MODSYS INTERNATIONAL LTD.
CONSOLIDATED FINANCIAL STATEMENTS
AS OF DECEMBER 31, 2017

CONTENTS

The amounts are stated in thousand U.S dollars

REPORT OF INDEPENDENT AUDITORS

To the Stockholders
MODSYS INTERNATIONAL LTD.

Report on Financial Statements

We have audited the accompanying consolidated financial statements of ModSys International Ltd. (the "Company"), which comprise the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of operations, the consolidated statements of comprehensive income, the consolidated statements of changes in stockholders' equity, and the consolidated statements of cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, the results of their operations, the results of their comprehensive income, their changes of equity and their cash flows for each of the two years period ended December 31, 2017 in accordance with accounting principles generally accepted in the United States of America.

Ziv Haft.
Certified Public Accountants (Isr.)
BDO Member Firm

June 28, 2018

Ziv Haft
Certified Public Accountants (Isr.)
BDO Member Firm

MODSYS INTERNATIONAL LTD.
CONSOLIDATED BALANCE SHEETS

	December 31,	
	2017	2016
	(in thousands)	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	4,253	410
Restricted cash	4	254
Trade accounts receivable, net (Note 12A1)	1,818	2,306
Other current assets (Note 12A2)	203	237
Total current assets	6,278	3,207
LONG-TERM ASSETS:		
Property and equipment, net (Note 4)	32	33
Goodwill (Note 5)	14,157	14,157
Intangible assets and others, net (Note 6)	1,788	2,361
Total long term assets	15,977	16,551
Total assets	22,255	19,758

MODSYS INTERNATIONAL LTD.
CONSOLIDATED BALANCE SHEETS

	December 31,	
	2017	**2016**
	(in thousands)	
LIABILITIES AND EQUITY		
CURRENT LIABILITIES:		
Short-term bank credit and others (Note 8)	281	785
Accounts payable and accruals:		
Trade accounts payable	959	1,155
Deferred revenue	641	324
Other current liabilities (Note 12A3)	425	915
Total current liabilities	2,306	3,179
LONG-TERM LIABILITIES:		
Accrued severance pay, net (Note 7)	253	238
Loans from banks and others (Note 8)	2,994	2,022
Other non-current liabilities	-	18
Total long-term liabilities	3,247	2,278
Total liabilities	5,553	5,457
COMMITMENTS AND CONTINGENCIES (Note 9)		
Equity (Note 10):		
Share capital - Preferred shares of .04 NIS par value (authorized: December 31, 2017 and December 31, 2016 – 1,000,000 share; shares issued: December 31, 2017 – 583,200 shares and December 31, 2016 – 540,000 shares)	1,317	1,247
Share capital - ordinary shares of NIS 0.04 par value (authorized: December 31, 2017 and 2016 - 25,000,000 shares; shares issued: December 31, 2017 – 22,061,941 and December 31, 2016 - 19,086,159)	205	173
Additional paid-in capital	157,708	155,468
Accumulated other comprehensive loss	(1,537	(1,537)
Accumulated deficit	(137,784	(138,028)
Treasury shares – December 31, 2017 and 2016 – 33,239 shares	(1,821	(1,821)
ModSys International Ltd. Shareholders' Equity	18,088	15,502
Non-controlling interest	(1,386	(1,201)
Total equity	16,702	14,301
Total liabilities and equity	22,255	19,758

June 28, 2018		
Date of approval of financial statements	Scott Miller Chairman of the Board of Directors	Brandon Edenfield CEO

MODSYS INTERNATIONAL LTD.
CONSOLIDATED STATEMENTS OF OPERATIONS

	Year ended December 31,	
	2017	**2016**
	(in thousands, except earning/loss per share)	
Revenue:		
Services	5,483	9,212
Products	5,601	1,769
Total revenue	11,084	10,981
Cost of revenue	2,768	4,857
Gross profit	8,316	6,124
Research and development costs	1,556	2,053
Selling, general, and administrative expenses	4,945	4,263
Amortization of intangible assets and depreciation	587	632
Impairment of intangible assets	-	182
Impairment of goodwill	-	11,646
Total operating expenses	7,088	18,776
Operating income (loss)	1,228	(12,652)
Financial expenses, net	1,232	312
Loss before taxes on income	(4)	(12,964)
Taxes on income	9	22
Total comprehensive income (loss)	(13)	(12,986)
Less: Net Loss attributable to non-controlling interest	(185)	(806)
Net Profit (loss) attributable to ModSys International Ltd. shareholders	172	(12,180)
Earning (loss) per share - basic and diluted:		
Basic:		
Attributable to the shareholders	0.0048	(0.66)
Total shares	21,049,462	18,657,653
Diluted:		
Attributable to the shareholders	0.0045	(0.66)
Weighted average shares outstanding, basic and diluted	22,281,816	18,657,653

MODSYS INTERNATIONAL LTD.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	Share capital								
	Number of ordinary shares	**Par value-ordinary shares**	**Preferred shares**	**Additional paid-in capital**	**Accumulated other comprehensive loss**	**Cost of Company Shares held by subsidiaries**	**Retained earnings (Accumulated deficit)**	**Non-controlling interest**	**Total**
Balance at January 1, 2016	18,568,802	172	1,164	154,882	(1,537)	(1,821)	(125,765)	(422)	26,673
Net loss	-	-	-	-	-	-	(12,180)	(806)	(12,986)
Stock-based compensation	-	-	-	337	-	-	-	27	364
Dividend in kind	-	-	83	-	-	-	(83)	-	-
Issuance of ordinary shares	378,788	1	-	249	-	-	-	-	250
Issued RSUs for SBC	138,569	*	-	*	-	-	-	-	-
Balance at December 31, 2016	**19,086,159**	**173**	**1,247**	**155,468**	**(1,537)**	**(1,821)**	**(138,028)**	**(1,201)**	**14,301**
Net income (loss)	-						172	(185)	(13)
Issuance of ordinary shares, net	1,884,340	21	-	1,229	-	-	-	-	1,250
Warrants exercised	1,091,442	11	-	-	-	-	-	-	11
Warrants granted	-	-	-	1,011	-	-	-	-	1,011
Issuance of preferred shares, net	-	-	70	-	-	-	(70)	-	-
Stock-based compensation	-	-		-	-	-	142	-	142
Balance at December 31, 2017	**22,061,941**	**205**	**1,317**	**157,708**	**(1,537)**	**(1,821)**	**(137,784)**	**(1,386)**	**16,702**

* Less than 1 thousand.

MODSYS INTERNATIONAL LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	December 31,	
	2017	**2016**
	(in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	(13)	(12,986)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	607	866
Intangible assets and goodwill impairment	-	11,828
Increase in accrued severance pay, net	15	6
Stock–based compensation and RSU termination	142	364
Issue of warrants to shareholders	1,011	-
Interests on loans	36	-
Changes in operating assets and liabilities:		
Decrease (increase) in trade receivables	488	(286)
Decrease (increase) in other assets	21	(117)
Increase (decrease) in trade payables	(196)	151
Decrease in other liabilities and deferred revenue	(191)	(657)
Net cash provided (used) in operating activities	1,920	(831)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(20)	(21)
Net cash provided (used) in investing activities	(20)	(21)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Short term bank credit	(527)	100
Issuance of ordinary shares, net	1,250	250
Warrants exercised	11	-
Long term loan	959	(317)
Net cash provided by financing activities	1,693	33
NET CASH INCREASE (DECREASE) IN CASH, CASH EQUVIALETS AND RESTRICTED CASH	3,593	(819)
Cash, Cash Equivalents and restricted cash at Beginning of the period	664	1,483
Cash, Cash Equivalents and restricted cash at end of the period	4,257	664
Cash paid during the year for:		
Interest	147	114

MODSYS INTERNATIONAL LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - General:

The Company:

ModSys International Ltd. (together with its subsidiaries, the "Company", or "Modern Systems") is an Israeli corporation, which operates in one operating segment of information technology modernization solutions.

Modern Systems develops and markets enterprise legacy migration solutions and provides tools and professional services to international markets through several entities including wholly-owned or majority-owned subsidiaries located in: the United States, the United Kingdom, Italy, Romania and Israel. These technologies and services allow business to migrate from their legacy mainframe and distributed information technology infrastructures to modern environments and programming languages.

Note 2 - Significant Accounting Policies:

A. Basic:

The significant accounting policies, applied on a consistent basis, are as follows:

1. Accounting Principles:

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

2. Functional Currency:

The currency of the primary economic environment in which the operations of the Company and its subsidiaries are conducted is the U.S. dollar ("USD"). In addition, a substantial portion of the Company's revenue and costs are incurred in USD. Thus, the functional and reporting currency of the Company is considered to be the USD. The functional currency of all subsidiaries is the USD therefore there is no unrealized gain/loss.

Non-monetary transactions denominated in currencies other than the USD are measured and recorded in USD at the exchange rates prevailing at transaction date. Monetary assets and liabilities denominated in currencies other than the USD are translated at the exchange rate on the balance sheet date. Transaction gain or losses on foreign currency translation are recorded in consolidated statement of operations.

3. Use of Estimates and Assumptions in the Preparation of the Financial Statements:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates.

B. Principles of Consolidation:

The consolidated financial statements include the accounts of the Company and its subsidiaries in which it has a controlling interest. Acquisition of subsidiaries is accounted for under the acquisition method. All intercompany balances and transactions have been eliminated upon consolidation. Non-controlling interests are included in equity.

Note 2 - Significant Accounting Policies (Cont.):

C. Cash and Cash Equivalents:

Cash equivalents are considered by the Company to be highly-liquid investments, including inter-alia, short-term deposits with banks, which do not exceed maturities of three months at the time of deposit and which are not restricted.

D. Allowance for Doubtful Accounts:

The Company establishes an allowance for doubtful accounts to ensure trade and financing receivables are not overstated due to uncollectability. The allowance for doubtful accounts was based on specific receivables, which their collection, in the opinion of Company's management, is in doubt. Trade receivables are charged off in the period in which they are deemed to be uncollectible.

E. Property and Equipment, Net:

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

	%
Computers and peripheral equipment	20-33 (mainly 33)
Office furniture and equipment	6-15 (mainly 7)
Leasehold improvements	Over the shorter of lease term or the life of the assets
Motor vehicles	15

F. Impairment of Long-Lived Assets:

The Company evaluates long-lived assets with definite lives for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. The Company assesses the recoverability of the assets based on the undiscounted future cash flow and recognizes an impairment loss when the estimated undiscounted future cash flow expected to result from the use of the asset plus the net proceeds expected from disposition of the asset, if any, are less than the carrying value of the asset. When the Company identifies an impairment, it reduces the carrying amount of the asset to its estimated fair value based on a discounted cash flow approach or, when available and appropriate, to comparable market values. For the year ending December 31, 2017, no impairment losses had been identified.

G. Goodwill and purchased intangible assets:

Goodwill and purchased intangible assets have been recorded as a result of acquisitions. Goodwill represents the excess of the purchase price in a business combination over the fair value of net tangible and intangible assets acquired.

Goodwill is not amortized, but rather is subject to an annual impairment test. The Company is one operating segment and one reporting unit related to its overall information technology modernization. The goodwill impairment tests are conducted in two steps. In the first step, the Company determines the fair value of the reporting unit. If the net book value of the reporting unit exceeds its fair value, the Company would then perform the second step of the impairment test which requires allocation of the reporting unit's fair value of all of its assets and liabilities in a manner similar to an acquisition cost allocation, with any residual fair value being allocated to goodwill. The implied fair value of the goodwill is then compared to the carrying value to determine impairment, if any.

Note 2 - Significant Accounting Policies (Cont.):

Generally, the company determines the fair value of the reporting unit using the market approach which is based on the market capitalization by using the share price of the Company in the stock market and an appropriate control premium.

As of the reporting date, the market capitalization of the Company was higher than the net book value of the reporting unit therefore no impairment was recorded for 2017.

Intangible assets that are not considered to have an indefinite useful life are amortized using the straight-line basis over their estimated useful lives of between 10 months to 9 years (for impairment of intangible assets see also Note 1F)

On completion of our merger on December 1, 2014 with Sophisticated Business Systems, Inc., a Texas corporation doing business as "Ateras" the fair value purchase price allocation from this acquisition resulted in the Company recording approximately 5.2 million in technology intangible assets. The Company subjected the value of these intangible assets to an annual impairment test as of December 31, 2016. In 2016, the impairment test indicated that the fair value of these intangible assets at this time was approximately 2.3 million, net of amortization, causing the Company to record an impairment of approximately 182 thousand. In 2017, no additional impairment was deemed necessary.

H. Research and Development Costs:

Research and development costs are charged to the statement of income as incurred. ASC No. 985, "Software", requires capitalization of certain software development costs subsequent to the establishment of technological feasibility.

Based on the Company's product development process, technological feasibility is established when detailed program design is completed and verified. Costs incurred by the Company between completion of detailed program design and the point at which the products are ready for general release, have been insignificant. Therefore, all research and development costs have been expensed.

I. Stock-based Compensation:

In the past two years, all of the stock-based compensation awards were of restricted stock units ("RSUs"). RSUs are valued based on the market value of the underlying stock at the date of grant since the restriction is imposed during the vesting period. The Company also has a stock option plan. Stock option awards are measured and recognized as compensation expense based on estimated fair values on the date of grant using the Black-Scholes option-pricing model. This option pricing model requires that the Company makes several estimates, including the option's expected life and the price volatility of the underlying stock.

The Company recognizes the estimated fair value of option-based awards and RSUs, net of estimated forfeitures, as stock-based compensation costs using the accelerated vesting method. For the years ended December 31, 2016 and 2015 the Company recorded stock-based and RSUs compensation costs in the amount of $364 and $426 thousand, respectively. On December 31, 2016, the total unrecognized stock-based and RSUs compensation costs amounted to 396 thousand, and were expected to be recognized over the next 3 years.

On April 10, 2017, the Board of Directors elected to terminate the RSU program. See Note 10A below.

Note 2 - Significant Accounting Policies (Cont.):

J. Revenue Recognition:

Revenue derived from direct software license agreements are recognized in accordance with FASB ASC Topic 985 “Software” (“ASC 985”), upon delivery of the software, when collection is probable, the license fee is otherwise fixed or determinable and persuasive evidence of an arrangement exists.

The Company recognizes revenue from consulting fees based on the number of hours performed. Revenue from maintenance services are recognized ratably over the term of the maintenance period.

When a project involves significant production, modification, customization of software, or delivery of service, that are essential to the fundamentals of the software, revenue is recognized according to the percentage of completion method in accordance with the provisions of FASB ASC Topic 605-35. Under this method, estimated revenue is generally recognized based on costs incurred to date, as a percentage of total updated estimated costs. The Company recognizes contract losses, if any, in the period in which they first become evident. There are no rights of return, price protection or similar contingencies in the Company’s contracts.

On December 31, 2016, approximately $1.5 million of the accounts receivable balance was unbilled due to the customer’s payment terms. On December 31, 2017, approximately $490 thousand of the accounts receivable balance was unbilled due to the customer’s payment terms.

The product revenue line item includes revenue generated from stand-alone software products. In the services revenue line item, the Company includes revenue generated from maintenance and consulting fees and revenue accounted for pursuant to ASC 605-20. Tax collected from customers and remitted to government authorities (including VAT) are presented in the income statement on a net basis.

K. Income Taxes:

Deferred taxes are determined utilizing the “asset and liability” method, whereby deferred tax asset and liability account balances are determined based on differences between financial reporting and the 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, when it’s more likely than not that deferred tax assets will not be realized in the foreseeable future. Deferred tax liabilities and assets are classified as current or non-current based on the expected reversal dates of the specific temporary differences.

The Company applied ASC Topic 740-10-05, Income Tax, which provides guidance for recognizing and measuring uncertain tax positions, it prescribes a threshold condition that a tax position must meet for any of the benefits of the uncertain tax position to be recognized in the financial statements. It also provides accounting guidance on derecognizing, classification and disclosure of these uncertain tax positions. The Company’s policy on classification of all interest and penalties related to unrecognized income tax positions, if any, is to present them as a component of income tax expense.

L. Earning /loss Per Share:

Basic net earning/loss per share is computed based on the weighted average number of ordinary shares outstanding during each year (including fully vested RSUs), net of treasury shares. Diluted earnings 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 (see also Note 12C).

Note 2 - Significant Accounting Policies (Cont.):

M. Concentration of credit risks:

Financial instruments that have the potential to expose the Company to credit risks are mainly cash and cash equivalents, bank deposit accounts, and trade receivables.

The Company holds cash and cash equivalents, and deposit accounts at large banks in Israel, the United States, and Europe, thereby substantially reducing the risk of loss.

The Company performs ongoing credit evaluations of its customers for the purpose of determining the appropriate allowance for doubtful accounts and generally does not require collateral. An appropriate allowance for doubtful accounts is included in the accounts.

N. Fair value measurement:

The Company measures fair value and discloses fair value measurements for financial and non-financial assets and liabilities. Fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The accounting standard establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2: Observable prices that are based on inputs not quoted on active markets, but corroborated by market data.

Level 3: Unobservable inputs are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

In determining fair value, the Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible and considers counterparty credit risk in its assessment of fair value.

O. Comprehensive loss:

Comprehensive loss includes only net income.

P. Treasury Shares:

In the past, the Company repurchased its ordinary shares from time to time on the open market and they are currently held as treasury stock. The Company presents the cost to repurchase treasury stock as a reduction of shareholders' equity. When treasury shares are used as consideration for share based payment the reduction is based on average purchase cost.

Note 2 - Significant Accounting Policies (Cont.):

Q. Recently Issued Accounting Pronouncements

In November 2016, the FASB issued Accounting Standards Update (ASU) 2016-18. This updates provides guidance on the classification and presentation of changes in restricted cash or restricted cash equivalents in the statement of cash flows under Topic 230, Statement of Cash Flows. The amendments are effective for reporting periods (interim and annual) beginning after December 15, 2017, with early adoption permitted. The amendments will be applied retrospectively to each period presented.

In July 2017, the FASB issued Accounting Standards Update, or ASU, No. 2017-11. The amendments in part I of the ASU change the classification analysis of certain equity-linked financial instruments (or embedded derivatives) with down round features. When determining the classification of an instrument as a liability or as equity, entities will be required to disregard down round features upon the assessment of whether the instrument is indexed to the entity's own stock. Entities that provide earnings per share, or EPS, data will adjust their basic EPS calculation for the effect of the feature when it is triggered (i.e. upon the occurrence of an event that results in the reduction of the strike price of the related equity-linked financial instrument), and will recognize the effect of the feature within equity. Part II of this guidance replaces the indefinite deferral of certain provisions of ASC Topic 480, distinguishing liabilities from equity, mandatorily redeemable non-controlling interests and mandatorily redeemable financial instruments of non-public entities with a scope exception.

The amendments in part I of the ASU should be applied either retrospectively to outstanding financial instruments with a down round feature by means of a cumulative-effect adjustment to the statement of financial position as of the beginning of the first reporting period in which the guidance is effective or retrospectively for each prior reporting period presented. These amendments are effective for reporting periods (interim and annual) beginning after December 15, 2018, with early adoption permitted. The Company is currently assessing the potential impact of this ASU on its consolidated financial statements.

In May 2017, the FASB issued (ASU) No. 2017-09, which clarifies when an entity should account for a change to the terms or conditions of a share-based payment award as a modification. Under the ASU, modification accounting is required if the fair value, vesting conditions or classification of the award changes because of the change in terms or conditions. The amendments in this update will be applied prospectively to an award modified on or after the effective date. The amendments are effective for reporting periods (interim and annual) beginning after December 15, 2017.

In January 2017, the FASB issued ASU No. 2017-04, which eliminates Step 2 from the goodwill impairment test. The goodwill impairment test will be performed by comparing the fair value of a reporting unit with its carrying amount. An impairment charge should be recognized for the amount by which the carrying amount exceeds the reporting unit's fair value. However, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. In addition, income tax effects from any tax deductible goodwill on the carrying amount of the reporting unit should be considered when measuring the goodwill impairment loss, if applicable. The amendments also eliminate the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment. The amendments should be applied on a prospective basis. For public business entities that are SEC file with the Securities and Exchange Commission, or the SEC, the amendments are effective for annual or any interim impairment tests in reporting periods beginning after December 15, 2019, with early adoption permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company is currently assessing the potential impact of this ASU on its consolidated financial statements.

Note 2 - Significant Accounting Policies (Cont.):

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)." Under the new standard, revenue is recognized when a customer obtains control of promised goods or services and is recognized in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, the standard requires disclosure of the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The impact of the new revenue standard relates to the arrangements that include software licenses bundled with maintenance and support. The standard will apply prospectively commencing from January 2018, the Company will recognize revenue attributable to these software licenses ratably over the term of the arrangement .Under Topic 606, the requirement to have VSOE for undelivered elements to enable the separation of revenue for the delivered software licenses is eliminated, the Company is recognizing income allocated to software license as revenue upon delivery.

Note 3 - Fair Value Measurement:

Items carried at fair value as of December 31, 2017 and 2016 are classified in the table below in one of the three categories described in Note 1N

	Fair value measurements using input type December 31, 2017			
	Level 1	**Level 2**	**Level 3**	**Total**
Cash and cash equivalents	4,253	-	-	4,253
Restricted cash	4	-	-	4
	4,257	-	-	4,257

	Fair value measurements using input type December 31, 2016			
	Level 1	**Level 2**	**Level 3**	**Total**
Cash and cash equivalents	410	-	-	410
Restricted cash	254	-	-	254
Intangible Assets	-	-	2,361	2,361
Goodwill	-	-	14,157	14,157
	664	-	16,518	17,182

Nonrecurring Fair Value Measurements- 2016

The Company's goodwill is measured at fair value on a nonrecurring basis when impairment indicators are present. The categorization of the framework used to estimate the fair value is considered a Level 3, due to the subjective nature of the unobservable inputs used to determine the fair value. The goodwill is adjusted to fair value only when the carrying values exceed its fair value. Based on the results of the Company's annual impairment tests completed during the year ended December 31, 2017, the Company determined that goodwill was not impaired.

MODSYS INTERNATIONAL LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 4 - Property and Equipment, Net:

Composition of property and equipment, grouped by major classifications:

	December 31,	
	2017	2016
	(in thousands)	
Cost:		
Computers and peripheral equipment	4,610	4,590
Office furniture and equipment	411	411
Leasehold improvements	432	432
Motor vehicles	17	17
	5,470	5,450
Accumulated Depreciation:		
Computers and peripheral equipment	4,582	4,562
Office furniture and equipment	407	406
Leasehold improvements	432	432
Motor vehicles	17	17
	5,438	5,417
	32	33

Note 5 - Goodwill:

The change in the carrying amount of goodwill for the years ended December 31, 2017 and 2016 is as follows:

	December 31,	
	2017	2016
	(in thousands)	
Balance as of January 1		
Goodwill	67,618	67,618
Accumulated impairment losses at the beginning of the period	(53,461)	(41,815)
	14,157	25,803
Changes during the year		
Goodwill impairment*	-	(11,646)
Balance as of December 31		
Goodwill	67,618	67,618
Accumulated impairment losses at the end of the period	(53,461)	(53,461)
	14,157	14,157

*see also Note 1G

Note 6 - Intangible Assets, Net:

	Useful life (years)	December 31, 2017	December 31, 2016
		(in thousands)	
Original amount:			
Technology	5	51,494	51,494
Customer related and backlog	0.8 to 9	5,313	5,313
Others		27	14
		56,834	56,821
Accumulated Depreciation:			
Technology**		49,733	49,147
Customer related and backlog		5,313	5,313
		55,046	54,460
		1,788	2,361

** Includes impairment to amortization expense of $0 thousand for 2017 and $182 thousand for 2016. (See also Note 1G).

Note 7 - Accrued Severance Pay, Net:

A. Accrued Liability:

The Company may be liable for severance pay to its employees pursuant to the applicable local laws prevailing in the respective countries of employment and employment agreements. For Israeli employees, the liability is partially covered by individual managers' insurance policies under the name of the employee, for which the Company makes monthly payments. The Company may make withdrawals from the managers' insurance policies only for the purpose of paying severance pay.

U.S. employees are eligible to participate in a 401(k) retirement plan. Under the plan, employees may elect to defer a portion of their salary from taxes and invest it for retirement. The Company may, on a discretionary basis, make matching contributions to the employee deferrals. There was a discretionary contribution of $0 and $0 thousand in 2017 and 2016, respectively.

The amounts accrued and the amounts funded with managers' insurance policies are as follows:

	December 31, 2017	December 31, 2016
	(in thousands)	
Accrued severance pay	692	593
Amount funded	(439)	(355)
	253	238

Note 7 - Accrued Severance Pay, Net (Cont.):

B. Expenses:

The expenses related to severance pay for the years ended December 31, 2017 and 2016, were $60 and $ 91 thousand, respectively.

Note 8 - Loans from Banks and Others:

A. Credit Facility

In September 2014, the Company entered into an amendment to the Company's existing loan agreement with Comerica Bank to: (i) increase the non-formula revolving line up to the amount of 2 million backed by guarantees; (ii) increase the borrowing base revolving line amount up to 1.5 million upon the closing of the Ateras merger; and (iii) extend the loan maturity date to December 31, 2015. The amendment has a financial covenant for a minimum liquidity ratio. The Company's obligations under the amendment are secured by a security interest in the Company's copyrights, trademarks, and patents. The remaining substantive provisions of the credit facility were not materially changed by this amendment.

In May 2015, the Company entered into an additional amendment to the Company's existing loan agreement with Comerica Bank to among other things: (i) extend the maturity date of the non-formula revolving line and the revolving line to June 30, 2016; (ii) require us to raise new equity, on terms and from investors satisfactory to the lender, of not less than 2.5 million on or before December 31, 2015; and (iii) increase the number of trade accounts for which the concentration limit is not applicable.

On March 16, 2016 , the Company entered into the Fifth Amendment to the existing loan agreement with Comerica Bank to: (i) waive the liquidity covenant violations of September and December 2015; (ii) extend the maturity date of the non-formula revolving line and the revolving line to June 30, 2017; (iii) amend the definition of eligible accounts receivable; (iv) waive the equity event of 2.5 million on or before December 31, 2015; (v) add a new six month rolling EBITDA covenant and (vi) limit the amount of cash transfer to the parent company. The remaining substantive provisions of the credit facility were not materially changed.

On August 4, 2016, the Company entered into the Sixth Amendment to the existing loan agreement with Comerica Bank to: (i) extend the maturity date of the non-formula revolving line and the revolving line to July 1, 2018; (ii) amend the EBITDA covenant requirements; and (iii) change the definition of liquidity to include a requirement to have a minimum balance of cash in Comerica Bank of 250 thousand at the end of each month. The remaining substantive provisions of the credit facility were not materially changed by this amendment.

On February 15, 2017, the Company entered into the Seventh Amendment to the existing loan agreement with to: (i) increase the amount of credit available on the non-formula line to 3.0 million; (ii) extend the maturity date of the non-formula revolving line and revolving line to February 15, 2019; (iii) amend the EBITDA covenant requirements; (iv) decrease the revolving line amount of credit available to 1.0 million from 1.5 million; and (iv) amend the definition of a new equity event.

Note 8 - Loans from Banks and Others (Cont.):

As of December 31, 2017, the Company had borrowed $2.9 million against our non-formula revolving line and 0 thousand against the revolving line. The principal terms of the agreement are as follows:

- non-formula revolving line in the amount up to 3.0 million backed by a guarantee from two of the major shareholders;
- revolving line (accounts receivable based) loan in the amount up to 1.0 million;
- both the non-formula revolving line and revolving line loan are at market based interest rates based on Prime + a margin; and
- financial covenant for a minimum bank debt liquidity coverage ratio, calculated as a ratio of liquidity to all indebtedness, other than indebtedness that is guaranteed, to the bank.

B. Composition:

	Average interest rate as of December 31, 2017	Linkage basis	December 31, 2017	December 31, 2016
			Total long-term liabilities net of current portion	
	%		(in thousands)	
Loan from bank	4.25		2,994	2,523
Related party promissory note	2.00		220	220
Ministry of Production in Italy (Note 9 A3)	0.87	€	36	64
Current portion			(256)	(785)
Long term portion			2,994	2,022

C. Long-term Loans from banks and Others are due as follows:

	December 31, 2017	December 31, 2016
	(in thousands)	
First year (current portion)	256	785
Second year	2,994	32
Third year	-	1,990
Fourth year and thereafter	-	-
Total	3,250	2,807

Note 9 - Commitments and Contingencies:

A. Commitments

1. **Lease.** The Company leases its offices, vehicles and, other equipment under various operating lease agreements. Rent expenses for the years ended December 31, 2016 and 2015 were 319 and 345 thousand, respectively. Aggregate minimum rental commitments under non-cancelable leases as of December 31, 2017 were as follows:

	Office Facilities	Vehicles, Equipment, and Other
	(in thousands)	
Fiscal 2018	214	32
Fiscal 2019	95	32
Fiscal 2020	39	-
Fiscal 2021	26	-
	373	64

2. **Israel's Office of the Chief Scientist.** One of the Company's subsidiaries has entered into agreements with Israel's Office of the Chief Scientist, or OCS. This subsidiary is obliged to pay royalties to the OCS at a rate of 18pt on sales of the funded products, up to 100% of the USD-linked grant received in respect of these products from the OCS. As of December 31, 2017, the contingent liability that was not recognized amounted to $ 206 thousand.

3. **Ministry of Production in Italy**. In July 2007, the Company's subsidiary, Blue Phoenix I-Ter S.R.L. ("I-Ter"), received an amount of 585 thousand from the Ministry of Production in Italy for I-Ter's Easy4Plan product. Easy4Plan is a workflow management tool designed for ISO9000 companies. 36.5% of the funds received constitute a grant, and the remaining 63.5%, is a 10-year loan to be repaid by I-Ter in annual installments until September 2018. The loan bears a minimal annual interest of 0.87% and is linked to the euro. As of December 31, 2017, the remaining loan balance was 36 thousand.

B. Contingencies

The Company evaluates estimated losses for indemnifications due to product infringement under FASB Topic ASC 450 "Contingencies". At this time, it is not possible to determine the maximum potential amount under these indemnification clauses due to lack of prior indemnification claims and the unique facts and circumstances involved in each particular agreement. Such indemnification agreements may not be subject to maximum loss clauses. Historically, the Company has not incurred costs as a result of obligations under these agreements and has not accrued any liabilities related to such indemnification obligations in the Company's financial statements.

Note 10 - Equity:

A. Share Capital:

The Company's shares began trading in the United States on the NASDAQ Global Market on January 31, 1997 under the symbol "BPHX.". In December 2014, in connection with a change of our corporate name, the symbol was changed to "MDSY." In January 2016, the Company moved to the NASDAQ Capital Market under the symbol "MDSY."

Note 10 - Equity (Cont.):

On April 24, 2017, Form 25 was file with the Securities and Exchange Commission as notification for ModSys International Ltd's removal from trading on The NASDAQ Stock Market. Trade simultaneously began on The OTC Market's Pink Sheets.

On May 5, 2017, Form 15 was filed with the Securities and Exchange Commission as notification ModSys International Ltd has terminated (or suspended) its duty to file reports under Section 13 and 15(d) of the SEC Act of 1934.

In addition to the above decisions, on April 10, 2017 the Board elected to terminate the restricted share unit (RSU) program which was due to expire in July 2017. All employees who had earned shares of ordinary stock through the employee compensation plan were paid their vested stares earned at either $1.00 per share. The previous C.E.O. was paid $.75 per share as agreed to in his Stock Repurchase Agreement..

As part of the above decision, the company paid the following payments:

	Dec. 31, 2017
	(in thousands)
Exercise of Employee Options	$ 243
Legal Fees	30
	$ 273

On November 25, 2015, the Company entered into a Securities Purchase Agreement (the "Purchase Agreement") with Columbia Pacific Opportunity Fund, LP, Prescott Group Aggressive Small Cap Master Fund and Mindus Holdings, Ltd. (the "Investors"), providing for the issuance in a private placement to the Investors thereunder an aggregate amount of (1) 500,000 preferred shares and (2) warrants to purchase an aggregate of 250,000 ordinary shares of the Company. These warrants have an exercise price of $0.01 per share, and may be exercised in whole or part at any time for two years after issuance. The preferred shares carry an 8% per annum cumulative dividend payable in kind by additional preferred shares, calculated based on amount of $2.00 per share, subject to adjustment for stock splits, combinations, recapitalizations and the like. The preferred shares are convertible into the Company's ordinary shares on a one-to-one basis at the option of the holder. Should the volume weighted average price of the ordinary shares be $5.00 or more for ten consecutive trading days at any time two years from the date of issuance, the preferred shares will be automatically converted into ordinary shares at the adjusted $2.00 share price. Upon any liquidation, dissolution, or winding up of the Company, whether voluntary or involuntary, the preferred shares are entitled to a preferential payout of $3.00 per share.

Concurrent with the closing of the purchase of the preferred shares and warrants, the Company issued 625,000 ordinary shares to Prescott Group Aggressive Small Cap Master Fund pursuant to the Amended and Restated Securities Purchase Agreement dated as of November 22, 2013 between the Company and Prescott Group Aggressive Small Cap Master Fund, as if such sale and issuance had occurred prior to November 22, 2015. This was approved by the Company's shareholders on December 29, 2015.

On December 29, 2015, the Company's shareholders also approved the issuance of 45,082 warrants for our ordinary shares with an exercise price of $0.01 per share for an amendment to a promissory note. Fifty percent (50%) of these warrants vested on issuance while the remaining 50% vested on February 24, 2016. At the same shareholder meeting, the shareholders approved the issuance of 409,837 warrants for the Company's ordinary shares with an exercise price of $0.01 per share for the issuance of guarantees of our term note with Comerica Bank.

Note 10 - Equity (Cont.):

Fifty percent (50%) of these warrants vested on issuance while the remaining 50% vested on February 24, 2016.

The fair value of these warrants was determined to be $982,625 as of December 31, 2015 and is considered an expense of the financing.

On December 29, 2016, the Company entered into a Share Purchase Agreement with Prescott Group Aggressive Small Cap Master Fund (Prescott), providing for the issuance to Prescott in a private placement of 378,788 ordinary shares at a purchase price of $0.66 per ordinary share, for total proceeds to the Company of $250 thousand. The issuance and sale of the shares occurred on December 29, 2016.

Also on December 29, 2016, in connection with the preferred share transaction in 2015, the Company issued 40,000 preferred shares to Columbia Pacific Opportunity Fund, Prescott Group Aggressive Small Cap Master Fund an Mindus Holdings in accordance with the rights, preferences and privileges of the preferred shares issued in the 2015 private placement. The preferred shares carry an 8% per annum cumulative dividend payable in kind by additional preferred shares, subject to adjustment for stock splits, combinations, recapitalizations and the like.

On February 14, 2017, the Company entered into two Share Purchase Agreements with Columbia Pacific Opportunity Fund, LP, providing for the issuance of ordinary shares in a private placement. The first Share Purchase Agreement is for the issuance of 757,575 ordinary shares of the Company, par value NIS 0.04 per share, at a price equal to $0.66 per share amounting to for aggregate purchase price of $500,000. The closing of the First Agreement took place on April 3, 2017. In addition, the Company entered in to a second Share Purchase Agreement (“Second Agreement”) for the issuance of 757,575 ordinary shares of the Company, par value NIS 0.04 per share, at a price equal to $0.66 per share amounting for an aggregate purchase price of $500,000. The closing of the Second Agreement took place on July 20, 2017.

Also on February 15, 2017, the Company entered into the Seventh Amendment to the existing loan agreement with Comerica Bank to: (i) increase the amount of credit available on the non-formula line to 3.0 million; (ii) extend the maturity date of the non-formula revolving line and revolving line to February 15, 2019; (iii) amend the EBITDA covenant requirements; (iv) decrease the revolving line amount of credit available to 1.0 million from 1.5 million; and (iv) amend the definition of a new equity event.

In consideration of the increased line of credit from 2.0 million to 3.0 million described above as part of the Amendment, the Company agreed to grant warrants to purchase 378,788 ordinary shares to Prescott Group Aggressive Small Cap Master Fund in exchange for extending a guaranty for 2017. In addition, the Company agreed to grant warrants to purchase 735,294 ordinary shares to Columbia Pacific Opportunity Fund, LP and 441,176 ordinary shares to Prescott Group Aggressive Small Cap Master Fund in exchange for the guaranty of the Existing Agreement for 2016 and 2017. Each of the warrants has an exercise price of 0.01 per share and has a three-year term from the date of grant. It was determined the fair value of these warrants to be $1,010,918 which was recorded as Finance Expense against the Company’s Additional Paid-in Capital.

356,100 of the 2015 warrant issuance and 735, 294 of the 2017 warrant issuance were exercised in April 2017 by Columbia Pacific Opportunity Fund, LP.

Note 10 - Equity (Cont.):

As of December 31, 2017, the following warrants remain unexercised.

Investor	Unexercised Warrant	Expiration
Prescott Group Aggressive Small Cap Master Fund	253,689	December 2018
Prescott Group Aggressive Small Cap Master Fund	819,964	December 2020
Mindus Holdings, Ltd.	95,082	December 2018
	1,168,735	

On April 10, 2017, the Company entered into a Share Purchase Agreement with Prescott Group Aggressive Small Cap Master Fund (Prescott), providing for the issuance to Prescott in a private placement of 378,788 ordinary shares at a purchase price of $0.66 per ordinary share, for total proceeds to the Company of 250 thousand. The issuance and sale of the shares occurred on May 9, 2017

As of December 31, 2017, the Company holds a total of 33,239 of its shares in treasury with a value of $1.8 million. All of the Company's ordinary shares have equal voting rights. However, under applicable Israeli law, the shares held by the Company have no voting rights and, therefore, are excluded from the number of its outstanding shares. Since 2010, the Company uses these treasury shares from time to time for the issuance of shares pursuant to exercise of options and vested RSUs to meet the Company's ordinary share requirements for its stock benefit plans. In March 2008, the board of directors approved two buy-back programs. Under the buy-back programs, the Company may purchase its shares from time to time, subject to market conditions and other relevant factors affecting the Company. In 2009, the Company repurchased 11,249 of its shares for an aggregate amount of $1.7 million under the buy-back programs.

B. Share Options:

1. **Employee Share Option Plans:**

In 1996, the Company adopted the 1996 Share Option Plan. Pursuant to the 1996 Share Option Plan, as amended, the Company reserved 1,050,000 ordinary shares for issuance to directors, officers, consultants and employees of the Company and its subsidiaries. The exercise price of the options granted under the 1996 Share Option Plan ranges from $1.80 to $20. As of December 31, 2017, 474,023 stock options remain available for future awards.

Under the 1996 Share Option Plan, unless determined otherwise by the board, options vest over a three to four years period from the date of grant and expire 10 years after grant date. Unvested options are forfeited 30-90 days following termination of employment. Any options that are forfeited before expiration become available for future grants.

In 2017, 300,000 options granted under the 1996 Share Option Plan with exercise price of $1.80 were forfeited. As of December 31, 2017 there were no remaining Options outstanding.

MODSYS INTERNATIONAL LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 10 - Equity (Cont.):

The following table summarizes information about share options outstanding and exercisable as of December 31, 2017:

	2017		2016	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Options outstanding at the beginning of year	300,000		300,000	1.80
Changes during the year:				
Forfeited/Cancelled	(300,000)		-	
Options outstanding at end of year	0		300,000	
Options exercisable at year-end	0		300,000	

2. Restricted Share Units (RSU):

In 2007, the Company adopted the 2007 Award Plan (RSU plan). In 2016 and 2015, under the RSU plan, as amended, the Company granted 198,000 and 263,000 RSUs, respectively. Under the RSU plan, unless determined otherwise by the board of directors, RSUs vest over a three years period from the date of the grant. There were no RSUs approved for immediate vesting on grant date in 2017 or 2016.

On April 10, 2017 the Board of Directors elected to terminate the RSU plan due to expire in July of 2017. As a result, all outstanding RSU were repurchased by the Company. All ungranted shares held in reserve were released.

Data related to the restricted stock units as of December 31, 2017 and 2016 and changes during the year were as follows:

	Year ended December 31,	
	2017	2016
	(in thousands)	
RSUs outstanding at the beginning of the year	252,778	360,444
Changes during the year:		
Granted *	-	198,000
Vested	-	(138,569)
Forfeited/Cancelled	(252,778)	(167,097)
RSUs outstanding at the end of the year	-	252,778
Weighted average fair value at grant date	-	1.90

* The fair value of RSUs is established based on the market value of the Company's stock on the date of the award. The Company has expensed compensation costs, net of estimated forfeitures, applying the accelerated vesting method.

MODSYS INTERNATIONAL LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 10 - Equity (Cont.):

C. Dividends:

The Company has not paid any cash dividends on its ordinary shares in the past and does not expect to pay cash dividends on its ordinary shares in the foreseeable future.

The Company paid share dividends on its preferred shares which carry an 8% per annum cumulative dividend payable in kind by additional preferred shares.

Note 11 - Income taxes:

A. Basis of taxation:

1. Recently Issued:

2017 One Time Tax on Deemed Repatriation of Accumulated Foreign Earnings: Under the new TCJA legislation, U.S. taxpayers owning at least 10% of a foreign corporation must include in their 2017 income their pro-rata share of the foreign corporation’s previously untaxed earnings, as if the associated income has been repatriated to the U.S. (and thus subject to current U.S. taxation). It is a one-time tax on undistributed corporate earnings, referred to as “deemed repatriation” income. Deemed repatriation income is calculated based on the company’s level of accumulated earnings and profits as of the end of 2017. The income is taxed at two discounted rates – 15.5 percent for accumulated earnings held as cash and cash equivalents, and 8 percent for all other earnings. U.S. shareholders may elect to pay the tax liability in installments over an eight-year period. According to the company's estimation there is no tax payment in relation to the new act.

FASB ASC 740 requires that the tax benefit of net operating losses, temporary differences, and credit carry forwards be recorded as an asset to the extent that management assesses that realization is “more likely than not.” Realization of the future tax benefits is dependent on the Company’s ability to generate sufficient taxable income within the carry forward period. Because of the Company’s recent history of operating losses, and despite the company's recent taxable income during the years 2017 and 2016 management estimation that realization of each tax losses will take many years, management believes that recognition of the deferred tax assets arising from the above-mentioned future tax benefits is currently not likely to be realized and, accordingly, has provided a valuation allowance as of December 31, 2017 and 2016, respectively.

2. The company:

The Company and its subsidiaries are subject to tax in many jurisdictions and a certain degree of estimation is required in recording the assets and liabilities related to income taxes. The Company believes that its accruals for tax liabilities are adequate for all open years. The Company considers various factors in making these assessments, including past history, recent interpretations of tax law, and the specifics of each matter. Non-Israeli subsidiaries are taxed according to the tax laws in their respective country of residence.

The Company elected to compute its taxable income in accordance with Income Tax Regulations (Rules for Accounting for Foreign Investors Companies and Certain Partnerships and Setting their Taxable Income), 1986. Accordingly, the Company’s taxable income or loss is calculated in USD. Applying these regulations reduces the effect of foreign exchange rate (of NIS against the USD) on the Company’s Israeli taxable income.

Note 11 - Income taxes (Cont.):

Taxable income of Israeli companies is subject to tax at the rate of 24% and 25% in 2017 and 2016, respectively.

On December 2016, the Israeli government published the Economic Efficiency Law (2016) (legislative amendments to accomplish budget goals for the years 2017 and 2018) According to which, in 2017 the tax rate will decrease by 1% and starting 2018 by 2%; so that the tax rate will be 24% in 2017 and 23% in 2018 and onwards. Accordingly, the tax rate will be 24% in 2017 and 23% in 2018 and onwards.

The Company has received final tax assessments through 2013.

B. Deferred tax assets and liabilities:

Deferred tax reflects the net tax effects of temporary differences between the carrying amounts of assets or liabilities for financial reporting purposes and the amounts used for income tax purposes. As of December 31, 2017 and 2016, the Company's deferred taxes were in respect of the following:

	December 31,	
	2017	**2016**
	(in thousands)	
Net operating losses carry forwards	34,937	34,924
Provisions for employee rights and other temporary differences	63	65
Deferred tax assets before valuation allowance	35,000	34,989
Valuation allowance	(35,000)	(34,989)
Deferred tax assets (liability), net	-	-

C. Loss before Income Taxes is composed as follows:

	Year ended December 31,	
	2017	**2016**
	(in thousands)	
Domestic (Israel)	(2,290)	(6,148)
Foreign	2,118	(6,816)
Total loss before income taxes	(172)	(12,964)

D. Provision for Taxes:

	Year ended December 31,	
	2017	**2016**
	(in thousands)	
Current:		
Domestic (Israel)	-	-
Foreign	-	13
	-	13
Taxes related to prior years	9	9
Total provision for income taxes	9	22

MODSYS INTERNATIONAL LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 11 - Income taxes (Cont.):

E. Uncertain Tax Position:

The Company has recorded no liability for income taxes associated with unrecognized tax benefits at the date of adoption and have not recorded any liability associated with unrecognized tax benefits during 2017 and 2016. Accordingly, the Company has not recorded any interest or penalty in regard to any unrecognized benefit.

F. Tax Losses :

The Company and its subsidiaries have NOL carry forwards for income tax purposes as of December 31, 2017 of approximately 120 million. 84 million were generated in Israel with no expiration date and the rest outside of Israel.

Note 12 - Supplementary Financial Statement Information:

A. Balance Sheets:

1. Trade Accounts Receivable:

	December 31,	
	2017	2016
	(in thousands)	
Trade accounts receivable	1,818	2,306
Less allowance for doubtful accounts	-	-
	1,818	2,306

For the year ended December 31, 2017 and 2016, the Company deducted from the allowance (bad debts) 0.

2. Other Current Assets:

	December 31,	
	2017	2016
	(in thousands)	
Prepaid expenses	144	148
Government departments and agencies- VAT, net	46	89
Short-term lease deposits	13	-
	203	237

3. Other Current Liabilities:

	December 31,	
	2017	2016
	(in thousands)	
Employees and wage-related liabilities	348	493
Accrued expenses and other current liabilities	54	249
Government departments and agencies	23	173
	425	915

Note 12 - Supplementary Financial Statement Information (Cont.):

4. The Company's Long-lived Assets are as Follows:

	December 31, 2017	December 31, 2016
	(in thousands)	
Israel	4	17
U.S.A.	25	12
Europe and other	3	4
	32	33

Long-lived assets information is based on the physical location of the assets at the end of each of the fiscal years. It is comprised from the Company's property and equipment and technology intangible asset. The Company does not identify or allocate goodwill by geographic areas.

B. Statements of Operations:

1. Geographic Areas Information:

Sales: Classified by Geographic Areas:

The Company adopted FASB ASC Topic 280, "segment reporting". The Company operates in one operating segment (see Note 1 for a brief description of the Company's business). The total revenue are attributed to geographic areas based on the location of end customers.

The following present total revenue for the years ended December 31, 2017 and 2016 by geographic area:

	Year ended December 31, 2017	Year ended December 31, 2016
	(in thousands)	
North America	3,385	6,306
Europe	7,274	4,387
Israel	425	288
Total Revenue	11,084	10,981

Principal Customers:
In 2017, one customer represented 50% of the Company's total revenue. There were two customers that represented 18.1% and 10.3% of the Company's total revenue in 2016.

2. Financial Expenses, Net:

	Year ended December 31, 2017	Year ended December 31, 2016
	(in thousands)	
Foreign currency translation adjustments	(9)	165
Interest expense	230	147
Grant of warrants to shareholders	1,011	-
Financial Expenses, Net	1,232	312

MODSYS INTERNATIONAL LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 12 - Supplementary Financial Statement Information (Cont.):

C. Earning/loss Per Share:

Basic and diluted earnings/loss per share ("EPS") was computed based on the average number of shares outstanding during each year and for the diluted earnings per share it was based on the outstanding shares and the potential instruments such as: preferred shares and warrants.

The following table sets forth the computation of basic and diluted net earnings/loss per share attributable to ModSys International Ltd.:

	Year ended December 31,	
	2017	**2016**
	(in thousands, except per share data)	
1. Numerator:		
Amount for basic and diluted profit (loss) per share	172	(12,180)
Dividend in kind	(70)	(83)
	102	(12,263)
2. Denominator:		
Denominator for basic earnings per share - weighted average of shares	21,049,462	18,657,653
Denominator for diluted net earnings per share - weighted average number of dilutive ordinary shares	22,281,816	18,657,653
3. Basic and Diluted earning (loss) per share		
Basic earnings (loss) per share attributed ModSys International Ltd.	0.0048	(0.66)
Diluted earnings (loss) per share attributed ModSys International Ltd.	0.0045	(0.66)