

**TEFRON LTD**

**CONSOLIDATED FINANCIAL STATEMENTS**  
**AS AT DECEMBER 31, 2014**

**IN DOLLARS THOUSANDS**

**TEFRON LTD.**

**Consolidated Financial Statements as at December 31, 2014**

**In Dollars Thousands**

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**Auditor's Report**

**To the Shareholders and Board of Directors of Tefron Ltd.**

We have audited the accompanying consolidated balance sheets of Tefron Ltd. (hereinafter -"the Company") as of December 31, 2014 and 2013 and the consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for each of the three years of the period ended December 31, 2014. These financial statements are the responsibility of the Company's Board of Directors and management. Our responsibility is to express an opinion on these financial statements based on our audit.

We have conducted our audit in accordance with generally accepted auditing standards in Israel, including those prescribed by the Auditor's Regulations (Auditor's Mode of Performance), 1973. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by the Company's Board of Directors and management, as well as evaluating the overall presentation of the financial statements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, based on our audit, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company and its subsidiaries as of December 31, 2014 and 2013, and the results of their operations, changes in shareholders' equity and cash flows for each of the three years of the period ended December 31, 2014, in conformity with the International Financial Reporting Standards ("IFRS") and with the provisions of the Israeli Securities Regulations (Annual Financial Statements), 2010.

Without qualifying our above opinion, we draw attention to Note 1c of the financial statements regarding the Company's operations and the results thereof, as well as to the Management's estimations regarding meeting the financial covenants with the banks, and its plans in that regard

Haifa,  
March 22, 2015

**KOST FORER GABBAY & KASIERER**  
Certified Public Accountants

## Consolidated balance sheets

	<u>Note</u>	<u>As of December 31</u>	
		<u>2014</u>	<u>2013</u>
		<u>Dollars thousands</u>	
<u>Current assets</u>			
Cash		224	6,697
Investments in securities available for sale		347	420
Trade receivables, net	6	18,023	13,691
Other receivables	7	2,536	2,711
Inventory	8	15,347	12,622
		<u>36,477</u>	<u>36,141</u>
<u>Non-current assets</u>			
Property, plant and equipment, net	9	25,857	27,984
Inactive assets	9	2,442	2,555
Goodwill and intangible assets, net	10	499	742
Computer software, net	10	549	329
Deferred taxes, net	18	3,265	2,825
		<u>32,612</u>	<u>34,435</u>
		<u>69,089</u>	<u>70,576</u>

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

**Consolidated balance sheets**

	<u>Note</u>	<u>As of December 31</u>	
		<u>2014</u>	<u>2013</u>
		<u>Dollars thousands</u>	
<u>Current liabilities</u>			
Bank credit	11	9,185	9,938
Trade payables	12	13,933	11,250
Other payables	13	2,257	3,058
		<u>25,375</u>	<u>24,246</u>
<u>Non-current liabilities</u>			
Long-term loans from banks and vendors	14	14,428	16,342
Liabilities for bank options	16	56	67
Liabilities for benefits to employees, net	17	783	689
Long-term payables	19	1,643	1,478
		<u>16,910</u>	<u>18,576</u>
<u>Equity attributed to the Company's shareholders</u>			
	21		
Share capital		20,281	19,995
Additional paid-in capital		107,467	107,444
Capital reserve for re-measurement of defined benefit plans		(1,109)	(928)
Accumulated deficit		(92,572)	(91,772)
Treasury shares		(7,408)	(7,408)
Capital reserve for financial assets available for sale		(97)	(44)
Capital reserve for hedging transactions		(30)	-
Other capital reserves		272	467
		<u>26,804</u>	<u>27,754</u>
<u>Total equity</u>		<u>69,089</u>	<u>70,576</u>

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

March 22, 2015

Date of approval of the  
financial statements

Arnon Tieberg  
Chairman of the Board

Gil Shimon  
CEO

Eliezer Parnafes  
CFO

**Consolidated statements of income**

	Note	For the year ended		
		December 31		
		2014	2013	2012
		Dollars thousands (excluding data on loss per share)		
Sales		93,915	82,912	98,963
Cost of sales	23a	<u>77,081</u>	<u>68,086</u>	<u>81,932</u>
Gross profit		16,834	14,826	17,031
Development expenses, net	23b	4,124	4,446	3,526
Selling and marketing expenses	23c	10,389	8,962	8,262
General and administrative expenses	23d	3,057	3,660	3,180
Other expenses (income)	23e	<u>(959)</u>	<u>(189)</u>	<u>35</u>
Operating profit (loss)		<u>223</u>	<u>(2,053)</u>	<u>2,028</u>
Financing income	23f	750	377	83
Financing expenses	23f	<u>(2,202)</u>	<u>(2,125)</u>	<u>(1,708)</u>
Financing expenses, net		<u>(1,452)</u>	<u>(1,748)</u>	<u>(1,625)</u>
Profit (loss) before taxes on income		(1,229)	(3,801)	403
Tax benefit	18	<u>429</u>	<u>639</u>	<u>2,233</u>
Income (loss) from continuing operations		(800)	(3,162)	2,636
Loss from discontinued operations, net		<u>-</u>	<u>(271)</u>	<u>(3,094)</u>
Loss		<u>(800)</u>	<u>(3,433)</u>	<u>(458)</u>
<u>Net earnings (loss) per share attributable to equity shareholders of the Company</u>	24			
Basic and diluted earnings (loss) per share from continuing operations		<u>(0.12)</u>	<u>(0.48)</u>	<u>0.40</u>
Basic and diluted loss per share from discontinued operations		<u>-</u>	<u>(0.04)</u>	<u>(0.47)</u>
Basic and diluted loss per share		<u>(0.12)</u>	<u>(0.52)</u>	<u>(0.07)</u>

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

**Consolidated statements of comprehensive loss**

	<b>For the year ended December 31</b>		
	<b>2014</b>	<b>2013</b>	<b>2012</b>
	<b>Dollars thousands</b>		
Loss	(800)	(3,433)	(458)
Other comprehensive loss (after the effect of the tax):			
<u>Amounts that will not be reclassified thereafter to the statements of income:</u>			
Loss for re-measurement of the defined benefit plan	(181)	(118)	(262)
Subtotal of items that will not be reclassified thereafter to the statements of income	(181)	(118)	(262)
<u>Amounts that will be reclassified or are reclassified to the statements of income provided that specific terms are met:</u>			
Transfer to the statement of income for cash flow hedging transactions	(30)	-	55
Income (loss) not yet realized for investments in securities available for sale	(53)	74	30
Realized income for cash flow hedging transactions	-	(55)	-
Subtotal of items that will be reclassified or are reclassified to the statements of income	(83)	19	85
Total other comprehensive loss	(264)	(99)	(177)
Total comprehensive loss attributed to the Company's shareholders	(1,064)	(3,532)	(635)

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

## Consolidated Statements of Changes in Shareholders' Equity

	Relating to the Company's shareholders								
	Share capital	Additional paid-in capital	Capital reserve for actuarial losses	Accum. deficit	Treasury shares	Capital reserve for financial assets available for sale	Capital reserve for hedging transactions	Other capital reserves	Total equity
	Dollars thousands								
<u>Balance as at January 1, 2014</u>	19,995	107,444	(928)	(91,772)	(7,408)	(44)	-	467	27,754
Loss	-	-	-	(800)	-	-	-	-	(800)
Total other comprehensive loss	-	-	(181)	-	-	(53)	(30)	-	(264)
Share-based payment to employees and directors	-	114	-	-	-	-	-	-	114
Allocation of shares to the consultant	286	(91)	-	-	-	-	-	(195)	-
<u>Balance as at December 31, 2014</u>	<u>20,281</u>	<u>107,467</u>	<u>(1,109)</u>	<u>(92,572)</u>	<u>(7,408)</u>	<u>(97)</u>	<u>(30)</u>	<u>272</u>	<u>26,804</u>
	Relating to the Company's shareholders								
	Share capital	Additional paid-in capital	Capital reserve for actuarial losses	Accum. deficit	Treasury shares	Capital reserve for financial assets available for sale	Capital reserve for hedging transactions	Other capital reserves	Total equity
	Dollars thousands								
<u>Balance as at January 1, 2013</u>	19,818	107,321	(810)	(88,339)	(7,408)	(118)	55	380	30,899
Loss	-	-	-	(3,433)	-	-	-	-	(3,433)
Total other comprehensive income (loss)	-	-	(118)	-	-	74	(55)	-	(99)
Share-based payment to employees and directors	-	90	-	-	-	-	-	-	90
Allocation of shares to the consultant	177	33	-	-	-	-	-	(210)	-
Share-based payment to the consultant	-	-	-	-	-	-	-	297	297
<u>Balance as at December 31, 2013</u>	<u>19,995</u>	<u>107,444</u>	<u>(928)</u>	<u>(91,772)</u>	<u>(7,408)</u>	<u>(44)</u>	<u>-</u>	<u>467</u>	<u>27,754</u>
	Relating to the Company's shareholders								
	Share capital	Additional paid-in capital	Capital reserve for actuarial losses	Accum. deficit	Treasury shares	Capital reserve for financial assets available for sale	Capital reserve for hedging transactions	Other capital reserves	Total equity
	Dollars thousands								
<u>Balance as at January 1, 2012</u>	19,818	107,198	(548)	(87,881)	(7,408)	(148)	-	190	31,221
Loss	-	-	-	(458)	-	-	-	-	(458)
Total other comprehensive loss	-	-	(262)	-	-	30	55	-	(177)
Share-based payment to employees and directors	-	123	-	-	-	-	-	-	123
Classification of bank options for liabilities	-	-	-	-	-	-	-	190	190
<u>Balance as at December 31, 2012</u>	<u>19,818</u>	<u>107,321</u>	<u>(810)</u>	<u>(88,339)</u>	<u>(7,408)</u>	<u>(118)</u>	<u>55</u>	<u>380</u>	<u>30,899</u>

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



**Consolidated statements of cash flows**

	<b>For the year ended</b>		
	<b>December 31</b>		
	<b>2014</b>	<b>2013</b>	<b>2012</b>
	<b>Dollars thousands</b>		
<u>Cash flows from operating activities</u>			
Loss	(800)	(3,433)	(458)
Adjustments required to present cash flows from operating activities:			
Adjustments to the statement of income items:			
Depreciation and amortization:			
Depreciation and amortization of fixed and intangible assets	5,127	5,158	4,999
Increase in provision for impairment of fixed assets, non-current assets held for sale and intangible assets	-	294	33
Loss (gain) on disposal of fixed assets	(974)	(78)	2
Cost of share based payments	114	527	197
Loss from impairment of inventory	758	1,177	864
	<u>5,025</u>	<u>7,078</u>	<u>6,095</u>
Change in deferred taxes, net	(429)	(499)	(992)
Change in liabilities for benefits to employees, net	(87)	(25)	(270)
Change in the fair value of liabilities for bank options	(11)	(251)	64
Taxes on income	242	114	112
Financing expenses, net	1,379	1,209	1,334
	<u>1,094</u>	<u>548</u>	<u>248</u>
Changes in assets and liabilities items:			
Decrease (increase) in trade receivables	(4,332)	4,665	(4,665)
Decrease (increase) in other receivables	179	80	(610)
Decrease (increase) in inventory	(3,483)	1,225	2,892
Increase (decrease) in trade payables	2,844	(2,315)	196
Decrease in other payables	(1,143)	(854)	(117)
	<u>(5,935)</u>	<u>2,801</u>	<u>(2,304)</u>
Cash paid and received during the year for:			
Interest paid	(1,333)	(1,104)	(1,201)
Interest received	23	20	18
Taxes paid	(330)	(126)	(112)
Taxes received	88	12	-
	<u>(1,552)</u>	<u>(1,198)</u>	<u>(1,295)</u>
Net cash provided from (used for) operating activities	<u>(2,168)</u>	<u>5,796</u>	<u>2,286</u>

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

**Consolidated statements of cash flows**

	<b>For the year ended December 31</b>		
	<b>2014</b>	<b>2013</b>	<b>2012</b>
	<b>Dollars thousands</b>		
<u>Cash flows from investing activities</u>			
Acquisition of fixed assets	(1,733)	(1,375)	(454)
Energy efficiency grant received	72	-	-
Acquisition of intangible assets	(356)	(134)	(100)
Proceeds from disposal of fixed assets	448	373	21
Net cash used for investing activities	<u>(1,569)</u>	<u>(1,136)</u>	<u>(533)</u>
<u>Cash flows from financing activities</u>			
Short-term bank credit, net	(18)	466	2,491
Repayment of long-term loans	(2,718)	(4,015)	(1,264)
Net cash provided by (used for) financing activities	<u>(2,736)</u>	<u>(3,549)</u>	<u>1,227</u>
<u>Increase (decrease) in cash and cash equivalents</u>	<u>(6,473)</u>	<u>1,111</u>	<u>2,980</u>
<u>Balance of cash and cash equivalents at beginning of year</u>	<u>6,697</u>	<u>5,586</u>	<u>2,606</u>
<u>Balance of cash and cash equivalents at end of year</u>	<u>224</u>	<u>6,697</u>	<u>5,586</u>

<b>For the year ended December 31</b>		
<b>2014</b>	<b>2013</b>	<b>2012</b>
<b>Dollars thousands</b>		

(A) Significant transactions not in cash

Acquisition of fixed assets on credit (see Note 9g as follows)	<u>1,346</u>	<u>2,081</u>	<u>-</u>
Acquisition of assets through an exchange	<u>972</u>	<u>-</u>	<u>1,777</u>
Disposal of assets through an exchange	<u>163</u>	<u>-</u>	<u>2,005</u>

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

**Notes to the consolidated financial statements**

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**Note 1 – General**

- a. Tefron Ltd. (hereinafter: "the Company") is a company registered in Israel. The Company's production operations are carried out by a self-production process and through subcontractors in plants located in Israel, Jordan, and the Far East. The Company focuses on the development, production, marketing and sale of intimate apparel and activewear which are sold throughout the world to companies with leading brands.

The Company's shares are traded on the Tel Aviv Stock Exchange. For additional details, also see Note 20.

The Company's head offices are located in the industrial area of "Misgav".

b. **Definitions**

In these financial statements:

The Company	- Tefron Ltd.
The Group	- Tefron Ltd. and its subsidiaries as detailed in the attached list.
Subsidiaries	- Companies in which the Company has control of (as defined in IFRS 10) and their statements are consolidated with those of the Company.
Related parties	- As defined in IAS 24.
Interested parties and controlling shareholders	- As defined in the Securities Regulations (Annual Financial Statements) – 2010.

- c. The Company has recorded losses of 800 thousand dollars and 3,433 thousand dollars during the years ended December 31, 2014 and 2013, respectively.

On March 27, 2014, the Company and the banks signed on an appendix to the amendment to the financing agreement, in the framework of which, amongst else, the financial covenants the Company is obligated to meeting were amended (see Note 14b, as follows).

As at December 31, 2014, the Company meets all the financial covenants that were determined in the amendment to the financing agreement as aforementioned.

The Company's management estimates that as at the date of signing this report, the chance of the Company meeting the amended financial covenants as aforementioned and its obligations in the coming year, is greater than 50%, however, there is no certainty of that, since the latter is subject to events occurring in the future.

**Note 2 – Significant accounting principles**

The accounting principles as detailed as follows were used consistently throughout the financial statements, during all the periods presented, unless it is noted otherwise.

- a. **Basis of presentation of the financial statements**  
The financial statements are prepared in accordance with the International Financial Reporting Standards (hereinafter: "IFRS").

**Notes to the consolidated financial statements**

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**Note 2 – Significant accounting principles (cont.)**a. Basis of presentation of the financial statements (cont.)

Furthermore, the financial statements are prepared in accordance with the Israeli Securities Regulations (Annual Financial Statements), 2010.

The Company's financial statements are prepared on the basis of cost, excluding derivatives and financial assets available for sale; financial assets and liabilities (including derivative instruments) which are presented at fair value through the statement of income which are measured according to their fair value and excluding liabilities for employee benefits.

The Company chose to present the items in statement of income by a method which characterizes its operations.

b. Consolidated financial statements

The consolidated financial statements include the statements of companies controlled by the Company (wholly-owned subsidiaries). Control exists when the Company has influence on the investee entity, exposure or rights to variable returns as a result from its involvement in the investee entity, as well as the ability to use its power to influence the sum of returns that shall derive from the investee entity. While assessing control, one takes into account the influence of the potential voting rights, only if they are substantive. The consolidation of the financial statements commences as of the date on which control is obtained and ends when such control ceases.

The financial statements of the Company and its subsidiaries are prepared for identical dates and periods. The Company's accounting policy in the financial statements of its subsidiaries was implemented uniformly and consistently with the one implemented in the Company's own financial statements. Significant intra-group balances and transactions, and any gains and losses resulting from intra-group transactions were eliminated in full in the consolidated financial statements.

c. Functional, presentation and foreign currency1. Functional and presentation currency

The presentation currency of the financial statements is the US dollar.

The functional currency which is the currency that best reflects the economic environment in which the Company operates and conducts its transactions, is determined separately for each entity in the Group, and by this functional currency its financial position and operating results are measured.

The Group determines the functional currency of the Company for each entity of the Group.

The functional currency of the Company is the US dollar.

2. Transactions, assets and liabilities in foreign currency

Transactions denominated in foreign currency are recorded initially at the exchange rate on the date of the transaction. After the initial recognition, monetary assets and liabilities that are denominated in foreign currency are translated on each balance sheet date into the functional currency, at the exchange rate on that date. Exchange rate differences, other than those that are discounted to qualifying assets or are recognized in equity in hedging transactions, are recognized in the statement of income. Non-monetary assets and liabilities denominated in foreign currency and presented by cost are retranslated according to the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currency and presented at fair value are translated into the functional currency, in accordance with the rates of exchange on the date on which the fair value is determined.

## Notes to the consolidated financial statements

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### Note 2 – Significant accounting principles (cont.)

#### d. Exclusion of separate financial information in the framework of the periodic statements

In the framework of the financial statements for 2014 the Company did not include separate financial information in accordance with Regulation 9c and the 10<sup>th</sup> Addendum to the Securities Regulations (Periodic and Immediate Reports) – 1970, because it believes the information contained in it is negligible from a qualitative standpoint, in spite of its quantitative scope, the reason for which is mainly due to the fact that as stated in Note 14b, the Group's credit agreements with the lending banks refer to Tefron Group as a whole with cross-guarantees between the companies of the Group and providing information regarding separate financial statements will not carry with it any additional material information to the reasonable investor (shareholder) or to the creditors regarding the liquidity risk of the parent company, that is not already included in the framework of the consolidated financial statements of the Company.

#### e. Allowance for doubtful accounts

The allowance for doubtful accounts is determined specifically in respect of trade receivables whose collection, in the opinion of the Company's management, is doubtful. Impaired trade receivables will be withdrawn once they are assessed as uncollectible.

#### f. Inventory

Inventory is measured at the lower of cost or net realizable value. The cost of inventory includes the expenses for purchasing the inventory as well as other costs incurred to bring it to its current location and condition. Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to carry out the sale. The Company periodically evaluates the condition and age of inventory and records provisions for slow-moving inventory accordingly.

The cost of inventories is determined as follows:

Raw materials	-	Based on cost by the weighted average method.
Work in progress and finished goods	-	Based on average cost including material, labor and other direct and indirect manufacturing costs.

#### g. Revenue recognition

Revenues are recognized in the statement of income when they can be measured in a reliable fashion, it is expected that the economic benefits associated with the transaction will flow to the Company, as well as the costs incurred or to be incurred in respect of the transaction and can be measured reliably. The revenues are measured at the fair value of the consideration received in the transaction less any trade discounts, volume rebates and returns.

The specific criteria regarding revenue recognition which are required to be fulfilled prior to the revenue recognition are as follows:

##### Revenues from the sale of goods

Revenues from the sale of goods are recognized once the significant risks and rewards derived from the ownership of the goods have been transferred to the buyer, and the seller no longer retains any continued managerial involvement. Usually the date of the delivery is the date on which the ownership was transferred.

##### Discounts to customers

Discounts given to customers at the end of the year, for which the customer is not required to meet certain objectives, are included in the financial statements upon reaching the proportional sales which entitle the customer to these discounts and are deducted from the sales item.

**Notes to the consolidated financial statements**

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**Note 2 – Significant accounting principles (cont.)**h. Government grants

Government grants from the Office of the Chief Scientist in Israel for supporting development activities do not include the payment of royalties to the State, and therefore have been reduced from the cost of the development. The grants are recognized when there is reasonable assurance that the grants will be received and the Company would meet all the relevant conditions for receiving the grant. Government grants relating to assets such as fixed assets have been recorded as a reduction in the carrying amount of the fixed assets for which the grants were received.

i. Taxes on income

Taxes on income in the statement of income include deferred taxes. The tax results in respect of deferred taxes are recorded to the statement of income except to the extent that the tax arises from items which are recognized directly to shareholders' equity. In such cases, the tax effect is also recorded to the relevant item in shareholders' equity.

Deferred taxes

Deferred taxes are computed for temporary differences between the carrying amounts in the financial statements and the amounts attributed for tax purposes.

Deferred tax balances are measured at the tax rate that is expected to apply once the asset is realized or the liability is settled, based on tax laws that have been enacted or substantively enacted by the balance sheet date.

Deferred tax assets are reviewed on each balance sheet date and reduced to the extent that it is not probable that they will be utilized, temporary differences for which deferred tax assets have not been recognized are reassessed on each balance sheet date and deferred tax assets are recognized to the extent that their recoverability has become probable.

When calculating deferred taxes, taxes that would have applied in the event of the sale of investments in subsidiaries have not been taken into account in computing the deferred taxes, as long as it is probable that the sale of the investments in investee companies is not expected in the foreseeable future. Moreover, deferred taxes that would have applied in the event of distribution of earnings by investee companies as dividends have not been taken into account in computing deferred taxes, since the distribution of dividends does not involve an additional tax liability or since it is the Company's policy not to initiate distribution of dividends by a subsidiary since it involves an additional tax liability.

Deferred tax assets and deferred tax liabilities are presented in the balance sheet as non-current assets and non-current liabilities, respectively. Deferred taxes are offset if there is a legally enforceable right to set off a current tax asset against a current tax liability and the deferred taxes relate to the same taxable entity and the same tax authority.

j. Discontinued operations

Discontinued operations is a component of the Company which constitutes operation that was realized or classified as held for sale, the results of the operations relating to the discontinued operations are presented separately in the statement of income, less the tax effect.

k. Leasing

The tests for classifying leases as finance or operating leases depend on the substance of the agreements and they are reviewed at the inception of the lease in accordance with the principles below as set out in IAS 17:

## Notes to the consolidated financial statements

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### Note 2 – Significant accounting principles (cont.)

#### The Group as a lessee

##### Operating lease

Assets, for which all risks and benefits inherent in the ownership of the leased asset are not actually transferred, are classified as operating lease. The lease fees are recognized as an expense in the statement of income on a straight-line basis continuously over the lease period.

#### The Group as lessor

##### Operating lease

Assets, for which all risks and benefits inherent in the ownership of the leased asset are not actually transferred, are classified as operating lease. The lease fees are recognized as an expense in the statement of income on a straight-line basis continuously over the lease period.

#### 1. Fixed assets

Items of fixed assets are presented at cost plus direct acquisition costs less any accumulated depreciation, less accumulated impairment losses and less related investment grants and excluding day-to-day servicing expenses. Cost includes spare parts and auxiliary equipment that can be used only in connection with machinery and equipment:

	%
Buildings	2
Machinery and equipment (mainly 5%)	5-15
Motor vehicles	10-15
Office furniture and equipment (mainly 10%)	6-10
Leasehold improvements	see below

Leasehold improvements are depreciated using the straight line method over the lease period or over the expected useful life of the improvement, whichever is shorter.

The useful life, depreciation method and residual value of an asset are reviewed at least at the end of each year and the changes are accounted for as a change in accounting estimate in way of prospective application. As for testing the impairment of fixed assets, see Clause o, as follows.

The depreciation of assets is discontinued on the earlier of the date that the asset is classified as held for sale and the date on which the asset is withdrawn.

#### m. Intangible assets

Separately acquired intangible assets are measured on initial recognition at cost with the addition of costs directly attributable to the acquisition. Intangible assets acquired in a business combination are included at fair value at the acquisition date. After initial recognition, intangible assets are carried at their cost less any accumulated amortization and any accumulated impairment losses.

Intangible assets with a finite useful life are amortized over their useful life and reviewed for impairment whenever there is an indication that the asset may be impaired. The period of amortization and method of amortization of an intangible asset is examined at least at the end of each year.

## Notes to the consolidated financial statements

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### Note 2 – Significant accounting principles (cont.)

#### m. Intangible assets (cont.)

The useful lifespan of intangible assets is as follows:

	<u>Years</u>
Computer software	4
Customer relations	8
Brand license	2.75
Order backlog	Order delivery period

Goodwill is not amortized methodically and is subject to consideration of its loss of impairment on a yearly basis, as well as any time there is an indication that there might be a loss from impairment (see also Note 10, as follows).

#### Software

The Group's assets include computer systems that are comprised of software and licenses. Software forming an integral part of the hardware to the extent that the hardware cannot function without the programs installed in it, is classified as fixed assets. In contrast, stand-alone software licenses that add additional functionality to the hardware are classified as intangible assets.

Gains or losses from the withdrawal of an intangible asset are measured by the difference between the proceeds from the realization, net and the cost of the asset, and are recorded to the statement of income.

#### n. Impairment of non-financial assets

The Company examines the need to record an impairment of the carrying amount of non-financial assets whenever there are indications resulting from events or changes in circumstances which indicate that the carrying amount in the financial statements is not recoverable. In cases where the carrying amount of non-financial assets in the financial statements exceeds their recoverable amount, the assets are reduced to their recoverable amount. The recoverable amount is the higher of the fair value less costs for sale and the value of its use. In evaluating the value of use, the expected cash flows are discounted according to the discounting rate before tax, which reflects the specific risks of every asset. For an asset that does not create independent cash flows, the recoverable amount is determined for the cash-generating unit to which the asset belongs. Impairment losses are recorded to the statement of income in accordance with the nature of the item whose value declines.

An impairment loss of an asset, other than goodwill, is reversed only if there have been changes in the estimates used to determine the asset's recoverable amount since the last date in which the impairment loss was recognized. Reversal of an impairment loss, as aforementioned, is limited to the lower of the amount of impairment recognized in the past (less depreciation or amortization) or its recoverable amount. A reversal of that impairment loss, as aforementioned, is recognized in the statement of income in the same section in which the impairment was recognized. See Note 10b, as follows.

The following unique criteria are applied in assessing impairment of the goodwill:

#### Goodwill in respect of subsidiaries

The Company reviews goodwill for impairment once a year on December 31, or more frequently if events or changes in circumstances indicate that impairment can be recognized.

Impairment is recognized for goodwill by reviewing the recoverable amount of the cash-generating unit (or a group of cash-generating units) to which the goodwill has been allocated.



**Notes to the consolidated financial statements**

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**Note 2 – Significant accounting principles (cont.)**n. Impairment of non-financial assets (cont.)

When the recoverable amount of the cash-generating unit (or a group of cash-generating units) is lower than the carrying amount in the financial statements of the cash-generating unit (or a group of cash-generating units), to which the goodwill has been allocated, it is recognized as a loss from impairment initially related to goodwill. Losses recognized for goodwill are not reversed in consecutive periods.

o. Financial instruments1. Financial assets

Financial assets within the scope of IAS 39 are initially recognized at fair value plus directly attributable transaction costs, excluding financial assets which are measured at fair value through the statement of income, for which the transaction costs are recorded in the statement of income.

After the initial recognition, the accounting treatment of investments in financial assets is based on their classification as detailed as follows:

a. Financial assets available for sale

Financial assets available for sale are financial assets (non-derivative) that have been designated as available for sale or have not been classified to one of the three following groups as detailed as follows. After the initial recognition, available for sale financial assets are measured at fair value. Gains or losses from fair value adjustments, except the ones resulted due to interest differences, are usually recognized in other comprehensive income. When the investment is reduced or in case of an impairment, the accumulated other comprehensive income (loss) is carried out to statement of income

b. Receivables

Short-term loans and receivables are presented according to their terms generally at their nominal value.

2. Financial liabilities

The liabilities are initially recognized at fair value. Other loans and liabilities which are measured at amortized cost are presented less the direct transaction costs.

After the initial recognition, the accounting treatment of the financial liabilities is based on their classification as detailed as follows:

a. Financial liabilities measured at amortized cost

After the initial recognition, other loans and liabilities are presented in accordance with their terms according to the cost less direct transaction costs using the effective interest method.

b. Financial liabilities measured at fair value through the statement of income

Financial liabilities measured at fair value through the statement of income include bank options which can be exercised to an unknown number of shares (such as cashless options) and are handled as a financial derivative. On the date of initial recognition and on every reporting date, the options are measured according to their fair value, and the changes in fair value are recorded on a current basis to the statement of income in the financing item.

**Notes to the consolidated financial statements**

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**Note 2 – Significant accounting principles (cont.)**o. Financial instruments (cont.)3. Withdrawal of financial instrumentsa. Financial assets

A financial asset is withdrawn when the contractual rights to the cash flows from the financial asset expire or when the Company has transferred its contractual rights to receive cash flows from the financial asset or has assumed an obligation to pay the received cash flows in full without significant delay to a third party and in addition has transferred substantially all the risks and rewards related to the asset, or has neither transferred nor retained substantially all the risks and rewards related to the asset, but has transferred the control of the asset.

A factoring transaction and credit vouchers of customers is handled as a withdrawal when the above conditions exist.

When the Company has transferred its rights to receive cash flows from an asset and did not substantially transfer or retain the risks and benefits connected with the asset, and did not even transfer control of the asset, this is recognized as a new asset according to the extent of the Company's continuing involvement in the asset. Involvement usually continues by way of a guarantee for the asset transferred and is measured at the lower of the original balance in the financial statements of the asset, and the maximum amount of the consideration that the Company is likely to be required to pay in return.

b. Financial liabilities

A financial liability is withdrawn when it is settled, hence, when the liability is discharged, cancelled or expired. A financial liability is withdrawn when the debtor:

- Pays the liability by paying in cash, other financial assets, goods or services; or
- Is legally released from the liability.

4. Impairment of financial assets

On each balance sheet date, the Group assesses whether there is any objective evidence that the following financial asset or group of financial assets are impaired:

a. Financial assets presented at amortized cost

Objective evidence of impairment includes one or more events that have had a negative impact on the estimated future cash flows of the asset since the recognition of the asset. The amount of the loss which is recognized in the statement of income, is measured as the difference between the balance of the asset in the financial statements and the current value of estimated future cash flows (excluding future credit losses that have not been incurred yet), discounted at the original effective interest rate of the financial asset. If the financial asset bears a variable interest rate, the process of discount is carried out in accordance with the rate of the current effective interest rate. In consecutive periods, the amount of the impairment loss is reversed when the returned value of the asset can be related objectively to an event occurring after the impairment was recognized. Such a reversal amount is recorded to the statement of income up to the amount of the loss recognized.

b. Financial assets available for sale

For debt instruments classified as financial assets available for sale, evidence of impairment includes one or more events that have had a negative impact on the estimated future cash

**Notes to the consolidated financial statements**

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**Note 2 – Significant accounting principles (cont.)**o. Financial instruments (cont.)

flows of the asset since the recognition of the asset. When evidence of impairment is detected, the cumulative loss carried to other comprehensive loss, is recognized as an impairment loss in the statement of income. In subsequent periods, the amount of the impairment loss is reversed if the increase in fair value can be related objectively to an event occurring after the impairment was recognized. Such a reversal amount is recorded to the statement of income up to the amount of the loss recognized.

p. Derivative financial instruments for hedging purposes (hedging)

The Group often carries out engagements in derivative financial instruments such as forward contracts, trading in foreign currency options in order to hedge itself against the risks connected with fluctuations in the rates of exchange of foreign currency. These financial derivatives are first recognized at fair value. After the initial recognition, the financial derivatives are measured at fair value. Derivatives are recognized in the consolidated balance sheets as assets when their fair value is positive and as liabilities when their fair value is negative.

Profits or losses resulting from changes in the fair value of derivatives which are not used for hedging purposes are immediately recorded to the statement of income.

Hedging transactions which meet the criteria of hedging transactions (hedging) are treated as follows:

Hedging fair value

A change in the fair value of the derivative (the hedging item) and the hedged item is recognized in the statement of income. In the events of hedging fair value which relates to the hedged item presented at amortized cost, the adjustments to the carrying amount in the financial statements are recognized in the statement of income over the remaining period until repayment. Adjustments to financial instruments hedged presented using the effective interest method, are recognized in the statement of income. When the hedged item is withdrawn, the balance of the adjustments of fair value not yet amortized is recognized in the statement of income at that time.

Hedging cash flows

The effective part of a profit or a loss from the hedging instrument is recognized in equity as other comprehensive income (loss) while the ineffective part is immediately recognized in the statement of income.

Other comprehensive income (loss) is transferred to the statement of income when the results of the hedging transaction are recorded to the statement of income; e.g. when the hedged revenue or expense is recognized in the statement of income or when a forecasted transaction occurs. When the hedged item is the cost of a non- financial asset or liability, this cost includes also the amount of the other relative comprehensive income (loss) which is transferred from shareholders' equity on the date of recognizing the asset or liability.

In those cases where a forecasted transaction or a firm commitment are no longer expected to occur, the amounts recognized in shareholder' equity in the past, are transferred to the statement of income. Once the hedging instrument expires or is sold, terminated or exercised, or when it is no longer designated as a hedging instrument, the amounts recognized in shareholders' equity in the past, remain in shareholders' equity until the date in which the forecasted transaction or the firm commitment occur.

## Notes to the consolidated financial statements

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### Note 2 – Significant accounting principles (cont.)

#### q. Changes in the estimates

In November 2014 the Israel Securities Authority has published a Staff Accounting Bulletin 21-1 regarding the existence of a deep market in a high quality corporate bonds in Israel (hereinafter: “the bulletin”), in order to determine the discount rate of defined benefit liabilities and other long-term benefits that are shekel-denominated in accordance with IAS 19. According to the bulletin, the transition from using the return rate of government bonds (3.1%) to the return rate of index-linked high quality corporate bonds (4.1%) should be treated, using a prospective application, as a change in accounting estimate.

Effects of the change in the rate of discount, as aforementioned, are:

- A decrease in liability due to a defined benefit plan and an increase in deferred taxes as at December 31, 2014, in the amount of 80 thousand dollars which were recognized against other comprehensive income.
- The expected impact on interest expenses, net for 2015 is 4 thousand dollars.

#### r. Fair value measurement

Fair value is the price that would have been received for selling an asset or the price that would have been paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Fair value measurement is based on the assumption that the transaction takes place in the principal market of the asset or liability, or in the absence of a principal market, in the most advantageous market.

The fair value of an asset or a liability is measured while using the assumptions that market participants would use while pricing the asset or liability, assuming that market participants operate for the benefit of their own economic interests.

Fair value measurement for a non-financial asset takes into account the ability of the market participant to produce economic benefits by using the asset in its highest and best use or by selling it to another market participant who would use the asset in its highest and best use.

The Group uses valuation techniques that are appropriate in the circumstances, and for which sufficient data is available to measure fair value, while maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

All of the assets and liabilities that are measured at fair value or that a disclosure related to their fair value has been provided, are categorized within the fair value hierarchy, based on the lowest source of input significant to the measurement of the fair value as a whole:

Level 1	Quoted prices (unadjusted) in active market for identical assets or liabilities.
Level 2	Data other than quoted prices included within Level 1 that are observable either directly or indirectly.
Level 3	Data that are not based on observable market data (valuation techniques which use inputs that are not based on observable market data).

**Notes to the consolidated financial statements**

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**Note 2 – Significant accounting principles (cont.)**s. Treasury shares

The shares of the Company which are held by a subsidiary, are measured at their acquisition cost and are presented as a deduction in shareholders' equity. Any gain or loss resulting from the acquisition, sell, issue or cancellation of treasury shares is recorded directly in shareholders' equity.

t. Provisions

A provision in accordance with IAS 37 is recognized when the Group has a present obligation (legal or implied) as a result of a past event and it is probable that economic resources will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. The expense shall be recognized in the statement of income less the reimbursement of the expense.

The following are the types of provisions that have been included in the financial statements:

Legal claims

Provision for claims is recognized when the Group has a legal obligation in the present or an implied obligation as a result of a past event, and it is more likely than not that the Group will require financial resources to settle the obligation and it can be estimated reliably.

u. Liabilities for benefits to employees

The Group has several employee benefits:

1. Short-term employee benefits:

Short-term employee benefits are benefits which are expected to be fully paid, up to 12 months after the end of the annual reporting period during which the employees provide the relating services. These benefits include salaries, leave pay, paid sick leave, paid annual leave and social security contributions and are recognized as expenses as the services are rendered. Liability for a cash grant is recognized when the Group has a legal or implied obligation to pay the aforesaid amount for a service that was provided by the employee in the past and the amount can be estimated in a reliable fashion.

2. Post-employment benefits

The plans are usually fund by contributions to insurance companies and they are classified as defined contribution plans and defined benefit plans.

The Group in Israel has defined contribution plans pursuant to Section 14 of the Israeli Severance Pay Law under which the Group pays fixed contributions and without having legal or implied obligation to pay further contributions even if the fund does not hold sufficient amounts to pay all employee benefits relating to the employee service in the current and prior periods.

Contributions in the defined contribution plan in respect of severance pay or compensation are recognized as an expense when contributed to the plan simultaneously with receiving the employee's services.

In addition, the Group also has a defined benefit plan with regard to severance pay pursuant to the Israeli Severance Pay Law. According to the Law, employees are entitled to severance pay upon dismissal or retirement. The liability in regards with termination of employment is determined using the actuarial value of the projected unit entitlement method. The actuarial calculation takes into account future salary increases and rates of employee turnover based

**Notes to the consolidated financial statements**

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**Note 2 – Significant accounting principles (cont.)**u. Liabilities for benefits to employees (cont.)

on the estimated time of payment. The amounts are presented based on discounted expected future cash flows, at interest rates in accordance with the expected yield at the reporting date of index-linked high quality corporate bonds with maturity dates that are close to the liability period of the severance pay. Regarding the impact of the change as a result of the use of interest rate of index-linked high quality corporate bonds, see Note p above.

The Company makes current deposits in respect of its liabilities to pay severance pay to certain of its employees regularly in pension funds and insurance companies (hereinafter – “the plan’s assets”). The plan’s assets consist of assets held in eligible insurance policies. The plan’s assets are not available to the Group’s own creditors and cannot be paid directly to the Group.

The liability for employee benefits which is presented in the balance sheet represents the present value of the defined contribution plan less the fair value of the plan’s assets.

Re-measurements of the liability net are recorded as other comprehensive income in the period in which they occur.

v. Share-based payment transactions

The Company’s employees, directors and service providers are entitled to benefits in the form of share-based payment settled with equity instruments.

w. Transactions settled with equity instruments

The cost of transactions settled with equity instruments with employees, directors and service providers is measured at the fair value of the equity instruments on the granting date. Fair value is determined using an accepted pricing model, for additional details see Note 22, as follows.

The cost of transactions to service providers is measured at the fair value on the date of granting, and thereafter, at the date of providing the service; it is revalued to fair value with the changes being recorded to the statement of income.

The cost of transactions settled with equity instruments is recognized in the statement of income, together with a corresponding increase in equity, over the period in which the performance conditions exist, and ends on the date on which the relevant employees and directors become entitled to the benefit (hereinafter – “the vesting period”). The cumulative expense recognized for transactions settled with equity instruments on each reporting date until the vesting date, reflects the extent to which the vesting period has expired, and the Group’s best estimate of the number of equity instruments that will ultimately vest. The charge or credit to the statement of income represents the movement in cumulative expense recognized at the beginning and end of that reported period.

No expense is recognized for grants that do not ultimately vest, except for grants where vesting is dependent on market conditions, which are treated as grants which vested irrespective of whether the market conditions are met, provided that all other vesting conditions (service and/or performance) were fulfilled.

When the Company modifies the conditions of a grant settled with equity instruments, the additional expense is recognized in addition to the original expense that was calculated for any modification that increases the total fair value of the benefit granted or is otherwise beneficial to the employee or director according to the fair value on the modification date.

**Notes to the consolidated financial statements**

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**Note 2 – Significant accounting principles (cont.)**w. Transactions settled with equity instruments (cont.)

Cancellation of the grant settled with an equity instrument is handled as if it vested on the date of the cancellation and the expense not yet recognized for the grant is immediately recognized. Nevertheless, if the grant that was cancelled is replaced by a new grant which is designated as an alternative grant on the date on which it is granted, the cancelled grant and the new grant will both be handled as a change in the original grant as described above.

x. Earnings (loss) per share

Earnings (loss) per share are calculated by dividing the net income (loss) attributable to shareholders of the Company by the weighted average number of ordinary shares outstanding during the period.

Potential ordinary shares are included in the computation of diluted earnings per share only if they result in diluted earnings per share from continuing operations. Potential ordinary shares that have been converted during the period are included in diluted earnings per share only until the conversion date and from that date they are included in basic earnings per share.

**Note 3 – The key considerations, estimates and assumptions in preparing the financial statements**

During the process of implementing the principals of the accounting policy throughout the financial statements, the Group has used discretion and has considered numerous considerations in regards to the following subjects, which have a significant effect on the amounts that were recognized in the financial statements:

a. The considerations:Impairment of financial assets available for sale

On each balance sheet date, the Group assesses whether there is any objective evidence whether the value of the asset is impaired and impairment exists in relation to it. For the purpose of evaluating the impairment, as aforementioned, the Group uses discretion regarding indications that point to an objective evidence which relate to the rate of the decline in the fair value in percentage, as well as to the duration of the decline in the fair value.

Lease classification

For the purpose of identifying whether to classify leases as financial or operating, the Company examines whether the lease transfers substantially all the risks and benefits relating to the ownership of the property. The Company evaluates, among other things, the existence of a bargain purchase option, the lease term in relation to the economic life of the asset and the present value of the minimum lease payments in relation to the fair value of the asset.

b. Estimates and assumptions

At the time of the preparation of the financial statements, the management is required to be assisted by estimates and assumptions which affect the implementation of the accounting policy and the amounts reported on assets, liabilities, revenues and expenses. Changes in accounting estimates are recorded during the period in which the change in estimate is made.

The following are the key assumptions made in the financial statements concerning uncertainties on the balance sheet date, and the critical estimates computed by the Group and that a significant adjustment in the estimates and assumptions is likely to change the value of the assets and liabilities in the financial statements in the consecutive reporting year:

Legal claims

When evaluating the chances of the legal claims filed against the Company and its subsidiaries, the Company relied on the opinion of its legal advisors. These opinions of the Company's legal

**Notes to the consolidated financial statements****Note 3 – The key considerations, estimates and assumptions in preparing the financial statements (cont.)****b. Estimates and assumptions (cont.)**

advisors are based on the best of their professional judgment, taking into account the stage of the proceedings and on the legal experience accumulated on these subjects. Since the outcomes of any legal claims will be determined in the courts, actual results could differ from these evaluations.

**Impairment of goodwill**

The Group reviews the impairment of goodwill at least once a year. The review obligates the management to estimate the future cash flows which are expected from the continued usage of a cash-generating unit (or a group of cash-generating units) to which the goodwill was allocated. Furthermore, the management is required to estimate the appropriate deduction rate for these cash flows.

**Deferred tax assets**

Deferred tax assets are recognized for carry forward tax losses and deductible temporary differences not yet utilized to the extent that it is probable that future taxable income will be available against which the losses could be utilized. The management's careful consideration is required to determine the amount of deferred tax assets that can be recognized, based upon the timing, the amount of future taxable income expected, its origin and the tax planning strategies.

**Pension and other post-employment benefits**

The liability in respect of defined post-employment benefit plans is determined using actuarial valuation techniques. Calculating the liability consists of making assumptions, amongst other things, regarding the discount rates, future salary increases and employee turnover. The balance of the liability may be affected significantly by changes in these estimates.

**Determining the fair value of an unlisted financial asset**

The fair value of an unlisted financial asset classified within level 3 of the fair value hierarchy, is determined in accordance with estimation methods, usually according to an assessment of future cash flows discounted according to the current discount rates for items with similar terms and risk characteristic. Changes in the estimation of future cash flows and estimated discount rate while taking into consideration the risks assessment such as liquidity risk, credit risk and volatility, may affect the fair value of these assets.

**Evaluating the fair value of share-based payment transactions**

The fair value of share-based payment transactions is determined at the initial recognition while using the accepted option pricing model. The model is based on data of the price of the share and the realization price, as well as the assumptions regarding the expected fluctuations, expected lifespan and expected dividends.

**Note 4 – Disclosure to new IFRS during the period prior to their implementation****a. IFRS 15 – Recognizing revenue from contracts with customers**

IFRS 15 (hereinafter: “the standard”) was issued by the IASB in May, 2014.

The standard replaces IAS 18 ‘Revenue’, IAS 11 ‘Construction Contracts’ and IFRIC 13 ‘Customer Loyalty Programmers’, IFRIC 15 ‘Agreements for the Construction of Real Estate’, IFRIC 18 ‘Transfer of Assets from Customers’ and SIC 31 ‘Revenue – Barter Transactions Involving Advertising Services’.

The standard presents a five-stage model that shall apply to revenue from contracts with customers:



## Notes to the consolidated financial statements

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### Note 4 – Disclosure to new IFRS during the period prior to their implementation (cont.)

#### a. IFRS 15 – Recognizing revenue from contracts with customers (cont.)

- Stage 1 - **Identify the contract with the customer**, including reference as to when to combine contracts and how to handle modifications in contracts.
- Stage 2 - **Identify several distinct performance obligations in the contract.**
- Stage 3 - **Determine the transaction price**, including recognition of variable consideration, a significant financing component, consideration in a form other than cash and consideration payable to the customer.
- Stage 4 - **Allocation of the transaction price to each distinct performance obligation**, on the basis of the relative stand-alone selling price while using observable prices if available, or estimates and assumptions.
- Stage 5 - **Recognize revenue when a performance obligation is satisfied**, while making a distinction when a performance obligation is satisfied at a point in time or over time.

The standard would be implemented retrospectively as of the financial statements for annual periods beginning on January 1, 2017 or thereafter. Early adoption is permitted. The standard allows selecting a partial retrospective application with some exemptions, according to which the standard will be implemented to existing contracts starting from the initial application and thereafter, and no restatement of the comparative figures would be required, as long as comparative disclosures required by the standard are included.

The Company estimates that the standard is not expected to have a material effect on the financial statements.

#### b. IFRS 9 – Financial instruments

In July 2014 the IASB issued the final and complete form of IFRS 9 ‘Financial Instruments’ which replaces IAS 39- ‘Financial Instruments: Recognition and Measurement’. IFRS 9 (hereinafter – “the standard”) focuses mainly on the classification and measurement of financial assets and it applies to all financial assets within the scope of IAS 39.

The standard states that upon initial recognition, all financial assets shall be measured at fair value. In consecutive periods, debt instruments should be measured at amortized cost only if both of the following cumulative conditions are met:

- The asset is held within a business model whose objective is to hold assets in order to collect the contractual cash flows derived from them.
- According to the contractual terms of the financial asset, on specified dates the Company is entitled to receive cash flows that constitute only as payments of principal and interest on the principal amount outstanding.

The subsequent measurement of all other debt instruments and financial assets will be at fair value. The standard provides a distinction between debt instruments measured at fair value through statement of income and debt instruments measured at fair value through other comprehensive income.

Financial assets that are equity instruments will be measured in subsequent periods at fair value and the differences will be recognized in the statement of income or in other comprehensive income (loss), in accordance with the election of the accounting policy by the Company, on an instrument-

**Notes to the consolidated financial statements****Note 4 – Disclosure to new IFRS during the period prior to their implementation (cont.)**

by- instrument basis. If the equity instruments are held for trading, they must be measured at fair value through statement of income.

Regarding derecognition and the subject of financial liabilities the standard provides the same instructions as required under IAS 39 regarding derecognition and financial liabilities for which the fair value option has not been elected.

According to the standard, the amount of the adjustment to the liability's fair value - that is attributable to changes in credit risk - should be presented in other comprehensive income. All other fair value adjustments should be presented in the statement of income.

The standard includes new requirements regarding hedge accounting.

The standard will be applied as of the financial statements for annual periods beginning on January 1, 2018. Earlier application is permitted.

The Company is evaluating the potential impact of the standard, but is presently unable to assess the impact, if any, on the financial statements.

c. **An amendment to IAS 19 regarding the accounting of employee contributions in respect of service**

The IASB has published an amendment to the current requirements within IAS 19 in regards of contributions made by employees or third parties related to the service.

According to the amendment, if the amount of the contributions is independent of the number of years of service (as in such cases where the contributions are calculated as a fixed percentage of the employee's salary, the contributions are a fixed amount throughout the period of service or the contributions are determined according to the employee's age), it is possible to recognize such contributions as a reduction of the service cost, in the period in which the related service is rendered, rather than attributing them to the periods of service.

When the contributions are dependent on the number of years of service in which the service was rendered, those contributions should be attributed to the periods of service while using the same attribution method required by IAS 19, paragraph 70, in regards of attribution of a benefit to the periods of service.

The amendments to IAS 19 would be implemented retrospectively as of the financial statements for annual periods beginning July 1, 2014 or thereafter. Early adoption is possible.

The Company estimates that the amendments to IAS 19 are not expected to have a significant effect on the financial statements.

**Note 5 – Discontinued operations**

On March 3, 2013, the Board of Directors decided on leaving the field of manufacturing and marketing of swimwear and beachwear. On March 20, 2013, the Company and Macro Clothing Ltd. (hereinafter: "the seller"), a subsidiary of the Company, signed on an agreement with Gottex Swimwear Brands Ltd. (hereinafter: "the purchaser"), in the framework of which the seller would sell the purchaser its operations in the field of developing, manufacturing and marketing of swimwear and beachwear, including the intellectual property and goodwill of the seller in regards to the aforementioned operations, the client and supplier list, and all of the seller's rights in the incorporated companies in Hong Kong and China (hereinafter: "the agreement" or "the transaction" and "the operation", respectively).

Furthermore, the agreement includes clauses regarding non-competition by the seller or any of the companies related to it in the field of swimwear, for a limited period of time, as well as clauses regarding indemnity the purchaser would be entitled to from the seller for damages that might be

**Notes to the consolidated financial statements**


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**Note 5 – Discontinued operations (cont.)**

caused to it due to false presentations, and/or legal claims, and/or demands by any third party, and all of the above as detailed in the agreement.

On November 14, 2013, the seller completed its engagement in the agreement, in return for the sum of US 280 thousand dollars.

The completion of the engagement in the agreement was made possible with the fulfilment of all of the conditions precedent in the agreement, including, a completion of a *due diligence* and the approval of the Company's lending banks.

It should be noted that the proceeds resulting from the agreement, were used on November 18, 2013, for an early repayment of the Company's credit at the Company's financing banks (Bank Hapoalim Ltd., Bank Leumi Le-Israel Ltd. and Israel Discount Bank Ltd.), respectively to the share of each bank as was determined in the agreement of re-organization of credit terms which was signed between the Company and its financing banks on March 2, 2010 (and as it was amended occasionally).

Furthermore, in 2013 the seller repaid 1 million dollars, as part of its obligations to the lending banks in regards with the selling transaction, at the expense of long term credit.

The following are the details regarding the operations' results relating to the discontinued operations:

	<b>For the year ended December 31,</b>		
	<b>2014</b>	<b>2013</b>	<b>2012</b>
	<b>Dollars thousand</b>		
Sales	-	8,190	14,527
Cost of sales	-	6,207	11,224
Gross profit	-	1,983	3,303
Selling and marketing expenses	-	1,508	4,801
General and administrative expenses	-	292	(11)
Other expenses	-	218	-
Operating loss	-	(35)	(1,487)
Financing expenses, net	-	(215)	(367)
Tax benefit (taxes on income)	-	(21)	(1,240)
Net loss relating to discontinued operations	-	(271)	(3,094)

The following is the data regarding the cash flows, net, relating to the discontinued operations, and originated from (used for) the discontinued operations:

	<b>For the year ended December 31,</b>		
	<b>2014</b>	<b>2013</b>	<b>2012</b>
	<b>Dollars thousand</b>		
Operating	-	(17)	(2,828)
Investing	-	280	(14)

**Notes to the consolidated financial statements****Note 5 – Discontinued operations (cont.)**

The following is the data regarding the balances of other comprehensive loss, net, attributed to the Company's shareholders, which were recorded to the shareholders' equity, relating to the discontinued operations:

	<b>For the year ended December 31,</b>		
	<b>2014</b>	<b>2013</b>	<b>2012</b>
	<b>Dollars thousand</b>		
Actuarial loss from defined benefit plan	-	(73)	(73)

**Note 6 - Trade receivables, net**

	<b>December 31,</b>	
	<b>2014</b>	<b>2013</b>
	<b>Dollars thousands</b>	
Open receivables	18,166	13,347
Checks for collection	99	624
	18,265	13,971
With deduction of provision for doubtful debts	(242)	(280)
Trade receivables, net	18,023	13,691

Trade receivables whose collection is in doubt are accounted for through recording a provision for doubtful debts.

The movement in the provision for doubtful accounts is as follows:

	<b>Dollars thousands</b>
<u>Balance as of January 1, 2013</u>	114
Provisions during the year	166
<u>Balance as of December 31, 2013</u>	280
Provision during the year	8
Recognition of doubtful debts deleted	(46)
<u>Balance as of December 31, 2014</u>	242

**Notes to the consolidated financial statements****Note 6 - Trade receivables, net (cont.)**

The following is the analysis of the balances of trade receivables for which no impairment was recorded (provisions for doubtful debts), trade receivables net, according to the period of delay in collection in relation to the reporting date:

	Trade receivables whose debts have not yet fallen due (no delay in collection)	Past due trade receivables and the delay in their collection is					Total
		Under 30 days	30 – 60 days	60 – 90 days	90 – 120 days	Over 120 days	
Dollars thousands							
December 31, 2014	17,368	309	124	36	84	102	18,023
December 31, 2013	12,734	428	326	71	87	45	13,691

**Note 7 - Other receivables**

	December 31,	
	2014	2013
Dollars thousands		
Prepaid expenses	808	510
Advances to vendors	787	777
Institutions	537	839
Derivatives for forward transactions	148	67
Revenues receivable	59	46
Other receivables	197	472
	<u>2,536</u>	<u>2,711</u>

**Note 8 - Inventories**

	December 31,	
	2014	2013
Dollars thousands		
Raw Materials	3,100	2,463
Work in process	4,069	5,747
Finished goods	8,178	4,412
	<u>15,347</u>	<u>12,622</u>

\*) An impairment of inventory recognized as part of cost of sales amounted to 758 thousand dollars (2013 – 1,177 thousand dollars, 2012 - 864 thousand dollars).

## Notes to the consolidated financial statements

**Note 9 – Property, plant and equipment**

a. Composition and movement:

The year of 2014:

	Land and buildings	Machinery and equipment (*)	Vehic- les	Office furniture and equipment	Leasehold improve- ments	Total
	Dollars thousands					
<u>Cost</u>						
Balance as at January 1, 2014	3,863	91,762	194	2,418	10,727	108,964
Additions during the year (**)	-	2,834	-	83	106	3,023
Disposals – realizations (**)	-	(14,139)	-	-	-	(14,139)
Balance as at December 31, 2014	3,863	80,457	194	2,501	10,833	97,848
<u>Accumulated depreciation</u>						
Balance as at January 1, 2014	1,572	69,036	194	1,829	5,325	77,956
Additions during the year	54	3,973	-	105	885	5,017
Disposals – realizations (**)	-	(13,624)	-	-	-	(13,624)
Balance as at December 31, 2014	1,626	59,385	194	1,934	6,210	69,349
<u>Provision for impairment</u>						
Balance as at January 1, 2014	470	2,430	-	124	-	3,024
Amortization during the year	-	(382)	-	-	-	(382)
Balance as at December 31, 2014	470	2,048	-	124	-	2,642
<u>Balance of depreciated cost as at</u>						
December 31, 2014	1,767	19,024	-	443	4,623	25,857

(\*) The balance is recorded after the deduction of the investment grants on the amount of 19,306 thousand dollars which their depreciated cost as at December 31, 2014, is 864 thousand dollars.

(\*\*) Additions on the sum of 972 thousand dollars and disposals on the sum of 163 thousand dollars were recorded as part of a transaction of replacing old machines with new ones.

## Notes to the consolidated financial statements

**Note 9 – Property, plant and equipment (cont.)**

## a. Composition and movement (cont.):

The year of 2013:

	Land and buildings	Machinery and equipment (*)	Vehic- les	Office furniture and equipment	Leasehold improve- ments	Total
	Dollars thousands					
<u>Cost</u>						
Balance as at January 1, 2013	3,863	89,343	221	2,923	11,147	107,497
Additions during the year	-	3,102	-	112	241	3,455
Disposals – realizations	-	(513)	(27)	(613)	(661)	(1,814)
Disposals - amortization of assets	-	(170)	-	(4)	-	(174)
Balance as at December 31, 2013	3,863	91,762	194	2,418	10,727	108,964
<u>Accumulated depreciation</u>						
Balance as at January 1, 2013	1,493	65,409	220	2,277	4,951	74,350
Additions during the year	79	4,019	1	126	888	5,113
Disposals – realizations	-	(310)	(27)	(572)	(514)	(1,423)
Disposals – amortization of assets	-	(82)	-	(2)	-	(84)
Balance as at December 31, 2013	1,572	69,036	194	1,829	5,325	77,956
<u>Provision for impairment</u>						
Balance as at January 1, 2013	470	2,997	-	124	-	3,591
Provision's adjustment according to the recoverable amount	-	-	-	-	187	187
Disposals – realizations	-	-	-	-	(187)	(187)
Amortization during the year	-	(567)	-	-	-	(567)
Balance as at December 31, 2013	470	2,430	-	124	-	3,024
<u>Balance of depreciated cost as at December 31, 2013</u>	<u>1,821</u>	<u>20,296</u>	<u>-</u>	<u>465</u>	<u>5,402</u>	<u>27,984</u>

(\*) The balance is recorded after the deduction of the investment grants on the sum of 19,715 thousand dollars which their depreciated cost as at December 31, 2013, is 1,381 thousand dollars.

b. Impairment of fixed assets

In 2013 and 2014 the Company did not record a provision for impairment in its books. In 2012, a provision for impairment of inactive assets on the amount of 33 thousand dollars was recorded, as described in Note 9f as follows.

c. Change in the estimated lifespan of the sewing machines

In June 2012 the Company engaged with an independent qualified evaluator who was required to determine the balance of the lifespan of the Company's operating sewing machines. Regarding part of the sewing machines, the evaluator determined the remaining lifespan is 6-7 additional years as of June 30, 2012. The balance of the sewing machines' average lifespan prior to the evaluator's work was approximately two and a half years. Accordingly, the balance of the lifespan of these machines was amended to six years as of the third quarter of 2012. The effect of the change in estimation as aforementioned was a decrease in quarterly depreciation expenses by approximately 120 thousand dollars.

## d. Regarding liens see Note 20c.

## Notes to the consolidated financial statements

Note 9 – Property, plant and equipment (cont.)f. Inactive assetsThe year of 2014

<u>Cost</u>	<u>Machinery and equipment (*)</u> <u>Dollars thousands</u>
Balance as at January 1 and December 31, 2014	45,050
<u>Accumulated depreciation</u>	
Balance as at January 1, 2014	41,719
Amortization recognized during the year	607
Balance as at December 31, 2014	42,326
<u>Provision for impairment</u>	
Balance as at January 1, 2014	776
Amortization during the year	(494)
Balance as at December 31, 2014	282
Balance of depreciated cost as at December 31, 2014	2,442

(\*) The balance is recorded after the deduction of the investment grants on the sum of 4,315 thousand dollars which their depreciated cost as at December 31, 2014, is 370 thousand dollars.

The year of 2013

<u>Cost</u>	<u>Machinery and equipment (*)</u> <u>Dollars thousands</u>
Balance as at January 1 and December 31, 2013	45,050
<u>Accumulated depreciation</u>	
Balance as at January 1, 2013	41,031
Amortization recognized during the year	688
Balance as at December 31, 2013	41,719
<u>Provision for impairment</u>	
Balance as at January 1, 2013	1,269
Amortization during the year	(493)
Balance as at December 31, 2013	776
Balance of depreciated cost as at December 31, 2013	2,555

(\*) The balance is recorded after the deduction of the investment grants on the sum of 4,315 thousand dollars which their depreciated cost as at December 31, 2013, is 556 thousand dollars.



**Notes to the consolidated financial statements****Note 9 – Property, plant and equipment (cont.)**f. Inactive assets (cont.)

On March 3, 2011 the Company decided to discontinue the production in the Cut & Sew field in Israel. This decision was due to the decline in the levels of production in Israel of this field until reaching minor production at the end of 2010. The Company took a decision to realize the production assets and started a process of locating a potential buyer. Accordingly the Company reclassified the machines used in these operations from the fixed assets item to current assets held for sale item. Since a long period of time has passed and the Company was successful in a partial realization of those assets, the Company reclassified in 2012 the rest of the assets that were yet to be realized, to the non-current assets item. This was done based on an evaluation of an independent qualified evaluator who evaluated the value of the equipment as at that day. Accordingly the Company recorded in 2012 an impairment loss in the amount of 33 thousand dollars. As of the first quarter of 2013 the equipment is treated as inactive fixed assets and is amortized on a regular basis.

g. Purchase of fixed assets on credit

During the year 2014 the Company has purchased fixed assets on credit on the sum of 1,346 thousand dollars. The credit for the automation machines that have been purchased is for a period of four years, so over this period principal will be repaid and interest shall be paid. As at the reporting date, the purchase price has not been paid yet.

During the year 2013, the Company has purchased fixed assets on credit on the sum of 2,081 thousand dollars, the purchase price on the sum of 884 thousand has not been paid as at December 31, 2014.

**Note 10 - Goodwill and intangible assets**

## a. Composition and movement:

The year of 2014

	Computer software	List of customers and brand license	Goodwill	Total
	Dollars thousands			
<u>Cost</u>				
Balance as at January 1, 2014	1,901	2,037	49	3,987
Additions during the year	356	-	-	356
Balance as at December 31, 2014	2,257	2,037	49	4,343
<u>Accumulated amortization</u>				
Balance as at January 1, 2014	1,572	1,344	-	2,916
Amortization recognized during the year	136	243	-	379
Balance as at December 31, 2014	1,708	1,587	-	3,295
Amortized balance as at December 31, 2014	549	450	49	1,048

## Notes to the consolidated financial statements

**Note 10 - Goodwill and intangible assets (cont.)**The year of 2013

	Computer software	List of customers and brand license	Goodwill	Total
	Dollars thousands			
<u>Cost</u>				
Balance as at January 1, 2013	1,939	3,330	49	5,318
Additions during the year	134	-	-	134
Withdrawals - realization	(172)	(1,293)	-	(1,465)
Balance as at December 31, 2013	1,901	2,037	49	3,987
<u>Accumulated amortization</u>				
Balance as at January 1, 2013	1,655	2,202	-	3,857
Amortization recognized during the year	89	328	-	417
Withdrawals - realization	(172)	(1,186)	-	(1,358)
Balance as at December 31, 2013	1,572	1,344	-	2,916
<u>Provision for impairment</u>				
Balance as at January 1, 2013	-	-	-	-
Additions during the year	-	107	-	107
Withdrawals - realization	-	(107)	-	(107)
Balance as at December 31, 2013	-	-	-	-
Amortized balance as at December 31, 2013	329	693	49	1,071

The list of customers, brand license for production and marketing and goodwill were bought through business combinations. Customer relationships are amortized over a period of 8 years and brand license for production and marketing was amortized over a period of 2.75 years, until the date of September 30, 2013.

b. Amortization expenses

Amortization expenses of intangible assets are classified in the statement of income as follows:

	For the year ended December 31		
	2014	2013	2012
	Dollars thousands		
Cost of sales	136	89	92
Selling and marketing expenses	243	328	494
	379	417	586

## Notes to the consolidated financial statements

**Note 11 - Credit from banks**a. Composition

	<u>In NIS</u>	<u>Unlinked</u>	<u>Total</u>
	<u>Dollars thousands</u>		
<u>December 31, 2014</u>			
Short-term credit from banks	579	6,906	7,485
Current maturities of long-term loans	<u>-</u>	<u>1,700</u>	<u>1,700</u>
	<u>579</u>	<u>8,606</u>	<u>9,185</u>
<u>December 31, 2013</u>			
Short-term credit from banks	502	7,001	7,503
Current maturities of long-term loans	<u>-</u>	<u>2,435</u>	<u>2,435</u>
	<u>502</u>	<u>9,436</u>	<u>9,938</u>

b. Regarding collateral and liens see Note 20c, as follows.

**Note 12 - Trade payables**

	<u>December 31</u>	
	<u>2014</u>	<u>2013</u>
	<u>Dollars thousands</u>	
Open accounts	10,963	7,100
Notes payable	<u>2,970</u>	<u>4,150</u>
	<u>13,933</u>	<u>11,250</u>

**Note 13 - Other payables**

	<u>December 31</u>	
	<u>2014</u>	<u>2013</u>
	<u>Dollars thousands</u>	
Liability to employees and other liabilities for wages and salaries	1,567	2,186
Accrued expenses	204	678
Institutions	250	192
Derivatives for forward transactions	236	-
Other payables	<u>-</u>	<u>2</u>
	<u>2,257</u>	<u>3,058</u>

## Notes to the consolidated financial statements

**Note 14 - Long-term loans from banks and vendors**

## a. Composition:

As at December 31, 2014

	Nominal rate of interest <u>                    </u> %	<u>Balance</u> Dollars	Balance less current maturities <u>                    </u> thousands
Loans from banks	Libor + 5.00-2.15	15,906	14,206
Loans from trade payables	Libor + 4.2	<u>447</u>	<u>222</u>
		<u>16,353</u>	<u>14,428</u>

As at December 31, 2013

	Nominal rate of interest <u>                    </u> %	<u>Balance</u> Dollars	Balance less current maturities <u>                    </u> thousands
Loans from banks	Libor + 3.85-2.15	18,273	15,838
Loans from trade payables	Libor + 4.2	<u>756</u>	<u>504</u>
		<u>19,029</u>	<u>16,342</u>

b. Agreement with the banks regarding the reorganization of the credit lines.

On March 2, 2010, the Company signed a final agreement with the banks which includes a reorganization of credit financing that the banks provide to the Company. The Company has adopted the provisions of IAS 39 (while examining the quantitative and qualitative criteria) and handled the new arrangement as an insignificant change in conditions. The agreement was amended on December 24, 2010, December 27, 2011, and March 27, 2014.

The following is a summary of the main provisions of the signed agreement and the amendments thereof:

The long term credit line provided to the Company was divided into loans and credit lines as follows:

1. Loan A

The principal of Loan A of a total sum of 15 million dollars was provided by the banks for a period of 10 years. The interest on Loan A will be paid quarterly. The principal of Loan A will be paid in three equal annual installments of 1.25 million dollars each, as of the end of the seventh year, as of the date of providing Loan A.

The balance for a total amount of 11.25 million dollars will be repaid at the end of the tenth year as of the date of providing Loan A.

Early repayment of Loan A

The Company will repay, in an early repayment, the unpaid balance of Loan A, in full or in part, in accordance with the conditions and dates as detailed as follows:

**Notes to the consolidated financial statements****Note 14 - Long-term loans from banks and vendors (cont.)****b. Agreement with the banks regarding the reorganization of the credit lines (cont.)**

- (1) Raising future capital – in any event in which the Company will raise capital, then a total equal to fifty percent (50%) of the net proceeds thereof will serve for the purpose of early repayment. In this regard, it should be mentioned, that in the Nouvelle agreement which was signed in December 2010 and included, amongst else, an investment on the sum of 5.8 million dollars in the Company, the banks agreed to deviate from applying this clause.
- (2) The sale of assets – in any event in which the Company will decide to sale an asset, not in the normal course of business, then the full net proceeds of the sale of the asset will serve for the purpose of early repayment. It should be noted that in continuation to the sale of the operations in the field of development, production and marketing of swimwear and beachwear from the subsidiary to Gottex Swimwear Brands Ltd. as described in Note 5 above, the full amount of the proceeds on the sum of 280 thousand dollars was used for early repayment of the Company's credit. In addition, the Company has repaid a total sum of 1 million dollars at the expense of a long-term loan. The source for the aforementioned repayment was due to a decrease in the working capital requirements of the Company at that time.
- (3) Cash flows surpluses (in accordance with the amendment as at 03.27.14) - in any event in which the total cash flows surpluses, in accordance with the financial statements, will exceed the determining amount, then a total comprising 60% (sixty percent) of the total difference between the surplus cash flows and the determining amount, will be used as early repayment, according to the determining ratio, at the expense of the last payment of principal Loan A, as it may be from time to time.

"Surplus cash flows" – the total EBITDA of the aforementioned corporations according to the financial statements, in every calendar year (hereinafter: "calendar year"), less: (a) the total repayment of principal loans of the aforementioned corporations from the aforementioned banks in a calendar year; (b) financing expenses in cash, including fees and exchange rate differences according to the financial statements of the calendar year; and (c) repayment at the expense of the principal and interest for current debts arrangements.

"The determining amount" – US 4.5 million dollar.

- (4) In the amendment dated 03.27.14 it was also agreed upon that on December 18th of every calendar year, the Tefron Group obligates to repay by an early repayment, at the expense of long term credit, the following sums
  - a. On 12.18.2015, an early repayment on the sum of US 300 thousand dollars.
  - b. On 12.18.2016, an early repayment on the sum of US 400 thousand dollars.
  - c. On 12.18.2017, and on December 18th of each calendar year thereafter, an early repayment on the sum of US 500 thousand dollars.

2. **Loan B**

The principal of Loan B of a total amount of 5 million dollars was provided by the banks for a period of six years. The interest will be paid quarterly and the principal will be paid in four equal annual installments of 1.25 million dollars each, as of the end of the third year, as of the date of providing Loan B by the banks.

3. **Short-time credit lines (in addition to loan A and loan B)**

In accordance with the amendment dated March 27, 2014, the short-term credit lines of up to a year were decreased by US 1 million dollars, as of this date, the banks provided to the Company short-term credit lines of up to a year of a total of 9.75 million dollars.

**Notes to the consolidated financial statements**

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**Note 14 - Long-term loans from banks and vendors (cont.)**b. Agreement with the banks regarding the reorganization of the credit lines (cont.)4. Loan C - Pursuant to the amendment to the agreement dated December 24, 2010

The principal of loan C for a total amount of US 3.8 million dollars was provided by the banks for a period of 36 months, for an annual interest rate as was agreed between the Company and any of the banks in monthly installments as of the date of providing the loan. The principal will be repaid by 36 equal monthly installments starting one year as of the date of signing the amendment to the agreement

5. Capital infusion

As a condition precedent for loans A and B, the Company has undertaken to carry out a rights offering and/or private placement of shares, in the framework of which an amount of no less than US 4 million dollars (less expenses) will be invested in the Company's shareholders' equity, and this by March 31, 2010. On February 26, 2010 the Company published a rights offering prospectus to the Securities Authority in the U.S. and a rights offering prospectus to the Israeli Securities Authority and the Tel Aviv Stock Exchange. In the framework of a rights offering and a private placement, the Company raised four (4) million dollars.

As a condition precedent for providing loans C and an additional loan on the sum of 1.2 million dollars, which was fully repaid on June 30, 2011, the Company has undertaken that shareholders' equity of not less than US 5 million dollars and no more than US 5.9 million dollars will be invested in the Company. The capital infusion, as aforementioned, was carried out as part of a private placement which also included the acquisition of Nouvelle's assets from Canada. In addition, the Company obligated that letters of commitment by the controlling shareholder of the Company will be submitted, to the satisfaction of the banks, and they will include, *inter alia*, a commitment not to make any change in ownership and/or control in the Company without receiving the banks' permission and a commitment not to compete with the Company's operations. These commitments have been fulfilled.

6. Providing additional credit lines

Following the capital infusion, as detailed previously in Clause 5 above, in full and in due time, the banks provided additional short-term credit lines to the Company on the amount of US 1.8 million dollars.

In the amendment to the agreement dated 12.27.11 it was agreed upon that any proceeds received from the sale of all or part of the equipment available to the Company, will be used at the time of its receiving to repay the credit from banks.

This amendment will also apply to the new equipment used by the Company and will be pledged to the banks for a fixed charge and for an unlimited amount.

7. Factoring

In accordance with the amendment to the agreement dated March 27, 2014, the Company may carry out factoring transactions (liens and/or sale of customers' notes in favor of third parties to provide financing) whose total amount shall not exceed at any given time US 2.5 million dollars.

8. Options to banks

In accordance with the provisions of the amendment to the agreement as at March 27, 2014, the Company issued to the banks, free of charge, a total of 300,000 option warrants, non-tradable and non-transferable, exercisable into ordinary shares of the Company of NIS 10 par value each, in accordance with the cashless mechanism against payment of an exercise price of US 2.5 dollars per share. The option warrants shall be exercisable (in whole or in part until)

## Notes to the consolidated financial statements

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### Note 14 - Long-term loans from banks and vendors (cont.)

#### b. Agreement with the banks regarding the reorganization of the credit lines (cont.)

##### 8. Options to banks (cont.)

on December 31, 2019. For details see Note 16 as follows.

It should be noted that according to the provisions of the agreement and its previous amendments, the Company issued to the banks, without charge, a total of 300,000 option warrants, which as at this date have expired, exercisable into 300,000 ordinary shares of the Company of NIS 10 par value each (1) 200,000 options allocated to the banks on October 11, 2011, expired on July 9, 2014, simultaneously with the grant of the new option warrants, (2) 100,000 option warrants which were allocated to the banks on August 17, 2010, which expired after 48 months and in accordance with the terms of the grant.

##### 9. Financial covenants

The following are the financial covenants (which will be calculated according to the quarterly and annual financial reports (consolidated), audited or reviewed by the Company), as set out in the amendments to the agreements as at December 24, 2010 and as at March 27, 2014.

The breach of each of the undertakings detailed as follows shall be considered as a breach of the financial ratios.

The banks may inform of a change in the financial covenants in the event of a change in accounting standards, and this without requiring the Company's consent.

9.1 The rate of tangible shareholders' equity of the total balance sheet will not be less than 30%; but in any case, the tangible shareholders' equity defined in the agreement will not be less at any time than the amounts stated below:

- a) In 2013 – US 35 million dollars.
- b) As of March 27, 2014 – US 25.5 million dollars.
- c) As of December 31, 2015 – US 26 million dollars.
- d) As of December 31, 2016 – US 26.5 million dollars.
- e) As of December 31, 2017 and thereafter – US 27 million dollars.

“Tangible shareholders’ equity”: The total issued and paid up share capital in addition with the capital reserves and the balance of the retained earnings, as well as the balance of the owners’ loans for which subordination was signed to the banks by the Company and its shareholders, in addition to its liabilities for options that were granted and/or shall be granted to the banks, less intangible assets (such as goodwill, copyrights, patents, trademarks and trade names etc.), less the treasury shares and receivables who are interested parties in the Company and/or its subsidiaries and/or related companies (as those are defined in the Securities Law-1968).

9.2 The trade receivables (less balances of trade receivables which have been factored by the Company) shall not be less at any given time than the following amounts detailed as follows:

- a) In 2013 – US 14 million dollars.
- b) As of 2014 and thereafter – US 11 million dollars.

9.3 The total amount of the balances of the Tefron Group's cash, inventory and trade receivables shall not be less at any given time than:

- a) In 2013 – US 33 million dollars.
- b) As of 2014 and thereafter – US 30 million dollars.

**Notes to the consolidated financial statements**

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**Note 14 - Long-term loans from banks and vendors (cont.)****b. Agreement with the banks regarding the reorganization of the credit lines (cont.)**

9.4. The ratio between the Company's total debts and liabilities to the banks and other financial organizations and the Company's annual EBITDA according to the consolidated annual statements:

- a) In 2013 – will not exceed 7.5
- b) In 2014 – will not exceed 6.5
- c) In 2015 – will not exceed 5.5
- d) In 2016 and thereafter – will not exceed 5

The breach of each of the undertakings to maintain the financial ratios detailed above (hereinafter: "the financial ratios"), will be considered as a breach of the financial ratios.

9.5 The current ratio (current assets divided by current liabilities) of the Company, according to its annual financial statements or quarterly reports, shall not be less than 1.2.

10. **Additional provisions:**

In addition to the detailed above, the Company has undertaken, amongst other things, the following additional obligations:

- a. As long as loan A and loan B have not been repaid in full to the banks, the Company will not pay and not commit to pay dividends to its shareholders without receiving in advance the written consent of the banks;
- b. Not to execute a change in the control of the Company in regards with the control structure (by Intimes Nouvelle Seamless Inc., Mivtach Shamir Holdings Ltd., Ben Lieberman and Martin Lieberman) as at 1.1.2014, and this without receiving the agreement of the banks in advance and in writing. In spite of the aforementioned, a cumulative change whereas the holdings of the controlling shareholders as at 1.1.2014, shall not be less than 38.9% of the issued and paid up share capital of the Company, shall not constitute a violation of this obligation;
- c. Not to hold subsidiaries or other related companies, unless those companies shall sign a letter of commitment to the banks.
- d. Unless the banks would grant their consent, the Tefron Group shall not carry out investments in fixed assets, including in the normal course of business, in an annual aggregate amount, to the whole of Tefron Group, exceeding the sum detailed as follows:
  - a) In each of the years 2014 and 2015, a total of US 3 million dollars, on a cumulative basis over a two-year period.
  - b) In each year as of 2016 and thereafter, a total of US 2 million dollars, on a cumulative basis over a two-year period.

As at December 31, 2014, the Company meets all the financial covenants that were determined in the amendment to the agreement with the banks.



## Notes to the consolidated financial statements

### Note 15 - Financial instruments

#### Financial assets

#### Classification of financial assets and financial liabilities

The financial assets and financial liabilities in the balance sheet are classified by groups of financial instruments pursuant to IAS 39, as follows:

	December 31,	
	2014	2013
	Dollars thousands	
<u>Financial assets:</u>		
Financial assets at fair value through other comprehensive income:		
Investment in securities available for sale	347	420
Total financial assets at fair value through other comprehensive income	347	420
Financial assets measured at amortized cost:		
Trade receivables	18,023	13,691
Loans and receivables	1,580	1,872
Financial assets at fair value through the statement of income:		
Derivatives for hedging transactions	148	67
Total financial assets at fair value through the statement of income	148	67
Total current financial assets	<u>20,098</u>	<u>16,050</u>
<u>Financial liabilities</u>		
Financial liabilities measured at amortized cost:		
Loans from banks	23,391	25,776
Trade payables	15,635	12,757
Payables	1,567	2,432
Total financial liabilities measured at amortized cost	40,593	40,965
Financial liabilities at fair value through statement of income:		
Derivatives for hedging transactions	236	-
Liabilities for bank options	56	67
Total financial liabilities at fair value through the statement of income	92	67
Total financial liabilities	<u>40,885</u>	<u>41,032</u>
Total current financial liabilities	<u>24,977</u>	<u>23,620</u>
Total non-current financial liabilities	<u>15,908</u>	<u>17,412</u>

#### a. Financial risk factors

The Group's activities expose it to various financial risks such as market risks (including foreign exchange risk and interest rate risk), credit risk and liquidity risk. The Group's comprehensive risk management plan focuses on activities that reduce to a minimum any

**Notes to the consolidated financial statements**

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**Note 15 - Financial instruments (cont.)**a. Financial risk factors (cont.)

possible negative effects on the Group's financial performance. The Group utilizes derivative financial instruments in order to hedge certain exposures to risks.

The Board discusses the overall risk management principles, including specific policy for certain risks such as foreign exchange risk, interest rate risk, credit risk and liquidity risk, and the use of derivative financial instruments and non-derivative financial instruments.

1. Foreign currency risk

The Group operates in a large number of countries and is exposed to foreign currency risk resulting from the exposure to different currencies, mainly the NIS. Foreign exchange risk arises from future commercial transactions, recognized assets and liabilities denominated in a different currency from the functional and the reporting currency (US Dollar). The finance department is responsible for managing the net position of each foreign currency by the use of forward contracts and currency options, according to the Company's hedging policy. The management's policy is to hedge the forecasted payroll expenses denominated in NIS, and payments to vendors in NIS. The hedging level is examined each period, according to market conditions.

2. Credit risk

The Group has no significant concentrations of credit risk. The Group has a policy to ensure the sale of its products are carried out to customers with an appropriate credit history

Credit risk may arise from the exposure of holding several financial instruments with a single entity or from entering into transactions with several groups of debtors with similar economic characteristics whose ability to discharge their obligations will likely be similarly affected by changes in economic or other conditions. Factors that have the potential of creating concentrations of risks consist of the nature of the debtors' activities, such as their business sector, the geographical area of their operations and the level of their financial strength.

Terms of sale to customers

Management of customer credit risk is managed in accordance with the policy, procedures and controls of the Company with respect to the management of customer credit risk. The evaluation of the credit quality of a customer is based on performance analysis and rating of each customer, according to which credit terms are determined for each specific customer. Outstanding customer balances that have yet to be repaid are reviewed regularly and shipments to major customers are usually covered by credit insurance.

The Company's revenues are mainly from customers in the USA and Europe. The Group follows trade receivable debts on a regular basis, and the financial statements include provisions for doubtful debts which properly reflect, in the Company's opinion, the loss inherent in the debts whose collection is in doubt

3. Interest risk

The Group is exposed to the risk of change in market interest rates resulting from short-term and long-term loans from banks which bear adjustable interest rate (the long-term loans are linked to the Libor and Prime base interest rate).

## Notes to the consolidated financial statements

**Note 15 - Financial instruments (cont.)**a. Financial risks factors (cont.)4. Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial liabilities on due dates. The responsibility for managing liquidity risk is handled by the Company's management which manages a plan of managing financial and liquidity risks for the short, medium and long terms according to the Company's needs. The Company manages the liquidity risk by preparing updated financial forecasts.

The Company holds cash and other financial instruments with various financial institutions in Israel and in additional countries in which the Group operates. The Group's policy, subject to the limitations of the financing agreement with the bank, is to spread its investments between various institutions.

As at December 31, 2014 the cash balance amounted to 224 thousand dollars.

The table below presents the maturity profile of the Group's financial liabilities based on contractual undiscounted payments:

As at December 31, 2014

	Up to one year	1 to 2 years	2 to 3 years	3 to 4 years	4 to 5 years	Over 5 years	Total
Dollars thousands							
Loans from banks	9,185	1,650	1,751	1,251	3,338	6,216	23,391
Trade payables	13,933	821	569	312	-	-	15,635
Other payables	1,567	-	-	-	-	-	1,567
	<u>24,685</u>	<u>2,471</u>	<u>2,320</u>	<u>1,563</u>	<u>3,338</u>	<u>6,216</u>	<u>40,593</u>

As at December 31, 2013

	Up to one year	1 to 2 years	2 to 3 years	3 to 4 years	4 to 5 years	Over 5 years	Total
Dollars thousands							
Loans from banks	9,938	1,400	1,250	1,244	1,244	10,700	25,776
Trade payables	11,250	694	540	273	-	-	12,757
Other payables	2,432	-	-	-	-	-	2,432
	<u>23,620</u>	<u>2,094</u>	<u>1,790</u>	<u>1,517</u>	<u>1,244</u>	<u>10,700</u>	<u>40,965</u>

b. Fair Value

The carrying amount of cash, trade receivables, other receivables, short-term and long-term banks' credit, short-term and long-term trade payables and other payables matches or approximates their fair value.

c. Classification of financial instruments by fair value levels:

The financial instruments presented in the balance sheet at fair value are grouped into classes with similar characteristics using the following fair value hierarchy which is determined based on the source of input used in measuring the fair value:

**Notes to the consolidated financial statements**


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**Note 15 - Financial instruments (cont.)**

 c. Classification of financial instruments by fair value levels (cont.):

- Level 1 - Quoted prices (unadjusted) in active market for identical assets or liabilities.
- Level 2 - Data other than quoted prices included within Level 1 that is observable either directly or indirectly.
- Level 3 - Data that is not based on observable market data (valuation techniques which use inputs that are not based on observable market data).

December 31, 2014

	<u>Level 2</u>	<u>Level 3</u>
	<u>Dollars thousand</u>	
Investment in securities available for sale	-	347
Liabilities for bank options	(56)	-
Derivatives for hedging transactions (forward transactions)	(236)	-
Derivatives for hedging transactions (options)	148	-
Total	<u>(144)</u>	<u>347</u>

December 31, 2013

	<u>Level 2</u>	<u>Level 3</u>
	<u>Dollars thousand</u>	
Investment in securities available for sale	-	420
Liabilities for bank options	(67)	-
Derivatives for hedging transactions	67	-
Total	<u>-</u>	<u>420</u>

 e. Cash flow hedging

Forward contracts and foreign currency options which are measured at fair value through other comprehensive income were designated as cash flow hedges of payroll payments and payments to vendors in NIS. These are highly probable forecasted transactions and they refer to approximately 80% of the payroll payments and payments to local vendors in NIS.

The conditions of the forward contracts and the options on foreign currency correspond to the conditions of the highly probable forecasted transactions.

- a. As a result, in forward transactions there is no ineffectiveness which requires recognition through statement of income. Regarding the options, the change in the time factor is not effective and therefore is recorded to statement of income.
- b. Cash flow hedges in respect of future payroll expenses expected in January 2015 were assessed to be in a high level of effectiveness, and therefore, a loss that has not yet been recognized as part of net loss on the amount of 30 thousand dollars was included in other comprehensive income in respect of these hedging contracts.

## Notes to the consolidated financial statements

Note 15 - Financial instruments (cont.)e. Cash flow hedging (cont.)

Changes in interest rates for financial liabilities as at December 31 would have increased (decreased) the shareholders' equity and the profit or loss by the following amounts. This analysis assumes that all other variables are constant and ignores tax effects.

	Sensitivity test to changes in interest rates	
	Profit (loss) from change	
	10% increase in interest	10% decrease in interest
	Dollars thousands	
2014	<u>(55)</u>	<u>55</u>
2013	<u>(31)</u>	<u>31</u>

Foreign currency risk

Foreign currency risk is the risk that fair value of future cash flows of a financial instrument will fluctuate due to changes in foreign exchange rates.

As at December 31, 2014, the Company has surplus of financial liabilities in NIS over financial assets in the amount of 4,913 thousand dollars (as at December 31, 2013 – 6,666 thousand dollars).

Changes in Dollar - NIS exchange rates as at December 31 would have increased (decreased) the shareholders' equity and profit or loss by the following amounts. This analysis assumes that all other variables are constant and ignores tax effects.

	Sensitivity test to changes in NIS exchange rates	
	Profit (loss) from change	
	10% increase in exchange rate	10% decrease in exchange rate
	Dollars thousands	
2014	<u>492</u>	<u>(492)</u>
2013	<u>667</u>	<u>(667)</u>

**Notes to the consolidated financial statements****Note 15 - Financial instruments (cont.)**e. Cash flow hedging (cont.)

Changes in Dollar - NIS exchange rates as at December 31 would have increased (decreased) the shareholders' equity and profit or loss by the following amounts. This analysis assumes that all other variables are constant and ignores tax effects.

	Profit (loss) from change	
	10% increase in market factor	10% decrease in market factor
	Dollars thousands	
<u>Foreign currency</u>		
<u>US dollar</u>		
2014 - for forward transactions and options	-	1,240
2013 - for forward transactions and options	(164)	385

Sensitivity tests and principal work assumptions:

The selected changes in the relevant risk variables were determined based on the management's estimates as to reasonably possible changes in these risk variables.

The Company has performed sensitivity tests of principal market risk factors that are liable to affect its reported operating results or reported financial condition. The sensitivity tests present the profit or loss and/or change in shareholders' equity (before tax), in respect of each financial instrument for the relevant risk variable chosen for that instrument as at each reporting date. The test of risk factors was determined based on the materiality of the exposure of the operating results or financial condition of each risk with reference to the operating currency and assuming that all the other variables are constant.

The sensitivity test for long-term loans with variable interest was only performed on the variable component of interest.

**Note 16 - Liability for options to banks**

On July 9, 2014, the Company allocated to the lending banks 300,000 cashless option warrants exercisable into 300,000 shares, as detailed in Note 14b8. These options replace two series of 100,000 and 200,000 cashless option warrants which were allocated in March 2010 and December 2010, respectively, exercisable into 300,000 shares, as part of the agreement for the reorganization of the Company's credit lines and the amendments thereof. The value of the benefits inherent in granting these options amounted to 56 thousand dollars as at December 31, 2014, and was recorded as a liability for options to banks, against the recording of financing expenses. This liability is measured periodically, according to the option evaluation model. In 2014, the Company recorded financing expenses of 10 thousand dollars as a result of the revaluation of the liability for the banks' options (2013 - 251 thousand dollars).

**Note 17 - Assets and liabilities for employee benefits**

Employee benefits consist of short-term benefits and post-employment benefits.

**Notes to the consolidated financial statements****Note 17 - Assets and liabilities for employee benefits (cont.)**Post-employment benefits

According to the Labor Laws and Severance Pay Law in Israel, the Company is required to pay severance pay to an employee upon dismissal or retirement or to make current contributions to defined contribution plans pursuant to Section 14 to the Severance Pay Law, as specified below. The Company's liability for the aforementioned is accounted for as a post-employment benefit. The computation of the Company's employee benefit liability is made in accordance with a valid employment contract and based on the employee's salary and term of service of the employment which establish the entitlement to receive the compensation.

The post-employment employee benefits are normally financed by contributions classified as defined contribution plans or as defined benefit plans, as detailed below.

1. Defined contribution plans

The provisions of Section 14 of the Severance Pay Law, 1963, applies to part of the severance pay payments, pursuant to which the fixed contributions paid by the Group into pension funds and/or policies of insurance companies, release the Group from any additional liability to employees for whom such contributions were made as aforementioned. These contributions as well as contributions for compensation represent defined contribution plans.

	<u>For the year ended December 31</u>		
	<u>2014</u>	<u>2013</u>	<u>2012</u>
	<u>Dollars thousands</u>		
Expenses in respect of defined contribution plans	<u>575</u>	<u>654</u>	<u>695</u>

2. Defined benefit plans

The Group accounts for that part of the payment of compensation that is not covered by contributions to defined contribution plans, as aforementioned, as a defined benefit plan for which an employee benefit liability is recognized and for which the Group contributes amounts in central severance pay funds and in qualifying insurance policies.

## Notes to the consolidated financial statements

Note 17 - Assets and liabilities for employee benefits (cont.)Post-employment benefits (cont.)2. Defined benefit plans (cont.)a. Changes in the defined benefit plan's liabilities and in the fair value of the plan's assetsThe year of 2014

	Expenses recorded in the statements of income					Gain (loss) due to re-measurement in other comprehensive income							Balance as of December 31, 2014	
	Balance as of January 1, 2014	Cost of current service	Interest expenses net	Past service costs and clearing cost	Total expenses recognized in statement of income in the period	Payments from the plan	Return on plan's assets (excluding amounts recognized in interest expenses, net)	Actuarial gain due to changes in demographic assumptions	Actuarial gain due to changes in financial assumptions	Actuarial gain due to experience deviations	Total effect on other comprehensive income in the period	Effect of changes in the rate exchange of foreign currency		Consideration deposited by the employer
Liabilities for defined benefit	1,012	108	38	-	146	207	-	59	32	79	170	(113)	-	1,008
Fair value of plan's assets	(323)	-	(8)	-	(8)	(78)	11	-	-	-	11	27	(10)	(225)
Liability (asset) net for defined benefit	689	108	30	-	138	129	11	59	32	79	181	(86)	(10)	783

The year of 2013

	Expenses recorded in the statements of income					Gain (loss) due to re-measurement in other comprehensive income							Balance as of December 31, 2013	
	Balance as of January 1, 2013	Cost of current service	Interest expenses net	Past service costs and clearing cost	Total expenses recognized in statements of income in the period	Payments from the plan	Return on plan's assets (excluding amounts recognized in interest expenses, net)	Actuarial gain due to changes in financial assumptions	Actuarial gain due to experience deviations	Total effect on other comprehensive income in the period	Effect of changes in the rate exchange of foreign currency	Consideration deposited by the employer		
Liabilities for defined benefit	1,208	89	40	71	200	610	-	77	58	135	79	-	-	1,012
Fair value of plan's assets	(612)	-	(13)	47	34	(337)	(17)	-	-	(17)	(32)	(33)	-	(323)
Liability (asset) net for defined benefit	596	89	27	118	234	273	(17)	77	58	118	47	(33)	-	689



**Notes to the consolidated financial statements****Note 17 - Assets and liabilities for employee benefits (cont.)**Post-employment benefits (cont.)2. Defined benefit plans (cont.)b. Principal assumptions used in determining the defined benefit plan

	<u>2014</u>	<u>2013</u>
	<u>%</u>	<u>%</u>
Discount rate (1)	4.0%	4.3%
Expected salary increase rate	2%	1%

(1) The discount rate is based on index-linked high quality corporate bonds (2013 – government bonds).

c. Amounts, timing and uncertainties of future cash flows

The following are possible changes which are considered reasonable for the end of the reporting period, for each actuarial assumption, assuming that the remaining actuarial assumptions remained unchanged:

	<u>The change in the defined benefit obligation</u>
	<u>Dollars thousand</u>
As at December 31, 2014:	
<u>Sensitivity test to changes in expected salary increase rate</u>	
The change as a result of:	
Salary increase of 1%	85
<u>Sensitivity test to changes in the discount rate of the plan's liabilities and assets</u>	
The change as a result of:	
1% increase of the discount rate	(70)
1% decrease of the discount rate	83
The Group's estimation for the expected contributions in 2015 is on the sum of 8 thousand dollars.	

**Note 18 - Taxes on income**a. Tax laws applicable to the Group's companies

The Company is subject to provisions of Income Tax Regulations (Rules for Bookkeeping by Foreign Investment Companies and Certain Partnerships and Determination of Taxable Income), 1986. In accordance with the aforementioned regulations, the Company files its income tax returns in US dollars.

Amendment to the Law for the Encouragement of Capital Investments, 1959 (Amendment 68)

In December 2010, the Knesset passed the Law for the Economic Policy for the Years 2011 and 2012 (Legislative Amendments) – 2011, which sets forth, *inter alia*, amendments to the Law for the Encouragement of Capital Investments – 1959 (hereinafter: "the Law").

## Notes to the consolidated financial statements

### Note 18 - Taxes on income (cont.)

#### a. Tax laws applicable to the Group's companies (cont.)

##### Amendment to the Law for the Encouragement of Capital Investments, 1959 (Amendment 68) (cont.)

The implementation of the amendment is as of January 1, 2011. The amendment changes the benefit tracks in the Law and applies a uniform tax rate on all of the Company's preferred income which will be considered as a beneficiary enterprise with a beneficiary plant. As of the 2011 tax year, the Company is entitled to choose, (without the possibility to change its choice), whether to have the amendment apply to it, and as of that tax year for which the choice was made, the amended tax rate will apply. According to the amendment to the Law, the tax rate of the companies whose plants are located in development area A are: in 2011 and 2012 – 10%, and in 2013 - 7%.

##### Amendment to the Law for the Encouragement of Capital Investments, 1959 (Amendment 71)

In August 2013 the Law for Changing National Priorities (Legislative Amendments for Achieving Budget Targets for 2013 and 2014), 2013 which consists of Amendment 71 to the Law for the Encouragement of Capital Investments (hereinafter: "the amendment") was issued. According to the amendment, the tax rate on preferred income from preferred enterprise in development area A for the years 2013 and thereafter is 9%.

Furthermore, the amendment states that any dividends distributed to an individual or a foreign resident from the preferred enterprise's earnings, as aforesaid, will be subject to a tax rate of 20%.

**Hi-Tex founded by Tefron Ltd. (hereinafter: "Hi-Tex"), a subsidiary of the Company-** In 2013 Hi-Tex chose to apply the amendments to the Law of Encouragement as stipulated as of amendment 68 ("preferred enterprise").

**Macro Clothing Ltd. (hereinafter: "Macro"), a subsidiary of the Company-** Macro chose the year of 2005 as the elective year under the alternative track, pursuant to the provisions of Section 51d of the Law for the Encouragement of Capital Investments – 1959. The Company informed the Assessing Officer of its choice in its letter dated December 27, 2006

##### The Law for the Encouragement of Industry (Taxes), 1969

Hi-Tex founded by Tefron Ltd. operates in Israel as "an industrial company" in conformity with the aforementioned Law. By virtue of the above status and the regulations that were published, it is entitled to claim increased rates of depreciation for equipment used during industrial operations, as was determined in the regulations of the Adjustments Law. Furthermore, the Company is entitled for a reduction for a patent or a right to use a patent or knowledge, which is used for the plant's development or promotion, and for a deduction of expenses for issue of shares listed on the Stock Exchange.

#### b. Tax rates applicable to the Group:

The rate of corporate tax in Israel in 2012 and 2013 was 25% and in 2014 – 26.5%.

The tax rate on a subsidiary in the United States is 34%.

El-Masira is incorporated in the Free Trade Zone in Jordan, and is taxed according to tax laws applicable in Jordan; the statutory tax rate in the Free Trade Zone in Jordan, for the industry in which the Group is engaged is 0%.

**Notes to the consolidated financial statements**

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**Note 18 - Taxes on income (cont.)**c. Final tax assessments

The Company and its subsidiary Hi-Tex, which operate in Israel, have final tax assessments up to and including 2010. The subsidiary Macro has final tax assessments up to and including 2009. The main subsidiary operating outside Israel has final tax assessments until 2010.

At the end of 2010 the Company submitted an amended tax return for the 2006 and 2008 tax years as a result of which there was a reduction in the reported tax liability compared to the present tax liability in accordance with the original tax report which was submitted. On August 5, 2013, the Company engaged with a tax assessor for large enterprises in an agreement for the regulation of the tax assessments for the aforementioned years (hereinafter: "the agreement").

According to the agreement the Company would pay a total sum of NIS 3 million in 24 payments as of September 1, 2013 as a final repayment of the outstanding balance for the submitted tax reports. It should be noted that notwithstanding the aforementioned agreement, the parties have agreed that the deployment of the payment would be carried out in 36 equal installments beginning October 1, 2013.

As a result of the agreement, the Company decreased the tax provision for 2013 against the income tax of previous years on a total sum of 120 thousand dollars.

d. Carry-forward losses for tax purposes and other temporary differences

Tefron and Hi-Tex have carry-forward losses for tax purposes as of December 31, 2014 amounting to 14,535 thousand dollars and 23,993 thousand dollars, respectively, which may be used over an unlimited period. In respect of these balances and other deductible temporary differences, the Company recorded in its financial statements deferred tax assets amounting to 5,105 thousand dollars (due to their expected utilization as a result of a reserve for deferred taxes of 1,840 thousand dollars, mainly for fixed assets, and due to the expectation of realizing them against taxable income). Two other subsidiaries of the Company has carry-forward losses for tax purposes amounting to 17,734 thousand dollars, for which no deferred taxes have been accumulated, in the absence of any expected utilization of them in the foreseeable future. It should be noted that the utilization of carry-forward losses of a subsidiary operating in the United States is subject to restrictions as to the period in which it will be possible to utilize future losses and as to the amount the Company could utilize each year.

## Notes to the consolidated financial statements

**Note 18 - Taxes on income (cont.)**e. Deferred taxes

Composition:

	Balance sheets		Statements of income		
	December 31		For the year ended December 31		
	2014	2013	2014	2013	2012
	Dollars thousands				
<u>Deferred tax liabilities</u>					
Property, plant and equipment	(1,840)	(2,060)	220	(528)	6,173
Cost surplus from operation acquisition	-	-	-	293	134
	<u>(1,840)</u>	<u>(2,060)</u>			
<u>Deferred tax assets</u>					
Carry forward losses for tax purposes	4,954	4,701	253	708	(5,021)
Allowance for doubtful debts	16	25	(9)	18	(89)
Employee benefits	100	135	(35)	7	(204)
Unrealized gain- from securities available for sale	35	24			
	<u>5,105</u>	<u>4,885</u>			
Deferred tax income			429	498	993
Deferred tax income (expenses) from discontinued operations			-	(21)	(1,240)
Deferred tax income from continuing operations			<u>429</u>	<u>519</u>	<u>2,233</u>
Deferred tax assets, net	<u>3,265</u>	<u>2,825</u>			

Deferred taxes are presented in the balance sheet as follows:

	December 31	
	2014	2013
	Dollars thousands	
Non-current assets	<u>3,265</u>	<u>2,825</u>
	<u>3,265</u>	<u>2,825</u>

The deferred taxes are computed at the average tax rate of 11.3% (2013- 12.0%) based on the tax rates that are expected to apply upon reversal.

Taxes on income relating to other comprehensive income items:

	For the year ended December 31		
	2014	2013	2012
	Dollars thousands		
Loss from investment in securities available for sale	36	21	39
Gain from cash flow hedging transactions	-	-	4
	<u>36</u>	<u>21</u>	<u>43</u>

## Notes to the consolidated financial statements

**Note 18 - Taxes on income (cont.)**f. Taxes benefit included in statement of income

	For the year ended December 31		
	2014	2013	2012
	Dollars thousands		
Deferred taxes	(429)	(519)	(2,233)
Taxes in respect of previous years	-	(120)	-
	<u>(429)</u>	<u>(639)</u>	<u>(2,233)</u>

The Company does not intend to distribute dividends resulted from its industrial plant in a manner which would create an additional tax liability.

g. Theoretical tax

The reconciliation between the tax expense assuming that all the income and expenses, gains and losses in the statement of income were taxed at the statutory tax rate, and the taxes on income recorded in the statement of income, is as follows:

	For the year ended December 31		
	2014	2013	2012
	Dollars thousands		
Gain (loss) before taxes on income	<u>(1,229)</u>	<u>(3,801)</u>	<u>403</u>
Statutory tax rate	<u>26.5%</u>	<u>25%</u>	<u>25%</u>
Tax benefit computed at the statutory tax rate	(326)	(950)	101
Increase (decrease) in taxes on income resulting from the following factors:			
Non-deductible expenses for tax purposes	145	175	277
Losses for which no deferred taxes were recorded	(835)	175	35
Income subject to special tax rates	558	178	-
Utilization of losses for tax purposes from previous years, for which no deferred taxes were recognized in the past	-	-	(2,814)
Update of deferred tax balances due to changes in tax rates	-	(60)	218
Taxes in respect of previous years	-	(120)	-
Others	<u>29</u>	<u>(37)</u>	<u>(50)</u>
Tax benefit	<u>(429)</u>	<u>(639)</u>	<u>(2,233)</u>
Average effective tax rate	<u>34.9%</u>	<u>16.8%</u>	<u>-</u>

**Note 19 - Long-term payables**

	December 31	
	2014	2013
	Dollars thousands	
Supplier credit – purchase of fixed assets (1)	1,480	1,003
Institutions (2)	163	475
	<u>1,643</u>	<u>1,478</u>

(1) For additional details see Note 9g above.

(2) For additional details see Note 18c above.

## Notes to the consolidated financial statements

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### Note 20 - Contingent liabilities, commitments and liens

#### a. Contingent liabilities

1. According to the Law for the Encouragement of Capital Investments - 1959, the Company and its subsidiary received in the past grants from the State of Israel according to their investments in enterprises. The receiving of the grants is conditional on implementing all of the conditions in the application for a pre-ruling and furthermore that at least 30% of the investments will be financed by outstanding share capital. Lack of implementing the conditions in the application for a pre-ruling will result in the return of the grants with an addition of interest and linkage differences as of the date of their grant. In the opinion of the Company's management and its subsidiary, they meet the conditions regarding receiving the grant.

In order to fulfill the conditions related to receiving the investment grants, the Company and its subsidiaries recorded floating liens on all their assets, in favor of the State of Israel.

#### 2. Legal proceedings

- a. On November 20, 2014 a claim in the amount of 1,040 thousand dollars was filed against the Company and its subsidiary Macro Clothing Ltd. (hereinafter: "Macro") by ILODEL (hereinafter: "the plaintiff") concerning an alleged "violation" of "Non-Circumvention, Non-Disclosure agreement" (hereinafter: "the agreement", as defined according to the claim). The plaintiff, a company incorporated in Sri Lanka, claims among other things, that even though Macro is the only one signed the agreement, it also applies to Tefron, as it were;

Since after engaging in the agreement, the plaintiff introduced the defendants to companies and various parties in Sri Lanka, including the company Brandix Lanka Limited (hereinafter: "Brandix"), as well as providing them with "knowledge" necessary for the purpose of engaging with local parties in Sri Lanka, "ideas", "paths of action" and so forth;

Since Tefron's engagement in a memorandum of understanding with Brandix, in December 2013, for the purpose of a joint venture (hereinafter: the "memorandum of understanding"), as described in Note 20b3 as follows, was a "violation" of the agreement;

On 02.17.15 the defendants filed a statement of defense, in the framework of which they argued, among other things, to a lack of rivalry between the plaintiff and Tefron, since the agreement was signed only by Macro, and refers only to Macro, since a detailed agreement has not been signed for reasons related to the plaintiff, and that the provisions of any of the drafts that were exchanged between the parties could not be "completed", since the familiarity and relationship between Tefron and Brandix, had been first created several years ago prior to the connection that was created between the plaintiff and Macro, and over the years, there have been occasional contacts between Tefron and Brandix, which later developed into signing the memorandum of understanding, without any relation to the plaintiff and without any "involvement" on its part, since contrary to other parties in Sri Lanka, which were introduced by the plaintiff to Macro's representatives (who also visited them), and with which Macro also did not form an engagement eventually, the stated above does not apply to Brandix and the "ideas" and "paths of action" which were supposedly presented by the plaintiff, were not "new" to Tefron, including the transfer of sewing machines abroad.

Due to the early stage of the claim and since the management of the Company rejects the plaintiff's claims and estimates that the claim would be entirely dismissed; no provisions were made in respect of this claim in the financial statements for the year of 2014.

**Notes to the consolidated financial statements**

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**Note 20 - Contingent liabilities, commitments and liens (cont.)**a. Contingent liabilities (cont.)2. Legal proceedings (cont.)

b. Two legal claims were filed against the Company by two former employees. The total amount of the claims amounted to 381 thousand dollars. The claims were filed due to allegations regarding the termination of employment relations. One claim had been discussed with an arbitrator that submitted his decision on March 2, 2014. The arbitrator rejected the majority of the former employee's claims and awarded him compensation due to a flaw in his dismissal procedure. Since the Company made a provision in its financial reports for the claim in 2009, the settlement agreement does not have any significant effect on the Company's financial reports in 2013.

The other employee's claim had been deliberated at the district labor court and on September 28, 2014, the parties reached a settlement agreement according to which the Company will pay the former employee an immaterial amount.

c. On May 16, 2012, a claim has been filed against the Company and its subsidiary by a former supplier on the sum of 270 thousand dollars due to the subsidiary of the Company's debts for work performed by the former supplier. On June 19, 2014, the parties signed a settlement agreement which was granted a valid and binding force as of that date by the Magistrates Court in Tel Aviv. As part of the settlement agreement, it was agreed that the defendants will pay the plaintiff a sum denominated in NIS equivalent to a sum of 130 thousand dollars. Since the Company has already made a full provision in its financial statements for the claim, the settlement agreement has no effect on the Company's financial statements for 2014.

d. The Company has a third party insurance policy, according to which the Company has to pay an excess of US 1,000 dollars per claim. Any changes in the deductible are recorded as an expense in the Company's books upon submission of a demand from the insurance company at the end of the claim.

b. Commitments1. Engagement in an agreement for strategic cooperation in China

On November 12, 2014, the Company entered into an agreement with a company incorporated in China, who operates in the apparel field of seamless technology and serves as a subcontractor of the Company in China, for the purpose of strategic cooperation in China in the field of production and development of seamless apparel, the core business of the Company (hereinafter: "the cooperation", "the agreement"). It should be noted that the Company is using several subcontractors in China on a regular basis. However, the purpose of this cooperation, as opposed to the operations with other subcontractors in China, is to allow the subcontractor with whom the Company entered into the said agreement, to produce products in the field of seamless products, using technology, that to the best knowledge of the Company, currently does not exist in China, and which the Company intends to teach the subcontractor while using means of protection against the usage of this technology by the subcontractor in favor of third parties.

The purpose of the subcontractor's usage of the said technology is to provide a marketing advantage for the Company with its customers who are interested in products made by this technology in China.

Note 20 - Contingent liabilities, commitments and liens (cont.)b. Commitments (cont.)2. Engagement in a joint venture agreement with Clover Group International Limited

On June 20, 2014, the Company engaged in a joint venture agreement (hereinafter: "the agreement") with Clover Group International Limited, a company incorporated in Hong Kong, specializing in the development, design and manufacturing of bras (hereinafter: "Clover") (hereinafter: "the parties"). In accordance with the agreement, utilizing the knowledge and experience of the Company in developing and manufacturing products using the seamless technology, and in conjunction with the knowledge and experience of Clover which is considered to be a leading company in the field of developing and manufacturing of bras, the parties will work to establish a jointly owned company, in equal shares, in Hong Kong, whose main goal is designing, developing, manufacturing and selling bras made by the seamless technology as well as other apparel products made by this technology. In the framework of the agreement, arrangements were determined regarding the management of the company and with regard to the rights and obligations of the parties as shareholders in it, which naturally, due to the fact that the parties hold equal shares in the company, these arrangements are based on an agreement between the parties. In addition, the agreement includes provisions to regulate disagreements as well as provisions regarding the right of first refusal and the right to participate in the sale of shares as well as provisions relating to non-competition.

During the month of July 2014, upon receiving the approval of the Company's Board and Clover's Board of Directors regarding the engagement in an agreement, all of the conditions precedent set out in the agreement have been satisfied.

3. Engagement in a memorandum of understanding with Brandix Lanka Limited (hereinafter: "Brandix")

On December 12, 2013, the Company entered into a memorandum of understanding with Brandix Lanka Limited, a company incorporated in Sri Lanka which specializes in the development, production and distribution of apparel products to the best brands in the world. According to the memorandum of understanding, the parties will work to establish a joint venture agreement (hereinafter: "the joint venture", "the agreement") within three months of signing the memorandum of understanding, whereby a jointly-owned company in equal shares will be established (hereinafter: "the designated company"), for the purpose of production, distribution, marketing and sale of products based on the Body-Size technology (hereinafter: "the technology") (hereinafter: "the products"), in Sri Lanka or India. The memorandum of understanding was signed following a technological and economic feasibility analysis which was conducted by the parties as of May 2013. The memorandum of understanding is subject to the approval of the Company's Board of Directors and Brandix and to the signing of the parties on the agreement. On December 30, 2013, the Company's Board approved the engagement in the memorandum of understanding.

The memorandum of understanding determines, *inter alia*, the following:

- (1) The investment of the parties in the joint venture shall be equal and in accordance with one of the alternatives listed below (and as it shall be agreed upon between the parties in the future agreement):
  - a. The Company will provide up to 50 specially designated knitting machines and related equipment from the Company's layout of fixed assets, for the purpose of manufacturing the products in the aforementioned offered technology (hereinafter: "the equipment") and Brandix will provide the infrastructures



## Notes to the consolidated financial statements

Note 20 - Contingent liabilities, commitments and liens (cont.)b. Commitments (cont.)3. Engagement in a memorandum of understanding with Brandix Lanka Limited (hereinafter: "Brandix") (cont.)

needed for establishing the joint venture (hereinafter: "the infrastructures"). The value of the machines and the value of the infrastructures will be assessed at market value and, and if necessary, Brandix would complete the rest of its investment in cash.

Or alternatively,

- b. The parties would rent the equipment and infrastructures to the designated company in costs which would be determined in advance and they would also provide a financial investment, as it would be agreed upon in advance.

It should be noted that the supply/rent of equipment would be subject to the approval of the Company's financing banks.

- (2) General arrangements have been made regarding the appointment of the management of the designated company, bearing the costs, distribution of profits, cost prices and selling prices of the products, review of financial statements, ownership of intellectual property developed by the parties as part of the joint venture, a business plan and so on.
- (3) Brandix committed to grant exclusivity to the Company in every aspect regarding the manufacturing of products using the technology.

Furthermore, the memorandum of understanding can be canceled by giving an advance notice of 6 months or upon signing the agreement.

As of the date of this report no agreement has been signed between the parties, the parties continue to negotiate.

4. Engagement in consultation and development agreement with Professor Bodo W. Lambertz (hereinafter: "the consultant"), and an essential private allocation to the consultant

On September 27, 2012, the Company's Board of Directors approved the engagement of the Company with Professor Bodo W. Lambertz, an expert in developing textile products and their promotion in the market, especially in the activewear field (hereinafter "the consultant" or "the offeree"). In the framework of this agreement the consultant would provide the Company with professional and business consulting services, as well as granting it a license to his developments in the field of textile and apparel as detailed as follows (hereinafter "the agreement"). In the framework of this agreement, *inter alia*, the Company would allocate to the consultant up to 400,000 of the Company's ordinary shares of NIS 10 par value each, in accordance to the following milestones (hereinafter: "the offered shares"):

An initial series of 65,000 shares once the Company's Board of directors' approves the agreement, which was allocated to the consultant on May 21, 2013.

A second series of 100,000 shares once reaching the net sales objective of licensed products (as detailed as follows) on the sum of US 2,000,000 dollars within 18 months as of the day of signing the agreement, which was allocated to the consultant on January 20, 2014. See the following details regarding the amendment to the terms of allocating the second series.

A third series of 100,000 shares once reaching the net sales objective of licensed products (as detailed in Clause 21a as follows) on the sum of US 4,000,000 dollars

**Notes to the consolidated financial statements****Note 20 - Contingent liabilities, commitments and liens (cont.)**b. Commitments (cont.)4. Engagement in consultation and development agreement with Professor Bodo W. Lambertz (hereinafter: "the consultant"), and an essential private allocation to the consultant (cont.)

within 30 months as of the day of signing the agreement. On March 20, 2015 this right expired. Upon the expiration of this right, the offeree is not an "interested party" any longer.

A fourth series of 135,000 shares once reaching the net sales objective of licensed products (as detailed in the Clause as follows) on the sum of US 6,000,000 dollars within 42 months as of the day of signing the agreement.

On May 21, 2013, the Company allocated 65,000 ordinary shares of NIS 10 par value each to the consultant, and granted him 335,000 share rights, the exercise of which is subject to meeting the objectives (hereinafter: "the rights to shares"), as determined by the parties.

On December 17, 2013, the parties agreed to amend the consultation and development agreement so the second series shall not be subject to meeting the net sales objective of licensed products, and shall be executed no later than 18 months as of the date of signing the consultation and development agreement (hence, until March 20, 2014); therefore, on January 20, 2014, and upon receiving the approval of the Company's Board for the agreement's amendment, 100,000 additional shares were allocated to the consultant out of the rights to shares.

As at the date of the report, the total amount of shares issued to the consultant constitute 2.46% of the issued and paid up capital of the Company and voting rights therein and 2.13% of the issued and paid up capital of the Company and voting rights therein on a fully diluted basis.

As of the date of the report, the total amount of shares issued to the consultant plus the shares arising from the exercise of the rights to shares, as described above, constitute approximately 4.38% of the issued and paid up capital of the Company and voting rights therein and 3.93% of the issued and paid up capital of the Company and voting rights therein on a fully diluted basis.

Listed below are the main principals of the consultation and development agreement:

The consultant has undertaken to develop up to 4 fashion-concepts for the Company (hereinafter "concept") every year, according to the Company's requirements that would include design and specification of activewear and apparel in the sports field, and furthermore, the concept that is being developed would include offered branding names and trademarks, packaging design and branding and promotion products of the apparel products which the consultant would develop. The Company would examine the proposed concepts and would be entitled to purchase from the consultant a license for the concept that was developed by him, and all in accordance with the terms set forth in the agreement.

The terms of the license that the Company will receive from the consultant regarding the concept or the products, according to which they were determined in the agreement between the parties whose principals are as follows: an exclusive license, unlimited by any time period (subject to exceptions that were determined in the agreement), and that is non-transferable (with the exception of an out-license under the terms that were agreed upon in the agreement) in regard with all the rights of the

**Notes to the consolidated financial statements****Note 20 - Contingent liabilities, commitments and liens (cont.)**b. Commitments (cont.)4. Engagement in consultation and development agreement with Professor Bodo W. Lambertz (hereinafter: "the consultant"), and an essential private allocation to the consultant (cont.)

intellectual property and the knowledge for manufacturing, marketing, distributing and selling the products, at least for the region of North America. For this license the Company would pay the consultant royalties at the rate that was determined in the agreement, during the period in which the Company manufactures, distributes or sells the products, however, at least for a period of 20 years as of starting the process of marketing and distributing the products in the market. Additionally, the Company would pay the consultant for every concept a total sum that would be determined in negotiations between both parties.

For every concept for which the Company has purchased a license, the consultant would provide the Company with support in the development of the product until the stage of creating an independent brand, as well as additional consulting services regarding the product's marketing and such, at the cost that was determined in the agreement.

In addition to the aforementioned payment and royalties in respect to the license and as it would be used by the Company, and subject to receiving the listing approval of the Tel Aviv Stock Exchange and the consent of the Company's financing banks, as detailed as follows, the Company would allocate the consultant the offered shares according to the aforementioned four milestones.

The agreement is for an unlimited period of time, but can be cancelled with a notice of 30 days. Furthermore, additional common causes for terminating the agreement were set forth in the agreement.

5. Agreement with Mr. Mike Gao, a related party, for providing services to locate raw materials and/or subcontractors

On April 4, 2012, the meeting of Company's shareholders approved the engagement of the Company with Mr. Mike Gao, who engaged with the Company through Asia Socks Inc., in an agreement for providing services to locate raw materials and products from new suppliers and/or locating subcontractors in all the Company's fields of operations, as well as supervision services, and all of the aforesaid for a period of three years (hereinafter: "the agreement"). During the month of February 2014, the agreement was terminated. For additional details regarding the terms of the agreement and its termination see Note 26l as follows.

6. Engagement in an agreement for a real estate property lease with a related party

On September 7, 2014, the Company's shareholders' meeting approved the engagement of Tefron USA, Inc., a wholly-owned private company, indirectly, of the Company (hereinafter: "Tefron USA"), with Trimfit Global Inc., a private company incorporated in Delaware, USA, related to the Nouvelle Group who is amongst the controlling shareholders of the Company (hereinafter: "Trimfit") in an agreement for a real estate property lease which is owned by Tefron USA in Valdese, North Carolina, USA. For additional details see Note 26e as follows.

**Notes to the consolidated financial statements****Note 20 - Contingent liabilities, commitments and liens (cont.)**b. Commitments (cont.)7. Pick and Pack service agreement with a related party

For details regarding the engagement of the subsidiary, Tefron USA, with related parties in agreements for providing Pick and Pack services (sorting, picking and delivering services) see Note 26g as follows. It is noted that upon the signing of the lease agreement for the building that served for the logistics activities in the United States, as detailed in Note 26e as follows, Tefron USA ceased to provide the Pick and Pack services to related parties and third parties.

c. Commitments to pay rent

The Company's plants and installations and most of those of its subsidiaries are located in buildings leased for various terms ending between 2015 - 2019.

The future minimum rent commitments under non-cancelable leases as of December 31 are as follows:

	<u>2014</u>	<u>2013</u>
	<u>Dollars thousands</u>	
Year 1	1,837	2,046
Year 2	1,631	1,838
Year 3	1,610	1,838
Year 4	1,608	1,838
Years 5 and thereafter	<u>1,608</u>	<u>3,676</u>
	<u>8,294</u>	<u>11,236</u>

d. Liens

1. All liabilities to banks are secured by a floating charge on the existing and future assets of the Company and its subsidiaries in both present and future, which permits the Company to dispose assets in the normal course of business.
2. To secure compliance with conditions of the "approved enterprise" status granted to the Company and its subsidiaries pursuant to the Law for the Encouragement of Capital Investments - 1959, the Company and its subsidiaries have pledged floating liens for an unlimited amount on all their assets in favor of the State of Israel.

**Note 21 - Capital**a. Issuance of shares in the framework of the consultation and development agreement with Professor Bodo W. Lambertz

On September 27, 2012, the Company's Board of Directors approved the engagement of the Company in an agreement with Professor Bodo W. Lambertz, an expert in developing textile products and their promotion in the market, especially in the activewear field (hereinafter "the consultant" or "the offeree"), in the framework of which the consultant would provide the Company with professional and business consulting services, as well as granting it a license to his developments in the field of textile and apparel (hereinafter "the agreement"). In the framework of the agreement, *inter alia*, the Company would allocate to the consultant up to 400,000 ordinary shares of the Company of NIS 10 par value each (hereinafter: "the shares") in four series: an

## Notes to the consolidated financial statements

Note 21 - Capital (cont.)a. Issuance of shares in the framework of the consultation and development agreement with Professor Bodo W. Lambertz (cont.)

initial series of 65,000 shares upon the date of signing the agreement and the other series in accordance with meeting the net sales objectives. On May 21, 2013, the Company allocated to the consultant the initial series of 65,000 shares, as aforementioned. On January 20, 2014, the Company allocated to the consultant the second series of 100,000 shares, see Note 20b4, above. On March 20, 2015, due to failure to meet the sales objectives which were agreed upon by the parties, his entitlement to 100,000 shares expired and therefore, as at this date, the consultant is entitled to 135,000 additional shares and this will be evaluated on March 20, 2016.

On the date of signing the agreement the Company recorded a capital reserve for the initial series of shares. Upon issuing the shares in effect, the amount was sorted into share capital. The minimum period of the agreement is one year, therefore once a quarter, a quarter of the shares was revaluated according to the average market value of the share in that period, which presumably represents the value of service that was rendered during that period of time. Furthermore, in each cut-off period the Company examined if the revaluated amount meets the definition of an intangible asset, in order to reclassify this amount from the future expenses item to the intangible asset item. Throughout the year of 2013, the Company believed that the terms for acknowledging future development as an intangible asset, have yet to be met. Accordingly, the Company recorded the full revaluated value of the shares to the development expenses item.

Registration of the share capital whose issuance depends on meeting the sales objectives was executed according to the probability of meeting the objectives.

For additional details see Note 20b4 above.

b. Submission of a shelf-prospectus draft

On May 28, 2012, the Company submitted a shelf-prospectus draft according to which the Company will be able to offer shares, bonds and warrants. At this stage the shelf-prospectus does not include an immediate fundraising and as at the date of the report, the Company did not carry out any fundraising under the shelf prospectus. On May 13, 2014, the Securities Authority passed a resolution under which, it was decided to extend the securities offering period of the Company's securities under the shelf prospectus in additional 12 months, hence up to (not including) May 29, 2015.

c. Composition of the share capital and the convertible securities

	December 31	
	2014	2013
	Number of shares	
Authorized share capital (ordinary shares of NIS 10 par value each)	20,000,000	20,000,000
Issued share capital (ordinary shares of NIS 10 par value each)	6,806,476	6,706,476
Paid up share capital (ordinary shares of NIS 10 par value each)	6,706,736	6,606,736
Option warrants (non-tradable) for the Company's employees and managers, directors and service providers exercisable into ordinary shares of NIS 10 par value each	770,105	1,012,605
Rights to shares	235,000	335,000
treasury shares held by a subsidiary	99,740	99,740

**Notes to the consolidated financial statements**

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**Note 21 - Capital (cont.)**d. Rights conferred by the sharesOrdinary shares

1. Voting rights at the general meeting, right to dividends, rights upon liquidation of the Company and the right to appoint directors of the Company.
2. Traded on the Tel Aviv Stock Exchange.

e. Treasury shares

Tefron Holdings (98) Ltd., a wholly-owned subsidiary of the Company, holds 99,740 Company shares, which constitute 1.47% of the Company's shares and whose cost is 7,408 thousand dollars, as at December 31, 2014 and 2013. The investment in these shares is recorded according to the "treasury shares" method in the shareholders equity.

The shares are pledged to the banks to secure a loan that was received.

f. Capital reserve for hedging transactions

The reserve serves to record profits and losses from the effective hedging of cash flows.

In 2013 the capital reserve recorded a profit from hedging cash flows on the amount of 55 thousand dollars which was recorded in 2012.

In 2014 no profit or loss were recorded from hedging cash flows since in 2013 no unrealized profits or losses were recorded in the capital reserve.

g. Capital management in the Company

The Company's capital management objectives are:

1. To preserve the Group's ability to ensure business continuity thereby creating a return for the shareholders, investors and other interested parties.
2. To ensure adequate return for the shareholders by pricing products and services commensurately with the level of risk in the Group's business operations.

The Company operates to achieve a return on capital at a level that is customary in the industry and markets in which the Company operates. This return is subject to changes depending on market factors in the Company's industry and business environment. The Company is required to have minimum tangible equity of 25.5 million dollars, as defined in the amendment of the agreement with the banks described in Note 14b above, in the framework of the financial covenants included in the agreements with the banks in connection with providing loans and is not subject to any demands relating to achieving a certain return on capital. In 2014, 2013 and 2012 the Company had a negative return on capital.

**Note 22 - Share-based payment transactions**a. Expense recognized in the financial statements

The expense recognized in the Company's financial statements for services rendered by employees, directors and consultants is presented in the following table:

## Notes to the consolidated financial statements

Note 22 - Share-based payment transactions (cont.)a. Expense recognized in the financial statements (cont.)

	For the year ended		
	December 31		
	2014	2013	2012
	Dollars thousands		
Share based payment plans settled with equity instruments for employees and directors	114	90	123
Share based payment for the consultant	-	437	74
Total share based payment plans settled with equity instruments	<u>114</u>	<u>527</u>	<u>197</u>

b. Share-based payment plan to the Company's employees and managers, directors and service providers1. Option plan to managers and employees of the Company

The share-based payment transactions the Company provided to its employees are described as follows.

On November 21, 2013, the Company's Board approved the option plan for employees, office holders and consultants. The option warrants shall vest and become exercisable and the offeree's eligibility to those warrants shall expire according to the following:

- One-third of the options (hereinafter: "the first series") will be exercisable beginning one year from the date of their allocation and until the end of five years as of the date on which the options included in the first series were first exercisable.
- One-third of the options (hereinafter: "the second series") will be exercisable from the end of two years as of the date of their allocation and until the end of five years as of the date on which the options included in the second series were first exercisable.
- One-third of the options (hereinafter: "the third series") will be exercisable after three years from the date of their allocation and until the end of five years as of the date on which the options included in the third series were first exercisable

This plan replaces the option plan which was approved in September 1997, and was extended once more in March 2008.

- a. On November 21, 2013, the Company's Board of Directors granted to the Company's CEO 150,000 option warrants exercisable to ordinary shares of the Company of NIS 10 par value each, in accordance with the cashless mechanism. The exercise price per option is US 2.22 dollars, after being translated to NIS at the representative rate of exchange of the US dollar on the day prior to the date of granting the options. Entitlement to realize the options will accrue over a period of 3 years as of the day of the allocation, in accordance with the Company's option plan.  
The value of the benefits included in granting these options according to the share price on the date of trading on the Stock Exchange amounted to 108 thousand dollars.
- b. On March 27, 2014, the Company granted an officer of the Company who is not an interested party in the Company and will not become an interested party in the Company after the granting, 32,500 options (non-tradable), which can be exercised to shares of NIS 10 par value each of the Company, in accordance with the cashless mechanism. The exercise price for each option will stand at 3.2 dollars after being translated to NIS at the representative rate of exchange of the US dollar on the day

**Notes to the consolidated financial statements**

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**Note 22 - Share-based payment transactions (cont.)****b. Share-based payment plan to the Company's employees and managers, directors and service providers (cont.)****1. Option plan to managers and employees of the Company (cont.)**

prior to the date of granting the options. The entitlement to realize the options will accrue over a period of 3 years as of the date of March 27, 2014. The value of the benefit included in granting these options according to the share price on the date of trading on the Stock Exchange amounts to 9 thousand dollars.

On March 17, 2013, the Company granted the same officer of the Company who at the date of the grant served as an external consultant of the Company who provided services in marketing and development (hereinafter: "the consultant"), 12,500 options (non-tradable) of the Company exercisable to up to 12,500 ordinary shares of the Company of NIS 10 par value each. The exercise price per option is US 3.8 dollars, after being translated to NIS at the representative rate of exchange of the US dollar on the day prior to the date of granting the options. Entitlement to realize the options will accrue over a period of 3 years as of the date of March 17, 2013. The value of the benefit included in granting these options according to the share price on the date of trading on the Stock Exchange amounts to 21 thousand dollars.

- c. On November 22, 2012, the Company's Board of Directors approved the granting of 50,000 option warrants which can be exercised into 50,000 ordinary shares of NIS 10 par value each to the executive director of operations in Israel, who is not an interested party in the Company and will not become an interested party in the Company upon the granting of the options. The exercise price per option will stand at US 3.8 dollars after being translated to NIS at the representative rate of exchange of the US dollar on the day prior to the date of the granting of the options. Entitlement to realize the options will accrue over a period of 3 years as of November 22, 2012. The value of the benefit included in granting these options according to the share price on the date of trading on the Stock Exchange amounts to 68 thousand dollars. The executive director of operations ended her employment with the Company on July 2, 2014, and after the reporting period, three months after the termination of the employment relationship all of the options she had received, expired.

- d. On November 22, 2012 the Company's Board of Directors approved the granting of 45,000 option warrants which can be exercised to 45,000 ordinary shares of NIS 10 par value each to the Company's CFO who is not an interested party in the Company and will not become an interested party in the Company upon the granting. The exercise price per option will stand at US 3.8 dollar after being translated into NIS at the representative rate of exchange of the US dollar on the day prior to the date of the granting of the options. Entitlement to realize the options will accrue over a period of 3 years. The value of the benefit included in the granting of these options according to the share price on the date of trading on the Stock Exchange amounts to 31 thousand dollars.

**2. Options granted to controlling shareholders**

On December 31, 2010, the Company granted to two controlling shareholders 450,000 options (225,000 option warrants each) to acquire up to 450,000 ordinary shares of the Company. The entitlement to exercise them is over a period of three years as of December 2010, and it expires after three years as of the date of the granting. The option warrants will vest subject to the Company's meeting its sales objectives and EBITDA. The Company made a calculation of the value of the options on the basis of its sales forecasts.



## Notes to the consolidated financial statements

**Note 22 - Share-based payment transactions (cont.)**

- b. Share-based payment plan to the Company's employees and managers, directors and service providers (cont.)

2. Options granted to controlling shareholders (cont.)

The fair value of the options is estimated on the date of the granting using the Black & Scholes Model in accordance with the terms and data, according to which the share options were granted.

In practice the Company did not meet its sales objectives and all of the option warrants have expired.

- c. Movement during the year

The following table lists the number of share options, the weighted average exercise price of the share options, and modifications in employee option plans which were carried out during the current year:

	As of December 31, 2014		As of December 31, 2013	
	Number of share options	Weighted average exercise price (dollar)	Number of share options	Weighted average exercise price (dollar)
Opening balance of options for shares	1,347,605	6.6	927,773	7.6
Options for shares granted during the year	332,500	2.6	497,500 (*)	2.3
Options for shares forfeited or expired during the year	(575,000)	6.9	(77,668)	4.1
Options for shares exercised during the year	(100,000)	-	-	-
Options for shares at the end of the year	<u>1,005,105</u>	<u>7.0</u>	<u>1,347,605</u>	<u>7.0</u>
Options for shares which can be exercised at the end of the year	<u>585,105</u>	<u>2.9</u>	<u>985,105</u>	<u>6.6</u>

(\*) Reclassified

- d. The weighted average of the remaining contractual term of the share options as at December 31, 2014 is 4.4 years (2013 – 4.1 years).
- e. The range of exercise prices of the share options as at December 31, 2014 stands at 3.8 – 2.1 dollars (as at December 31, 2013: 35.0 – 2.1). The balance of options at end of the year includes, amongst else, 235,000 options rights granted to the consultant without an exercise price.
- f. Measurement of the fair value of the share options settled with equity instruments

The Company uses the Black & Scholes model to measure the fair value of options to shares settled with equity instruments. The measurement is carried out on the date of granting the options for shares settled with equity instruments

**Notes to the consolidated financial statements****Note 22 - Share-based payment transactions (cont.)**f. Measurement of the fair value of the share options settled with equity instruments (cont.)

The following table lists the data used for the fair value measurement of options for shares settled with equity instruments and which were granted in 2014, according to the Black & Scholes option pricing model, for the above plan:

	<u>2014</u>
Dividend yield for the share (%)	0.0
Expected volatility of the share prices (%)	53.5
Risk-free interest rate (%)	1.49
Average life expectancy of share options (years)	4.5
Weighted average share price (dollars)	1.32

Based on the above data, the fair value of the options granted in 2014 was calculated at 9 thousand dollars on the dates of the granting.

The expected life of the share options is based on the Company's historical data which is not necessarily indicative of the future exercise pattern of share options.

The expected volatility of the share price reflects the assumption that the historical volatility of the share price is reasonably indicative of expected future trends.

**Note 23 - Supplementary information to the statement of income items**

	For the year ended December 31		
	<u>2014</u>	<u>2013</u>	<u>2012</u>
	Dollars thousands		
a. <u>Cost of sales</u>			
Materials	49,557	36,851	48,944
Payroll and benefits	8,467	8,161	8,614
Sub-contracted work	8,491	9,168	8,323
Depreciation	4,468	4,430	4,017
Other manufacturing expenses	<u>7,959</u>	<u>8,353</u>	<u>8,233</u>
	78,942	66,963	78,131
Decrease (increase) in work-in-progress and finished goods inventories (*)	<u>(1,861)</u>	<u>1,123</u>	<u>3,801</u>
	<u>77,081</u>	<u>68,086</u>	<u>81,932</u>
(*) Including provision for inventories write-off	<u>758</u>	<u>1,177</u>	<u>864</u>

## Notes to the consolidated financial statements

Note 23 - Supplementary information to the statement of income items (cont.)

	For the year ended		
	December 31		
	2014	2013	2012
	Dollars thousands		
<b>b. <u>Development expenses, net</u></b>			
Payroll and benefits	2,776	2,910	2,616
Manufacturing expenses	720	732	736
Depreciation and amortization	240	240	240
Materials	244	301	224
Share-based payment for the consultant	-	437	74
Others	144	152	120
Total	4,124	4,772	4,010
Less grant from the Chief Scientist	-	326	484
Development expenses, net	<u>4,124</u>	<u>4,446</u>	<u>3,526</u>
<b>c. <u>Selling and marketing expenses, net</u></b>			
Payroll and benefits	3,724	3,826	3,184
Freight, export and distribution	2,620	1,443	1,138
Commissions paid	1,566	666	852
Overseas office maintenance	514	491	401
Travel expenses	627	628	664
Depreciation and amortization	419	444	553
Others	919	1,464	1,470
	<u>10,389</u>	<u>8,962</u>	<u>8,262</u>
<b>d. <u>General and administrative expenses</u></b>			
Payroll and benefits	1,468	1,752	1,692
Consulting	764	917	707
Directors' remuneration and insurance	309	364	339
Provision for doubtful debts	8	92	(134)
Others	508	535	576
	<u>3,057</u>	<u>3,660</u>	<u>3,180</u>
<b>e. <u>Other expenses (income)</u></b>			
Capital loss (gain) from the sale of fixed assets (1)	(974)	(2)	2
Restitution of mutual fund to employers (2)	15	(187)	-
Impairment of fixed assets, net	-	-	33
	<u>(959)</u>	<u>(189)</u>	<u>35</u>

- (1) In 2014 the Company had a capital gain of 810 thousand dollars as a result of a transaction of exchanging machines.
- (2) On December 3, 2013, the Company received repayment of participation fees for a total amount of 187 thousand dollars from the mutual fund of employers as a refund for participation fees which were paid by it to the fund.

## Notes to the consolidated financial statements

Note 23 - Supplementary information to the statement of income items (cont.)

	For the year ended December 31		
	2014	2013	2012
	Dollars thousands		
f. <u>Financial income (expenses)</u>			
<u>Financial income</u>			
Interest income from securities available for sale	23	21	18
Net gain from change in foreign exchange rates	717	-	19
Net change in fair value of cash flow hedging	-	105	46
Revaluation of liability for options to banks	10	251	-
	<u>750</u>	<u>377</u>	<u>83</u>
<u>Financial expenses</u>			
Financial expenses from short-term credit and bank loans	811	747	823
Net loss from change in foreign exchange rates	-	339	-
Reduction of discounting of options for banks	69	123	183
Net change in fair value of cash flow hedging transferred from equity	486	-	-
Revaluation of liability for options to banks	-	-	64
Bank expenses and interest-related expenses for others	836	916	638
	<u>2,202</u>	<u>2,125</u>	<u>1,708</u>

Note 24 - Earnings (loss) per share

Detail of number of shares and earnings (loss) used to calculate the earnings (loss) per share:

	For the year ended December 31,					
	2014		2013		2012	
	Weighted average number of shares of thousands	Loss attributed to shareholders of the Company Dollars thousands	Weighted average number of shares of thousands	Loss attributed to shareholders of the Company Dollars thousands	Weighted average number of shares of thousands	Loss attributed to shareholders of the Company Dollars thousands
Amounts of shares and loss- from continuing operations						
For the purpose of calculating basic loss from continuing operations	6,701	(800)	6,582	(3,162)	6,542	2,636
Effect of potentially dilutive ordinary shares	-	-	-	-	7	-
For the purpose of calculating diluted net loss from continuing operations	6,701	(800)	6,582	(3,162)	6,549	2,636
Amounts of shares and loss – from discontinued operations						
For the purpose of calculating basic and diluted loss from discontinued operations	-	-	6,582	(271)	6,542	(3,094)
Amount of shares and loss						
For the purpose of calculating basic and diluted net loss	6,701	(800)	6,582	(3,433)	6,542	(458)

## Notes to the consolidated financial statements

Note 25 - Operating segmentsa. General

In light of the decision of the discontinuation of the production in the Cut & Sew field in Israel, and the discontinuation of the swimwear operations, the scope of operations of the Cut & Sew field has diminished significantly, and so it no longer meets the definition of a reportable operating segment. As of January 1, 2014, the Company's chief operating decision maker (CODM hereinafter: "CEO") reviews only the consolidated operations data and refers to the Company's entire operations as operations of the seamless segment.

The seamless operating segment includes two cash-generating units which are characterized by the production locations: production in Israel and production in the Far East (offshore) These units were grouped into a single reportable segment based on the criteria in IFRS 8 – Section 12.

The information that the Company provides in accordance with the definitions of IFRS 8 is based on the available financial information which is reviewed regularly and is used by the Company's CEO so as to make decisions regarding the resources to be allocated to the segment and in order to evaluate the segment's performance

c. Secondary reporting regarding operating segments

## 1. Sales by geographic markets (based on customer location):

	For the year ended December 31		
	2014	2013	2012
	Dollars thousands		
North America	90,225	81,091	96,747
Europe	2,807	582	1,349
Israel	618	649	815
Others	265	590	52
	<u>93,915</u>	<u>82,912</u>	<u>98,963</u>

## 2. Carrying amount of assets and capital expenditures by geographical areas (based on asset location):

	Balance of non-current assets (*)		Capital expenditures		
	December 31,		for the year ended December 31		
	2014	2013	2014	2013	2012
	Dollars thousands				
Israel	27,043	29,426	3,320	3,547	2,306
North America	2,101	1,780	39	18	21
Others	203	404	20	25	4
	<u>29,347</u>	<u>31,610</u>	<u>3,379</u>	<u>3,590</u>	<u>2,331</u>

(\*) Excluding deferred taxes, net.

## Notes to the consolidated financial statements

Note 25 - Operating segments (cont.)3. Major customers

	For the year ended December 31		
	2014	2013	2012
	Dollars thousands		
Turnover with major customers	<u>72,419</u>	<u>55,597</u>	<u>67,114</u>
	Percentage of total sales		
Customer A	45.4	44.3	28.2
Customer B	16.4	12.7	18.3
Customer C	15.3	10.1	11.1
Customer D	-	-	10.3
	<u>77.1</u>	<u>67.1</u>	<u>67.9</u>

Note 26 - Balances and transactions with interested parties and related partiesa. Balances with interested parties and related parties

Composition:

As at December 31, 2014

	Linkage terms	Related parties	Key executives
	Dollars thousands		
Trade receivables		7,953	-
Trade payable	Unlinked	(129)	-
Other payables		(84)	(67)
		<u>7,740</u>	<u>(67)</u>

As at December 31, 2013

	Linkage terms	Related parties	Key executives
	Dollars thousands		
Trade receivables		656	-
Trade payables	Unlinked	(497)	-
Other payables		(31)	(73)
		<u>128</u>	<u>(73)</u>

## Notes to the consolidated financial statements

Note 26 - Balances and transactions with interested parties and related parties (cont.)b. Benefits to interested parties and related parties

	<u>For the year ended December 31</u>		
	<u>2014</u>	<u>2013</u>	<u>2012</u>
	<u>Dollars thousands</u>		
Salaries and benefits for employees in the Company or on its behalf, including the CEO	<u>466</u>	<u>695</u>	<u>949</u>
Fees of directors not employed by or on behalf of the Company	<u>265</u>	<u>319</u>	<u>276</u>
<u>Number of beneficiaries of salaries and benefits</u>			
Related parties employed by or on behalf of the Company	1	2	2
Directors not employed by the Company	<u>8</u>	<u>9</u>	<u>9</u>
	<u>9</u>	<u>11</u>	<u>11</u>

c. Transactions with related parties and interested partiesFor the year ended December 31, 2014

	<u>Related parties</u>	<u>Interested parties</u>	<u>Executive officers</u>
	<u>Dollars thousands</u>		
Sales	128	14,661	-
Cost of sales	-	(3,134)	-
Sales and marketing expenses	-	(411)	-
General and administrative expenses	(10)	(265)	(466)

For the year ended December 31, 2013

	<u>Related parties</u>	<u>Interested parties</u>	<u>Executive officers</u>
	<u>Dollars thousands</u>		
Sales	159	5,811	-
Cost of sales	-	(6,092)	-
Sales and marketing expenses	-	(509)	-
General and administrative expenses	(30)	(319)	(695)
Financing expenses	-	(58)	-

For the year ended December 31, 2012

	<u>Related parties</u>	<u>Interested parties</u>	<u>Executive officers</u>
	<u>Dollars thousands</u>		
Sales	285	10,998	-
Cost of sales	-	(2,337)	-
Sales and marketing expenses	-	(368)	-
General and administrative expenses	(69)	(276)	(949)
Financing expenses	-	(235)	-

d. Share based payment to controlling shareholder

On December 31, 2010 the Company granted two controlling shareholders 450,000 options to purchase 450,000 ordinary shares of the Company, subject to the Company's meeting the sales objectives which were determined in the option agreement with the controlling shareholders. In practice, the Company did not actually meet the sales objectives that were agreed upon, and all the option warrants have expired. For additional details see Note 22b2.

**Notes to the consolidated financial statements****Note 26 - Balances and transactions with interested parties and related parties (cont.)**e. Agreement for a real estate property lease in the U.S. with an interested party

On September 7, 2014, the Company's shareholders' meeting approved, upon receiving the approval of the Company's Audit Committee and Board of Directors, the engagement of the company Tefron USA, Inc., a wholly-owned private company, indirectly, of the Company (hereinafter: "Tefron USA"), with Trimfit Global Inc., a private company incorporated in Delaware, USA, related to the Nouvelle Group who is amongst the controlling shareholders of the Company (hereinafter: "Trimfit") in an agreement for a real estate property lease which is owned by Tefron USA in Valdese, North Carolina, USA, in an area of about 170,000 square feet, which is used as a center for logistics, for a consideration of US 108 thousand dollars per year, for a period of two years as of September 1, 2014 with an option of extension for an additional year. Furthermore, it was agreed upon between the parties in the framework of the aforementioned engagement, that Trimfit would provide Tefron USA, according to its needs, sorting, picking and delivering services (Pick and Pack) (hereinafter: "the services"), for a consideration that is equal to the cost of receiving these services through a subcontractor (hereinafter: "the agreement").

In the framework of the agreement with Trimfit, the consideration to be received in return of the lease fee, was determined by negotiation between the Company and Trimfit, and based on an expert assessment, conducted by an external and independent appraiser office in North Carolina (Integral Realty Resources-Greensboro), which was based, amongst other things, on the comparison data of the lease fees and similar leased property that is in the vicinity of the property. In accordance with the aforementioned assessment, the appropriate annual lease fee for the property is in the price range between US 0.62 dollars per square feet to US 0.72 dollars per square feet. The lease fee stipulated in the agreement is based on an annual consideration of approximately US 0.64 dollars per square feet.

Tefron USA would be entitled to receive these services from Trimfit. The consideration agreed upon between the parties in respect of granting the services by Trimfit to the Company, as the Company shall require these services, shall be determined by an annual comparison to the prices of a subcontractor who provides similar services to the Company and is not related to the company and/or to any of its controlling shareholders.

f. Investment agreement with Litef Holdings Inc.

On February 17, 2015, the Company signed an agreement with Litef according to which, Litef will invest a total of US 5 million dollars in the Company against an extraordinary private allocation, as this term is defined in the Israeli Securities Regulations (Private Offering of Securities in a Listed Company), 2000, of 4,672,897 ordinary shares of the Company (hereinafter: "the agreement") at a price of US 1.07 dollars per share. The agreement is subject to the approval of the meeting of the shareholders of the Company. For additional details see Note 27 as follows.

g. Pick and Pack service agreements with a related parties

In general, the Company, through its subsidiary, Tefron USA, provided as part of its current operations in the United States, sorting, picking and delivering services (Pick and Pack) to its customers during its normal course of business (hereinafter: "the services").

(1) In November 2011, the Company's Board of Directors approved, following the approval of the Audit Committee of the Company, the Company's engagement in a non-extraordinary transaction for providing services to: (a) BL Intimates (hereinafter: ("BLI"), which is a partnership of Lamour Global Inc. Limited (a private company incorporated in Hong Kong and related to the Lieberman family who is among the controlling shareholders of the Company) (hereinafter: "Lamour"), and another



**Notes to the consolidated financial statements****Note 26 - Balances and transactions with interested parties and related parties (cont.)**g. Pick and Pack service agreements with a related parties (cont.)

partner; and to (b) companies related to BLI, which are under the control of the Lieberman family's members who are among the controlling shareholders of the Company. The scope of engagement with BLI and its related companies is up to an amount of revenues of US 200,000 dollars when the price per unit is a fixed price (not dependent on the quantity of services required), which is higher than the price per unit that the Company collects from its customers.

- (2) Further to the aforesaid, on May 19, 2013, after receiving the Audit Committee's approval, the Company's Board of Directors decided to approve the renewal of the Company's engagement, occasionally, in non-extraordinary transactions, as this term is defined in the Companies Law, in providing services to BLI, to an additional holder of BLI and to related companies to BLI, which are controlled by the Lieberman family (hereinafter together: "the BLI Group"). The scope of engagement with the BLI Group that has been approved, is up to an amount of revenues of US 500 thousand dollars, when the price per unit, which will be collected from the BLI Group, is a fixed price (not dependent on the quantity of services required), and which is higher than the price per unit that the Company collects from its customers to whom the Company provides services in similar volumes. The period of engagement which has been approved, is three years as of the date of the Company's Board's decision, as aforementioned, or up to the amount of revenues detailed above, whichever is earlier.
- (3) On July 2, 2013, after receiving the Audit Committee's approval, the Company's Board of Directors decided to approve the Company's engagement for the purpose of providing the services to Trimfit and this for a consideration of four percent (4%) of the total volume of sales of Trimfit for which the services are rendered. Notwithstanding the aforementioned, the Company has continued the negotiation with Trimfit in order to improve the consideration which shall be collected for the services provided. In continuation of the aforesaid, the parties have reached commercial agreements, according to which the consideration collected from Trimfit shall be five percent (5%) of the total volume of Trimfit's sales for which the services are rendered (plus expenses), and this retroactively as of July 1, 2013. The period of engagement that was approved is a period of three years as of July 1, 2013 or up to a total sum of 1,500 thousand dollars, whichever is earlier. The Company believes that such consideration reflects a consideration that is at least equal to the consideration collected by the Company, at this time, from its external customers for whom the Company provides the service in similar volumes.

It should be noted that with the signing of the lease agreement for the property that would serve as the center for logistics activities in the U.S., as detailed in Note 26e above, Tefron USA ceased to provide services to related companies, as specified in the Clauses (1) - (3) above, and to third parties.

h. Agreement for the employment of employees through a related party

In February 2012, the Company's Board of Directors approved, following the approval of the Audit Committee of the Company, the Company's engagement in an extra-ordinary transaction with Intimes Nouvelle Seamless Inc., who is amongst the controlling shareholders of the Company (hereinafter: "Nouvelle"), for the purpose of the employment of three of the company's employees in Canada through Nouvelle, for the reasons detailed as follows. After the completion of the transaction for the acquisition of Nouvelle's operations, the Company sought out, amongst other things, to engage in an employment agreement with three salespersons of Nouvelle, who specialize in sales to customers in

**Notes to the consolidated financial statements**

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**Note 26 - Balances and transactions with interested parties and related parties (cont.)**h. Agreement for the employment of employees through a related party (cont.)

North America (hereinafter: the “employees”). Due to the fact that the employees’ employment in Canada requires the establishment of a legal entity under Canadian law, and involve additional costs to the Company, the Company reached an agreement with Nouvelle, whereby the employees will be employed by Nouvelle (Back to Back), for a period of three years and/or up to the date of the termination of employment of the employees, whichever is earlier. It should be noted that the mere employment of employees, conditions of employment and their duties are carried out according to the sole discretion of the Company, and Nouvelle operates according to the Company’s guidelines, as those are provided to Nouvelle from time to time. It should also be emphasized that Nouvelle does not receive any consideration from the Company for this service. On March 27, 2014, the Board of Directors approved, following the approval of the Audit Committee, the continuation of the Company’s engagement in an extra-ordinary transaction with Nouvelle for the employment of three of the Company’s employees, through Nouvelle, in Canada and this due to the arguments listed above.

On December 19, 2014, with the incorporation of a Canadian subsidiary, wholly owned by the Company, the Company began to employ the employees directly, while terminating the agreement described above.

i. Lease Agreement with a related party

On February 14, 2012, following the approval of the Company’s Audit Committee, the Company’s Board approved the engagement of the Company in an agreement with Nouvelle for the sublease of office space in Montreal, Canada where the sale operations of the Company in North America takes place, for a monthly payment of US 2,000 dollars. Further to the Company’s management’s decision to transfer the offices in Canada to an alternative location, on November 21, 2013, the Company’s Board decided, following the approval of the Company’s Audit Committee, to approve the Company’s engagement in a non-extraordinary transaction, as this term is defined in the Companies Law, with a subsidiary of Lamour, for the purpose of sublease of office space in Montreal, Canada, on a total area of approximately 280 square meters for a monthly payment of US 2,000 dollars (excluding taxes) plus an additional amount of US 270 dollars for the leasing of 3 parking spaces in the office building, and this *in lieu* of the Company’s engagement with Nouvelle, for leasing office space, as detailed above. The approval of the Company’s Board, as stated above, will remain in effect for a period of up to three years.

j. Service agreement with a related party for providing invoices

In February 2012, the Company’s Board approved, following the approval of the Audit Committee of the Company, the Company’s engagement in a non-extraordinary transaction with Lamour which shall serve as a channel for the sale of the Company’s products to Wal-Mart, and this for the reasons described below: Wal-Mart is a significant customer of the Company. In order for the Company to sell products directly to Wal-Mart, it must first complete the process of issuing a manufacturer’s identification number. As of this date, the Company has not yet completed the process of issuing the said manufacturer’s identification number due to the difficulty to obtain it opposite Wal-Mart. In light of the aforesaid, the Company decided to sell its products to Wal-Mart through Lamour which already acquire a Wal-Mart’s manufacturer’s identification number. According to the agreements between Lamour and the Company, the proceeds from Wal-Mart which is paid to Lamour, is transferred to the Company upon receiving it and under the same payment terms. On March 22, 2015, the Company’s Board approved the a extension of the term of the agreement in 3 additional years, after receiving the recommendation of the Audit

## Notes to the consolidated financial statements

**Note 26 - Balances and transactions with interested parties and related parties (cont.)**j. Service agreement with a related party for providing invoices (cont.)

Committee according to which the extension of the period, as aforementioned, is reasonable under the circumstances.

k. Agreement for accounting services with a related party

Following the non-completion of the issuing of the manufacturer's identification number carried out by Wal-Mart in favor of the Company, as detailed in Note 26e above, there was a need to perform accounting procedures for accounting purposes regarding the funds due from Wal-Mart to the Company as well as to the other companies in the Lamour Group (hereinafter: "the accounting services"). Therefore on May 19, 2013, the Company's Board approved, following the approval of the Company's Audit Committee, the engagement of the Company for the purpose of receiving accounting services from Lamour, for a monthly fee of US 750 dollars for the accounting services. In light of the increase in the Company's operations with Wal-Mart, Lamour has approached the Company and asked to update the terms of engagement for providing the accounting services and to add an amount of US 960 dollars to the monthly consideration, and in total the company pays Lamour a sum of US 1,710 dollars in return of the accounting services

l. Agreement with Mr. Mike Gao for providing services for locating raw materials and/or subcontractors

On April 4, 2012, the meeting of the Company's shareholders approved the engagement of the Company with Mr. Mike Gao, who is engaged with the Company through Asia Socks Inc. (hereinafter: "Asia Socks") (hereinafter jointly: "Gao"), in an agreement for services related to locating raw materials and products from new suppliers and/or locating subcontractors, in all of its areas of operations, as well as supervision services, and this for a period of three years (hereinafter: "the services"). In return for the services, the Company paid Gao, a commission of 3% of the amount of the invoice issued by the aforementioned suppliers and/or subcontractors. Furthermore, in cases when Gao purchased raw materials and/or products for the Company, Gao was eligible for a full refund from the Company, in accordance with the payment terms set forth in the work orders. Moreover, in the framework of the agreement Gao assigned the Company a supplier credit line of up to US 4 million dollars. For utilizing this credit line, the Company paid Gao an interest equivalent to LIBOR (for three months) plus 5.8%.

During 2013 The parties have re-examined the need for continuing the engagement with Asia Socks and came to the conclusion that during the period of the engagement the Company has established its ability to act independently in locating raw materials and products from new suppliers and/or locating subcontractors and it no longer requires the support of the Asia Socks. Thus, on December 30, 2013, after receiving the recommendation of the Company's management, the Board of Directors of the Company decided to cancel the agreement, as of February 1, 2014, subject to the completion of establishing a representative office in China under the subsidiary of the Company (hereinafter: the "representative office") . It should be noted that the termination of the agreement does not have a material effect on the operations and results of the Company. The company has encountered difficulties in the process of establishing the representative office and is currently working to establish a wholly owned company (indirectly) in China. Notwithstanding the foregoing, in February 2014, the agreement was terminated.

To the best knowledge of the Company, Mr. Mike Gao holds all the issued and paid up capital of Asia Socks, a private company incorporated in China, and is engaged together with his brother, in an agreement that grants him rights in Litef, who is among the

**Notes to the consolidated financial statements**

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**Note 26 - Balances and transactions with interested parties and related parties (cont.)**

- l. Agreement with Mr. Mike Gao for providing services for locating raw materials and/or subcontractors (cont.)

controlling shareholders of the Company; therefore, and as a precaution only, the Company views him and the company Asia Socks as a related party.

- m. Lease agreement with a related party

On December 30, 2013, the Company's Board of directors approved, following the approval of the Company's Audit Committee, the Company's engagement in a non-extraordinary transaction, as this term is defined in the Companies Law, with Asia Socks for the purpose of subleasing office space in Shanghai China, of an area of approximately 140 square meters for a daily payment of US 63 dollars (a total of US 1,890 dollars monthly), and this as of February 1, 2014.

- n. Service agreement for export license number with a related party

On December 17, 2014, the Company's Board approved, following the approval of the Company's Audit Committee, the engagement of the Company in a transaction which does not require the approval of the general meeting of the Company, pursuant to Regulation 1(2) of the Companies Regulations (Relief in Transactions with Interested Parties) 2000, between the Company and the Asia Socks, according to which the Company will use, free of charge, the export license of Asia Socks for the purpose of importing raw materials, from various suppliers of raw materials, from China to Israel. It should be noted that the engagement with the raw material suppliers in China and the terms of engagement with them will be carried out by a representative of the Company and at the sole discretion of the Company, while the export process will be carried out by Asia Socks, without any consideration paid to Asia Socks for this service (the export will be on back to back terms to the terms of the procurement of raw materials). The transaction was approved for a period of three years and/or until the Company's subsidiary, who the company intends to establish, acquires its own export license, when it shall be established

- o. Director remuneration for a related party

Pursuant to the resolution of the general meeting of the shareholders of the Company dated December 29, 2010, regarding the approval of granting remuneration to Mr. Guy Shamir (son of Mr. Meir Shamir who is among the controlling shareholders of the Company) (hereinafter: "Mr. Shamir"), in respect of his service as a director of the Company and since 3 years has passed as of the date of the approval, as aforesaid, on November 21, 2013, pursuant to the decision of the Remuneration Committee of the Company dated July 14, 2013, the Company's Board approved, in accordance with section 275(a1)(1) of the Companies Law, and in accordance with the provisions of Regulation 1b of the Companies Regulations (Relief in Transactions with Interested Parties) 2000, granting remuneration for Mr. Shamir in respect of his service as a director of the Company, in accordance with the director remuneration paid for the other directors of the Company, in 2014 the Company paid Mr. Guy Shamir 16 thousand dollars for his service as a director of the Company.

**Notes to the consolidated financial statements****Note 27 - Events after the balance sheet date**a. Investment agreement with Litef Holdings Inc.

On February 17, 2015, the Company signed an agreement with Litef Holdings Inc., a private company incorporated in Canada, which is among the controlling shareholders of the Company (hereinafter: "Litef"), according to which, Litef will invest a total of US 5 million dollars in the Company against an extraordinary private allocation, as this term is defined in the Israeli Securities Regulations (Private Offering of Securities in a Listed Company), 2000, of ordinary shares of the Company (hereinafter: "the agreement"), as detailed as follows.

As at this date, Litef and Nouvelle Intimes Seamless Inc., a private company incorporated in Canada (hereinafter: "Nouvelle") (Litef and Nouvelle jointly will be called hereinafter: "Nouvelle Group") jointly hold approximately 32.47% of the issued and paid up share capital of the Company and the voting rights therein and approximately 28.24% of the issued and paid up share capital of the Company and the voting rights therein on a fully diluted basis.

The principals of the agreement are detailed as follows:

1. Litef will invest a total of US 5 million dollars in the Company (hereinafter: "the investment amount"), against an allocation of 4,672,897 ordinary shares of the Company, at a price of US 1.07 dollars per share, which will grant the Nouvelle Group more than 45% of the voting rights in the Company, noting that as at the date of this report, the Company has no shareholder holding more than 45% of the voting rights therein. The share price was determined as the average share price of the Company's share price in dollars during the last 30 trading days prior to the signing of the agreement.  
Upon the closing of the transaction, the Nouvelle Group shall jointly hold approximately 60.2% of the issued and paid up share capital of the Company and the voting rights therein and approximately 55.31% of the issued and paid up share capital of the Company and the voting rights therein on a fully diluted basis.
2. Nouvelle and Messrs. Ben and Martin Lieberman, who are amongst the controlling shareholders of the Company, signed on 30 December 2010, a commitment not to compete with the Company in the field of seamless products for a limited period of 5 years as of the date of signing such non-competition commitment. In the framework of the agreement it was agreed upon that Litef would join as a party to the non-competition commitment and it will remain in force as long as Nouvelle, Messrs. Ben and Martin Lieberman, and Litef, each on its own, will be amongst the controlling shareholders of the Company.
3. The closing of the transaction has been set to five business days after the fulfillment of all the conditions precedent as specified in the agreement, including:
  - a. The approval, in accordance with the provisions of any law, of the competent organs of the Company (Audit Committee, Board of Directors and the general meeting of the Company's shareholders) regarding the Company's engagement in the agreement including the approval of the allocation of shares as specified in the agreement. It shall be noted that for the purpose of accompanying the negotiations with the controlling shareholder, the Company's Board has established a special and independent committee whose members are the members of the Audit Committee of the Company, and it has accompanied the negotiations with the controlling shareholder and approved the terms of the agreement.
  - b. The approval of the Stock Exchange regarding the registration for trading of the shares allocated under the agreement.

## Notes to the consolidated financial statements

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### Note 27 - Events after the balance sheet date (cont.)

#### a. Investment agreement with Litef Holdings Inc. (cont.)

- c. The Company's engagement with its financing banks, Bank Leumi Le-Israel Ltd., Bank Hapoalim Ltd. and Israel Discount Bank Ltd. (hereinafter: "the banks") in an agreement to amend the existing financing agreement of the Company (hereinafter: "the financing agreement") regarding the following topics:
- (1) Refinancing of the Company's long-term loans in the amount of sixteen million US dollars into long term loans with a repayment term of 10 years, which will be repaid in equal annual principal repayments.
  - (2) Increasing the Banks' short-term credit lines (a credit limit of US 9.75 million dollars) as well as increasing the agreed-upon amount of the factoring limits (a factoring limit of US 2.5 million dollars), in an amount equal to 150% of the investment amount (meaning US 7.5 million dollars), when the ratio between the amount of the increase of the credit line and the amount of increase in the factoring limits, and out of the amount stated above, the amount of the immediate increase in the aforementioned limits and the increase that will depend on the Company's sales growth, will be subject to an agreement between the Company and Litef.
  - (3) Cancellation of the mechanisms for the early repayment of the long-term loans set out in the financing agreement.
  - (4) The investments that will be made by the Company as of 1.1.2015, shall not exceed, each year during the period of long-term loans, an amount equal to the investment amount plus the free EBITDA (the annual EBITDA less payments of principal and interest and financing costs for the banks and tax payments) on an accumulated basis, less the investments made by the Company since the beginning of 2015 on an accumulated basis.
  - (5) No change in the financial covenants currently existing in the financing agreement despite the increase in the equity resulting from the investment, except, as the change may be required in the framework of increasing the credit line limits as specified in the previous clause (2) above.

The Company is in the midst of discussions with the banks in order to reach an agreement with them which will allow the existence of all the conditions precedent described in the previous clauses (1) - (5) however at this stage it has not been completed yet.

4. In any event that, for whatever reason, all of the aforementioned conditions precedent will not be completed until April 21, 2015, then the agreement will be terminated, and neither of the parties to the agreement shall have any complaint and/or claim of any kind whatsoever, against the other.
5. On April 16, 2015, a meeting of the Company's shareholders is scheduled and on its agenda the approval of the Company's engagement in this agreement.

#### b. Appointment of an independent director – Mr. Eytan Stiassnie

On January 27, 2015, Mr. Eytan Stiassnie was appointed as an independent director of the Company.

#### c. Expiration of rights to shares

On March 22, 2014, 100,000 of 335,000 rights to shares granted to Professor Bodo W. Lambertz (hereinafter: "the consultant") expired. These shares were granted as part of the

**Notes to the consolidated financial statements**

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**Note 27 - Events after the balance sheet date (cont.)**c. Expiration of rights to shares (cont.)

consulting and development agreement signed by the Company with the consultant on September 27, 2012. The rights to the shares have expired due to failure to meet the milestones. For further details regarding the agreement and the private allocation to the consultant see Note 20b 4 above.

d. Extending the service agreement with a related party for providing invoices

On March 22, 2015, the Company's Board approved the extension of the term of the agreement for providing invoicing services with Lamour Global Inc. Limited (hereinafter: "Lamour") in a non-extraordinary transaction, for an additional period of 3 years. Lamour shall serve as a channel for the sale of the Company's products to Wal-Mart as detailed in Note 26 above. The Board's approval was obtained after receiving the recommendation of the Audit Committee according to which the extension of the period, as aforesaid, is reasonable under the circumstances.

## Notes to the consolidated financial statements

Additional details regarding investments in subsidiaries as at December 31, 2014:

Active subsidiaries wholly-owned and wholly-controlled (100%)	Number of shares the company holds	Shares par value (Dollars thousands)	Book value (Dollars thousands)	Capital notes (Dollars thousands)
Hi-Tex, founded by Tefron Ltd.	162,646	28,339	(20,986)	-
Macro Clothing Ltd	628	150	(11,973)	-
Tefron USA Inc., wholly-owned by Tefron US Holdings, Corp	100	0.0025	4,819	48,000
Tefron UK Ltd., wholly-owned by Macro Clothing Ltd.	0.001	0.001 GBP	3,939	-
El-Masira Textile Co., wholly-owned by Tefron USA Inc.	72	72	4,648	-
Tefron Canada Inc., wholly-owned by Tefron Ltd.	100	0.01	(25)	-
Tefron HK	1	1 HK dollar	-	-
Seeds Tefron	50	50 HK dollar	-	-
Tefron Holdings (98) Ltd.	100	27	-	12,095