

BOS BETTER ONLINE SOLUTIONS LTD

Form 6-K

April 04, 2013

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FORM 6 - K  
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Report of Foreign Private Issuer

Pursuant to Rule 13a - 16 or 15d -16  
Under the Securities Exchange Act of 1934

For the Month of April 2013

Commission file number 001-14184

B.O.S. Better Online Solutions Ltd.  
(Translation of Registrant's Name into English)

20 Freiman Street, Rishon LeZion, 75100, Israel  
(Address of principal executive office)

Indicate by check mark whether the registrant files or will file annual reports under cover Form 20-F or Form 40-F.

Form 20-F  x

Form 40-F  o

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1): \_\_\_\_\_

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7): \_\_\_\_\_

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B.O.S. Better Online Solutions Ltd.

The Financial Statements and the consent attached to this Form 6-K are hereby incorporated by reference into all effective registration statements filed by us under the Securities Act of 1933, to the extent not superseded by documents or reports subsequently filed or furnished.

Attached hereto and incorporated by reference are:

1. The Consolidated Financial Statements of the Registrant as of December 31, 2012.
  2. Consent of Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global.
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Signature

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

B.O.S. Better Online Solutions Ltd.  
(Registrant)

By: /s/ Eyal Cohen  
Eyal Cohen  
Chief Financial Officer

Dated: April 4, 2013

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B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND SUBSIDIARIES  
CONSOLIDATED FINANCIAL STATEMENTS  
AS OF DECEMBER 31, 2012  
IN U.S. DOLLARS  
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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of

B.O.S. BETTER ONLINE SOLUTIONS LTD.

We have audited the accompanying consolidated balance sheets of B.O.S Better Online Solutions Ltd. ("the Company") and subsidiaries as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive loss, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2012. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's 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 and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and subsidiaries at December 31, 2012 and 2011, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2012, in conformity with U.S. generally accepted accounting principles.

Tel-Aviv, Israel  
April 4, 2013

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

B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	December 31,	
	2012	2011
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 354	\$ 411
Trade receivables (net of allowance for doubtful accounts of \$ 127 and \$ 115 at December 31, 2012 and 2011, respectively)	8,007	8,507
Other accounts receivable and prepaid expenses	616	744
Inventories	3,160	4,020
<b>Total current assets</b>	<b>12,137</b>	<b>13,682</b>
<b>LONG-TERM ASSETS:</b>		
Severance pay fund	21	41
Bank deposits	438	427
Investment in other company	-	68
Other assets	11	23
<b>Total long-term assets</b>	<b>470</b>	<b>559</b>
<b>PROPERTY, PLANT AND EQUIPMENT, NET</b>	<b>963</b>	<b>1,166</b>
<b>OTHER INTANGIBLE ASSETS, NET</b>	<b>357</b>	<b>540</b>
<b>GOODWILL</b>	<b>4,122</b>	<b>4,122</b>
	<b>\$18,049</b>	<b>\$20,069</b>

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

B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands, except share and per share data

	December 31,	
	2012	2011
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Short-term bank loans and current maturities	\$6,383	\$7,496
Trade payables	4,915	4,165
Employees and payroll accruals	408	553
Deferred revenues	467	550
Current maturities of liability to Dimex Systems	136	300
Accrued expenses and other liabilities	567	967
<b>Total current liabilities</b>	<b>12,876</b>	<b>14,031</b>
<b>LONG-TERM LIABILITIES:</b>		
Long-term bank loans, net of current maturities	1,188	1,530
Accrued severance pay	119	163
Liability to Dimex Systems, net of current maturities	710	747
<b>Total long-term liabilities</b>	<b>2,017</b>	<b>2,440</b>
<b>COMMITMENTS AND CONTINGENT LIABILITIES</b>		
<b>SHAREHOLDERS' EQUITY:</b>		
Share capital:		
Ordinary shares of NIS 80.00 nominal value: Authorized; 2,500,000 shares at December 31, 2012 and 2011; Issued and outstanding: 1,132,685 and 1,116,981 shares at December 31, 2012 and 2011, respectively	23,374	23,065
Additional paid-in capital	50,891	51,093
Accumulated other comprehensive loss	(243 )	(243 )
Accumulated deficit	(70,866 )	(70,317 )
<b>Total shareholders' equity</b>	<b>3,156</b>	<b>3,598</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$18,049</b>	<b>\$20,069</b>

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





B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

U.S. dollars in thousands, except per share data

	Year ended December 31,		
	2012	2011	2010
Revenues	\$ 24,503	\$ 33,434	\$ 30,187
Cost of revenues	19,050	26,481	22,668
Inventory write offs	385	443	36
Gross profit	5,068	6,510	7,483
Operating costs and expenses:			
Research and development	125	403	372
Sales and marketing	3,058	4,273	4,068
General and administrative	1,693	2,252	1,786
Impairment of other intangible assets	-	555	-
Total operating costs and expenses	4,876	7,483	6,226
Operating Profit (loss)	192	(973 )	1,257
Financial expenses, net	(781 )	(2,241 )	(961 )
Other expenses, net	(147 )	(172 )	(120 )
Income (loss) before taxes on income	(736 )	(3,386 )	176
Tax benefit (taxes on income)	187	172	(5 )
Income (loss) from continuing operations	(549 )	(3,214 )	171
Loss from discontinued operations	-	-	(806 )
Net loss	\$ (549 )	\$ (3,214 )	\$ (635 )
Basic and diluted net earnings (loss) per share from continuing operations	\$ (0.49 )	\$ (4.56 )	\$ 0.28
Basic and diluted net loss per share from discontinued operations	\$ -	\$ -	\$ (1.24 )
Basic and diluted net loss per share	\$ (0.49 )	\$ (4.56 )	\$ (0.96 )

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



B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

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U.S. dollars in thousands, except per share data

	Year ended December 31,		
	2012	2011	2010
Net loss	\$(549 )	\$(3,214 )	\$(635 )
Other comprehensive income (loss):			
Change in foreign currency translation adjustment	-	(295 )	262
Realized gain related to available for sale securities	-	-	(54 )
	-	(295 )	208
Comprehensive loss	\$(549 )	\$(3,509 )	\$(427 )

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B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

## STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. dollars in thousands, except share data

	Ordinary shares	Share capital and additional paid-in capital	Accumulated other comprehensive income (loss)	Accumulated deficit	Total shareholders' equity
Balance at January 1, 2010	654,540	\$ 70,267	\$ (156 )	\$ (66,468 )	\$ 3,643
Issuance of Ordinary shares for options exercised	9,499	-	-	-	-
Issuance of shares related to the private placement (net of \$ 35 issuance expenses)	24,090	265	-	-	265
Issuance of warrants related to convertible note	-	15	-	-	15
Share-based compensation expense	-	217	-	-	217
Other comprehensive loss	-	-	208	-	208
Net loss	-	-	-	(635 )	(635 )
Total comprehensive loss	-	-	-	(635 )	(635 )
Balance at December 31, 2010	688,129	70,764	52	(67,103 )	3,713
Issuance of Ordinary shares for options exercised	8,361	-	-	-	-
Issuance of Ordinary shares related to an inducement of a convertible note	420,491	3,319	-	-	3,139
Extension of warrants related to convertible note	-	86	-	-	86
Share-based compensation expense	-	169	-	-	169
Other comprehensive loss	-	-	(295 )	-	(295 )
Net loss	-	-	-	(3,214 )	(3,214 )
Total comprehensive loss	-	-	-	(3,214 )	(3,214 )
Balance at December 31, 2011	1,116,981	74,158	(243 )	(70,317 )	3,598
Issuance of Ordinary shares for options exercised	1,254	-	-	-	-
Issuance of Ordinary shares to directors	14,450	84	-	-	84
Share-based compensation expense	-	23	-	-	23
Other comprehensive loss	-	-	-	-	-
Net loss	-	-	-	(549 )	(549 )

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Balance at December 31, 2012	1,132,685	\$	74,265	\$	(243	)	\$	(70,866	)	\$	3,516
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The accompanying notes are an integral part of the consolidated financial statements.

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B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2012	2011	2010
<b>Cash flows from operating activities:</b>			
Net loss	\$(549 )	\$(3,214 )	\$(635 )
Loss from discontinued operations	-	-	806
<b>Net profit (loss) from continuing operations</b>	<b>(549 )</b>	<b>(3,214 )</b>	<b>171</b>
<b>Adjustments to reconcile net loss to net cash provided by (used in) operating activities:</b>			
Depreciation and amortization	363	656	611
Inventory write off	385	443	36
Impairment of other intangible assets	-	555	-
Capital gain / loss from sale and disposal of property, plant and equipment	79	-	-
Capital loss from sale of investment in other company	-	-	7
Currency fluctuation of long term deposits	(11 )	-	-
Impairment of available for sale securities	-	156	-
Impairment of investment in other company	68	39	111
Severance pay, net	(24 )	5	-
Share-based compensation expenses related to employees, directors and service providers	107	169	217
Amortization of discount on convertible note	22	202	225
Accrued interest on long-term convertible note and liability to Dimex Systems Ltd	32	230	196
Conversion expenses of convertible note	-	760	-
Revaluation of fair value related to extension of warrants as part of an Inducement of a convertible note	-	86	-
Decrease (increase) in trade receivables, net	500	(1,045 )	(417 )
Change in income tax accruals	(187 )	(199 )	52
Decrease (increase) in other accounts receivable and other assets	140	363	(114 )
Decrease (increase) in inventories	475	506	138
Increase (decrease) in trade payables	750	(46 )	332
Decrease in employees and payroll accruals, deferred revenues, accrued expenses and other liabilities	(441 )	(31 )	(105 )
<b>Net cash provided by (used in) operating activities from continuing operations</b>	<b>1,709</b>	<b>(365 )</b>	<b>1,460</b>
<b>Net cash used in operating activities from discontinued operations</b>	<b>-</b>	<b>-</b>	<b>(176 )</b>

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Net cash provided by (used in) operating activities	1,709	(365 )	1,284
Cash flows from investing activities:			
Purchase of property, plant and equipment	(82 )	(357 )	(108 )
Proceeds from sale of property, plant and equipment	26	-	-
Change in long term bank deposits	-	(427 )	-
Proceeds from sale of investment in other company	-	-	150
Repayment of deferred consideration for the acquisition of Dimex Systems Ltd activity	(255 )	(256 )	(147 )
Net cash used in investing activities from continuing operations	(311 )	(1,040 )	(105 )
Net cash used in investing activities from discontinued operations	-	-	-
Net cash used in investing activities	(311 )	(1,040 )	(105 )
Cash flows from financing activities:			
Proceeds from issuance of shares, net	-	-	265
Repayment of (proceeds from) short and long-term bank loans	(1,455 )	1,113	(841 )
Proceeds from (repayment of) long-term convertible note and warrants, net of issuance expenses	-	-	(28 )
Net cash provided by (used in) financing activities from continuing operations	(1,455 )	1,113	(604 )
Net cash provided by (used in) financing activities from discontinued operations	-	-	(308 )
Net cash used in (provided by) financing activities	(1,455 )	1,113	(912 )
Increase (decrease) in cash and cash equivalents	(57 )	(292 )	267
Increase (decrease) in cash and cash equivalents from discontinued operations	-	-	(128 )
Cash and cash equivalents at the beginning of the year	411	703	564
Cash and cash equivalents at the end of the year	\$354	\$411	\$703

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

B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	2012	Year ended December 31, 2011	2010
Supplemental disclosure of cash flow activities:			
(i) Net cash paid during the year for:			
Interest	\$ 502	\$ 572	\$ 463
(ii) Non-cash activities:			
Conversion of payable into long-term convertible debentures	\$ -	\$ -	\$ 161
Sale of investment in other company	\$ -	\$ -	\$ 150
Conversion of convertible note into share capital	\$ -	\$ 2,523	\$ -

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



B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands, except share and per share data

NOTE 1:- GENERAL

- a. B.O.S. Better Online Solutions Ltd. ("BOS" or "the Company") is an Israeli corporation.

The Company's shares are listed on NASDAQ under the ticker BOSC.

b. In the years ended December 31, 2012, 2011, and 2010 the Company incurred losses of \$ 549, \$3,214, and profit of 635 respectively. In the years ended December 31, 2012, 2011, and 2010 the Company generated positive cash flow from operating activities from continuing operations amounting to \$ 1,709 in 2012, negative cash flow of \$365 in 2011, and positive cash flow of \$1,460 in 2010. Due to the above, the Company's cash and cash equivalent decreased from \$ 411 as of December 31, 2011 to \$ 354 as of December 31, 2012. The Company had negative working capital of \$739 as of December 31, 2012 and \$349 as of December 31, 2011. As of December 31, 2012, the Company was not in compliance with certain financial covenants. The Company received a waiver from the lender with respect to the covenants as of December 31, 2012, valid through May 1, 2014.

c. All share and per share data in this report is reported after giving effect to the 1 for 4 reverse split that occurred on December 14, 2012 (see Note 14).

d. The Company has two operating segments: the RFID and Mobile Solutions segment and the Supply Chain Solutions segment (see Note 17).

The Company's wholly-owned subsidiaries include:

- (1) BOS-Dimex Ltd. (previously "Dimex Solutions Ltd"), an Israeli company that provides comprehensive turn-key solutions for Automatic Identification and Data Collection. BOS-Dimex comprises the RFID and Mobile Solutions segment.
- (2) BOS-Odem Ltd. ("BOS-Odem"), an Israeli company, is a distributor of electronic components and advanced technologies worldwide. BOS-Odem is a part of the Supply Chain Solutions segments; and
- (3) Ruby-Tech Inc., a New York corporation, a wholly-owned subsidiary of BOS-Odem and a part of the Supply Chain Solutions segments;

B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 1:-

GENERAL (Cont.)

e. Discontinued operations:

On November 23, 2010 the Company announced that its two U.S. subsidiaries that were part of its Supply Chain Solutions division, Lynk and its subsidiary Summit, have filed a Chapter 7 petition with the US Bankruptcy Court.

Summarized selected financial information of the discontinued operations is as follows:

	2010
Revenues	\$ 8,338
Cost of revenues	6,990
Gross profit	1,348
Impairment of goodwill	-
Total operating costs and expenses	1,487
Operating loss	(139 )
Financial expenses, net	(213 )
Other expenses, net (*)	(496 )
Loss before taxes on income	(848 )
Tax benefit (taxes on income)	42
Net loss	\$ (806 )

(\*)In 2010, other expenses include \$ 554 related to the write off of net assets and liabilities related to discontinued operations.

B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

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 are prepared according to 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, provision for inventory, revenue recognition, tax assets and tax positions, legal contingencies, stock-based compensation costs, and assumptions utilized in troubled debt restructuring. Actual results could differ from those estimates.

b. Financial statements in U.S. dollars:

A substantial portion of the Company's revenues is generated in U.S. dollar ("dollars"). In addition, most of the Company's costs are incurred in dollars. The Company's management believes that the dollar is the primary currency of the economic environment in which the Company operates. Thus, the functional and reporting currency of the Company is the dollar. Accordingly, monetary accounts maintained in currencies other than the dollar are premeasured into dollars in accordance with ASC 830, Foreign Currency Matters. All transactions 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.

As of December 31, 2011, the financial statements of a certain subsidiary, whose functional currency is other than the dollar, have been translated into U.S. dollars. All balance sheet accounts have been 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 period. The resulting translation adjustments are reported as a component of shareholders' equity in accumulated other comprehensive loss.

As of January 1, 2012, as a result of business changes in a certain subsidiary, the Company changed the functional currency of the subsidiary from NIS to US Dollars.

c. Principles of consolidation:

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



B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

## NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

## d. Cash equivalents:

Cash equivalents are short-term highly liquid investments that are readily convertible to cash purchased with original maturities of less than three months.

## e. Inventories:

Inventories are valued at the lower of cost or market value. Cost is determined using the moving average cost method.

Inventory write-offs and write-downs are made to cover risks arising from slow-moving items or technological obsolescence.

## f. Property, plant and equipment:

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

	%	
Computers and software	20 - 33	(Mainly 33%)
Office furniture and equipment	6 - 15	(Mainly 10%)
Leasehold improvements	over the shorter of the period of the lease or the life of the assets	
Motor vehicles	15	
Real estate	4	

## g. Impairment of long-lived assets:

The Company's long-lived assets are reviewed for impairment in accordance with ASC 360-10, Accounting for the Impairment or Disposal of Long-Lived Asset, whenever events or changes in circumstances indicate that the carrying amount of an asset (or asset group) may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset (or asset group) to the future undiscounted cash flows expected to be generated by the assets (or asset group). If such assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the assets exceeds their fair value. During 2012 no impairment losses have been identified. The fair value of the brand name and customer list related intangibles was determined by the income approach method. Assumptions in the fair value assessment included: the impact of changes in economic conditions, revenue and cash flow forecasts for the remaining lives of the intangibles and the Company's weighted average cost of capital ("WACC").

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B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

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.)

During the year 2011 the Company recognized an impairment loss \$555 related to a brand name and customer list of which \$470 was attributed to the Supply Chain solutions segment and \$85 were attributed to the RFID and Mobile solutions segment.

During 2012 and 2010 no impairment losses have been identified.

h. Goodwill:

Goodwill represents excess of the costs over the net assets of businesses acquired. Under ASC 350, Intangibles - Goodwill and Other ("ASC 350"), goodwill is not amortized but instead is tested for impairment at least annually or between annual tests in certain circumstances, and written-down when impaired.

Goodwill as of December 31, 2012 and December 31, 2011 amounted to \$4,122. The translation impact on goodwill during the year ended December 31, 2011 was (\$316), and \$0 during the year ended December 31, 2012 due to the reporting segment's change in functional currency from the NIS to the US Dollar.

Testing Methodology:

The Company performs its annual impairment analysis of goodwill as of December 31 of each year, or more often if there are indicators of impairment present. The provisions of ASC 350 requires that a two-step impairment test be performed on goodwill at the level of the reporting units. In the first step, or Step 1, the Company compares the fair value of each reporting unit to its carrying value. If the fair value exceeds the carrying value of the net assets, goodwill is considered not impaired, and the Company is not required to perform further testing. If the carrying value of the net assets exceeds the fair value, then the Company must perform the second step, or Step 2, of the impairment test in order to determine the implied fair value of goodwill. To determine the fair value used in Step 1, the Company uses discounted cash flows. If and when the Company is required to perform a Step 2 analysis, determining the fair value of its net assets and its off-balance sheet intangibles would require it to make judgments that involve the use of significant estimates and assumptions.

The reporting unit of the Company for purposes of the impairment test is the Company's RFID and Mobile solutions segment. Discrete financial information is available for this component of the business. Segment management regularly reviews the operating results of this component.

The Company determined the fair value of the reporting unit using the Income Approach, which utilizes a discounted cash flow model, as it believes that this approach best approximates the reporting unit's fair value at this time. Judgments and assumptions related to revenue, operating income, future short-term and long-term growth rates, weighted average cost of capital, interest, capital expenditures, cash flows, and market conditions are inherent in developing the discounted cash flow model. The material assumptions used for the Income Approach for 2012 were five years of projected net cash flows, WACC of 16.06% and a long-term growth rate of 3%. 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. The aggregate fair value of the Company depends on various factors, some of which are qualitative and involve management judgment, including stable backlog coverage and experience in meeting operating cash flow targets.

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B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND ITS SUBSIDIARIES

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.)

Testing Results:

During 2012, 2011 and 2010 no impairment losses have been identified.

i. Research and development costs:

ASC 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 upon completion of a working model. Research and development costs incurred in the process of developing product improvements or new products, are generally charged to expenses as incurred. Costs incurred by the Company between completion of the working model and the point at which the product is ready for general releases are insignificant.

j. Severance pay:

The Company's liability for severance pay for Israeli employees is calculated pursuant to the Israeli Severance Pay Law based on the most recent salary of the employees multiplied by the number of years of employment as of the balance sheet date. Employees are entitled to one month's salary for each year of employment or a portion thereof above one year. The Company's liability for its Israeli employees is mostly covered by insurance policies designed solely for distributing severance pay. The value of these policies is not under the Company's control, thus just the liability net of funds under insurance policy is presented in the balance sheet.

The Company has two general deposit funds for severance. The value of the deposited funds includes profits, and is recorded as an asset in the Company's balance sheet.

The Company's payroll includes employees whom its severance pay liability is calculated pursuant to Article 14 of the Israel's Severance Pay Law. The Company currently deposits the corresponding amounts required in accordance with Article 14 to the relevant pension funds. These amounts will be released to the applicable employees upon termination of employment and this substitutes the obligation described above, to pay severance based on the most recent salary of the employee multiplied by the number of years of employment. The aforementioned deposited amounts are not reflected on the financial statements due to the fact that they are not under the Company's control.

Severance expenses for 2012, 2011 and 2010 amounted to \$ 117, \$ 242 and \$ 137, respectively.

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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.)

k. Revenue recognition:

The Company derives its revenues mainly from the sale of products and support services.

Revenues from product sales, related to both the Supply Chain Solutions and RFID and Mobile Solutions segments, are recognized in accordance with SAB 104, Revenue Recognition ("ASC 605") when delivery has occurred, persuasive evidence of an arrangement exists, the vendor's fee is fixed or determinable, no further obligation exists, and collectability is reasonably assured.

l. Income taxes:

The Company and its subsidiaries account for income taxes in accordance with ASC 740, Income Taxes ("ASC 740"). ASC 740 prescribes the use of the liability method whereby deferred tax assets and liability account balances are determined based on the differences between the 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 and its subsidiaries provide a valuation allowance, if necessary, to reduce deferred tax assets to the amounts that are more likely-than-not to be realized.

The Company implements a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with ASC 740. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is- more- likely- than- not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. During the years ended December 31, 2012 and 2011, the Company recorded tax income of \$ 195 and \$261, respectively in regard to a decrease of uncertain tax position for closed tax years.

m. Concentrations of credit risk:

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, trade receivables and other accounts receivable.

The trade receivables of the Company are derived from sales to customers located primarily in Israel, America, the Far East and Europe. The Company generally does not require collateral; however most of the Company's customers outside of Israel are insured against customer nonpayment, through the Israeli Credit Insurance Company Ltd. In certain circumstances, the Company may require letters of credit, other collateral, additional guarantees or advanced payments. An allowance for doubtful accounts is determined with respect to specific debts that are doubtful of collection.



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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

n. Derivative financial instruments:

The Company's derivatives consist primarily of forward contracts the Company uses to hedge the Company's exposure to currencies other than the U.S. dollar. The Company recognized derivative instruments as either assets or liabilities and measures those instruments at fair value. The derivative instruments that the Company holds do not meet the definition of hedging instruments under ASC 815, Derivatives and Hedging (originally issued as SFAS 133 and SFAS161). Therefore, the Company recognizes changes in the fair values of the derivatives in its statement of income in financial income, net, at the same period as the re-measurement of gain and loss of the related foreign currency denominated assets and liabilities.

As of December 31, 2012, the notional principal of foreign exchange contracts to purchase U.S. dollars with foreign currencies and to sell Euros for foreign currencies was \$ 770 and € 930, respectively. The Company recorded the fair value of derivative liability in the amount of \$ 5 in accrued expenses and other liabilities.

o. Basic and diluted net earnings (loss) per share:

Basic net earnings (loss) per share are calculated based on the weighted average number of ordinary shares outstanding during each year. Diluted net earnings (loss) per share are calculated based on the weighted average number of ordinary shares outstanding during each year, plus the potential dilution to ordinary shares considered outstanding during the year, in accordance with ASC 260, Earning per Share.

The total number of ordinary shares related to outstanding options and warrants that was excluded from the calculations of diluted net earnings (loss) per share, since they would have an anti-dilutive effect, was 255,228, 381,153 and 360,585 for the years ended December 31, 2012 , 2011 and 2010, respectively.

p. Accounting for share-based compensation:

The Company accounts for equity-based compensation in accordance with ASC 718, Stock Compensation ("ASC 718") which requires the recognition of compensation expenses based on estimated fair values for all equity-based awards made to employees and nonemployees and directors.

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 statements of operations.

The Company recognizes compensation expenses for the value of its awards granted based on the straight line method over the requisite service period of each of the awards, net of estimated forfeitures. ASC 718 requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Estimated forfeitures are based on actual historical pre-vesting forfeitures. The Company considers many factors when estimating forfeitures, including employee class and historical experience.

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## 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 using the Black-Scholes option pricing model. The option-pricing model requires a number of assumptions, of which the most significant are expected stock price volatility and the expected option term. Expected volatility was calculated based upon actual historical stock price movements over the most recent periods ending on the date of grant, equal to the expected option terms. The expected option term represents the period that the Company's stock options are expected to be outstanding and was determined based on the Simplified method permitted by SAB 107 and extended by SAB 110 as the average of the vesting period and the contractual term. The Company currently uses the simplified method as adequate historical experience is not available to provide a reasonable estimate. The Company adopted SAB 110 effective January 1, 2008 and will continue to apply the simplified method until enough historical experience is available to provide a reasonable estimate of the expected term for stock option grants. The risk-free interest rate is based on the yield from U.S. Treasury zero-coupon bonds with an equivalent term. The Company has historically not paid dividends and has no foreseeable plans to pay dividends.

The fair value for options granted in 2012 and 2011 was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	Year ended December 31,	
	2012	2011
Risk-free interest	1.34 %	1.17 %
Dividend yields	0 %	0 %
Volatility	83 %	96 %
Expected option term	3 years	3.83 years
Forfeiture rate	0 %	24 %

During 2012, 2011 and 2010, the Company recognized stock-based compensation expense related to employee and director stock options as follows:

	Year ended December 31,		
	2012	2011	2010
Selling and marketing	\$ -	\$ 8	\$ 39
General and administrative	107	161	178
Total stock-based compensation expense	\$ 107	\$ 169	\$ 217



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U.S. dollars in thousands, except share and per share data

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company applies ASC 718 and ASC 505-50 for equity instruments that are issued to other than employees for acquiring, or in conjunction with, selling, goods or services.

q. Fair value of financial instruments:

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

The carrying amounts of cash and cash equivalents, trade receivables, other accounts receivable, short term loans and trade payables approximate their fair value due to the short-term maturities of such instruments. The carrying amounts of long-term loans approximate their fair value.

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2012 are comprised of foreign currency forward contracts.

Assets measured at fair value on a non-recurring basis as of December 31, 2012 are Investment in shares of a cost method investee and intangible assets and goodwill that were written down to zero as a result of an impairment loss.

ASC 820 establishes a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1 - Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 - Include other inputs that are directly or indirectly observable in the marketplace.

Level 3 - Unobservable inputs which are supported by little or no market activity.

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

r. Reclassification:

Certain 2011 figures have been reclassified to conform to the 2012 presentation. The reclassification had no effect on previously reported net income or shareholders' equity.



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NOTE 3:- OTHER ACCOUNTS RECEIVABLE AND PREPAID EXPENSES

	December 31,	
	2012	2011
Government authorities	\$ 78	\$ 92
Advances to suppliers	258	411
Prepaid expenses	163	172
Deferred expenses attributed to software projects	22	52
Other	95	17
	\$ 616	\$ 744

NOTE 4:- FAIR VALUE MEASUREMENTS

In accordance with ASC 820, derivative contracts are classified within Level 2 as the valuation inputs are based on quoted prices and market observable data of similar instruments.

The Company's financial liabilities and assets measured at fair value on a recurring basis, consisted of derivatives which were classified within Level 2 and amounted to a \$ (5) and a \$ (67) liability as of December 31, 2012 and 2011, respectively.

NOTE 5:- INVENTORIES

	December 31,	
	2012	2011
Raw materials	\$ 163	\$ 189
Finished goods	2,997	3,831
	\$ 3,160	\$ 4,020

NOTE 6:- INVESTMENT IN OTHER COMPANIES

The Company's investments in companies comprise of an investment in Surf Communication Systems Ltd.:

	December 31,	
	2012	2011
Cost net of cumulative impairment losses	\$ -	\$ 68

During 2012, a full impairment loss of \$68 was recognized against the investment in Surf Communication Systems Ltd.

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## NOTE 7:- PROPERTY, PLANT AND EQUIPMENT

	December 31,	
	2012	2011
<b>Cost:</b>		
Computers and software	\$ 728	\$ 921
Office furniture and equipment	706	1,031
Leasehold improvements and real estate	648	1,446
Motor Vehicles	347	341
	2,429	3,739
<b>Accumulated depreciation:</b>		
Computers and software	674	805
Office furniture and equipment	343	615
Leasehold improvements and real estate	299	988
Motor vehicles	150	165
	1,466	2,573
<b>Depreciated cost</b>	<b>\$ 963</b>	<b>\$ 1,166</b>

Depreciation expenses amounted to \$ 180, \$ 280 and \$ 241 for the years ended December 31, 2012, 2011 and 2010, respectively.

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NOTE 8:- OTHER INTANGIBLE ASSETS, NET

	December 31, 2012	Weighted average amortization period	December 31, 2011	Weighted average amortization period
<b>Cost:</b>				
Backlog	\$ 27	-	\$ 27	-
Technology	226	-	226	-
Brand name	670	4.1	670	4.1
Customer list	2,450	2.5	2,450	2.5
	3,373		3,373	
<b>Accumulated amortization:</b>				
Backlog	27		27	
Technology	226		226	
Brand name	475		411	
Customer list	2,288		2,169	
	3,016		2,833	
<b>Amortized cost</b>	<b>\$ 357</b>		<b>\$ 540</b>	

Intangible assets are amortized based on the straight line method for their remaining useful life.

Amortization expenses amounted to \$ 183, \$ 931 and \$ 369 for the years ended December 31, 2012, 2011 and 2010, respectively.

Estimated amortization expenses for the years ended:

December 31,	
2013	180
2014	177
	\$ 357



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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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## NOTE 9:- SHORT-TERM BANK LOANS AND CURRENT MATURITIES

Loan currency	Weighted interest rate as of December 31, 2012 %	December 31,	
		2012	2011
NIS	6.70	\$ 929	\$ 3,904
\$	4.8	4,937	2,932
Euro	4.67	93	-
		5,959	6,836
Current maturities	4.97	424	660
		\$ 6,383	\$ 7,496

The repayment of the Company's bank debt (to Bank Leumi) is secured by a first priority floating charge on all of the Company's assets, and by a first priority fixed charge on all of the Company's issued and unpaid share capital, its goodwill and its shares of its Israeli subsidiaries.

The loan terms restrict substantial asset sales, cash dividends, and certain inter-company and shareholders payments. In addition, the Company and its Israeli subsidiaries entered into a series of inter-company guarantees in favor of the bank.

There were no Bank Leumi covenants related to short term loans applicable for the fiscal years 2012 and 2011.

## NOTE 10:- ACCRUED EXPENSES AND OTHER LIABILITIES

	December 31,	
	2012	2011
Government authorities	\$ 300	\$ 275
Professional services	120	196
Derivative liability	5	67
Tax accruals	86	273
Other	56	156
	\$ 567	\$ 967



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## NOTE 11:- LONG-TERM BANK LOANS, NET OF CURRENT MATURITIES

- a. Classified by linkage terms and interest rates, the total amount of the loans is as follows:

Loan currency	Weighted interest rate as of December 31, 2012 %	December 31, 2012	December 31, 2011
NIS	4.97 (Prime minus 0.5 up to Prime plus 1.5)	\$ 1,612	\$ 2,190
Less - current maturities	4.97	424	660
		\$ 1,188	\$ 1,530

Bank Leumi debt amounted to \$ 0 and \$ 367 in December 31, 2012 and December 31, 2011, respectively.

Bank HaPoalim debt amounted to \$ 1,521 and \$ 1,714 as of December 31, 2012 and 2011, respectively.

The repayment of the Company's bank debt to Bank HaPoalim is not secured, except by long term bank deposits in the amount of \$ 438. The Bank HaPoalim loan agreements contain various financial covenants which require that the Company's Israeli subsidiaries maintain certain financial ratios and level of profitability.

As of December 31, 2012, the Company was not in compliance with certain financial covenants. The Company received a waiver from the bank with respect to the covenants as of December 31, 2012, valid through the earlier of May 1, 2014 or the Company's filing of its 2013 financial statements.

- b. The Company loans mature in the following years subsequent to the balance sheet dates:

2013 (Current maturities)	\$424
2014	464
2015	399
2016	325
	\$1,612





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NOTE 12:- LIABILITY TO DIMEX SYSTEMS

In March 2008, BOS-Dimex purchased the assets and activities of Dimex Systems Ltd. As part of this acquisition, the Company and BOS Dimex owe to Dimex Systems Ltd. an amount on account of the purchase price as summarized below:

Loan currency	Nominal interest rate as of December 31, 2012 %	December 31, 2012	December 31, 2011
NIS (1)	4.0	\$ 527	\$ 473
NIS (2)	4.0	319	\$ 574
		846	1,047
Less - current maturities	4.0	136	300
		\$ 710	\$ 747

(1) Will be paid in 24 equal monthly payments commencing January, 2014 (see note 14a).

(2) The loan originally carried a nominal interest rate of 8% and with principle and interest payments to be made through December 2013. On December 31, 2012, the loan agreement was modified to reduce the nominal interest rate to 4% and principle and interest payments were spread out through June 2015. The Company accounted for the loan modification in accordance with ASC 470-60 Troubled Debt Restructurings by Debtors, and as a result of which, there was no material effect to the December 31, 2012 balance sheet and the results of operations through December 31, 2012.

NOTE 13:- COMMITMENTS AND CONTINGENT LIABILITIES

a. Commitments:

1. Royalty commitments:

a) Under the Company's research and development agreements with the Office of the Chief Scientist ("OCS") and pursuant to applicable laws, the Company is required to pay royalties at the rate of 3.5% of sales of products developed with funds provided by the OCS, up to an amount equal to 100% of the Research and development grants (dollar-linked) received from the OCS. The obligation to pay these royalties is contingent upon actual sales of the products. Royalties payable with respect to grants received under programs approved by the OCS after January 1, 1999, are subject to interest on the U.S. dollar-linked value of the total grants received at the annual rate

of LIBOR applicable to U.S. dollar deposits at the time the grants are received. No grants were received during the years 2010 through 2012.

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NOTE 13:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

As of December 31, 2012, the Company has an outstanding contingent obligation to pay royalties to the OCS, including interest, in the amount of approximately \$ 3,316, in respect of these grants. Royalty expenses in the amount of \$ 0 and \$3 were recorded on such royalties during 2012 and 2011, respectively. Commencing year 2012, there are no sales of products that were developed using funds provided by the OCS. Additionally, the developed software for which the grant was received is no longer being sold.

b) The Israeli Government, through the Overseas Marketing Fund, awarded the Company grants for participation in expenses for overseas marketing. The Company is committed to pay royalties to the Fund for Encouragement of Marketing Activities (the "Marketing Fund") at the rate of 3% of the increase in export sales, up to the amount of the grants received by the Company linked to the dollar and bearing interest. No grants were received during the years 2010 through 2012.

As of December 31, 2012, the Company has an outstanding contingent obligation to pay royalties to the Marketing Fund including interest, in the amount of \$ 107. No Marketing Fund royalty expenses were recorded during 2012, 2011 and 2010. Additionally, the developed software for which the grant was received is no longer being sold.

2. The facilities of the Company are rented under operating lease agreements that expire on various dates ending in 2016. Minimum future rental payments for 2013, 2014 and 2015 are \$ 105, \$ 80 and \$ 51, respectively.

The Company's motor vehicles are leased under various cancelable operating lease agreements. The lease agreements for the motor vehicles expire on various dates ending in 2015. The maximum breach of contract fees may amount to \$ 37.

Lease expenses for the facilities occupied by the Company and the Company's motor vehicles in 2012, 2011 and 2010 amounted to \$ 420, \$ 551 and \$ 563, respectively.

3. Litigation:

On November 2008, Blockshtil Ltd. filed a claim in the Petach-Tikva Magistrate Court alleging breach of contract by the Company and seeking damages in the amount of NIS 149 thousand (approximately \$43). During 2012, The Company has served a statement of defense and the case has been heard. The parties will be filing their written summations and thereafter the Court will render its judgment. The Company's financial statements include a provision in this respect.

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NOTE 14:- SHAREHOLDERS' EQUITY

a. Share reverse split

On December 14, 2012 the Company announced a reverse split of its Ordinary shares.

Pursuant to the reverse split, each 4 Ordinary Shares, NIS 20.00 nominal value per share, will be converted into one Ordinary Share, NIS 80.00 nominal value per share. No fractional shares will be issued as a result of the reverse-split. Instead, all fractional shares will be rounded up to the next higher whole number of shares. All share and per share data in these financial statements and related notes are reported after the giving effect to the 1 for 4 reverse split.

As of December 13, 2012, there were 4,472,298 Ordinary Shares outstanding and after the reverse split there were 1,118,081 Ordinary Shares outstanding.

b. Private placements:

On October 5, 2010 the Company entered into a definitive private placement agreement with Telegraph Hill Capital Fund I, LLC ("THCAP") for the issuance of an aggregate of 24,091 Ordinary Shares at a price per share of \$ 12.44, or approximately \$ 300 in total. In addition, the Company announced that Mr. Luis Gutierrez Roy, managing partner in THCAP was appointed to its Board of Directors.

On December 21, 2011 the company announced that it has entered into agreements with its convertible debt lenders, for the amendment of their loan agreements and the subsequent conversion of their debt into the Company's ordinary shares.

The amendments to the loan agreements provide that the amount of \$ 2,523 of these loans was converted into the company's ordinary shares at a reduced conversion price of \$ 6 per share, instead of the conversion rate of \$ 13 per share set in the original loan agreements. As a result of the conversion, the company issued 420,491 ordinary shares.

In connection with the conversion, the term of warrants to purchase 160,996 shares that had been issued to the lenders, was extended by 2 years, until July 2014 and February 2015 (see Note 12). Following the extension of the warrants as mentioned above, in accordance with ASC 815, the Company recorded \$86 financial expenses in its statement of operations in 2011, reflecting the incremental compensation caused directly from the extension.

On December 21, 2011 the remaining convertible loan of \$ 501 (the "Deferred Loan" or the "2011 restructuring") remains outstanding, and will bear a reduced interest rate of 4% (as was accounted for in the Conversion Agreements). The Deferred Loan will no longer be convertible. The Deferred Loan will be repaid in 24 equal monthly installments commencing January 10, 2014 (instead of in two payments - in July 2012 and February 2013, according to the original convertible note agreement). The balance of the deferred loan as of December 31, 2012 is \$527(see note 12).



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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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## NOTE 14:- SHAREHOLDERS' EQUITY (Cont.)

## c. Warrants to shareholders

The Company's outstanding warrants to shareholders as of December 31, 2012 are as follows

Outstanding and exercisable warrants as of December 31, 2012	Weighted average exercise price of outstanding warrants	Weighted average remaining contractual life (years)
154,780	\$ 11	1.6
6,215	\$ 11	2.1

## d. Stock option plans:

In May 2003, the Company's shareholders approved the adoption of the 2003 Israeli Stock Option Plan ("the Plan"), pursuant to which 31,250 ordinary shares were reserved for purchase by the employees, directors, consultants and service providers of the Company and its subsidiaries. Subsequently, the shareholders approved increases of the shares reserved for issuance under the Plan, initially to 50,000, and thereafter to 75,000, to 130,000, to 208,000 and in December 21, 2011 to 275,000. Any option which is canceled or forfeited before expiration will become available for future grants.

In December 2012, the Company's shareholders approved a 10-year extension to the Plan, until May 31, 2023,

As of December 31, 2012 an aggregate of 144,982 options are available for future grants under the Plan. Each option granted under the Plan expires between 3-10 years from the date of the grant. The options vest gradually over a period of up to four years.

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## NOTE 14:- SHAREHOLDERS' EQUITY (Cont.)

A summary of the Company's employee and director stock option activity and related information for the year ended December 31, 2012, is as follows:

	Number of options	Weighted-average exercise price	Weighted-average remaining contractual term (in years)	Aggregate intrinsic value
Outstanding at January 1, 2012	124,707	\$ 25	2.91	\$ 60
Changes during the year:				
Granted	-			
Exercised	1,093			
Forfeited or cancelled	30,102	\$ 55.85		
Outstanding at December 31, 2012	93,512	\$ 23.45	2.74	78
Vested and expected to vest	81,284	\$ 26.20	2.59	70
Exercisable at December 31, 2012	81,284	\$ 26.20	2.59	70

No options were granted during 2012 and 2010, the weighted-average grant-date fair value of options granted during the year ended December 31 2011 was \$ 6.76. The aggregate intrinsic value in the table above represents the total intrinsic value (the difference between the fair market value of the Company's ordinary shares on December 31, 2012 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on December 31, 2012.

Total intrinsic value of options exercised for the years ended December 31, 2012, 2011 and 2010 was \$ 5, \$ 33 and \$ 62, respectively. As of December 31, 2012, there was \$ 21 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the Company's Plan. That cost is expected to be recognized through 2014.

No cash was received from exercise of options in the years ended December 31, 2012, 2011 and 2010.



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## NOTE 14:- SHAREHOLDERS' EQUITY (Cont.)

The options granted to employees and director outstanding as of December 31, 2012 separated into ranges of exercise prices, are as follows:

exercise price	Options outstanding as of December 31, 2012	Weighted average remaining contractual life (years)	Options exercisable as of December 31, 2012	Weighted average Remaining contractual life of options exercisable (years)
\$ 0	11,751	0.85	10,363	0.96
\$ 3.80	22,360	3.97	11,180	3.97
\$ 8.00	9,199	3.25	9,199	3.25
\$ 9.91	375	1.14	375	1.14
\$ 11.00	617	1.56	617	1.56
\$ 12.20	1,500	0.88	1,500	0.88
\$ 20.00	9,155	1.00	8,107	1.00
\$ 29.98	375	0.49	375	0.49
\$ 33.60	3,750	5.24	3,750	5.24
\$ 47.70	20,000	1.75	20,000	1.75
\$ 50.40	14,030	4.3	14,030	4.3
\$ 60.00	400	1.63	400	1.63
	93,512	2.74	79,896	3.2

## e. Warrants issued to service providers and debt providers:

The Company accounts for warrants issued to service providers and debt providers in accordance with the provisions of ASC 505-50, "Equity-Based Payments to Non-Employees". The fair value for these warrants was estimated at the date of grant using the Black-Scholes option pricing model. During the years 2012 and 2010 the Company granted warrants to several service and debt providers (see Note 12). No warrants were granted in 2011 to service and debt providers.

In March 2012, the company's Audit Committee and Board of Directors approved a grant of warrants to purchase 3,600 Ordinary shares to THCAP. The grant was approved by the company's shareholders on December 13, 2012. The warrants exercise price is \$2.39 and will be exercisable for 3 years starting December 13, 2012.



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## NOTE 14:- SHAREHOLDERS' EQUITY (Cont.)

The Company's outstanding warrants to service and debt holders as of December 31, 2012 are as follows:

exercise price	Warrants outstanding as of December 31, 2012	Weighted average remaining contractual life (years)	Warrants exercisable as of December 31, 2012	Weighted average remaining contractual life of warrants exercisable (years)
\$ 0.00	330	1.00	330	1.00
\$ 2.39	3,600	2.95	3,600	2.95
\$ 10.00	5,000	3.58	5,000	3.58
\$ 11.00	6,216	0.09	6,216	0.09
\$ 14.88	17,274	1.093	17,274	1.093
\$ 20.00	3,300	1.00	3,300	1.00
\$ 80.80	1,218	0.62	1,218	0.62
\$ 106.00	2,436	0.62	2,436	0.62
	39,374	1.37	39,374	1.37

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NOTE 15:-

## TAXES ON INCOME

## a. Change in corporate tax rate:

The Israeli corporate tax rate was 25% in 2010 and 24% in 2011 and 25% in 2012.

On December 5, 2011, the Israeli Parliament (the Knesset) passed the Law for Tax Burden Reform (Legislative Amendments), 2011 ("the Law") which, among other things, cancels, effective from 2012, the scheduled progressive reduction in the corporate tax Rate. The Law also increases the corporate tax rate to 25% in 2012.

## b. Loss carry forward:

The Company and its Israeli subsidiaries have accumulated losses for Israeli income tax purposes as of December 31, 2012, in the amount of approximately \$ 32,463. These losses may be carried forward and offset against taxable income in the future for an indefinite period. In addition, the Company and its Israeli subsidiaries have accumulated capital losses in the amount of approximately \$21,914 which may be carried forward under certain limitations.

## c. Deferred income taxes:

Deferred income taxes reflect the net tax effect 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 liabilities and assets are as follows:

	December 31,	
	2012	2011
Assets in respect of:		
Allowances and provisions	\$ 142	\$ 195
Net operating loss carry forward (1)	8,116	7,778
	8,258	7,973
Valuation allowance (2)	(8,168 )	(7,838 )
	90	135
Liabilities in respect of intangible assets	(90 )	(135 )
Net deferred tax assets (liability)	\$ -	\$ -



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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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## NOTE 15:- TAXES ON INCOME (Cont.)

(1) See Note 15b.

(2) In 2012, the Company has provided valuation allowances on deferred tax assets that results from tax loss carry forward and other reserves and allowances due to its history of operating losses and current uncertainty about the ability to realize these deferred tax assets in the future.

d. Tax benefit (taxes on income) is comprised as follows:

	Year ended December 31,		
	2012	2011	2010
Current	\$ 187	\$ 172	\$ (2 )
Prior years	-	-	(3 )
	\$ 187	\$ 172	\$ (5 )
Domestic	195	172	\$ (73 )
Foreign	(8 )	-	68
	\$ 187	\$ 172	\$ (5 )

e. Profit (Loss) before taxes is comprised as follows:

	Year ended December 31,		
	2012	2011	2010
Domestic	\$ (572 )	\$ (3,429 )	\$ 228
Foreign	23	43	(52 )
	\$ (549 )	\$ (3,386 )	\$ 176

f. Reconciliation of the theoretical tax expense to the actual tax expense:

The main reconciling items between the statutory tax rate of the Company and the effective tax rate are the non-recognition of tax benefits from accumulated net operating losses carry forward among the Company and various subsidiaries due to uncertainty of the realization of such tax benefits.

g. Tax assessments:

BOS Odem and BOS Dimex have final assessments through 2008. Bos has final assessments through 2007. Dimex Hagalil was incorporated in 2008, and therefore, does not have any final assessments.

Ruby-Tech Inc., a U.S. subsidiary, has final assessments through 2008.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

## NOTE 15:- TAXES ON INCOME (Cont.)

h. In accordance with the Company's accounting policy, interest expense and potential penalties related to income taxes are included in the tax expense line of the Company's consolidated statements of operations.

The Company and its subsidiaries file income tax returns in Israel and in the United States. BOS, BOS Dimex and BOS Odem may be subject to auditing by the Israel tax authorities for fiscal years 2009 and thereafter. Dimex Hagalil may be subject to auditing by the Israel tax authorities for fiscal years 2008 and thereafter. Ruby-Tech Inc., a U.S.

subsidiary, may be subject to auditing by the U.S. Internal Revenue Service for fiscal years 2008 and thereafter.

The Company believes that it has adequately provided for any reasonably foreseeable outcome related to tax audits and settlement. The final tax outcome of the Company's tax audits could be different from that which is reflected in the Company's income tax provisions and accruals. Such differences could have a material effect on the Company's income tax provision and net loss in the period in which such determination is made.

## i. Uncertain tax positions

	December 31,	
	2012	2011
Uncertain tax positions, beginning of year	\$ 172	\$ 379
Decreases in tax positions for prior years	(172 )	(207 )
Increases in tax positions for current year	31	-
Uncertain tax positions, end of year	\$ 31	\$ 172

The Company recognizes interest accrued that is related to unrecognized tax benefits and penalties in taxes on income. During the years ended December 31, 2012 and 2011, the Company recognized approximately \$ (54) and \$ (54), respectively, in interest and penalties. The Company had approximately \$ 0 and \$ 54 accruals for the payment of interest and penalties at December 31, 2012 and 2011, respectively.



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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 16:- SUPPLEMENTARY INFORMATION TO STATEMENTS OF OPERATIONS

a.	Financial expenses, net:		
	Year ended December 31,		
	2012	2011	2010
<b>Financial income:</b>			
Interest on bank deposits	\$ 5	\$ 3	\$ 32
Change in fair value of forward contracts	-	-	141
	5	3	173
<b>Financial expenses:</b>			
In respect of bank loans, bank fees, convertible note and liability to Dimex Systems	(681 )	(1,251 )	(1,039 )
Inducement and related cost (Note 12)	-	(760 )	-
Revaluation of fair value related to extension of warrants as part of an Inducement of a convertible note	-	(86 )	-
Change in fair value of forward contracts	(34 )	(44 )	
Other (mainly foreign currency transaction losses)	(71 )	(103 )	(95 )
	(786 )	(2,244 )	(1,134 )
	\$ (781 )	\$ (2,241 )	\$ (961 )
b.	Net earnings (loss) per share:		
<b>1. Numerator:</b>			
Numerator for basic and diluted net Earnings (loss) per share:			
Income (loss) from continuing operations	\$ (549 )	\$ (3,214 )	\$ 171
Loss from discontinued operations	-	-	(806 )
Net loss available to ordinary shareholders	\$ (549 )	\$ (3,214 )	\$ (635 )
<b>2. Denominator (in thousands):</b>			
Basic weighted average ordinary shares outstanding (in thousands)			
	1,118	705	656
Diluted weighted average ordinary shares outstanding (in thousands)			
	1,118	705	690
	\$ (0.49 )	\$ (4.56 )	\$ 0.28

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Basic and diluted net earnings (loss) per share from  
continuing operations

Basic and diluted net earnings (loss) per share from discontinued operations	\$ -	\$ -	\$ (1.24 )
Basic and diluted net loss per share	\$ (0.49 )	\$ (4.56 )	\$ (0.96 )

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

## NOTE 17:- SEGMENTS AND GEOGRAPHICAL INFORMATION

The Company manages its business in two reportable segments, consisting of the RFID and Mobile Solutions segment and the Supply Chain Solutions segment.

The Company's management makes financial decisions and allocates resources, based on the information it receives from its internal management system. The Company allocates resources and assesses performance for each operating segment using information about revenues and gross profit. The Company applies ASC 280, Segment Reporting.

a. Revenues, gross profit and assets for the operating segments for the years 2012, 2011 and 2010 were as follows:

	RFID and Mobile Solutions	Supply Chain Solutions	Not Allocated/ Intercompany	Consolidated
<b>2012</b>				
Revenues	\$ 8,894	\$ 15,915	\$ (306 )	\$ 24,503
Gross profit	\$ 2,345	\$ 2,723	\$ -	\$ 5,068
Assets related to segment	\$ 8,558	\$ 9,491	\$ -	\$ 18,049
<b>2011</b>				
Revenues	\$ 13,128	\$ 21,332	\$ (1,026 )	\$ 33,434
Gross profit	\$ 3,105	\$ 3,405	\$ -	\$ 6,510
Assets related to segment	\$ 10,132	\$ 9,869	\$ 68	\$ 20,069
<b>2010</b>				
Revenues	\$ 12,463	\$ 17,724	\$ -	\$ 30,187
Gross profit	\$ 3,632	\$ 3,851	\$ -	\$ 7,483
Assets related to segment	\$ 12,418	\$ 9,605	\$ 107	\$ 22,130

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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## NOTE 17:- SEGMENTS AND GEOGRAPHICAL INFORMATION (Cont.)

b. The following presents total revenues and long-lived assets for the years 2012, 2011 and 2010 based on the location of customers:

	2012		Year ended December 31, 2011		2010	
	Total revenues	Long-lived assets *)	Total revenues	Long-lived assets *)	Total revenues	Long-lived assets *)
America	\$ 493	\$ -	\$ 1,514	\$ -	\$ 2,596	\$ -
Far East	1,985	-	3,943	-	2,228	-
Europe	1,178	-	976	-	811	-
Israel and others	20,847	963	27,001	1,166	24,552	1,135
	\$ 24,503	\$ 963	\$ 33,434	\$ 1,166	\$ 30,187	\$ 1,135

\*)Long-lived assets are comprised of property, plant and equipment (intangible assets and goodwill are not included).

c. Major customer data as a percentage of total revenues:

	Year ended December 31,		2011		2010	
	2012		2011		2010	
Customer A (Supply Chain Segment)	15	%	10	%	7	%

## NOTE 18:-

## RELATED PARTIES

a. Service Agreement of Cukierman & Co.:

The Company's Audit Committee and Board of Directors approved an engagement with Cukierman & Co. Investment House Ltd. ("Cukierman & Co"), to provide non-exclusive investment-banking services and business development services to the Company ("the Service Agreement"), effective April 15, 2003. Cukierman & Co. is a company indirectly controlled by Mr. Edouard Cukierman. Since June 26, 2003, Mr. Cukierman serves as Chairman of the Company's Board, and he is also a co-manager of the Catalyst Fund, the Company's largest shareholder. For its services, Cukierman & Co. is paid a monthly sum of \$ 10 plus VAT, in addition to a success fee of 4%-6% for a consummated private placement. The Service Agreement provides for success fees in connection with securing M&A transactions of 3.5% of the proceeds exchanged in such a transaction and also for a success fee of 6% of the revenues actually received by the Company in respect of a sale of the Company's products to a new customer which was introduced by Cukierman & Co. According to its terms, the Company may terminate the Service Agreement at any time, by giving a one-month prior written notice.

Pursuant to an amendment to the Service Agreement, as of July 1, 2012, the monthly payment was reduced to \$6.4 plus VAT.

In addition, the payment will be made once a year at the end of each calendar year by way of issuance of the Company's shares and not in cash, using a price per share as stipulated in the revised Service Agreement.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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## NOTE 18:- RELATED PARTIES (Cont.)

On December 31, 2012 the company issued 6,501 ordinary shares to Cukierman & Co as per the revised Service Agreement.

Expenses the Company recorded according to the Service Agreement with Cukierman & Co. are:

	Year ended December 31,		
	2012	2011	2010
Retainer fee	\$ 98	\$ 120	\$ 95
Success fee in respect of issuance of private placements, According to Service Agreement	-	-	18
<b>Total</b>	<b>\$ 98</b>	<b>\$ 120</b>	<b>\$ 113</b>

## b. Active Chairman Agreement with Edouard Cukierman:

On November 7, 2007, the shareholders approved an Active Chairman Agreement with Mr. Edouard Cukierman, the Chairman of the Board, pursuant to which, Mr. Edouard Cukierman was granted options (the "Options") to purchase up to 5,000 ordinary shares of the Company per each calendar year of service as the Company's Chairman of the Board of Directors (the "Service") in the years 2007-2010. The Options were in lieu of any compensation, fees or options otherwise payable by the Company to Mr. Cukierman as a director.

The exercise price of the Options was \$ 47.7, which was equal to the weighted average of the closing prices of the Company's ordinary shares on the Nasdaq Global Market during the thirty-day period preceding the shareholders' approval. Unexercised Options expire after five years from their grant date.

In March 2011, the Company's Audit Committee and Board of Directors approved a new Active Chairman Agreement with Mr. Cukierman for services in the years 2011-2014. The agreement was approved by the Company's shareholders on December 20, 2011. Pursuant to this agreement in consideration for Mr. Cukierman's services as the Company's Active Chairman in the years 2011-2014, he shall be granted options to purchase 22,360 ordinary shares, and be paid a monthly cash payment of \$ 5,000 plus VAT at the prevailing rate. Payment of the cash fee shall be made each month in respect of the previous month of service. Following approval by the shareholders, the cash fees for 2011 were paid retroactively for the entire year.

The exercise price of the options is \$ 3.8 and they vest and become exercisable in 16 equal quarterly installments. The first three installments vested immediately following the shareholders' approval, and the fourth installment vested on December 31, 2011. Additional installments vest at the end of each subsequent calendar Quarter, provided that Mr. Cukierman shall hold his position as Chairman of the Board at the applicable vesting date.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

## NOTE 18:- RELATED PARTIES (Cont.)

Pursuant to the agreement, if Mr. Cukierman's service to the Company is terminated by the Company, for reasons other than cause, then: (a) any unvested options shall be accelerated, so that they become immediately vested in full as of the date of the termination and (b) the accelerated options and any previously vested options shall be exercisable for twenty four (24) months following the termination.

The options and the cash fee are in lieu of any compensation, fees or options otherwise payable by the Company to Mr. Cukierman as a director.

On December 13, 2012 an amendment to the agreement was approved stating that commencing July 1, 2012 the payment for the Chairman services will be paid in ordinary shares of the company instead of in cash.

On December 31, 2012 the company issued to Edouard Cukierman 5,119 ordinary shares pursuant to the revised Agreement.

Expenses incurred in accordance with the Active Chairman Agreement with Edouard Cukierman are as follows:

	Year ended December 31,		
	2012	2011	2010
Chairman fees	\$ 60	\$ 60	\$ -
Share based compensation expenses	10	43	75
Total	\$ 70	\$ 103	\$ 75

## c. Agreements with THCAP:

In September 2009, the Company entered into a service agreement with THCAP, pursuant to which THCAP shall provide the Company with non-exclusive private financing and business consulting services. In consideration, the Company issued to THCAP warrants to purchase 3,600 ordinary shares at an exercise price of \$ 11 per share. The warrants were exercisable as of February 28, 2011 and could be exercised until August 31, 2012.

In November 2009, the Company entered into an amendment to the service agreement with THCAP, pursuant to which THCAP shall be paid a success fee of 5% of the revenues generated to the Company from the sale of the Company products to business partners introduced by THCAP.

On October 5, 2010 the Company entered into a definitive private placement agreement with THCAP pursuant to which the Company issued to THCAP ordinary shares (see Note 14a), and Mr. Luis Gutierrez Roy, the managing partner in THCAP was appointed to its Board of Directors.





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U.S. dollars in thousands, except share and per share data

## NOTE 18:- RELATED PARTIES (Cont.)

On December 13, 2012, The Company's shareholders approved an additional grant to THCAP of warrants to purchase 3,600 ordinary shares. The warrants' exercise price is \$2.39. The warrants will be exercisable for 3 years from the grant date.

On December 13, 2012 the company's shareholders approved an additional amendment to the agreement with THCAP. Pursuant to this amendment, THCAP will be paid a monthly retainer for business development services in the amount of \$3.7 per month to be paid in the Company's ordinary shares.

On December 31, 2012, the Company issued 1,439 ordinary shares to THCAP pursuant to the amendment.

Expenses incurred according to the agreements with THCAP are as follows:

	Year ended December 31,		
	2012	2011	2010
Retainer fees	\$2	\$ -	\$ -
Share based compensation expenses	6	1	10
Total	\$8	\$ 1	\$ 10

## NOTE 19:- SUBSEQUENT EVENTS

On January 2, 2013 the company received a notice from the NASDAQ Office of General Counsel, Hearings, advising that the Company has regained compliance with the applicable minimum bid price rule and is in compliance with all other applicable requirements for listing on The NASDAQ Capital Market. Accordingly, the Hearings Panel has determined to continue the listing of the Company's securities on The NASDAQ Stock Market.

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CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statements on Form F-3 (Nos. 333-130048 and No. 333-152020) and related prospectus and in the Registration Statements on Form S-8 (Nos. 333-160414, 333-148318, 333-136957, 333-110696, 333-100971, 333-11650 and 333-179253) of B.O.S Better Online Solutions Ltd. (“BOS”) of our report dated April 4, 2013, with respect to the consolidated financial statements of BOS for the year ended December 31, 2012, which appears in BOS’s current report on Form 6-K.

Tel Aviv Israel  
April 4, 2013

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

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