Dispute Board's Decision

In the event that a Party fails to comply with a DB decision which has become final and binding, then the other Party may, without prejudice to any other rights it may have, refer the failure itself to arbitration under GC Sub-Clause 47.5. GC Sub- Clauses 46.3 and 46.4 shall not apply to this reference.



47.7 Expiry of Dispute Board's Appointment

If a dispute arises between the Parties in connection with the performance of the Contract, and there is no DB in place, whether by reason of the expiry of the DB's appointment or otherwise:

- (a) GC Sub-Clauses 47.3 and 47.4 shall not apply, and
- (b) the dispute may be referred directly to arbitration under GC Sub-Clause 47.5

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## Appendix A

### A General Conditions of Dispute Board Agreement

#### 1. Definitions

Each "Dispute Board Agreement" is a tripartite agreement by and between:

the "Employer";

the "Contractor"; and

the "Member" who is defined in the Dispute Board Agreement as being:

- (i) the sole member of the "DB" and, where this is the case, all references to the "Other Members" do not apply, or
- (ii) one of the three persons who are jointly called the "DB" (or "dispute board") and, where this is the case, the other two persons are called the "Other Members".

The Employer and the Contractor have entered (or intend to enter) into a contract, which is called the "Contract" and is defined in the Dispute Board Agreement, which incorporates this Appendix. In the Dispute Board Agreement, words and expressions which are not otherwise defined shall have the meanings assigned to them in the Contract.

#### 2. General Provisions

Unless otherwise stated in the Dispute Board Agreement, it shall take effect on the latest of the following dates:

- (a) the Commencement Date defined in the Contract,
- (b) when the Employer, the Contractor and the Member have each signed the Dispute Board Agreement, or
- (c) when the Employer, the Contractor and each of the Other Members (if any) have respectively each signed a dispute board agreement.

This employment of the Member is a personal appointment. At any time, the Member may give not less than 70 days' notice of resignation to the Employer and to the Contractor, and the Dispute Board Agreement shall terminate upon the expiry of this period.

#### 3. Warranties

The Member warrants and agrees that he/she is and shall be impartial and independent of the Employer, the Contractor and the Project Manager. The Member shall promptly disclose, to each of them and to the Other Members (if any), any fact or circumstance which might appear inconsistent with his/her warranty and agreement of impartiality and independence.



When appointing the Member, the Employer and the Contractor relied upon the Member's representations that he/she is:

- (a) experienced in the work which the Contractor is to carry out under the Contract,
- (b) experienced in the interpretation of contract documentation, and
- (c) fluent in the language for communications defined in the Contract.

4. General Obligations of the Member

The Member shall:

- (a) have no interest financial or otherwise in the Employer, the Contractor or the Project Manager, nor any financial interest in the Contract except for payment under the Dispute Board Agreement;
- (b) not previously have been employed as a consultant or otherwise by the Employer, the Contractor or the Project Manager, except in such circumstances as were disclosed in writing to the Employer and the Contractor before they signed the Dispute Board Agreement;
- (c) have disclosed in writing to the Employer, the Contractor and the Other Members (if any), before entering into the Dispute Board Agreement and to his/her best knowledge and recollection, any professional or personal relationships with any director, officer or employee of the Employer, the Contractor or the Project Manager, and any previous involvement in the overall project of which the Contract forms part;
- (d) not, for the duration of the Dispute Board Agreement, be employed as a consultant or otherwise by the Employer, the Contractor or the Project Manager, except as may be agreed in writing by the Employer, the Contractor and the Other Members (if any);
- (e) comply with the annexed procedural rules and with GC Sub-clause 47.3;
- (f) not give advice to the Employer, the Contractor, the Employer's Personnel or the Contractor's Personnel concerning the conduct of the Contract, other than in accordance with the annexed procedural rules;
- (g) not while a Member enter into discussions or make any agreement with the Employer, the Contractor or the Project Manager regarding employment by any of them, whether as a consultant or otherwise, after ceasing to act under the Dispute Board Agreement;
- (h) ensure his/her availability for all site visits and hearings as are necessary;
- (i) become conversant with the Contract and with the progress of the Facilities (and of any other parts of the project of which the Contract forms part) by studying all documents received which shall be maintained in a current working file;



- (j) treat the details of the Contract and all the DB's activities and hearings as private and confidential, and not publish or disclose them without the prior written consent of the Employer, the Contractor and the Other Members (if any); and
- (k) be available to give advice and opinions, on any matter relevant to the Contract when requested by both the Employer and the Contractor, subject to the agreement of the Other Members (if any).

5. General Obligations of the Employer and the Contractor

The Employer, the Contractor, the Employer's Personnel and the Contractor's Personnel shall not request advice from or consultation with the Member regarding the Contract, otherwise than in the normal course of the DB's activities under the Contract and the Dispute Board Agreement. The Employer and the Contractor shall be responsible for compliance with this provision, by the Employer's Personnel and the Contractor's Personnel respectively.

The Employer and the Contractor undertake to each other and to the Member that the Member shall not, except as otherwise agreed in writing by the Employer, the Contractor, the Member and the Other Members (if any):

- (a) be appointed as an arbitrator in any arbitration under the Contract;
- (b) be called as a witness to give evidence concerning any dispute before arbitrator(s) appointed for any arbitration under the Contract; or
- (c) be liable for any claims for anything done or omitted in the discharge or purported discharge of the Member's functions, unless the act or omission is shown to have been in bad faith.

The Employer and the Contractor hereby jointly and severally indemnify and hold the Member harmless against and from claims from which he is relieved from liability under the preceding paragraph.

Whenever the Employer or the Contractor refers a dispute to the DB under GC Sub-clause 47.3, which will require the Member to make a site visit and attend a hearing, the Employer or the Contractor shall provide appropriate security for a sum equivalent to the reasonable expenses to be incurred by the Member. No account shall be taken of any other payments due or paid to the Member.

6. Payment

The Member shall be paid as follows, in the currency named in the Dispute Board Agreement:

- (a) a retainer fee per calendar month, which shall be considered as payment in full for:
  - (i) being available on 28 days' notice for all site visits and hearings;
  - (ii) becoming and remaining conversant with all project developments and maintaining relevant files;

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- (iii) all office and overhead expenses including secretarial services, photocopying and office supplies incurred in connection with his duties; and
- (iv) all services performed hereunder except those referred to in sub-paragraphs (b) and (c) of this Clause.

The retainer fee shall be paid with effect from the last day of the calendar month in which the Dispute Board Agreement becomes effective; until the last day of the calendar month in which the Taking-Over Certificate is issued for the whole of the Works.

With effect from the first day of the calendar month following the month in which Taking-Over Certificate is issued for the whole of the Works, the retainer fee shall be reduced by one third. This reduced fee shall be paid until the first day of the calendar month in which the Member resigns or the Dispute Board Agreement is otherwise terminated.

- (b) a daily fee which shall be considered as payment in full for:
  - (i) each day or part of a day up to a maximum of two days' travel time in each direction for the journey between the Member's home and the site, or another location of a meeting with the Other Members (if any);
  - (ii) each working day on site visits, hearings or preparing decisions; and
  - (iii) each day spent reading submissions in preparation for a hearing.
- (c) all reasonable expenses including necessary travel expenses (air fare in less than first class, hotel and subsistence and other direct travel expenses) incurred in connection with the Member's duties, as well as the cost of telephone calls, courier charges, faxes and telexes: a receipt shall be required for each item in excess of five percent of the daily fee referred to in sub-paragraph (b) of this Clause;
- (d) any taxes properly levied in the Country on payments made to the Member (unless a national or permanent resident of the Country) under this Clause 6.

The retainer and daily fees shall be as specified in the Dispute Board Agreement. Unless it specifies otherwise, these fees shall remain fixed for the first 24 calendar months, and shall thereafter be adjusted by agreement between the Employer, the Contractor and the Member, at each anniversary of the date on which the Dispute Board Agreement became effective.

If the Parties fail to agree on the retainer fee or the daily fee the appointing entity or official named in the PC shall determine the amount of the fees to be used.

The Member shall submit invoices for payment of the monthly retainer and air fares quarterly in advance. Invoices for other expenses and for daily fees shall be submitted following the conclusion of a site visit or hearing. All invoices shall be accompanied by a brief description of activities performed during the relevant period and shall be addressed to the Contractor.

The Contractor shall pay each of the Member's invoices in full within 56 calendar days after receiving each invoice and shall apply to the Employer (in the Statements under the Contract) for reimbursement of one-half of the amounts of these invoices. The Employer shall then pay the Contractor in accordance with the Contract.

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If the Contractor fails to pay to the Member the amount to which he/she is entitled under the Dispute Board Agreement, the Employer shall pay the amount due to the Member and any other amount which may be required to maintain the operation of the DB; and without prejudice to the Employer's rights or remedies. In addition to all other rights arising from this default, the Employer shall be entitled to reimbursement of all sums paid in excess of one-half of these payments, plus all costs of recovering these sums and financing charges calculated at the rate specified in accordance with GC Sub-Clause 13.3.

If the Member does not receive payment of the amount due within 70 days after submitting a valid invoice, the Member may (i) suspend his/her services (without notice) until the payment is received, and/or (ii) resign his/her appointment by giving notice under Clause 8.

#### 7. Termination

At any time: (i) the Employer and the Contractor may jointly terminate the Dispute Board Agreement by giving 42 days' notice to the Member; or (ii) the Member may resign as provided for in Clause 2.

If the Member fails to comply with the Dispute Board Agreement, the Employer and the Contractor may, without prejudice to their other rights, terminate it by notice to the Member. The notice shall take effect when received by the Member.

If the Employer or the Contractor fails to comply with the Dispute Board Agreement, the Member may, without prejudice to his other rights, terminate it by notice to the Employer and the Contractor. The notice shall take effect when received by them both.

Any such notice, resignation and termination shall be final and binding on the Employer, the Contractor and the Member. However, a notice by the Employer or the Contractor, but not by both, shall be of no effect.

#### 8. Default of the Member

If the Member fails to comply with any of his obligations under Clause 4 concerning his impartiality or independence in relation to the Employer or the Contractor, he/she shall not be entitled to any fees or expenses hereunder and shall, without prejudice to their other rights, reimburse each of the Employer and the Contractor for any fees and expenses received by the Member and the Other Members (if any), for proceedings or decisions (if any) of the DB which are rendered void or ineffective by the said failure to comply.

#### 9. Disputes

Any dispute or claim arising out of or in connection with this Dispute Board Agreement, or the breach, termination or invalidity thereof, shall be finally settled by institutional arbitration. If no other arbitration institute is agreed, the arbitration shall be conducted under the Rules of Arbitration of the International Chamber of Commerce by one arbitrator appointed in accordance with these Rules of Arbitration.

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## Appendix B

### DISPUTE BOARD GUIDELINES

1. Unless otherwise agreed by the Employer and the Contractor, the DB shall visit the site at intervals of not more than 140 days, including times of critical construction events, at the request of either the Employer or the Contractor. Unless otherwise agreed by the Employer, the Contractor and the DB, the period between consecutive visits shall not be less than 70 days, except as required to convene a hearing as described below.
2. The timing of and agenda for each site visit shall be as agreed jointly by the DB, the Employer and the Contractor, or in the absence of agreement, shall be decided by the DB. The purpose of site visits is to enable the DB to become and remain acquainted with the progress of the Works and of any actual or potential problems or claims, and, as far as reasonable, to prevent potential problems or claims from becoming disputes.
3. Site visits shall be attended by the Employer, the Contractor and the Project Manager and shall be co-ordinated by the Employer in co-operation with the Contractor. The Employer shall ensure the provision of appropriate conference facilities and secretarial and copying services. At the conclusion of each site visit and before leaving the site, the DB shall prepare a report on its activities during the visit and shall send copies to the Employer and the Contractor.
4. The Employer and the Contractor shall furnish to the DB one copy of all documents which the DB may request, including Contract documents, progress reports, variation instructions, certificates and other documents pertinent to the performance of the Contract. All communications between the DB and the Employer or the Contractor shall be copied to the other Party. If the DB comprises three persons, the Employer and the Contractor shall send copies of these requested documents and these communications to each of these persons.
5. If any dispute is referred to the DB in accordance with GC Sub-Clause 47.3, the DB shall proceed in accordance with GC Sub-Clause 47.3 and these Guidelines. Subject to the time allowed to give notice of a decision and other relevant factors, the DB shall:
  - (a) act fairly and impartially as between the Employer and the Contractor, giving each of them a reasonable opportunity of putting his case and responding to the other's case, and
  - (b) adopt procedures suitable to the dispute, avoiding unnecessary delay or expense.
6. The DB may conduct a hearing on the dispute, in which event it will decide on the date and place for the hearing and may request that written documentation and arguments from the Employer and the Contractor be presented to it prior to or at the hearing.
7. Except as otherwise agreed in writing by the Employer and the Contractor, the DB shall have power to adopt an inquisitorial procedure, to refuse admission to hearings or audience at hearings to any persons other than representatives of the Employer, the Contractor and the Project Manager, and to proceed in the absence of any Party who the DB is satisfied received notice of the hearing; but shall have discretion to decide whether and to what extent this power may be exercised.



8. The Employer and the Contractor empower the DB, among other things, to:
- (a) establish the procedure to be applied in deciding a dispute,
  - (b) decide upon the DB's own jurisdiction, and as to the scope of any dispute referred to it,
  - (c) conduct any hearing as it thinks fit, not being bound by any rules or procedures other than those contained in the Contract and these Guidelines,
  - (d) take the initiative in ascertaining the facts and matters required for a decision,
  - (e) make use of its own specialist knowledge, if any,
  - (f) decide upon the payment of financing charges in accordance with the Contract,
  - (g) decide upon any provisional relief such as interim or conservatory measures,
  - (h) open up, review and revise any certificate, decision, determination, instruction, opinion or valuation of the Project Manager, relevant to the dispute, and
  - (i) appoint, should the DB so consider necessary and the Parties agree, a suitable expert at the cost of the Parties to give advice on a specific matter relevant to the dispute.
9. The DB shall not express any opinions during any hearing concerning the merits of any arguments advanced by the Parties. Thereafter, the DB shall make and give its decision in accordance with GC Sub-Clause 47.3, or as otherwise agreed by the Employer and the Contractor in writing. If the DB comprises three persons:
- (a) it shall convene in private after a hearing, in order to have discussions and prepare its decision;
  - (b) it shall endeavour to reach a unanimous decision: if this proves impossible the applicable decision shall be made by a majority of the Members, who may require the minority Member to prepare a written report for submission to the Employer and the Contractor; and
  - (c) if a Member fails to attend a meeting or hearing, or to fulfil any required function, the other two Members may nevertheless proceed to make a decision, unless:
    - (i) either the Employer or the Contractor does not agree that they do so, or
    - (ii) the absent Member is the chairman and he/she instructs the other Members to not make a decision.

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**Particular Conditions**

The following Particular Conditions shall supplement the General Conditions in Section. Whenever there is a conflict, the provisions herein shall prevail over those in the General Conditions.



Two handwritten signatures in black ink. The first signature on the left is a stylized, cursive mark. The second signature on the right is more complex, featuring several loops and a prominent vertical stroke.

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## Particular Conditions

The following Particular Conditions (PC) shall supplement the General Conditions (GC). Whenever there is a conflict, the provisions herein shall prevail over those in the GC. The clause number of the PC is the corresponding clause number of the GC.

### PC 1. Definitions

The Employer is: KENYA PORT AUTHORITY

The Project Manager is: SYLVESTER K. NDONGOLI

The Bank is: INTERNATIONAL DEVELOPMENT ASSOCIATION

Country of Origin: all countries and territories as indicated in Section V of the bidding documents, Eligible Countries.

### PC 5. Law and Language

PC 5.1 The Contract shall be interpreted in accordance with the laws of: KENYA

PC 5.2 The ruling language is: *ENGLISH*

PC 5.3 The language for communications is: *ENGLISH*

### PC 8. Scope of Facilities [Spare Parts] (GC Clause 7)

PC 8.3 The Contractor agrees to supply spare parts for a period of years: 10

#### Add the following to Clause 8:-

The Contractor shall carry sufficient inventories to ensure an ex-stock supply of consumable spares for the Plant. Other spare parts and components shall be supplied as promptly as possible, but at the most within two (2) months of placing the order and opening the letter of credit. In addition, in the event of termination of the production of spare parts, advance notification will be made to the Employer of the pending termination, with sufficient time to permit the Employer to procure the needed requirement. Following such termination, the Contractor will furnish to the extent possible and at no cost to the Employer the blueprints, drawings and specifications of the spare parts, if requested.

### PC 9. Time for Commencement and Completion.

PC 9.1 The Contractor shall commence work on the Facilities within 30 days from the Effective Date for determining Time for Completion as specified in the Contract Agreement.

PC 9.2 The Time for Completion of the whole of the Facilities shall be 18 months from the Effective Date as described in the Contract Agreement.



**PC 11 Employer's Responsibilities**

- PC 11.3 In the first line, replace "Employer" with "Contractor"
- PC 11.5 In the second line, replace "Employer" with "Contractor"
- PC 11.7 Delete this sub-clause in its entirety

**PC 12. Contract Price**

- PC 12.2 The Contract Price shall be fixed and the adjustment clause shall not apply.

**PC 14. Securities**

- PC 14.3.1 The amount of performance security, shall be 10% of the Contract Price.
- PC 14.3.2 The performance security shall be in the form of the "Performance Security Form - Bank Guarantee" attached hereto in Section IX, Contract Forms.
- PC 14.3.3 The performance security shall not be reduced on the date of the Operational Acceptance.
- PC 14.3.3 The performance security shall be reduced to ten percent (10%) of the value of the component covered by the extended defect liability to cover the Contractor's extended defect liability in accordance with the provision in the PC, pursuant to GC Sub-clause 28.10.

**PC 15 Taxes and Duties**

- PC 15.1 In the 5<sup>th</sup> line of this sub-clause, delete the words "in and"
- PC 15.2 Delete this sub-clause in its entirety
- PC 15.4 Delete this sub-clause in its entirety

**PC 17 Confidential Information**

- PC 17.6 Each of the Parties shall not unreasonably withhold its consent to disclosures that are required by any applicable law or regulation.

**PC 23 Installation**

- PC 23.2.5 Working Hours  
Normal working hours are: Monday to Friday: 07:45 – 12:10, 14:00 – 17:00.

Two handwritten signatures in black ink, one on the left and one on the right, appearing to be initials or names.

**PC 24 Test and Inspection**

**PC24.2** Replace the word "Employer" with "Contractor" in the 3<sup>rd</sup> line. Add the following words at the end of the sub-clause:- "The Contractor shall allow for such costs in his priced bills of quantities to cover the number of such trips".

**PC 25 Completion of the Facilities**

**PC 25.2** Delete this sub-clause in its entirety and substitute with:

"Within 7 days after issuing the notice under sub-clause 25.1, the Contractor shall commence Pre-commissioning of the Facilities or the relevant part thereof in preparation for Commissioning, all in accordance with the requirements of **PART I – Chapter 2: General Conditions for Project Implementation** of the Technical Specifications. The Contractor shall allow for all associated costs in the Bills of Materials".

**PC 25.3** Delete this sub-clause in its entirety.

**PC 26. Commissioning and Operational Acceptance**

**PC 26.1.2** Delete this sub-clause in its entirety and replace with the following:-

"The Employer shall supply the operating personnel and the Contractor shall supply the maintenance personnel and all raw materials, utilities, lubricants, chemicals, catalysts, facilities, services and other matters required for Commissioning."

**PC 26.2.2** The Guarantee Test of the Facilities shall be successfully completed within ninety (90) days from the date of Completion

**PC 26.3.1 (a)** Delete this sub-clause in its entirety

**PC 26.3.1 (b)** Delete this sub-clause in its entirety

**PC 26.3.1 (c)** Delete this sub-clause in its entirety

**PC 26.3.4** Change seven (7) days to read twenty one (21) days in the first line.

**PC 26.5.2** Delete this sub-clause in its entirety

**PC 27. Completion Time Guarantee**

**PC 27.2** Applicable rate for liquidated damages: 0.03% of the Contract Price (or relevant part thereof) per day.

Two handwritten signatures in black ink, one on the left and one on the right, appearing to be initials or names.



This rate applies to the price of the part of the Facilities, as quoted in the Price Schedule, for that part for which the Contractor fails to achieve Completion within the particular Time for Completion.

Maximum deduction for liquidated damages: 15% of the contract price.

**PC 27.3** No bonus will be given for earlier Completion of the Facilities or part thereof.

**PC 28. Defect Liability**

**PC 28.9** Delete this sub-clause in its entirety.

**PC 28.10** The contractor shall enter into full maintenance contract with the Employer for a period of 3 years at the end of the defects liability period as defined in Sub- Clause 28.2 of the GC.

**PC 29. Functional Guarantees**

**PC 29.3** In the 6<sup>th</sup> line, delete the words "at the Contractor's option, either".

**PC 29.3 (b)** Delete this sub-clause in its entirety.

**PC 29.4** Delete this sub-clause in its entirety.

**PC 32 Transfer of Ownership**

**PC 32.1** Delete this sub-clause in its entirety.

**PC 33 Care of Facilities**

**PC 33.2(a)** Delete this sub-clause in its entirety.

**PC 39 War Risks - Delete this clause in its entirety**

**PC 41 Extension of Time for Completion**

**PC 41.2** In the 5<sup>th</sup> line, substitute the words "...as soon as reasonably practicable.." with "...within 28 days..".

In the 6<sup>th</sup> line, substitute the words "...as soon as reasonably practicable.." with "...within 28 days..".

**PC 47. Disputes and Arbitration**

**PC 47.1** The DB shall be appointed within 28 days after the Effective Date.

**PC 47.1** The DB shall be shall comprise of three persons to be appointed by the parties.

**PC 47.1** List of potential DB members is: N/A

**PC 47.2** Appointment (if not agreed) to be made by: the London Court of International Arbitration

**PC 47.5** Delete "(a) For contracts with foreign contractors:"

**PC 47.5 (i)** The place of arbitration shall be London

**PC 47.5(b)** Delete this sub-clause in its entirety.

Two handwritten signatures in black ink. The first signature on the left is a stylized, cursive mark. The second signature on the right is more complex, with multiple overlapping strokes and a vertical line extending downwards.

## Appendix 1. Terms and Procedures of Payment

In accordance with the provisions of GC Clause 13 (Terms of Payment), the Employer shall pay the Contractor in the following manner and at the following times, on the basis of the Price Breakdown given in the section on Price Schedules. Payments will be made in the currencies quoted by the Bidder unless otherwise agreed between the Parties. Applications for payment in respect of part deliveries may be made by the Contractor as work proceeds.

### TERMS OF PAYMENT

#### Schedule No. 1. Plant and Equipment Supplied from Abroad

In respect of plant and equipment supplied from abroad, the following payments shall be made:

Ten percent (10%) of the total CIP amount as an advance payment against receipt of invoice and an irrevocable advance payment security for the equivalent amount made out in favor of the Employer. The advance payment security may be reduced in proportion to the value of the plant and equipment delivered to the site, as evidenced by shipping and delivery documents.

Eighty percent (80%) of the total or pro rata CIP amount upon Incoterm "CIP", upon delivery to the carrier within forty-five (45) days after receipt of documents.

Five percent (5%) of the total or pro rata CIP amount upon issue of the Completion Certificate, within forty-five (45) days after receipt of invoice.

Five percent (5%) of the total or pro rata CIP amount upon issue of the Operational Acceptance Certificate, within forty-five (45) days after receipt of invoice.

#### Schedule No. 2. Plant and Equipment Supplied from within the Employer's Country

In respect of plant and equipment supplied from within the Employer's country, the following payments shall be made:

Ten percent (10%) of the total EXW amount as an advance payment against receipt of invoice, and an irrevocable advance payment security for the equivalent amount made out in favor of the Employer. The advance payment security may be reduced in proportion to the value of the plant and equipment delivered to the site, as evidenced by shipping and delivery documents.

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Eighty percent (80%) of the total or pro rata EXW amount upon Incoterm "Ex-Works," upon delivery to the carrier within forty-five (45) days after receipt of invoice and documents.

Five percent (5%) of the total or pro rata EXW amount upon issue of the Completion Certificate, within forty-five (45) days after receipt of invoice.

Five percent (5%) of the total or pro rata EXW amount upon issue of the Operational Acceptance Certificate, within forty-five (45) days after receipt of invoice.

Schedule No. 3. Design Services

In respect of design services for both the foreign currency and the local currency portions, the following payments shall be made:

Ten percent (10%) of the total design services amount as an advance payment against receipt of invoice, and an irrevocable advance payment security for the equivalent amount made out in favor of the Employer.

Ninety percent (90%) of the total or pro rata design services amount upon acceptance of design in accordance with GC Clause 21 by the Project Manager within forty-five (45) days after receipt of invoice.

Schedule No. 4. Installation Services

In respect of installation services for both the foreign and local currency portions, the following payments shall be made:

Ten percent (10%) of the total installation services amount as an advance payment against receipt of invoice, and an irrevocable advance payment security for the equivalent amount made out in favor of the Employer. The advance payment security may be reduced in proportion to the value of work performed by the Contractor as evidenced by the invoices for installation services.

Eighty percent (80%) of the measured value of work performed by the Contractor, as identified in the said Program of Performance, during the preceding month, as evidenced by the Employer's authorization of the Contractor's application, will be made monthly within forty-five (45) days after receipt of invoice.

Five percent (5%) of the total or pro rata value of installation services performed by the Contractor as evidenced by the Employer's authorization of the Contractor's monthly applications, upon issue of the Completion Certificate, within forty-five (45) days after receipt of invoice.

Five percent (5%) of the total or pro rata value of installation services performed by the Contractor as evidenced by the Employer's authorization of the Contractor's monthly applications, upon issue of the Operational Acceptance Certificate, within forty-five (45) days after receipt of invoice.

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In the event that the Employer fails to make any payment on its respective due date, the Employer shall pay to the Contractor interest on the amount of such delayed payment at the rate of zero decimal six percent (0.6%) per month for period of delay until payment has been made in full.

#### PAYMENT PROCEDURES

The procedures to be followed in applying for certification and making payments shall be as follows:

##### **Payment Procedures**

The procedures to be followed in applying for certification and making payments shall be as follows:

##### **Monthly Payment Certificate**

The Contractor shall submit to the Project Manager, in the manner required by the Project Manager after the end of each month a statement showing the estimated total value of installation services properly executed and materials or goods for permanent works brought to Site up to the end of the previous month. The Contractor shall amend or correct his estimate as directed by the Project Manager and the latter shall not accept it until he is satisfied that it is fair and reasonable. With respect to the said materials and goods, no payment for them shall be made unless:-

- (vi) The materials are in accordance with the contract specifications;
- (vii) The materials have been delivered to Site and are properly stored and protected against loss, damage or deterioration;
- (viii) The Contractor's record of the requirements, orders, receipts and use of materials are kept in a form approved by the Project Manager, and such records are available for inspection by the Project Manager;
- (ix) The Contractor has submitted a statement of his cost of acquiring and delivering the materials and goods to the Site, together with such documents as may be required for the purpose of evidencing such cost;
- (x) The materials are to be used within a reasonable time.

The Contractor will be paid on the certificate of the Project Manager the amount due to him on account of the estimated total value of the installation services executed up to the end of the previous month together with such amount (not exceeding 75% of the invoice value) as the Project Manager may consider proper on account of materials and goods for permanent Work delivered by the Contractor on Site.

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Within 14 days after receiving a statement from the Contractor as aforesaid, and subject to the Contractor having made such further amendments and corrections as the Project Manager may require, the Project Manager shall issue a Certificate of Payment to the Employer showing the amount due, with a copy to the Contractor.

The Project Manager shall not unreasonably withhold certifying a Monthly Payment Certificate and where there is a dispute regarding an item for payment, the Project Manager may delete this disputed item from the Monthly Payment Certificate and certify the remainder for payment provided the said payment is in accordance with the preceding paragraph.

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## SUBSIDIARIES OF MAGAL SECURITY SYSTEMS LTD.

Below is a listing of Magal Security Systems Ltd.'s wholly-owned subsidiaries:

Subsidiary Name	Country/State of Incorporation/Organization
KOBB Inc.	United States (Delaware)
Magal B.V.	Netherlands
Magal Sisteme S.R.L.	Romania
Pranco Limited	Cyprus
Senstar Andina S.A.S	Colombia
SIS Inc.	United States (Delaware)
Senstar Inc.	United States (Delaware)
Senstar Stellar LA	Mexico
Senstar Limited	United Kingdom
Senstar Corp.	Canada
Defcon Technologies S.L.	Spain
Fidifull Finance B.V.	Netherlands
Senstar GmbH	Germany
JEE Investment A.G.	Switzerland
E.S.E. Ltd.	Israel

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER  
Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended**

I, Eitan Livneh, certify that:

1. I have reviewed this annual report on Form 20-F of Magal Security Systems Ltd.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;
4. The company's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the company and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting;
5. The company's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and the audit committee of the company's board of directors (or persons performing the equivalent function):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

Date: April 11, 2011

/s/Eitan Livneh \*

Eitan Livneh  
President and Chief Executive Officer

\* The originally executed copy of this Certification will be maintained at the Company's offices and will be made available for inspection upon request.



**CERTIFICATION OF CHIEF FINANCIAL OFFICER  
Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended**

I, Ilan Ovadia, certify that:

1. I have reviewed this annual report on Form 20-F of Magal Security Systems Ltd.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;
4. The company's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the company and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting;
5. The company's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and the audit committee of the company's board of directors (or persons performing the equivalent function):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

Date: April 11, 2011

/s/Ilan Ovadia \*

Ilan Ovadia

Senior Vice President – Finance, Chief Financial Officer and Secretary

\* The originally executed copy of this Certification will be maintained at the Company's offices and will be made available for inspection upon request.

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Magal Security Systems Ltd. (the "Company") on Form 20-F for the period ending December 31, 2010 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Eitan Livneh, Chairman of the Board of Directors of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/Eitan Livneh \*

Eitan Livneh  
President and Chief Executive Officer

Date: April 11, 2011

\* The originally executed copy of this Certification will be maintained at the Company's offices and will be made available for inspection upon request.

This certification accompanies this Annual Report on Form 20-F pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Such certification will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Exchange Act, except to the extent that the Company specifically incorporates it by reference

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Magal Security Systems Ltd. (the "Company") on Form 20-F for the period ending December 31, 2010 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Ilan Ovadia, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/Ilan Ovadia\*

Ilan Ovadia

Senior Vice President – Finance, Chief Financial Officer and Secretary

Date: April 11, 2011

\* The originally executed copy of this Certification will be maintained at the Company's offices and will be made available for inspection upon request.

This certification accompanies this Annual Report on Form 20-F pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Such certification will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Exchange Act, except to the extent that the Company specifically incorporates it by reference

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in the Registration Statements on Form S-8 (File Nos. 333-127340 and 333-164696) of our report dated April 11, 2011 with respect to the consolidated financial statements and schedule of Magal Security Systems Ltd. included in this Annual Report on Form 20-F for the year ended December 31, 2010 filed with the Securities and Exchange Commission.

Tel-Aviv, Israel  
April 11, 2011

/s/ Kost Forer Gabbay & Kasierer  
KOST FORER GABBAY & KASIERER  
A Member of Ernst & Young Global

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**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in the Registration Statements on Form S-8 (Nos. 333-127340 and 333-164696) of our report dated March 27, 2009, with respect to the financial statements of SENSTAR STELLAR LATIN AMERICA, S.A. DE C.V. as of December 31, 2008 and for the year ended December 31, 2008, which appears in this Annual Report on Form 20-F of Magal Security Systems Ltd. for the year ended December 31, 2010.

Mexico, D F  
April 11, 2011

/s/ Salles, Sáinz - Grant Thornton, S. C.  
Salles, Sáinz - Grant Thornton, S. C.

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