MAGAL SECURITY SYSTEMS LTD
Form 20-F
April 15, 2019

SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

FORM 20-F

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

OR

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

For the fiscal year ended December 31, 2018

OR

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

For the transition period from __________ to __________

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

Date of event requiring this shell company report

Commission file number: 0 21388

MAGAL SECURITY SYSTEMS LTD.
(Exact Name of Registrant as specified in its charter
and translation of Registrant’s name into English)

Israel
(Jurisdiction of incorporation or organization)

P.O. Box 70, Industrial Zone, Yehud 5621617, Israel
(Address of principal executive offices)

Yaacov Vinokur, Chief Financial Officer
Magal Security Systems Ltd.
P.O. Box 70, Industrial Zone
Yehud 5621617, Israel
+972-3-5391444 (phone), +972-3-5366245 (fax)
(Name, Telephone, E-mail and/or Facsimile number of Company Contact Person)

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

Title of each class	Name of each exchange on which registered
Ordinary Shares, NIS 1.0 Par Value	NASDAQ Global Market

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

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

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

Ordinary Shares, par value NIS 1.0 per share ……..…23,049,639 (as of December 31, 2018)

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

Yes No

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

Yes No

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

Yes No

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

Yes No

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

Large accelerated filer Accelerated filer

Non-accelerated filer Emerging growth company

If an emerging growth company that prepares its financial statements in accordance with U.S. GAAP, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

U.S. GAAP International Financial Reporting Standards as issued by the International Accounting Standards Board Other

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

Item 17 Item 18

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

Yes No

This Annual Report on Form 20-F is incorporated by reference into the Registrant's Registration Statements on Form S-8, File Nos. 333-164696, 333-174127 and 333-190469.

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INTRODUCTION

Magal Security Systems Ltd. is a leading international provider of solutions and products for physical and video security solutions, as well as site management. Since 1969, we have delivered our products as well as tailor-made security solutions and turnkey projects to customers in over 100 countries under some of the most challenging conditions. We offer comprehensive integrated solutions for critical sites, which leverage our broad portfolio of homegrown PIDS (Perimeter Intrusion Detection Systems), advanced VMS (Video Management Software) with native IVA (Intelligent Video Analytics) security solutions, as well as a proprietary command and control platform.

Based on our multi decade industry experience and interaction with customers, we have developed a comprehensive set of solutions and products, optimized for perimeter, outdoor and general security applications. Our broad portfolio of critical infrastructure protection and site protection technologies includes a variety of smart barriers and fences, fence mounted sensors, virtual gates, buried and concealed detection systems and sophisticated sensors for sub-surface intrusion such as to secure pipelines, as well as advanced video analytics software and video management systems. Our turnkey solutions are typically integrated and managed by sophisticated modular command and control software, supported by expert systems for real-time decision support. We have successfully installed customized solutions and products in more than 100 countries worldwide. Our ordinary shares are traded on the NASDAQ Global Market under the symbol “MAGS”. Our website is www.magalsecurity.com. The information on our website is not incorporated by reference into this annual report. As used in this annual report, the terms “we,” “us,” “our,” and “Magal” mean Magal Security Systems Ltd. and its subsidiaries, unless otherwise indicated.

AIMETIS, AIMETIS SYMPHONY, FIBERPATROL, FLARE, FLEXPI, FLEXPS, FLEXZONE, GUIDAR, INTELLI-FIELD, OMNITRAX, PANTHER, PINPOINTER, REPELS, SENNET, SENSTAR, SENSTAR & DESIGN, SENTIENT, ULTRAWAVE DESIGN, XFIELD, MAGAL, DTR, FORTIS, MAESTRO DB, FENSOR, and ROBOGUARD, are registered trademarks. ARMOURFLEX, CYBERSEAL, ENTERPRISE MANAGER, GALLIUM PDS, INTELLI-FLEX, INTELLIFIBER, LM100, the MAGAL logo, NETWORK MANAGER, RUBIDIUM, STARLED, STARNET, SYMPHONY, TUNGSTEN, VANADIUM and all other marks used to identify particular products and services associated with our businesses are unregistered trademarks. Any other trademarks and trade names appearing in this annual report are owned by their respective holders.

Our consolidated financial statements appearing in this annual report are prepared in U.S. dollars and in accordance with generally accepted accounting principles in the United States, or U.S. GAAP. All references in this annual report to “dollars” or “$” are to U.S. dollars, all references to “NIS” are to New Israeli Shekels and all references to “CAD” are to Canadian dollars.

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

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

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. Selected Consolidated Financial Data.

The following selected consolidated financial data for and as of the five years ended December 31, 2018 are derived from our audited consolidated financial statements which have been prepared in accordance with U.S. GAAP. We have derived the following selected consolidated financial data as of December 31, 2017 and 2018 and for each of the years ended December 31, 2016, 2017 and 2018 from our consolidated financial statements set forth elsewhere in this annual report that have been prepared in accordance with U.S. GAAP. We have derived the following selected consolidated financial data as of December 31, 2014, 2015 and 2016 and for each of the years ended December 31, 2014 and 2015 from our audited consolidated financial statements not included in this annual report. The selected consolidated financial data set forth below should be read in conjunction with and are qualified entirely by reference to Item 5. “Operating and Financial Review and Prospects” and our audited consolidated financial statements and notes thereto included elsewhere in this annual report.

	2014	2015	2016	2017	2018
Revenues	$77,543	$63,736	$67,825	$64,292	$92,602
Cost of revenues	43,049	32,722	34,570	32,967	52,299
Gross profit	34,494	31,014	33,255	31,325	40,303
Operating expenses:					
Research and development, net	4,604	4,814	6,779	6,558	6,852
Selling and marketing	17,130	14,785	17,536	18,158	18,557
General and administrative	8,898	7,026	7,445	7,853	10,160
Impairment of goodwill and other intangible assets	2,439	-	-	-	979
Total operating expenses	33,071	26,625	31,760	32,569	36,548
Operating income (loss)	1,423	4,389	1,495	(1,244)	3,755
Financial income (expenses), net	1,979	642	(591)	(3,961)	1,361
Income (loss) before income taxes	3,402	5,031	904	(5,205)	5,116
Taxes on income (tax benefit)	82	1,923	(122)	1,695	2,072
Net income (loss)	$3,320	$3,108	$1,026	$(6,900)	$3,044
Less: net income (loss) attributable to non-controlling interest	(90)	(33)	(3)	14	95
Net income (loss) attributable to Magal’s shareholders	$3,410	$3,141	$1,029	$(6,914)	$2,949
Basic and diluted net earnings (loss) per share	$0.21	$0.19	$0.06	$(0.30)	$0.12
Weighted average number of ordinary shares used in computing basic net earnings per share	16,186,148	16,347,948	17,999,779	22,989,009	23,040,436
Weighted average number of ordinary shares used in computing diluted net earnings per share	16,338,056	16,410,711	18,031,433	22,989,009	23,287,751

	2014	2015	2016	2017	2018

Consolidated Balance Sheets Data:					
Cash and cash equivalents	$21,602	$27,319	$19,692	$22,463	$38,665
Short and long-term deposits and restricted deposits	10,979	3,977	32,971	30,022	16,431
Working capital	45,805	43,996	58,752	59,401	61,023
Total assets	83,759	74,996	105,993	112,545	119,171
Short term bank credit (including current maturities of long-term loans)	3,071	-	-	-	-
Long term bank loans	1,406	-	-	-	-
Total shareholders' equity	55,957	55,695	81,918	82,949	81,216

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B. Capitalization and Indebtedness.

Not applicable.

C. Reasons for the Offer and Use of Proceeds.

Not applicable.

D. Risk Factors.

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

Risks Related to Our Business

We depend on large orders from a relatively small number of customers for a substantial portion of our revenues. The loss of one or more of our key customers could result in a loss of a significant amount of our revenues.

Historically, a relatively small number of customers account for a significant percentage of our revenues. The Israeli Ministry of Defense, or the MOD, and the Israeli Defense Forces, or the IDF accounted for 8.6%, 10.2% and 10.9% of our revenues in the years ended December 31, 2016, 2017 and 2018, respectively. In addition, revenues from a national electricity company in Latin America accounted for 11.91%, 14.6% and 25.3% of our revenues in the years ended December 31, 2016, 2017 and 2018, respectively. The MOD, the IDF or any of our other major continuing customers may not maintain their volume of business with us or, if such volume is reduced, other customers generating similar revenues may not replace the lost business. Our inability to replace business from large contracts will adversely affect our financial results. Any unanticipated delays in a large project, changes in customer requirements or priorities during the project implementation period, or a customer's decision to cancel a project, may adversely impact our operating results and financial performance. Our revenues may also be affected in the future if there is a reduction in Israeli government defense spending for our programs or a change in priorities to purchase products other than ours. Accordingly, changes in government contracting policies, budgetary constraints and delays or changes in the appropriations process could have an adverse effect on our business, financial condition and results of operations.

While we were profitable in 2018, we have incurred major losses in past years and may not operate profitably in the future.

We reported an operating profit of $3.8 million and a net income of $3 million in the year ended December 31, 2018. We may not be able to regain and sustain profitable operations in the future. If we do not generate sufficient cash from operations, we will be required to reduce our level of expenditure or cash balance. Such financing may not be available in the future, or, if available, may not be on terms favorable to us. If adequate funds are not available to us, our business, results of operations and financial condition will be materially and adversely affected.

Our operating results may fluctuate from quarter to quarter and year to year.

Our sales and operating results may vary significantly from quarter to quarter and from year to year in the future. Our operating results are characterized by a seasonal pattern, with a higher volume of revenues towards the end of the year and lower revenues in the first part of the year. In addition, our operating results are affected by a number of factors, many of which are beyond our control. Factors contributing to these fluctuations include the following:

- changes in customers' or potential customers' budgets as a result of, among other things, government funding and procurement policies;
- changes in demand for our existing products and services;
- our long and variable sales cycle;
- our ability to maintain sales volumes at a level sufficient to cover fixed manufacturing and operating costs;
- the timing of the introduction and market acceptance of new products, product enhancements and new applications.

Our expense levels are based, in part, on expected future sales. If sales levels in a particular quarter do not meet expectations, we may be unable to adjust operating expenses quickly enough to compensate for the shortfall of sales, and our results of operations may be adversely affected. Due to these and other factors, we believe that quarter to quarter and year to year comparisons of our past operating results may not be meaningful. You should not rely on our results for any quarter or year as an indication of our future performance. Our operating results in future quarters and years may be below expectations, which would likely cause the price of our ordinary shares to fall.

Our financial results may be significantly affected by currency fluctuations.

Most of our sales are made in North America, Latin America, Africa, Israel and Europe. Our revenues are primarily denominated in Dollars, NIS, Mexican Pesos and Euros, while a portion of our expenses, primarily labor expenses, is incurred in NIS and Canadian Dollars. Additionally, certain assets, especially trade receivables, as well as part of our liabilities are denominated in NIS. As a result, fluctuations in rates of exchange between the dollar and non-dollar currencies may affect our operating results and financial condition. The dollar cost of our operations in Israel may be adversely affected by the appreciation of the NIS against the dollar. In addition, the value of our non-dollar revenues could be adversely affected by the depreciation of the dollar against such currencies. Our financial expenses may also be adversely affected by the depreciation of a currency in which we maintain our monetary assets.

We recorded foreign exchange losses, net of $0.6 million and $4 million in the years ended December 31, 2016 and 2017, respectively and a foreign exchange gain, net of $1.1 million in the year ended December 31, 2018. As a result of our rights offering in late 2016, we held a significant amount of cash and cash equivalents in U.S. dollars at year end 2016 and during 2017 and 2018. These balances were translated into Israeli Shekels, which depreciated by 1.5% and 9.8% against the U.S. dollar in 2016 and 2017, respectively and which appreciated by 8.1% against the U.S. dollar in 2018. We may incur exchange losses in the future which may materially affect our operating results.

Because our project related sales tend to be concentrated among a small number of customers during any period, our operating results may be subject to substantial fluctuations. Accordingly, our revenues and operating results for any particular quarter may not be indicative of our performance in future quarters, making it difficult for investors to evaluate our future prospects based solely on the results of any one quarter.

Given the nature of our customers and projects, we receive relatively large orders for projects from a relatively small number of customers. Consequently, a single order from one customer may represent a substantial portion of our sales in any one period and significant orders by any customer during one period may not be followed by further orders from the same customer in subsequent periods. Our sales and operating results are subject to very substantial periodic variations. Since quarterly performance is likely to vary significantly, our results of operations for any quarter or calendar year are not necessarily indicative of the results that we might achieve for any subsequent period. Accordingly, quarter-to-quarter and year-to-year comparisons of our operating results may not be meaningful. In addition, we have a limited order backlog that is generally composed of orders that are mostly fulfilled within a period of three to twelve months after receipt, which makes revenues in any quarter substantially dependent upon orders received in prior quarters.

We may be unable to successfully integrate our recent acquisitions to fully realize targeted synergies, revenues and other expected benefits of the acquisitions. We expect to make additional acquisitions in the future that could disrupt our operations and harm our operating results.

In April 2018, we completed the acquisition of a 55% controlling interest in ESC BAZ Ltd., an Israeli-based company, focused on the development and manufacturing of military-grade smart Security Video Observation and Surveillance systems. In April 2016, Senstar, our fully owned Canadian subsidiary, acquired Aimetis, a Canadian-based company, which specializes in advanced video analytics software and intelligent IP video management software (VMS). In July 2017 we amalgamated our two Canadian subsidiaries. Following the amalgamation, the company maintained the name Senstar Corporation.

Achieving the targeted synergies, such as operating and long-term strategic cost-savings, of the acquisitions will depend in part upon whether we can continue to integrate their businesses and technologies in an efficient and effective manner. We may not be able to accomplish this integration process smoothly or successfully. The integration of our respective operations will require the dedication of significant management resources, which may distract management's attention from day-to-day operations. Employee uncertainty and lack of focus during the integration process may also disrupt our business and result in undesired employee attrition. An inability of management to successfully integrate the operations into our business could have a material adverse effect on our business, results of operations and financial condition.

An inability to realize the full extent of, or any of, the anticipated benefits and synergies of the acquisitions, as well as any delays encountered in the integration process, could have an adverse effect on our business, results of operations and financial condition. We may also be required in the future to record impairment charges relating to the carrying value of our intangible assets and goodwill arising from such acquisitions. Moreover, future acquisitions by us could result in potentially dilutive issuances of our equity securities, the incurrence of debt and contingent liabilities and amortization expenses related to identifiable intangible assets, any of which could materially adversely affect our operating results and financial position. Acquisitions also involve other risks, including risks inherent in entering markets in which we have no or limited prior experience.

Mergers and acquisitions of companies are inherently risky and subject to many factors outside of our control and no assurance can be given that our future acquisitions will be successful and will not adversely affect our business, operating results, or financial condition. In the future, we may seek to acquire or make strategic investments in complementary businesses, technologies, services or products, or enter into strategic partnerships or alliances with third parties in order to expand our business. Failure to manage and successfully integrate such acquisitions could materially harm our business and operating results. Prior acquisitions have resulted in a wide range of outcomes, from successful introduction of new products technologies and professional services to a failure to do so. Even when an acquired company has previously developed and marketed products, there can be no assurance that new product enhancements will be made in a timely manner or that pre-acquisition due diligence will have identified all possible issues that might arise with respect to such products. If we acquire other businesses, we may face difficulties, including:

· Difficulties in integrating the operations, systems, technologies, products, and personnel of the acquired businesses or enterprises;

· Diversion of management's attention from normal daily operations of the business and the challenges of managing larger and more widespread operations resulting from acquisitions;

· Integrating financial forecasting and controls, procedures and reporting cycles;

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Difficulties in entering markets in which we have no or limited direct prior experience and where competitors in such markets have stronger market positions;

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- Insufficient revenue to offset increased expenses associated with acquisitions; and

- The potential loss of key employees, customers, distributors, vendors and other business partners of the companies we acquire following and continuing after announcement of acquisition plans.

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

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

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

- their requirements or budgetary constraints change;

- they cancel multi-year contracts and related orders if funds become unavailable;

- they shift spending priorities into other areas or for other products; or

- they adjust contract costs and fees on the basis of audits.

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

Because competition in our industry is intense, our business, operating results and financial condition may be adversely affected.

The global market for security, safety, site management solutions and products is highly fragmented and intensely competitive. We compete principally in the market for perimeter intrusion detection systems, or PIDS, Video Management Software, or VMS, Intelligent Video Analytics, or IVA, and turnkey projects and solutions. Some of our competitors and potential competitors have greater research, development, financial and personnel resources, including governmental support, as well as established greater penetration into certain vertical markets or geographical market segments. We cannot assure you that we will be able to compete effectively relative to our competitors or continue to develop and market new products effectively. Continued competitive pressures could cause us to lose significant market share or erode profitability margins.

Increased competition and bid protests in a budget-constrained environment may make it more difficult to maintain our financial performance.

A substantial portion of our business is awarded through competitive bidding. Governments increasingly have relied upon competitive contract award types and multi-award contracts, which has the potential to create pricing pressure and increase our cost by requiring that we submit multiple bids and proposals. The competitive bidding process entails substantial costs and managerial time to prepare bids and proposals for contracts that may not be awarded to us or may be split among competitors. Multi award contracts require that we make sustained efforts to obtain task orders under the contract. Following award, we may encounter significant expenses, delays, contract modifications, or even loss of the contract if our competitors protest or challenge contracts that are awarded to us.

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

During periods of slowing economic activity, our customers may reduce their demand for our products, technology and professional services, which would reduce our sales, and our business, operating results and financial condition may be adversely affected. The global and domestic economies continue to face a number of economic challenges, including threatened sovereign defaults, credit downgrades, restricted credit for businesses and consumers and potentially falling demand for a variety of products and services. These developments, or the perception that any of them could occur, could result in longer sales cycles, slower adoption of new technologies and increased price competition for our products and services. We could also be exposed to credit risk and payment delinquencies on our accounts receivable, which are not covered by collateral.

Significant portions of our operations are conducted outside the markets in which our products and solutions are manufactured or generally sold, and accordingly, we often export a substantial number of products into such markets. We may, therefore, be denied access to potential customers or suppliers or denied the ability to ship products from any of our subsidiaries into the countries in which we currently operate or wish to operate, as a result of economic, legislative, political and military conditions, including hostilities and acts of terrorism, in such countries.

We may also be required in the future to increase our reserves for doubtful accounts. In addition, the fair value of some of our assets may decrease as a result of an uncertain economy and as a result, we may be required to record impairment charges in the future. If global economic and market conditions or economic conditions in key markets remain uncertain or weaken further, our financial condition and operating results may be materially adversely affected.

We may be adversely affected by our long sales cycles.

We have in the past and expect in the future to experience long time periods between initial sales contacts and the execution of formal contracts for our products and completion of product installations. The cycle from first contact to revenue generation in our business involves, among other things, selling the concept of our technology and products, developing and implementing a pilot program to demonstrate the capabilities and accuracy of our products, negotiating prices and other contract terms, and, finally, installing and implementing our products on a full-scale basis. This cycle entails a substantial period of time, sometimes as much as one or more years, and the lack of revenues during this cycle and the expenses involved in bringing new sales to the point of revenue generation may put a substantial strain on our resources. Our business involves significant risks and uncertainties that may not be covered by indemnity or insurance.

Our business involves significant risks and uncertainties that may not be covered by indemnity or insurance.

A significant portion of our business relates to designing, developing, and manufacturing advanced security, site management and systems and products. New technologies may be untested or unproven. Failure of some of these products and services could result in extensive loss of life or property damage. Accordingly, we also may incur liabilities that are unique to our products and services. In some, but not all circumstances, we may be entitled to certain legal protections or indemnifications from our customers, either through regulatory protections, contractual provisions or otherwise. The amount of insurance coverage that we maintain may not be adequate to cover all claims or liabilities, and it is not possible to obtain insurance to protect against all operational risks and liabilities.

Substantial claims resulting from an accident, failure of our products or services, or other incident, or liability arising from our products and services in excess of any indemnity and our insurance coverage (or for which indemnity or insurance is not available or not obtained) could adversely impact our financial condition, cash flows, or operating results. Any accident, even if fully indemnified or insured, could negatively affect our reputation among our customers and the public, and make it more difficult for us to compete effectively. It also could affect the cost and availability of adequate insurance in the future.

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

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

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

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

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

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

Our international operations require us to comply with anti-corruption laws and regulations of various governments and different international jurisdictions, and our failure to comply with these laws and regulations could adversely affect our reputation, business, financial condition and results of operations.

Doing business on a worldwide basis requires us and our subsidiaries to comply with the laws and regulations of various governments and different international jurisdictions, and our failure to successfully comply with these rules and regulations may expose us to liabilities. These laws and regulations apply to companies, individual directors, officers, employees and agents, and may restrict our operations, trade practices, investment decisions and partnering activities. In particular, as a company registered with the Securities and Exchange Commission, or the SEC, we are subject to the regulations imposed by the Foreign Corrupt Practices Act, or FCPA. The FCPA prohibits us from providing anything of value to foreign officials for the purposes of influencing official decisions or obtaining or retaining business or otherwise obtaining favorable treatment, and requires companies to maintain adequate record-keeping and internal accounting practices to accurately reflect the transactions of the company. As part of our business, we deal with state-owned business enterprises, the employees and representatives of which may be considered foreign officials for purposes of the FCPA. If our efforts to screen third-party agents and detect cases of potential misconduct fail, we could be held responsible for the noncompliance of these third parties under applicable laws and regulations, which may have a material adverse effect on our reputation and our business, financial condition and results of operations. In addition, some of the international locations in which we operate lack a developed legal system and have elevated levels of corruption. As a result of the above activities, we are exposed to the risk of violating anti-corruption laws. We have established policies and procedures designed to assist us and our personnel to comply with applicable U.S. and international laws and regulations. However, there can be no assurance that our policies and procedures will effectively prevent us from violating these regulations in every transaction in which we may engage, and such a violation could adversely affect our reputation, business, financial condition and results of operations.

We face risks associated with doing business in international markets.

A large portion of our sales is to markets outside of Israel. For the years ended December 31, 2016, 2017 and 2018 approximately 87.1%, 85.1% and 85.3%, respectively, of our revenues were derived from sales to markets outside of Israel. A key component of our strategy is to continue to expand in such international markets. Our international sales efforts are affected by costs associated with the shipping of our products and risks inherent in doing business in international markets, including:

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

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

We have significant operations in countries that may be adversely affected by political events, economic instability, regime replacement, major hostilities or acts of terrorism.

We are a global security company with worldwide operations. Significant portions of our operations are conducted outside the markets in which our products and solutions are manufactured or generally sold, and accordingly, we often export a substantial number of products into such markets. We may be denied access to potential customers or suppliers or denied the ability to ship products from any of our subsidiaries into the countries in which we currently operate or wish to operate, as a result of economic, legislative, political and military conditions, including hostilities and acts of terrorism, in such countries.

The UK's decision to exit the European Union (referred to as Brexit) has caused additional volatility in the markets and currency exchange rates. Market conditions and exchange rates could continue to be volatile in the near term as this decision is implemented. The impacts of Brexit are still uncertain while the UK’s future trading and transition relationship with the EU is determined. There is the potential for our costs to increase, for example through any changes required to our systems to reflect new taxes or customs duties or other processes. Our regulatory risk could increase if there were to be future divergence with the EU regime. Our suppliers may face disruption as a result of challenges in their own organizations and supply chains. Also, delivering a great customer experience and great network will become more challenging if it is harder for us to recruit and retain skilled talent and to source sufficient construction workforce. The UK economy may also suffer as a result of this uncertainty.

In the United States, market volatility accelerated during the second quarter of 2018, resulting from increasing concerns about global trade wars, the slowing pace of global growth, inflation and more aggressive monetary policy in the U.S. and global equity markets were mixed, with U.S. markets trading higher while global and emerging markets traded in negative territory. The U.S. Federal Reserve, based on strong economic data and low unemployment, increased interest rates in 2018. As a result, the U.S. dollar strengthened against the Euro and most other currencies. In China, the industrial sector slowed and the risk of decreased growth rose as the U.S. and China each imposed tariffs on various goods and services.

These developments, or the perception that any of them could occur, could have a material adverse effect on global economic conditions and the stability of global financial markets, and could significantly reduce global market liquidity and restrict the ability of key market participants to operate in certain financial markets. Asset valuations, currency exchange rates and credit ratings may be especially subject to increased market volatility. Any of these events would likely harm our business, operating results and financial condition.

Breaches of network or information technology security, natural disasters or terrorist attacks could have an adverse effect on our business.

Cyber-attacks or other breaches of network or information technology (IT) security, natural disasters, terrorist acts or acts of war may cause equipment failures or disrupt our systems and operations. We may be subject to attempts to breach the security of our networks and IT infrastructure through cyber-attacks, malware, computer viruses and other means of unauthorized access. While we maintain insurance coverage for some of these events, the potential liabilities associated with these events could exceed the insurance coverage we maintain. A failure to protect the privacy of customer and employee confidential data against breaches of network or IT security could result in damage to our reputation. To date, we have not been subject to cyber-attacks or other cyber incidents which, individually or in the aggregate, resulted in a material impact to our operations or financial condition.

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

Our success and ability to compete depend in large part upon protecting our proprietary technology. We have 24 patents and have 8 patent applications pending. We also rely on a combination of trade secret and copyright law and confidentiality, non-disclosure and assignment-of-inventions agreements to protect our proprietary technology. It is our policy to protect our proprietary rights in our products and operations through contractual obligations, including confidentiality and non-disclosure agreements with certain employees, distributors and agents, suppliers and subcontractors. These measures may not be adequate to protect our technology from third-party infringement, and our competitors may independently develop technologies that are substantially equivalent or superior to ours. Additionally, our products may be sold in foreign countries that provide less protection to intellectual property than that provided under U.S. or Israeli laws.

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

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

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

Despite our regular quality assurance testing, the development, enhancement and implementation of our complex systems entail substantial risks of product defects or failures. Undetected errors or “bugs” may be found in existing or new products, resulting in delays, loss of revenues, warranty expense, loss of market share, failure to achieve market acceptance, adverse publicity, product returns, loss of competitive position or claims against us by customers. Any such problems could be costly to remedy and could cause interruptions, delays, or cessation of our product sales, which could cause us to lose existing or prospective customers and could negatively affect our results of operations. Moreover, the complexities involved in implementing our systems entail additional risks of performance failures. We may encounter substantial difficulties due to such complexities which could have a material adverse effect upon our business, financial condition and results of operations.

Systems and information technology interruptions or cyber-attacks could adversely impact our ability to operate.

Our operations rely on computer, information and communications technology and related systems. From time to time, we may experience system interruptions and delays. If we are unable to continually add software and hardware, effectively upgrade our systems and network infrastructure and take other steps to improve the efficiency of and protect our systems, our operations could be interrupted or delayed. Our computer and communications systems and operations could be damaged or interrupted by natural disasters, telecommunications failures, acts of war, terrorism or similar events or disruptions. Any of these or other events could cause system interruption, delays and loss of critical data, or delay or stoppage of our operations, and adversely affect our operating results.

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

We acquire most of the components utilized in our products, including our turnkey solutions, from a limited number of suppliers. We may not be able to obtain such items from these suppliers in the future or we may not be able to obtain them on satisfactory terms. Temporary disruptions of our manufacturing operations would result if we were required to obtain materials from alternative sources, which may have an adverse effect on our financial results.

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

We currently benefit from grants and tax benefits under Israeli government programs, which require us to meet specified conditions, including, but not limited to, making specified investments from our equity in fixed assets and paying royalties with respect to grants received. In addition, some of these programs restrict our ability to manufacture particular products or transfer particular technology outside of Israel. We also benefit from tax credits pursuant to the Scientific Research and Experimental Development Tax incentive Program in Canada, and from research grant programs such as the "Industrial Research Assistance Program" (IRAP).

If we fail to comply with the conditions imposed by the Israeli law or the Canadian tax program in the future, the benefits we receive could be cancelled and we could be required to refund any payments previously received under these programs, including any accrued interest, or pay increased taxes or royalties. Canadian research grant programs are dependent on the Government's continued commitment to support R&D, on availability of funding, and may be more difficult to realize or may not be available in the future. Such a result would adversely affect our results of operations and financial condition.

The Israeli government has reduced the benefits available under these programs in recent years and these programs and benefits may be discontinued or curtailed in the future. If the Israeli or Canadian governments resolve to end these programs and benefits, our business, financial condition, results of operations and net income could be materially adversely affected.

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

The Sarbanes-Oxley Act of 2002 imposes certain duties on us and our executives and directors. Our efforts to comply with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 governing internal controls and procedures for financial reporting have resulted in increased general and administrative expense and a diversion of management time and attention, and we expect these efforts to require the continued commitment of significant resources. Section 404 of the Sarbanes-Oxley Act requires management's annual review and evaluation of our internal control over financial reporting in connection with the filing of the annual report on Form 20-F for each fiscal year. We may identify material weaknesses or significant deficiencies in our internal control over financial reporting. Failure to maintain effective internal control over financial reporting could result in material misstatements in our financial statements. Any such failure could also adversely affect the results of our management's evaluations and annual auditor reports regarding the effectiveness of our internal control over financial reporting. We have documented and tested our internal control systems and procedures in order for us to comply with the requirements of Section 404. While our assessment of our internal control over financial reporting resulted in our conclusion that as of December 31, 2018, our internal control over financial reporting was effective, we cannot predict the outcome of our testing in future periods. If we fail to maintain the adequacy of our internal controls, we may not be able to ensure that we can conclude on an ongoing basis that we have effective internal controls over financial reporting. Failure to maintain effective internal control over financial reporting could result in investigation or sanctions by regulatory authorities and could have a material adverse effect on our operating results, investor confidence in our reported financial information and the market price of our ordinary shares.

Regulations related to conflict minerals may cause us to incur additional expenses and could limit the supply and increase the costs of certain metals used in the manufacturing of our solutions.

The Dodd-Frank Wall Street Reform and Consumer Protection Act imposes disclosure requirements regarding the use in components of our products of "conflict minerals" mined from the Democratic Republic of Congo and adjoining countries, whether the components of our products are manufactured by us or third parties. These requirements could affect the pricing, sourcing and availability of minerals used in the manufacture of components we use in our products. Although the SEC has provided guidance with respect to a portion of the conflict mineral filing requirements that may somewhat reduce our reporting practices, there are costs associated with complying with the disclosure requirements and customer requests, such as costs related to our due diligence to determine the source of any conflict minerals used in our products. We may face difficulties in satisfying customers who may require that all of the components of our products are certified as conflict mineral free or free of numerous other hazardous materials.

Risks Relating to Our Ordinary Shares

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

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

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

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

The FIMI Partnerships owned approximately 43% of our outstanding ordinary shares as of April 12, 2019. For as long as FIMI has a controlling interest in our company, it will have the ability to exercise a controlling influence over our business and affairs, including any determinations with respect to potential mergers or other business combinations involving us, our acquisition or disposition of assets, our incurrence of indebtedness, our issuance of any additional ordinary shares or other equity securities, our repurchase or redemption of ordinary shares and our payment of dividends. Because the interests of FIMI may differ from the interests of our other shareholders, actions taken by FIMI with respect to us may not be favorable to our other shareholders.

We have not distributed dividends in the past.

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

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

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

We may in the future be classified as a passive foreign investment company, or PFIC, which will subject our U.S. investors to adverse tax rules.

U.S. holders of our ordinary shares may face income tax risks. There is a risk that we will be treated as a "passive foreign investment company" or PFIC. Our treatment as a PFIC could result in a reduction in the after-tax return to the holders of our ordinary shares and would likely cause a reduction in the value of such shares. A foreign corporation will be treated as a PFIC for U.S. federal income tax purposes if either (1) at least 75% of its gross income for any taxable year consists of certain types of "passive income," or (2) at least 50% of the average value of the corporation's gross assets produce, or are held for the production of, such types of "passive income." For purposes of these tests, "passive income" includes dividends, interest, gains from the sale or exchange of investment property and rents and royalties other than rents and royalties that are received from unrelated parties in connection with the active conduct of trade or business. For purposes of these tests, income derived from the performance of services does not constitute "passive income". If we are treated as a PFIC, U.S. Holders of shares (or rights) would be subject to a special adverse U.S. federal income tax regime with respect to the income derived by us, the distributions they receive from us, and the gain, if any, they derive from the sale or other disposition of their ordinary shares (or rights). In particular, any dividends paid by us, if any, would not be treated as “qualified dividend income” eligible for preferential tax rates in the hands of non-corporate U.S. shareholders. We believe that we were not a PFIC for the taxable year of 2018. However, since PFIC status depends upon the composition of our income and the market value of our assets from time to time, there can be no assurance that we will not become a PFIC in any future taxable year. U.S. Holders should carefully read Item 10E. “Additional Information – Taxation” for a more complete discussion of the U.S. federal income tax risks related to owning and disposing of our ordinary shares (or rights).

Risks Relating to Our Location in Israel

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

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

Conflicts in North Africa and the Middle East, including in Egypt and Syria which border Israel, have resulted in continued political uncertainty and violence in the region. Efforts to improve Israel’s relationship with the Palestinian Authority have failed to result in a permanent solution, and there have been numerous periods of hostility in recent years. In addition, relations between Israel and Iran continue to be seriously strained, especially with regard to Iran’s nuclear program. Such instability may affect the local and global economy, could negatively affect business conditions and, therefore, could adversely affect our operations. To date, these matters have not had any material effect on our business and results of operations; however, the regional security situation and worldwide perceptions of it are outside our control and there can be no assurance that these matters will not negatively affect us in the future.

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

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

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

The rights and responsibilities of the shareholders are governed by Israeli law and differ in some respects from the rights and responsibilities of shareholders under U.S. law.

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

Provisions of Israeli law may delay, prevent or make difficult a change of control and therefore depress the price of our shares.

Some of the provisions of Israeli law could discourage potential acquisition proposals, delay or prevent a change in control and limit the price that investors might be willing to pay in the future for our ordinary shares. Israeli corporate law regulates mergers and acquisitions of shares through tender offers, requires approvals for transactions involving significant shareholders and regulates other matters that may be relevant to these types of transactions. Furthermore, Israel tax law treats stock-for-stock acquisitions between an Israeli company and a foreign company less favorably than does U.S. tax law. For example, Israeli tax law may subject a shareholder who exchanges his ordinary shares for shares in a foreign corporation to immediate taxation or to taxation before his investment in the foreign corporation becomes liquid. These provisions may adversely affect the price of our shares.

Our shareholders generally may have difficulties enforcing a U.S. judgment against us, our executive officers and directors and some of the experts named in this annual report, or asserting U.S. securities law claims in Israel.

We are incorporated in Israel and all of our executive officers and directors named in this annual report reside outside the United States. Service of process upon them may be difficult to effect within the United States. Furthermore, since substantially all of our assets and all of our directors and officers are located outside the United States, any judgment obtained in the United States against us or these individuals may not be collectible within the United States and may not be enforced by an Israeli court. It also may be difficult for you to assert U.S. securities law claims in original actions instituted in Israel.

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

ITEM 4. Information on the Company

A. History and Development of the Company.

We were incorporated under the laws of the State of Israel on March 27, 1984 under the name Magal Security Systems Ltd. We are a public limited liability company under the Israeli Companies Law, 5759-1999, and operate under this law and associated legislation. Our principal executive offices are located near Tel Aviv, Israel, in the Yehud Industrial Zone. Our mailing address is P.O. Box 70, Industrial Zone, Yehud 5621617, Israel and our telephone number is +972-3-539-1444. Our agent for service of process in the United States is Senstar Inc., 13800 Coppermine Road, Second Floor, Herndon, Virginia 20171. Our website address is www.magalsecurity.com. The information on our website is not incorporated by reference into this annual report.

We are a leading international provider of products and solutions for physical security, safety and site management. We commenced operations in 1969 as a department of Israel Aircraft Industries Ltd., specializing in perimeter security systems and have delivered products, tailor-made solutions and turnkey projects to thousands of satisfied customers in over 100 countries in some of the world's most demanding locations.

We offer broad portfolio of homegrown Perimeter Intrusion Detection Systems (PIDS),Video Management Software (VMS), Intelligent Video Analytics (IVA), technology and cyber security solutions. Our offering is complemented by our comprehensive integrated solutions for critical sites, managed by Fortis^{4G} – our 4th generation cutting edge Physical Security Information Management system (PSIM).

We intend to increase our revenues in the perimeter products segment as well as the VMS/IVA segments by (i) locating new channels to promote and market our products; (ii) maintaining technology leadership; (iii) investing in research and development; (iv) entering into OEM agreements; and (v) acquiring new technologies independently or through mergers and acquisitions.

In April 2018, we completed the acquisition of a 55% controlling interest in ESC BAZ Ltd. an Israeli-based company, focused on the development and manufacturing of military-grade smart security video observation and surveillance systems.

In April 2016, we acquired Aimetis, a Canadian-based company, which specializes in advanced video analytics software and intelligent IP video management software (VMS). In July 2017 we amalgamated our two Canadian subsidiaries. Following the amalgamation, the company maintained the name Senstar Corporation.

In April 2014, we acquired a U.S. based fiber-optic technology company which provides advanced solutions for sensing, security, and communication. In January 2013, we purchased CyberSeal Ltd., an Israeli cyber security company whose products and services complement our physical security products and services.

Our capital expenditures (not including acquisition costs) for the years ended December 31, 2016, 2017 and 2018 were approximately $0.8 million, $0.9 million and $2.1 million, respectively.

B. Business Overview.

Overview and Strategy

We develop, manufacture, market and sell comprehensive lines of perimeter intrusion detection sensors, physical barriers, video analytics and video management systems, cyber security products and systems as well as security video observation and surveillance systems to high profile customers. Our systems are used in more than 100 countries to protect sensitive facilities, including national borders, military bases, power plants, airports, seaports, prisons, industrial sites, large retailer organizations, banks, oil and gas facilities, sporting events including athlete villages and stadiums, and municipalities from intrusion, terror, crime, sabotage or vandalism to infrastructure, assets and personnel.

Based on our decades of experience and interaction with customers, we have developed a comprehensive set of solutions and products, optimized for perimeter, outdoor and general security applications. Our portfolio of mission critical infrastructure and site protection technologies includes a variety of smart fences and barriers, fence mounted sensors, fence mounted sensors with perimeter lighting, virtual (volumetric) fences and gates, buried and concealed detection systems and tunneling sensors to secure prisons, bank vaults and pipelines. We deliver comprehensive IP technology and traditional closed circuit television, or CCTV, solutions, supported by our own advanced Video Management Software, or VMS solutions, which include Video Motion Detection, or VMD and Intelligent Video Analytics, or IVA.

Since the addition of Aimetis' products and expertise, we were able to address new markets and offer solutions incorporating advanced video analytics and VMS for physical indoor and outdoor security applications. Since the addition of the newly acquired state of the art technology and expertise, we were able to expand our overall solution, offer a wider range of products in addition to our PSIM, PIDS and Cyber solutions, and address new markets.

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

- Leverage existing customer relationships. We believe that we have the capability to offer certain of our customers a comprehensive security package. As part of our product development process, we seek to maintain close relationships with our customers to identify market needs and to define appropriate product specifications. We intend to expand the depth and breadth of our existing customer relationships while initiating similar new relationships. Our VMS offering is an excellent opportunity to revisit our existing customers.

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- Refine and broaden our product portfolio. We have identified the security needs of our customers and intend to enhance our current products' capabilities, develop new products, acquire complementary technologies and products and enter into OEM agreements with third parties in order to meet those needs.

- Refine and broaden our integration and turnkey delivery capabilities. As a solution provider we depend on our capability to tailor specific solutions for each customer. Our integration building blocks and our execution skills are key factors in achieving our growth and profitability.

- Develop and enhance our presence in new and existing verticals. We intend to enhance our presence in vertical markets as pharmaceutical marijuana, oil and gas terminals and infrastructure. Both verticals are highly regulated and require unique security solutions. As a solution provider with a wide selection of security technologies and products we believe that we can offer a comprehensive security solution that meets the standards required by the applicable regulations. Additionally, we intend to improve our position in a number of legacy vertical markets, such as correctional, utilities and transportation.

- Enhance our presence in emerging markets. We intend to enhance our presence in emerging markets such as India and China, in order to increase our exposure to small and medium size business opportunities for both our perimeter products and solutions and turnkey projects segments.

- Strengthen our presence in existing markets.   We intend to increase our marketing efforts in our existing markets mainly in North America and the APAC region and to acquire or invest in complementary businesses and joint ventures

Emerging Opportunities

We believe that the proliferation of digital communication and information technology into the security market provides us with the opportunity to consolidate safety and site management with security applications. Cities and municipalities, air and sea ports, chemical factories, sporting event villages and stadiums, and critical infrastructure sites are currently utilizing the benefits of this approach to security management. This integration allows users to share diverse sensors (such as cameras and emergency buttons), IT systems, traffic management tools, Cyber solutions and other resources and feed them into a single command and control platform. Users from different departments within organizations can now share the same information, allowing for improved communication and coordination, whether it is a routine operation or crisis situation. We believe that we are well positioned and are in the forefront of this emerging market opportunity. We can also address the increasing cyber threats that the trend towards networking imposes on sites we traditionally protect with physical security.

The unrest in Africa and the Middle East along with terrorist actions by ISIS, Boco Haram and El Shabab and massive migration of refugees may generate new requirements in these regions and in Europe.

Products and Services

General

Our principal physical, VMS, and cyber security products and solutions include:

- Perimeter Intrusion Detection Systems (PIDS);

- PIDS fence sensor with perimeter LED based lighting;

- VMS, including IVA applications;

- CCTV systems, including a perimeter security robotic camera platform;
- Security Video Observation & Surveillance systems;

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- Pipeline security, third party interference (TPI);
- Cyber security systems for security networks;
- Life safety/duress alarm systems;
- Command and control systems; and
- Miscellaneous systems tailored for specific vertical market needs.

The following table shows the breakdown of our consolidated revenues for the calendar years 2016, 2017 and 2018 by operating segments:

	Year ended December 31,		
	2016	2017	2018
	(In thousands)		
Products	$32,372	$22,301	$27,626
Turnkey projects	31,823	34,742	57,072
Video & Cyber security	5,626	8,350	9,461
Eliminations	(1,996)	(1,101)	(1,557)
Total	$67,825	$64,292	$92,602

Perimeter Security Products

Perimeter security products enable customers to monitor, limit and control access by unauthorized personnel to specific regions or areas. High-end perimeter products are sophisticated in nature and are used for correctional facilities, borders, nuclear and conventional power plants, air and sea ports, military installations and other high security installations.

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

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

- Fence mounted detection systems – mechanical sensors, “microphonic” wire sensors, fiber optic sensors and electronic ranging sensors;
- Smart barriers – a variety of robust detection grids, gates and innocent looking fences, designed to protect water passages, VIP residences and other outdoor applications;
- Buried sensors – volumetric buried cable sensors for PIDS and seismic and fiber sensors to secure pipelines and critical assets against digging, and a new fiber based pipeline leak detection system;
- Taut wire – hybrid perimeter intrusion detection system with physical barrier;
- Electrical field disturbance sensors (volumetric);

- Microwave sensors; and

- Our new hybrid perimeter intrusion detection and intelligent lighting system.

Fence Mounted Detection Systems

We offer various types of detection systems. While less robust than taut wire installations, the adaptability of these systems to a wide range of pre-existing barrier structures makes these products viable alternatives for cost-conscious customers. Our detection devices are most effective when installed on common metal fabric perimeter systems, such as chain link or welded mesh. In our BARRICADE system, electro-mechanical sensors are attached to fence panels approximately three meters apart on any of several common types of fence structures. Once attached to the fence, each sensor detects vibrations in the underlying structures. The sensor system’s built-in electro-mechanical filtering combines with system input from a weather analysis to minimize the rate of false alarms from wind, hail or other sources of nuisance vibrations. Our most recent product is the FENSOR – an accelerometer based fence mounted detection system that is capable of locating the exact location of an intrusion within 3 meters and is optimized for rigid fences such as palisade.

FlexZone, our latest coaxial cable based fence mounted ranging sensor can pinpoint intrusions to within ±3 m (±10 ft); it provides long physical cable lengths (up to 600 m per processor) configurable through software to many smaller virtual zones. Power and data between processors is supported through the sensor cable and thus it reduces the requirement for supporting infrastructure. A novel wireless gate sensor module is available with FlexZone providing an accelerometer based gate sensor integrated via wireless communications into a FlexZone network eliminating the need to have sensor cables attached to sliding gates.

Intelli-FIBER is a zone based fence mounted detection system based on a fiber optic sensor. During 2014, we acquired a U.S. based company with advanced fiber technology and completed the merger of its business into the group. This acquisition added new state-of-the-art products, designed for mid and long range perimeters under the product family name FiberPatrol.

Buried Sensors

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

FiberPatrol, our new fiber product, is also offered to protect pipelines against sabotage or accidental third party interference (TPI). FiberPatrol has the capability to protect up to 80 km of a pipeline with a single processor.

Taut Wire Perimeter Intrusion Detection Systems

Our taut wire perimeter systems consist of wire strung at high tension between anchor posts. Sensor posts are located at the middle between anchor posts. These sensor posts contain one or more devices that detect changes in the tension being exerted on and by the taut wires. Any abnormal force applied against these wires or released from them (such as by cutting) automatically triggers an alarm. Taut wire technology provides three critical elements of protection against unauthorized intruders: deterrence, detection and delaying (until first responders may react and intercept the intruder).

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

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

Taut wire perimeter systems have been approved by various Israeli and U.S. security and military authorities. We have installed several hundred kilometers of these perimeter systems along Israel’s borders to assist in preventing unauthorized entry and infiltration.

Electro-static Field Disturbance Sensors

Terrain following volumetric sensors can detect intrusions before the intruder touches the sensor. They can be installed on buildings, free-standing posts, existing fences, walls or rooftops, and will sense changes in the electrostatic field when events, such as intruders penetrating through the wires, take place. The system’s tall, narrow, well contained detection zone allows the sensor to be installed in almost any application and minimizes nuisance alarms caused by nearby moving objects. Our flagship product is X-Field; it consists of a set of four to as many as eight parallel field generating and sensing wires that can form a volumetric detection field as much as 5m (16.4’) in height.

Microwave Products

We also offer a K-band all digital bi-static microwave system, designed for stable, reliable operation in extreme outdoor environments. Coverage distance range from 5 meters to 200 meters. Older generations of X band microwaves are retired but still supported.

Hybrid Perimeter Intrusion Detection and Intelligent Lighting System

The Senstar LM100 is the world’s first 2-in-1 perimeter intrusion detection and intelligent lighting system. Combining high performance LED lighting with accelerometer-based sensors, the LM100 deters potential intruders by detecting and illuminating them at the fence line.

Video and Cyber Security

VMS / IVA Solutions

Senstar Symphony 7, scheduled for release in first half 2019, has been designed to become a new benchmark for intelligent Video Management Software (VMS). The Symphony software package includes a proprietary seamless set of EAC Electronic Access Control (EAC) features. Symphony Access Control will provide control over a broad array of security functions, integrating Symphony's VMS feature set to one of the broadest arrays of trusted hardware brands for access control, intrusion, HVAC and elevator control.

Senstar Symphony 7 is highly scalable, easy to set up and use, and can be used in both single server installations and multi-server deployments. Symphony 7 offers web-based administrator capabilities, centralized cloud management, native analytics applications which include motion tracking, auto-PTZ (pan–tilt–zoom) tracking, people counting, and high security and server and storage failover which reduces the need for expensive Microsoft clustering and extra servers. We intend to expand the Symphony product line over time to address a broad new market of applications.

Our intelligent video analytics (IVA) transforms IP video into more than a passive monitoring tool with video analytics that are seamlessly incorporated into Senstar Symphony 7. Each video analytic is specially designed for physical security and business intelligence applications, providing value across many vertical markets.

Our intelligent video analytics (IVA) capabilities include:

- Face Recognition - A robust video analytic, ideally suited for securing facilities that require a stronger layer of protection for access control. With real-time alarms and intuitive searching when paired with Senstar Symphony, the Face Recognition video analytic transforms what is possible with a video surveillance system.

- Automatic License Plate Recognition - Automatically recognize and record vehicle license plates from over 100 countries. Set alarms for specific plates to deny or approve entry.

- Outdoor People and Vehicle Tracking - Detect and track all moving objects and classify them as a person, vehicle, or unknown. Movement tracks are recorded to know exactly where each object came from and where it left the camera's point-of-view.

- Left and Removed Item Detection - Monitor changes in an environment to detect when objects are added or removed from a scene. Set alarms to notify security staff when an item has been removed from an area or left unattended for a designated amount of time. This solution designed for use in airports, train stations, and other public spaces.

- Indoor People Tracking - Detect and track people moving within the frame of a camera. Alarms can be set when unauthorized entry into an area is detected and dwell times can be tracked and recorded for the detection of unwanted loitering. Heat maps can also be created in retail stores and public spaces to determine areas of highest traffic and interest.

- Crowd Detection - Real-time occupancy estimation for indoor and outdoor deployments, ideal for monitoring public spaces, event venues, and capacity restricted environments. Crowd Detection also offers numerous business intelligence applications.

- PTZ Auto-Tracking (Auto PTZ) - Auto PTZ can automatically control a PTZ camera, enabling it to zoom in and follow moving people and vehicles within the field of the camera. This is designed for use in outdoor perimeter monitoring and provides a closer look at people and vehicles for future forensic purposes.

Hardware solutions offered supporting our VMS software products are an "R series" of preconfigured servers, "E series" of physical appliances for smaller applications and a novel POE powered Thin Client device for convenient network access for monitors or other applications.

Cyber Security

Our solutions monitor, detect and protect against abnormal network activity, both landline and wireless, within and close to protected sites. Our current solutions are:

- Tungsten – A hardened managed edge switch with built in security capabilities to monitor unauthorized traffic which is optimized for outdoors security and ICS networks (Industrial Control System); and

- Rubidium – An easily operated SIEM (Security Information & Event Management) application, designed to manage an array of Tungsten products as well as third party network and cyber monitoring devices.

Perimeter Security Robot

In 2014, we introduced our new concept for perimeter security called RoboGuard, a robotic platform that runs on an elevated rail along the perimeter of protected sites or border lines, carrying an assortment of sensors. The robot can respond promptly and rush to the exact zone or location where intrusions are suspected, or automatically patrol and inspect fence integrity, looking for holes or suspicious nearby objects by using a sophisticated laser scanner. The robot is powered by a battery which is recharged automatically.

A typical RoboGuard configuration includes:

- One or two fixed cameras with IR illuminators for fence surveillance;

- One PTZ camera with IR illuminator; and

- Two-way intercom in order to communicate with intercepted would-be intruders.

Other Products

Life Safety / Duress Alarm Systems

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

Flash and Flare personal emergency locating systems use radio frequency technology to provide a one touch emergency system that can be worn on a belt, or used with our newly released pendant style alarm initiation device The systems, sold to prisons, consist of transmitters that send distress signals to receivers mounted throughout the building. Receivers relay the signal to a central location, indicating that someone requires assistance and their exact location in the building. As a radio frequency based product, it can also perform its function in outdoor areas surrounding a building. The systems employ an automated testing mechanism that helps to reduce maintenance costs.

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

CCTV Systems

We have a proven track record in delivering CCTV and IVA solutions that are designed for use in outdoor applications. Following the ESC BAZ and Aimetis acquisitions, our VMS outdoor and indoor solutions present advanced technologies. These capabilities are now fully embedded as part of our Fortis4G Physical Security Information Management (PSIM) system.

Following the ESC BAZ acquisition, our portfolio includes a wide range of modular and customizable medium and long range dual technology (thermal Imaging and CCD) surveillance systems for distances of 500m up to 25km. These surveillance systems include:

- AVIV - a short to mid-range surveillance system designed for perimeter defense and border protection.

- Giraffe - a long-range surveillance system designed to provide powerful Intelligence, Surveillance and Reconnaissance capabilities (ISR) for commercial ports and merchant ships.

- TOM Vehicle - a vehicle-mounted surveillance system that offers any type of patrol vehicle patrol vehicles a high quality, mobile video surveillance unit that gives vehicles operators real-time video enabling them to be fully aware of what is happening outside and around the vehicle.

- Hawk-Eye - a surveillance system, designed for perimeter defense and border protection. It is ideal for strategic locations such as airports, borders, critical utilities, nuclear plants and oil refineries.

- C-HAWK - a surveillance system designed for maritime environments, such as civilian ports and ships that are often difficult to protect.

- MODOS - a discreet early-warning multi-sensor intruder detection and observation system that includes motion-detection radar, seamlessly integrated with an AVIV Video Surveillance system that can play a significant role in urban security architecture.

Command and Control Systems

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

- Fortis^{4G} – a fourth generation high-end comprehensive command and control system;

- StarNet 2 – our security management system, or SMS, was launched in the latter part of 2015 and replaces the legacy StarNet 100; and

- Network Manager – a middleware (software) package which is essential for integration with 3rd party control systems and offers an entry level alarm management system called AIM.

Fortis ^{4G}

FORTIS^{4G} is our PSIM system. It is a comprehensive, wide area and real time command and control solution, designed for entities requiring management of security, safety and site management as well as cyber events (Integrated PSIM with SEIM). It is designed to manage daily routines and site activities, security, regular and irregular events as well as crisis situations.

FORTIS^{4G} architecture integrates with legacy systems and sensors from the physical and logical (cyber) levels through a configuration and business logic layer and up to the situational awareness and management levels. It is based on a strong GIS engine (Geospatial Information System), which creates a common layer for inputs, outputs and presentation. The GIS engine enables the display of synchronized information in time and space across all screens such as location of mobile forces, located alarms from stationary sensors, video of related cameras, pop-ups of associated radar screens and managed voice communication related to the managed area. Real-time information enables security personnel to respond immediately, while maintaining a full two-way communication and situational awareness between the command and control center(s) and the first responder(s). The target markets for Fortis^{4G} are safe city applications airports, seaports border and homeland security applications. Fortis^{4G} incorporates the Symphony advanced video management system with its full suite of native IVA features:

- Our investments in IVA tools help eliminate dependency on constant human monitoring. Automatic tools and algorithms extract abnormalities and only irregular events are transferred and analyzed for verification. This approach saves bandwidth and storage and more importantly requires human intervention only when needed.

- Our IVA / VMD have been developed to meet the challenge of the outdoor environment (such as weather effects, moving objects like trees, glare and flashing lights).

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

StarNet 2

StarNet 2, an SMS, is designed to manage basic sites, consisting of a PIDS with a few other devices.

Network Manager

Network Manager is a middleware (software) package interfacing between our family of PIDS sensors and any command and control solution, be it our own system or an external third party application. It is provided to integrators with a full software development kit to enable fast integration of our PIDS into any other SMS and physical security information system. It offers an entry level operator display system called the Alarm Information Module (AIM), typically for management of a single PIDS sensor.

Marketing, Sales and Distribution

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

Our sales efforts focus on:

- PIDS products are sold indirectly through system integrators and distribution channels. Due to the sophistication of our products, we often need to approach end-users directly and be in contact with system integrators; however, sales are directed through third-parties.

- Video and Cyber Security. Video management system software licenses, the associated maintenance and support services, as well as Cyber security products are sold primarily through locally based distributor partners. Some key accounts are managed directly with the end-users.

- Projects. This part of the business deals with end-customers or high-end system integrators. We offer full comprehensive solutions, which include our in-house portfolio of products and products manufactured by third parties. Solutions are focused around our core competencies -outdoor and cyber security, safety and site management, VMS and IVA applications. In many cases we take responsibility for the full turnkey solution and we integrate and deliver a full solution, including civil works infrastructure, installation, training, warranty and after sale support. Cyber security solutions are now offered as an integrated part of our comprehensive solutions.

In addition to our main facilities in Israel, Canada, the United States and Mexico, we have sales and technical support offices in India, the United Kingdom, Germany, Spain, China, the Philippines and other countries.

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Customers

The following table shows the geographical breakdown of our consolidated revenues for the three years ended December 31, 2018:

	Year Ended December 31,___		
	2016	2017	2018
	(In thousands)		
Israel	$8,727	$9,599	$13,577
North America	23,467	15,547	24,324
Europe	8,330	11,232	14,021
South and Latin America	10,364	13,152	25,471
Africa	7,585	9,370	7,126
Others	9,352	5,392	8,083
Total	$67,825	$64,292	$92,602

For the years ended December 31, 2016, 2017 and 2018, revenues generated from sales to the MOD and IDF accounted for 8.6%, 10.2% and 10.9% of our revenues, respectively. In addition, revenues from the national electricity company in Latin America, or CFE accounted for 11.9%, 14.6% and 25.3% of our revenues in 2016, 2017 and 2018, respectively. We cannot assure you that any of our major customers will maintain their level of business with us or that, if such business is reduced, other customers generating similar revenues will replace the lost business. The failure to replace these customers with one or more customers generating similar revenues will have a material adverse effect on our financial results.

Installation, Support and Maintenance

Our systems are installed by us or by an integrating partner or in some cases by the customer after appropriate training, depending on the size of the specific project and the location of the customer's facilities, as well as prior experience with our systems. We generally provide our customers with training on the use and maintenance of our systems, that we conduct either on-site or at our facilities. In addition, some of our local perimeter security products customers have signed maintenance contracts with us. The life expectancy of a high-security perimeter system is approximately ten years. Consequently, many miles of perimeter systems need to be replaced each year.

For systems installed outside of Israel, maintenance is provided by our local subsidiaries, by an independent third party, by partners or by the end-user. We also provide services, maintenance and support on an "as needed" basis. During the years ended December 31, 2016, 2017 and 2018, we derived approximately 20.4%, 26.7% and 19.3% of our total revenues, respectively, from maintenance and services.

Research and Development; Royalties

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

We have development centers in Israel, Canada and the United States, each of which develops products and technologies based on its area of expertise.

Our research and development expenses during 2016, 2017 and 2018 were $6.8 million, $6.6 million and $6.9 million, respectively. In addition to our own research and development activities, we also acquire know-how from external sources. We cannot assure you that any of our research and development projects will yield profitable results in the future.

Manufacturing and Supply

Our manufacturing operations consist of engineering, fabricating, assembly, quality control, final testing and shipping of finished products. Substantially all of our manufacturing operations are currently performed at our facilities in Canada and Israel. In 2018 we launched a "Made in USA" version of our FlexZone product to better serve our US-based partners and customers. See Item 4D. "Information on the Company – Property, Plants and Equipment."

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

Competition

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

The PIDS market is very fragmented. Our most frequently encountered competition includes EL-FAR Electronics Systems 2000 LTD. and Afcon Security and Parking Ltd. in Israel and outside of Israel our competitors include Southwest Microwave Inc., Future Fiber Technologies, Fiber Sensys Inc., Geoquip Ltd., GPS Standard SpA, CIAS Elettronica Srl, Sorhea and Gallagher (New Zealand).

We believe that our principal competitors for our pipeline security products (FiberPatrol) are; Future Fibre Technologies Pty. Ltd., Optasense, a QinetiQ Company, Omnisens SA, and Fotech Solutions Ltd; and that our principal competitors for personal emergency location systems are Actall Corp., Bosch LLC and Visonic Networks.

The video management software market is well developed internationally with several large manufacturers. Our most frequently encountered competitors are Genetec Inc., Avigilon Corp., Milestone Systems A/S, and SeeTec GmbH. There are a large number of entrants into the cyber security market which is expected to mature over the next few years.

Indirect competition from competing technologies such as Ground Based Radar and thermal cameras as sensors with principle competitors being, Spotter RF, Navtech, and FLIR.

Turn Key Projects and Solutions. Thousands of solution providers offer security products and services. Most of the integrators focus on indoor applications, but some also offer outdoor solutions. Most of the market players are local to their countries; however, some are global, such as ADT, Honeywell, Johnson Controls and Siemens. In some cases, we may cooperate with global integrators or may supply equipment to them. We believe that our principal competitors in Israel for security solutions are C. Mer Industries Ltd., Afcon Industries Ltd., Shamrad Electronics (1977) Ltd., EL-FAR Electronics Systems 2000 LTD and Orad Ltd.

Some of our competitors and potential competitors have greater research, development, financial and personnel resources, including governmental support, or more extensive business experience than we do. We cannot assure you that we will be able to maintain the quality of our products relative to those of our competitors or continue to develop and market new products effectively.

Intellectual Property Rights

We have 24 patents issued and have 8 patent applications pending in the U.S. and in several other countries and have obtained licenses to use proprietary technologies developed by third parties. We cannot assure you:

- that patents will be issued from any pending applications, or that the claims allowed under any patents will be sufficiently broad to protect our technology;

- that any patents issued or licensed to us will not be challenged, invalidated or circumvented; or

- as to the degree or adequacy of protection any patents or patent applications may or will afford.

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

We have registered trademarks for AIMETIS, AIMETIS SYMPHONY, FIBERPATROL, FLARE, FLEXPI, FLEXPS, FLEXZONE, GUIDAR, INTELLI-FIELD, OMNITRAX, PANTHER, PINPOINTER, REPELS, SENNET, SENSTAR, SENSTAR & DESIGN, SENTIENT, ULTRAWAVE design, XFIELD, MAGAL, DTR, FORTIS, MAESTRO DB, FENSOR and ROBOGUARD.

ARMOURFLEX, CYBERSEAL, ENTERPRISE MANAGER, GALLIUM PDS, INTELLI-FLEX, INTELLIFIBER, LM100, the MAGAL logo, NETWORK MANAGER, RUBIDIUM, STARLED, STARNET, SYMPHONY, TUNGSTEN, VANADIUM GALLIUM-PDS, VANADIUM and all other marks used to identify particular products and services associated with our businesses are unregistered trademarks. Any other trademarks and trade names appearing in this annual report are owned by their respective holders.

Government Regulations

Current Israeli governmental policy encourages the export of security related products to approved customers, as long as the export is consistent with Israeli government policy. We are also subject to regulations related to the export of “dual use” items (items that are typically sold in the commercial market, but which may also be used for military use). Israel enhanced enforcement of export control legislation under the Defense Export Control Law, 2007, under which a license is required to initiate marketing activities and a specific export license is required for any hardware, software and knowhow exported from Israel. The law provides for certain exemptions from the licensing requirement and broadens certain areas of licensing, particularly with respect to transfer of technology.

At present, only a limited number of our products require a permit or license for export. We cannot assure that we will receive all the required permits and licenses for which we may apply in the future. In addition, our participation in governmental procurement processes in Israel and other countries is subject to specific regulations governing the conduct of the process of procuring defense contracts. Furthermore, solicitations for procurements by governmental purchasing agencies in Israel and other countries are governed by laws, regulations and procedures relating to procurement integrity, including avoiding conflicts of interest and corruption in the procurement process.

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

C. Organizational Structure.

We have wholly owned and majority-owned active subsidiaries that operate world-wide. Set forth below are our significant subsidiaries.

Subsidiary Name	Country of Incorporation/Organization	Ownership Percentage
Senstar Corporation	Canada	100%
Senstar Inc.	United States (Delaware)	100%
Senstar Latin America, S.A. DE C.V.	Mexico	100%
MAGAL-S3 CANADA INC.	Canada	100%
ESC BAZ LTD.	Israel	55%

D. Property, Plants and Equipment.

We own a two-story 2,533 square meter facility located on a 4,352 square meter parcel in the Yehud Industrial Zone, Israel, which is used as our principal facility. Approximately 600 square meters are devoted to administrative, marketing and management functions and approximately 800 square meters are used for engineering, system integration and customer service. We use the remaining area of approximately 1,100 square meters for production management and production operations, including manufacturing, assembly, testing, warehousing, shipping and receiving. We also lease a one-story 810 square meter facility located on a 1,820 square meter parcel in the Yehud Industrial Zone for $120,000 per year for use in production and operations. The lease terminates in 2029. The products that we manufacture at our facilities in the Yehud Industrial Zone include our taut-wire intrusion detection systems, our detection systems Fortis^{4G}, MTC-1500, MSS-1500, RoboGuard, Fensor and other perimeter systems.

We own a 33,000 square foot facility in Carp, Ontario, Canada. Approximately 9,000 square feet are devoted to administrative, marketing and management functions, and approximately 8,000 square feet are used for engineering, system integration and customer service. We use the remaining area of approximately 16,000 square feet for production operations, including cable manufacturing, assembly, testing, warehousing, shipping and receiving. We own an additional 182,516 square feet of vacant land adjacent to this property, which is being held for future expansion. We also lease 358,560 square feet of land near this facility for use as an outdoor sensor test and demonstration site for our products including the Omnitrax buried cable intrusion detection system, the X-Field volumetric system, the FlexZone microphonic fence detection system, Flash and Flare, and various perimeter monitoring and control systems. The lease for this site is approximately $3,500 per year plus taxes under a lease that expires in November 2024.

We own a 999 square meter facility in Cuernavaca, Mexico, which we built in August 2013.

We lease office space in Waterloo, Canada, providing the facility which houses our video management software operations. We also lease office space in two sites in the U.S. and sites world-wide. The aggregate annual rent for such offices was approximately $660,000 in 2018.

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

ITEM 4A. Unresolved Staff Comments

Not applicable.

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ITEM 5. Operating and Financial Review and Prospects

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

A. Operating Results.

Overview

We develop, manufacture, market and sell complex computerized security systems. Our systems are used in more than 100 countries to protect aircraft, national borders and sensitive facilities, including military bases, power plant installations, airports, sea ports, postal facilities, prisons, banks, retail operations, hospitals, municipal security, sporting events including athlete villages and stadiums, and industrial locations from terrorism, theft and other security threats.

Following organizational changes adopted in the course of 2016, we operate in three business segments:

- Perimeter Products segment – sales of perimeter products, including services and maintenance that are performed either on a fixed-price basis or pursuant to time-and-materials based contracts.

- Turnkey Projects segment – installation of comprehensive turnkey solutions for which revenues are generated from long-term fixed price contracts.

- Video and Cyber Security segment (includes Video Management Software , Intelligent Video Analytics and Cyber Security) – sales of integrated intelligent video management solutions for security surveillance and business intelligence applications complemented by cyber-security products for monitoring, securing, and the active management of wired, wireless, and fiber optic communication networks.

Perimeter Products Segment

The Perimeter Products segment sells its products worldwide and this segment primarily includes the operations of Senstar Canada, Senstar US, and Senstar Germany. as one reporting unit. The Israeli operation of the Perimeter Products segment is considered as separate reporting unit within this segment.

Turnkey Projects Segment

The Turnkey Projects segment has operations worldwide and the segment includes a number of reporting units operating in Israel, Mexico, Romania, India, Spain and Canada.

Video and Cyber Security Segment

This segment includes Video Management Software (VMS), Intelligent Video Analytics (IVA) and Cyber-Security products. The VMS and IVA activity which is operated and managed by Senstar, following the amalgamation of Senstar and Aimetis (acquired in 2016) offers integrated intelligent video management solutions for security surveillance and business intelligence applications worldwide. Cyber security sales are mainly in the U.S., Mexico and Israel. In early 2017, product management as well as sales management of this business activity was transferred to our facility in Waterloo, Canada.

Business Challenges/Areas of Focus

Our primary business challenges and areas of focus include:

- continuing the growth of revenues and profitability of our perimeter security system and video management system lines of products;

· enhancing the introduction and recognition of our new products into the markets;

· penetrating new markets and strengthening our presence in existing markets; and

· succeeding in selling our comprehensive turnkey solutions.

· succeeding in selling our comprehensive physical and cyber products as a combined solution.

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

Key Performance Indicators and Sources of Revenues

Our management believes that our revenues and operating income are the two key performance indicators for our business.

Our revenues from our perimeter products, turnkey projects and Video and Cyber-Security segments for the three years ended December 31, 2018 were as follows:

	Year Ended December 31,		
	2016	2017	2018
	(In thousands)		
Products	$32,372	$22,301	$27,626
Turnkey projects	31,823	34,742	57,072
Video and Cyber-Security	5,626	8,350	9,461
Eliminations	(1,996)	(1,101)	(1,557)
Total	$67,825	$64,292	$92,602

The increase in revenues from products was primarily due to the change in our leadership in the USA and EMEA, including better management of our sales force. In addition, the increase in revenues of the Video and Cyber security segment was attributable to the Aimetis operation, which we acquired in April 2016. The increase in revenues from turnkey projects was primarily due to the positive performance of our Israeli and Mexican based projects activity.

Our operating income (loss) from our perimeter products, turnkey projects and Video and Cyber Security segments for the three years ended December 31, 2018 were as follows:

	Year Ended December 31,		
	2016	2017	2018
	(In thousands)		
Products	$5,799	$242	$2,863
Turnkey projects	(163)	1,762	2,782
Video and Cyber Security	(3,383)	(2,830)	(1,298)
Eliminations	(758)	(418)	(592)
Total	$1,495	$(1,244)	$3,755

Our operating profit in 2018 increased mainly due to the increase in sales in all of our segments of operations and major business units, as well as the results of our cost saving initiatives.

Key Factors Affecting our Business

Our operations and the operating metrics discussed below have been, and will likely continue to be affected by certain key factors as well as certain historical events and actions. The key factors affecting our business and results of operations include among others, reliance on large orders from a small number of customers, reliance on government contracts and competition. For further discussion of the factors affecting our results of operations, see “Risk Factors.”

Reliance on large orders from a small number of customers

We receive relatively large orders for products from a relatively small number of customers. Consequently, a single order from one customer may represent a substantial portion of our sales in any one period and significant orders by any customer during one period may not be followed by further orders from the same customer in subsequent periods. Our sales and operating results are subject to very substantial periodic variations. Since quarterly performance is likely to vary significantly, our results of operations for any quarter or calendar year are not necessarily indicative of the results that we might achieve for any subsequent period. Accordingly, quarter-to-quarter and year-to-year comparisons of our operating results may not be meaningful. In addition, we have a limited order backlog that is generally composed of orders that are fulfilled within a period of three to twelve months after receipt, which makes revenues in any quarter substantially dependent upon orders received in prior quarters.

Growth Strategy

In the first quarter of 2016 we initiated a strategic plan to implement our growth strategy for the following 3-4 years. The strategic plan was adopted by our board of directors in the third quarter of 2016. Pursuant to the plan, we reorganized our group structure and clearly separated our two core areas of operation - Products and Projects. We also streamlined our product sales activity to concentrate on three regions, the Americas, EMEA and APAC. We intend to continue to expand our sales team in the U.S., which is the main strategic market for our product activity. In 2018, we consolidated, our EMEA operations under a new in-region leadership.

We may not be able to implement our growth strategy plan and may not be able to successfully expand our business activity and increase our sales. If we are successful in the implementation of our strategic plan, we may be required to hire additional employees in order to meet customer demands. If we are unable to attract or retain qualified employees, our business could be adversely affected.

Our failure to successfully integrate the operations of an acquired business or to retain key employees of acquired businesses and integrate and manage our growth may have a material adverse effect on our business, financial condition, results of operation or prospects. We may not be able to realize the anticipated benefits of any acquisition. Moreover, future acquisitions by us could result in potentially dilutive issuances of our equity securities, the incurrence of debt and contingent liabilities and amortization expenses related to identifiable intangible assets, any of which could materially adversely affect our operating results and financial position. Acquisitions also involve other risks, including risks inherent in entering markets in which we have no or limited prior experience.

Reliance on government contracts

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

Competition

The global market for safety, security, video management, site management solutions and products is highly fragmented and intensely competitive. It is characterized by changing technology, new product introductions and changing customer requirements. We compete principally in the market for perimeter intrusion detection systems, or PIDS, video management systems, and turnkey projects and solutions. Some of our competitors and potential competitors have greater research, development, financial and personnel resources, including governmental support. We cannot assure you that we will be able to maintain the quality of our products relative to those of our competitors or continue to develop and market new products effectively. Continued competitive pressures could cause us to lose significant market share.

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Explanation of Key Income Statement Items

Cost of revenues. Our cost of revenues for perimeter products consists of component and material costs, direct labor costs, subcontractor costs, shipping expenses, overhead related to manufacturing and depreciation. Our cost of revenues for turnkey projects consists primarily of component and material costs, subcontractor costs, direct labor costs and overhead related to the turnkey projects. Our cost of revenues for Video and Cyber Security sales consists primarily of direct labor costs, some component, material and subcontractor costs and overhead related to those sales.

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

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

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

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

Depreciation, Amortization and Impairment of goodwill. The amount of depreciation, amortization and Impairment of goodwill attributable to our perimeter products, turnkey projects and Video and Cyber-security segments for the three years ended December 31, 2018 were as follows:

	Year Ended December 31,		
	2016	2017	2018
	(in thousands)		
Products	$632	$614	$586
Turnkey projects	512	498	879
Video and Cyber-security	596	764	1,759
Total	$1,740	$1,876	$3,224

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

Discussion of Critical Accounting Policies

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

Revenue Recognition

We generates our revenues mainly from (1) installation of comprehensive security systems for which revenues are generated from long-term fixed price contracts; (2) sales of security products; (3) services and maintenance, which are performed either on a fixed-price basis or as time-and-materials based contracts; and (4) software license fees and related services.

Revenues from our contracts are recognized using the five-step model in ASC 606 - "Revenue from Contracts with Customers" ("ASC 606"). At first, we determine if an agreement with a customer is considered to be a contract to the extent it has a commercial substance, it is approved in writing by both parties, all rights and obligations including payment terms are identifiable, the agreement between the parties creates enforceable rights and obligations, and collectability in exchange for goods and services that will be transferred to the customer is considered as probable. We then assess the transaction price for a contract in order to determine the consideration we expects to receive for satisfying the performance obligations called for in the contract. To the extent, the transaction price includes variable consideration (e.g., contract penalties, unpriced change orders or like measures), we usually estimate the most likely amount that should be included in the transaction price subject to constraints based on the specific facts and circumstances.

At the inception of a contract, we also evaluate and determines if a contract should be separated into more than one performance obligation. Our installation of comprehensive security systems contracts usually includes one-performance obligations due to a significant customization for each customer's specific needs and integrated system or solution.

For most of our installation of comprehensive security systems contracts, where our performance does not create an asset with an alternative use, we recognizes revenue over performance time because of continuous transfer of control to the customer. For these performance obligations that are satisfied over time, we generally recognize revenue using an input method with revenue amounts being recognized proportionately as costs are incurred relative to the total expected costs to satisfy the performance obligation. We believe that costs incurred as a portion of total estimated costs is an appropriate measure of progress towards satisfaction of the performance obligation since this measure reasonably depicts the progress of the work effort and we have the ability to make reasonably dependable estimates of the extent of progress towards completion, contract revenues and contract costs. In addition, contracts executed include provisions that clearly specify the enforceable rights regarding services to be provided and received by the parties to the contracts, the consideration to be exchanged, the manner, and the terms of settlement, including in cases of termination for convenience. Project costs include materials purchased to produce the system, related labor, overhead expenses and subcontractor's costs. The performance costs are measured by monitoring costs and efforts devoted using records of actual costs incurred to date in the project compared to the total estimated project requirements, which corresponds to the costs related to earned revenues. We estimate the profit on a contract as the difference between the total estimated transaction price and the total expected performance costs of the contract and recognizes revenue and costs over the life of the contract. Estimated gross profit or loss from long-term contracts may change due to changes in estimates resulting from differences between actual performance and original forecasts. Such changes in estimated gross profit are recorded in results of operations when they are reasonably determinable by management, on a cumulative catch-up basis.

For contracts that are deemed to be loss contracts, we establishe forward loss reserves for total estimated costs that are in excess of total estimated consideration under a contract in the period in which they become probable.

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

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Revenues for performance obligations that are not recognized over time are recognized at the point in time when control is transferred to the customer (which is generally upon delivery) and include mainly revenues from the sales of security products and software license fees without significant installation work. We generally do not provide a right of return to our customers. For performance obligations that are satisfied at a point in time, we evaluates the point in time when the customer can direct the use of, and obtain the benefits from, the products. Shipping and handling costs are not considered performance obligations and are included in cost of sales as incurred.

Services and maintenance are performed under either fixed-price or time-and-materials based contracts. Under fixed-price contracts, we agree to perform certain work for a fixed price. Under time-and-materials contracts, we are reimbursed for labor hours at negotiated hourly billing rates and for materials. Our service contracts include contracts in which the customer simultaneously receives and consumes the benefits provided as the performance obligations are satisfied, accordingly, related revenues are recognized, as those services are performed or over the term of the related agreements.

Maintenance and support agreements provide customers with rights to unspecified software product updates, if and when available. These services grant the customers on line and telephone access to technical support personnel during the term of the service. We recognize maintenance and support services revenues ratably over the term of the agreement, usually one year.

We generate revenues from the sales of our software products user licenses as well as from maintenance, support, consulting and training services.

As required by ASC 606, following the determination of the performance obligations in the contract, we allocate the total transaction price to each performance obligation in an amount based on the estimated relative standalone selling prices of the promised license fees or services underlying each performance obligation. Standalone selling price is the price at which we would sell a promised license or service separately to a customer.

We capitalizes sales commission as costs of obtaining a contract when they are incremental and if they are expected to be recovered. Amortization of sales commission expense is included in selling and marketing expenses in the accompanying consolidated statements of income. For costs that we would have capitalized and amortized over one year or less, we have elected to apply the practical expedient and expense these contract costs as incurred.

Inventories

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

- Raw materials, parts and supplies – using the “first-in, first-out” method.

- Work-in-progress and finished products –on the basis of direct manufacturing costs with the addition of allocable indirect manufacturing costs.

During the years ended December 31, 2016, 2017 and 2018 we recorded inventory write-offs from continuing operations in the amounts of $0.2 million, $0.1 million and $0.1 million, respectively. Such write-offs were included in cost of revenues.

Income taxes

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

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

As of December 31, 2018, we had a net deferred tax asset of $3.3 million attributable to our subsidiaries. We had total estimated available tax loss carryforwards of $8.9 million with respect to our operations in Israel and our non-Israeli subsidiaries, had estimated total available tax loss carryforwards of $8.7 million, of which $6.1 million was attributable to our U.S. subsidiaries, which may be used as an offset against future taxable income for periods ranging between 1 and 20 years. As of December 31, 2018, we recorded a partial valuation allowance on these carryforward tax losses due to the uncertainty of their future realization. Utilization of U.S. net operating losses may be subject to a substantial annual limitation due to the “change in ownership” provisions of the Internal Revenue Code of 1986 and similar state provisions. The annual limitation may result in the expiration of net operating losses before utilization.

Goodwill

We have recorded goodwill as a result of acquisitions, which represents the excess of the cost over the net fair value of the assets of the businesses acquired. We follow ASC 350, “Intangibles – Goodwill and Other,” which requires goodwill to be tested for impairment, at the reporting unit level, at least annually or between annual tests in certain circumstances, and written down when impaired, rather than being amortized.

ASC 350 allows an entity to first assess qualitative factors to determine whether it is necessary to perform the quantitative goodwill impairment test. If the qualitative assessment does not result in a more likely than not indication of impairment, no further impairment testing is required. If it does result in a more likely than not indication of impairment, the quantitative impairment test is performed. Alternatively, ASC 350 permits an entity to bypass the qualitative assessment for any reporting unit and proceed directly to performing the first step of the goodwill impairment test. We perform annual impairment test of goodwill as of December 31 of each year, or more frequently if impairment indicators are present

In January 2017, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2017-04, “Intangibles—Goodwill and Other (Topic 350): - Simplifying the Test for Goodwill Impairment”, which eliminates the requirement to calculate the implied fair value of goodwill (i.e., Step 2 of the goodwill impairment test) for the purpose of measuring a goodwill impairment charge. Instead, an impairment charge shall be recognized based on the excess of a reporting unit’s carrying amount over its fair value. The standard shall be applied prospectively and is effective for annual and interim impairment tests performed in periods beginning after December 15, 2019, for public entities. Early adoption is permitted for annual and interim goodwill impairment testing dates after January 1, 2017. We early adopted the new guidance on January 1, 2018.

We evaluate the risk of goodwill impairment at a reporting unit level. Our goodwill as of December 31, 2018, relates to our Video reporting unit, PIDS reporting unit and BAZ reporting unit. As of December 31, 2018, the fair values of these reporting units significantly exceeded their carrying values. Accordingly, we determined that (i) the estimated fair value of each reporting unit was substantially in excess of its carrying value, (ii) each reporting unit's goodwill balance was not at risk of impairment, and (iii) therefore, no additional disclosure was required.

During the three years ended December 31, 2018, we did not record any impairment charges relating to the goodwill allocated to our Product segment, BAZ reporting unit within the Project segment and Video reporting unit within the Video and Cyber security segment.

In 2018, we recorded an impairment loss of goodwill in the amount of $1 million with respect to our Cyber security reporting unit within the Video and Cyber security segment. During the years ended December 31, 2017 and 2016, we did not record any impairment charges relates to the goodwill allocated to the Cyber security reporting unit within the Video and Cyber security segment.

Goodwill annual impairment tests

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

The material assumptions used for the goodwill annual impairment test for the PIDS reporting unit within the Products segment, according to the income approach for 2018, were five years of projected net cash flows, a weighted average cost of capital rate of 13% and a long-term growth rate of 3%. We consider 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, we may be required to record impairment charges for the goodwill associated with the PIDS reporting unit within the Products segment.

The material assumptions used for the goodwill annual impairment test for the Cyber security reporting unit within the Video and Cyber security segment, according to the income approach for 2018, were five years of projected net cash flows, a weighted average cost of capital rate of 14% and a long-term growth rate of 2%. We consider current market conditions when determining the discount and growth rates to use in our analyses. As a result of our impairment testing we have determined that an impairment charge of $1 million was recorded, which was the remaining good will for that reporting unit.

The material assumptions used for the goodwill annual impairment test for the Video reporting unit within the Video and Cyber security segment, according to the income approach for 2018, were five years of projected net cash flows, a weighted average cost of capital rate of 16.4% and a long-term growth rate of 3%. We considered historical rates and current market conditions when determining the discount and growth rates to use in our analyses. If these estimates or their related assumptions change in the future, we may be required to record impairment charges for goodwill.

The material assumptions used for the goodwill annual impairment test for the BAZ reporting unit within the Project segment, according to the income approach for 2018, were five years of projected net cash flows, a weighted average cost of capital rate of 15% and a long-term growth rate of 1.5%. We considered historical rates and current market conditions when determining the discount and growth rates to use in our analyses. If these estimates or their related assumptions change in the future, we may be required to record impairment charges for goodwill.

Intangible assets

Our intangible assets are comprised of patents, acquired technology, customer relations and backlog. Intangible assets are amortized over their useful lives using a method of amortization that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used up, in accordance with ASC 350, “Intangibles – Goodwill and Other.”

During the three years ended December 31, 2018, we did not record any impairment charges relating to intangible assets.

Impairment of long lived assets

We periodically evaluate our intangible assets and long-lived assets (mainly property and equipment) in all of our reporting units for potential impairment indicators in accordance with ASC 360, “Property, Plant and Equipment”, or “ASC 360”. Our judgments regarding the existence of impairment indicators are based on legal factors, market conditions, operational performance and prospects of our acquired businesses and investments. Our long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the assets to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. In measuring the recoverability of assets, we are required to make estimates and judgments in assessing our future cash flows which derive from the estimated useful life of our current primary assets, and compare that with the carrying amount of the assets. Additional significant estimates used by management in the methodologies employed to assess the recoverability of our long-lived assets include estimates of future short-term and long-term growth rates, useful lives of assets, market acceptance of products and services, our success in winning bids and other judgmental assumptions, which are also affected by factors detailed in our risk factors section in this annual report.

During the three years ended December 31, 2018, we did not record any impairment charges relating to long lived assets.

Functional Currency and Financial Statements in U.S. Dollars

While our functional currency in Israel is the NIS, our reporting currency is the U.S. dollar. Translation adjustments resulting from translating our financial statements from NIS and other local operation currencies to the U.S. dollar are reported as a separate component in shareholders' equity.

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

After the re-measurement process is complete the financial statements are translated into our reporting currency, which is the U.S. dollar, using the current rate method. Equity accounts are translated using historical exchange rates. All other balance sheet accounts are translated using the exchange rates in effect at the balance sheet date. Statement of operations amounts have been translated using the average exchange rate for the year. The resulting translation adjustments are reported as a component of shareholders' equity. For the years ended December 31, 2016, 2017 and 2018, our foreign currency translation adjustments totaled $0.4 million, $5.9 million and $2.8 million, respectively. The losses in 2016 and 2017 were exacerbated as a result of our increased cash balances. In late 2016 we completed a rights offering that provided us with proceeds of $ 23.6 million, which we deposited into our bank accounts in Israel. These balances were translated into NIS, which depreciated by 1.5% and 9.8% against the U.S. dollar in 2016 and 2017, respectively and in 2018 we recorded a gain of approximately $ million as the NIS appreciated by 8.1% against the U.S. dollar.

Concentrations of credit risk

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

Of our cash and cash equivalents and short-term and restricted bank deposits at December 31, 2018, $25.6 million was deposited with major Israeli banks. An additional $29.4 million was deposited mainly with the Royal Bank of Canada, BBVA Bankcomer, Comerica Bank and Deutsche Bank. Cash and cash equivalents deposited with U.S. banks or other banks may be in excess of insured limits and are not insured in other jurisdictions. Generally these deposits maybe redeemed upon demand and therefore bear low risk.

The trade receivables and the unbilled accounts receivable of our company and our subsidiaries are derived from sales to large and solid organizations located mainly in Israel, the United States, Canada, Africa, Mexico and Europe. We perform ongoing credit evaluations of our customers and to date have generally not experienced any material losses. An allowance for doubtful accounts is determined with respect to those amounts that we have determined to be doubtful of collection and in accordance with an aging policy. In certain circumstances, we may require letters of credit, other collateral or additional guarantees. During the years ended December 31, 2016, 2017 and 2018 we recorded $0.4 million, $0.3 million and $1.5 million of expenses related to doubtful accounts, respectively. As of December 31, 2018, our allowance for doubtful accounts amounted to $2.8 million.

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

Results of Operations

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

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

	Year Ended December 31		
	2016	2017	2018
Revenues	100 %	100 %	100 %
Cost of revenues	51.0	51.3	56.5
Gross profit	49.0	48.7	43.5
Operating expenses:			
Research and development, net	10.0	10.2	7.4
Selling and marketing, net	25.9	28.2	20.0
General and administrative	11.0	12.2	11.0
Impairment of goodwill	-	-	1.1
Operating income (loss)	2.2	(1.9)	4.1
Financial income (expenses), net	(0.9)	(6.2)	1.5
Income before income taxes	1.3	(8.1)	5.5
Taxes on income (tax benefit)	0.2	(2.6)	(2.2)
Net income	1.5	(10.8)	3.3

Year Ended December 31, 2018 Compared with Year Ended December 31, 2017

Revenues. Revenues increased by 44% to $92.6 million for the year ended December 31, 2018 from $64.3 million for the year ended December 31, 2017. Revenues from sales of perimeter products increased by 23.9% to $27.6 million in 2018 from $22.3 million in 2017, primarily due to the improved management and improved market conditions in North America and EMEA markets. Revenues from turnkey projects increased by 64.3% to $57.1 million in 2018 from $34.7 million in 2017, primarily due to the increased bookings and executions in our worldwide projects mainly in the Americas and Israel, as well as consolidation of revenues from the ESC BAZ reporting unit. Revenues of the Video and Cyber security segment increased by 13.3% to $9.5 million in 2018 from $8.4 million in 2017, primarily due to the increase in VMS software and hardware sales.

Cost of revenues. Cost of revenues increased by 58.6% to $52.3 million for the year ended December 31, 2018 from $33 million for the year ended December 31, 2017. This increase was primarily due to the increase in revenues. Cost of revenues as a percentage of revenues increased slightly to 56.5% in 2018 from 51.3% in 2017, primarily due to the increased percentage of lower margin projects and video hardware sales within our revenue mix.

Research and development expenses, net. Research and development expenses, net increased by 4.5% to $6.9 million for the year ended December 31, 2018 from $6.6 million for the year ended December 31, 2017. The increase in mainly due to the acquisition of ESC BAZ during 2018.

Selling and marketing expenses. Selling and marketing expenses increased by 2.2% to $18.6 million for the year ended December 31, 2018 from $18.2 million for the year ended December 31, 2017. Selling and marketing expenses as a percentage of revenues, decreased to 20% in 2018 from 28.2% in 2017, primarily due to the increase in revenues in 2018.

General and administrative expenses. General and administrative expenses increased by 29.4% to $10.2 million for the year ended December 31, 2018 from $7.9 million for the year ended December 31, 2017. The increase is mainly due to the acquisition of ESC BAZ, an increase in the provision for a doubtful account and to severance costs. General and administrative expenses amounted to 11% and 12.2% of revenues in 2018 and 2017, respectively.

Impairment of goodwill. Impairment of goodwill amounted to $1 million for the year ended December 31, 2018, which impairment relates to our Cyber security reporting unit within the Video and Cyber security segment. There were no impairment charges in 2017.

Operating income (loss). We had operating income of $3.8 million for the year ended December 31, 2018 compared to an operating loss of $1.2 million for the year ended December 31, 2017. The increase in operating income was primarily attributable to increase in sales and gross profit, as well as the beneficial impact of operating cost reduction initiatives. The operating income (loss) of our business segments in the years ended December 31, 2017 and 2018 were as follows:

	Year Ended December 31	
	2017	2018
	(In thousands)	
Perimeter products	$242	$2,863
Turnkey projects	1,762	2,782
Video and Cyber Security	(2,830)	(1,298)
Eliminations	(418)	(592)
Total	$(1,244)	$3,755

Our perimeter products segment recorded operating income of $2.9 million for the year ended December 31, 2018 compared to operating income of $0.2 million for the year ended December 31, 2017, primarily as a result of an increase in revenues and gross profit, partially offset by the increase in the provision for a doubtful account. Our turnkey project segment recorded operating income of $2.8 million in the year ended December 31, 2018 compared to an operating income of $1.8 million for the year ended December 31, 2017, primarily as a result of an increase in revenues. Our Video and Cyber security segment recorded an operating loss of $1.3 million in the year ended December 31, 2018 compared to an operating loss of $2.8 million for the year ended December 31, 2017. The improved result is primarily due to an increase in revenues and operating costs reductions, partially offset by the goodwill impairment.

Financial income, net. Our financial income, net, for the year ended December 31, 2018 was $1.4 million compared to financial expense, net of $4 million for the year ended December 31, 2017. The financial income in 2018 were primarily attributable to foreign exchange gain, net of $1.1 million compared to foreign exchange loss, net of $4 million in 2017.

Income taxes. We recorded tax expenses of $2.1 million in the year ended December 31, 2018 compared to tax expenses of $1.7 million in the year ended December 31, 2017, primarily due to the increase in pre-tax income and changes in our net deferred tax assets.

Year Ended December 31, 2017 Compared with Year Ended December 31, 2016

Revenues. Revenues decreased by 5.2% to $64.3 million for the year ended December 31, 2017 from $67.8 million for the year ended December 31, 2016. Revenues from sales of perimeter products decreased by 31.1% to $22.3 million in 2017 from $32.4 million in 2016, primarily due to the decrease in sales in North America. Revenues from turnkey projects increased by 9.2% to $34.7 million in 2017 from $31.8 million in 2016, primarily due to the executions in our worldwide projects. Revenues of the Video and Cyber security segment increased by 48.4% to $8.4 million in 2017 from $5.6 million in 2016, primarily due to additional quarter of revenues in 2017, as Aimetis was acquired on April 1, 2016 and to an increase in sales.

Cost of revenues. Cost of revenues decreased by 4.6% to $33 million for the year ended December 31, 2017 from $34.6 million for the year ended December 31, 2016. This decrease was primarily due to the decrease in revenues. Cost of revenues as a percentage of revenues increased slightly to 51.3% in 2017 from 51% in 2016, primarily due to the revenue mix.

Research and development expenses, net. Research and development expenses, net decreased by 3.3% to $6.6 million for the year ended December 31, 2017 from $6.8 million for the year ended December 31, 2016.

Selling and marketing expenses. Selling and marketing expenses increased by 3.5% to $18.2 million for the year ended December 31, 2017 from $17.5 million for the year ended December 31, 2016. Selling and marketing expenses amounted to 28.2% and 25.9% of revenues in 2017 and 2016, respectively.

General and administrative expenses. General and administrative expenses increased by 5.5% to $7.9 million for the year ended December 31, 2