TEFRON LTD

CONSOLIDATED FINANCIAL STATEMENTS
AS OF DECEMBER 31, 2012

IN U.S. DOLLARES THOUSANDS

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In U.S. Dollars Thousands

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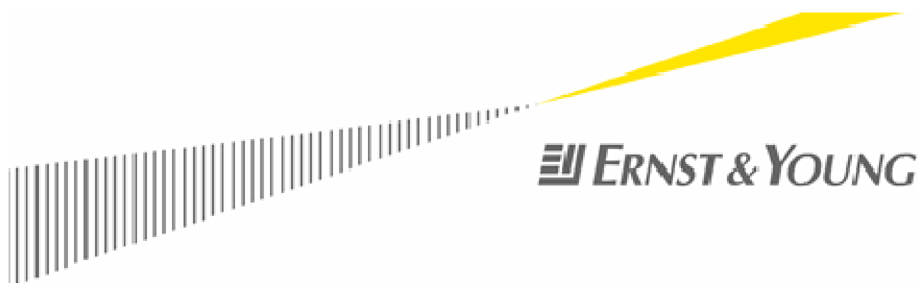

Kost Forer Gabbay & Kasierer

2 Pal-Yam Ave.
Haifa 33095, Israel

Auditors Report to the Shareholders of Tefron Ltd.

Regarding the Audit of Components of Internal Control over Financial Reporting

Pursuant to Section 9b(c) of the Securities Regulations
(Periodic and Immediate Reports) - 1970

We have audited the components of internal control over financial reporting of Tefron Ltd. (hereinafter: "the Company") as of December 31, 2012. These control components have been determined as explained in the following paragraph. The Company's Board of Directors and Management are responsible for maintaining effective internal control over financial reporting, and evaluating the effectiveness of the components of the internal control over the financial reporting which is attached to the period report for the above date. Our responsibility is to express an opinion on the component of the internal control over the financial reporting of the Company, based on out Audit.

Components of internal control over the financial reporting that we have audited, were determined in accordance with Audit Standard 104 of the Institute of Certified Public Accountants in Israel "Audit of Components of Internal Control over Financial Reporting" (hereinafter - "Audit Standard 104"). These components are: (1) Controls at the organizational level, including control over the process of preparing and closing the financial reporting, and general controls over the information systems; (2) Controls over the sales process; (3) Controls over the inventory process; (4) Controls over the purchasing process (all of these jointly are hereinafter called - "Audited Control Components").

We have conducted our Audit in accordance with generally accepted Audit Standard 104. According to this Standard, we are required to plan and perform the Audit in order to identify the components of internal control and to obtain reasonable assurance as to whether these control components have been effectively implemented from all significant aspects. Our Audit included achieving understanding regarding internal control of the financial reporting, identifying the Audited Control Components, evaluating the risk that there might be a significant weakness in the Audited Control Components, and examining and evaluating the effectiveness of the planning and operation of those control components based on the evaluated risk. Regarding those Audited Control Components, our Audit included performing additional procedures that we have viewed as necessary considering the circumstances. Our Audit has referred only to the to the Audited Control Components, which must be differentiated from the internal control over all the significant processes in connection with the financial reporting, hence, our opinion relates solely to the Audited Control Components. Moreover, our Audit did not relate to the mutual effects between the Audited Control Components and those which were not audited and, therefore, our opinion does not take into account such possible effects. We believe that our Audit provides a reasonable basis for our opinion in connection with the above.

Due to obvious limitations, the internal control of financial reporting in general, and components of them in particular, are likely not to prevent or disclose a misleading presentation. In addition, reaching conclusions regarding the future on the basis of an evaluation of any present effectiveness, is exposed

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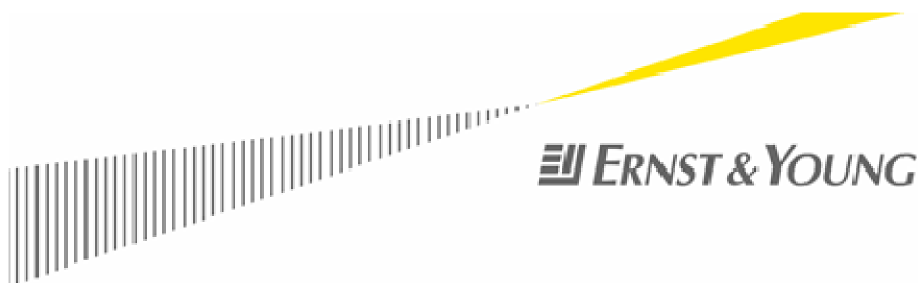
to the risk that controls will become unsuitable due to the change in circumstances or that the level of the existence of policy or procedures were detrimentally changed.

In our opinion, the Company has effectively maintained, from all significant aspects, the Audited Control Components, as of December 31, 2012

We have also audited, in accordance with generally accepted auditing standards in Israel, the consolidated financial statements of the Company as of December 31, 2012 and 2011, and for each of the years for the period ended December 31, 2012, 2011 and 2010, and our report dated March 17, included an unqualified opinion on those financial statements as well as drawing attention regarding the Company's operations and their outcomes, and likewise to the Management's measures regarding meeting the financial covenants with the banks, and its plans in that regard.

Haifa, Israel	*KOST FORER GABBAY & KASIERER*
March 17, 2013	*Certified Public Accountants*



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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, 2012 and 2011 and the consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for each of the years ended December 31, 2012, 2011 and 2010. 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 audits.

We have conducted our audits 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 Board of Directors and Management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company and its subsidiaries as of December 31, 2012 and 2011, and the results of their operations, changes in shareholders' equity and cash flows for each of the years ended December 31, 2012, 2011, and 2010, in conformity with 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 their outcomes, as well as to the Management's measures regarding meeting the financial covenants with the banks, and its plans in that regard

We have also audited, in accordance with Auditing Standard 104 of the Institute of Certified Public Accountants in Israel "Auditing of Internal Control Components over Financial Reporting", internal control components over financial reporting of the Company as of December 31, 2012, and our report of March 17, 2012 included an unqualified opinion on the effective existence of those components.

Haifa, Israel	*KOST FORER GABBAY & KASIERER*
March 17, 2013	*Certified Public Accountants*

Consolidated balance sheets

	Note	As of December 31 2012	2011
		Dollars thousands	
Current assets			
Cash		5,586	2,606
Investments in securities available for sale		323	334
Trade receivables, net	4	18,356	13,691
Other receivables	5	2,986	2,202
Inventory	6	15,024	18,780
Assets held for sale	7	-	2,805
		42,275	40,418
Non-current assets held for sale	7	-	2,005
		42,275	42,423
Non-current assets			
Property, plant and equipment, net	7	29,556	31,716
Non current assets held for sale	7	2,750	-
Goodwill and intangible assets, net	8	1,177	1,671
Computer programs, net	8	284	277
Deferred taxes, net	16	2,659	1,318
		36,426	34,982
		78,701	77,405

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

Consolidated balance sheets

	Note	As of December 31 2012	As of December 31 2011
		Dollars thousands	
Current liabilities			
Bank credit	9	9,504	5,763
Trade payables	10	12,487	13,212
Other payables	11	4,387	4,504
Loans to be repaid from the proceeds of assets held for sale	7	-	2,805
		26,378	26,284
Non-current liabilities			
Long-term loans from banks	12	20,200	19,042
Liabilities for bank options	14	318	254
Liabilities for benefits to employees, net	15	596	604
Liabilities for deferred taxes, net	16	310	-
		21,424	19,900
Equity attributed to the Company's shareholders	18		
Share capital		19,818	19,818
Additional paid-in capital		107,321	107,198
Accumulated deficit		(89,149)	(88,429)
Treasury shares		(7,408)	(7,408)
Capital reserve for financial assets available for sale		(118)	(148)
Capital reserve for hedging transactions		55	-
Other capital reserves		380	190
Total equity		30,899	31,221
		78,701	77,405

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

March 17, 2013			
Date of approval of the financial statements	Arnon Tieberg Chairman of the Board	Amit Meridor CEO	Eliezer Parnafes CFO

Consolidated statements of statements of income

	Note	2012	2011	2010
		For the year ended December 31		
		Dollars thousands (excluding data on loss per share)		
Sales		113,490	118,418	86,044
Cost of sales	20a	93,156	100,296	83,848
Gross profit		20,334	18,122	2,196
Development expenses, net	20b	3,526	3,628	2,869
Selling and marketing expenses	20c	13,063	15,421	11,850
General and administrative expenses	20d	3,169	2,949	4,050
Other expenses (income)	20e	35	(404)	6,233
Operating loss		541	(3,472)	(22,806)
Financing income	20f	64	696	30
Financing expenses	20f	(2,056)	(1,832)	(2,379)
Financing expenses, net		(1,992)	(1,136)	(2,349)
Loss before taxes on income		(1,451)	(4,608)	(25,155)
Tax benefit	16	993	354	2,469
Net loss for the year		(458)	(4,254)	(22,686)
Net loss per share attributable to equity shareholders of the Company (in $)	21			
Basic and diluted loss per share		(0.1)	(0.7)	(7.7)

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

Consolidated statements of comprehensive income

	For the year ended December 31		
	2012	2011	2010
	Dollars thousands		
Net loss for the year	(458)	(4,254)	(22,686)
Other comprehensive income (loss):			
Realized income for hedging transaction of cash flows	-	-	(115)
Loss realized for investments in securities available for sale	-	12	-
Profit not yet realized for hedging cash flows transactions	55	-	-
Income (loss) not yet realized for investments in securities available for sale	30	(69)	(5)
Actuarial loss from defined benefit program	(262)	(372)	(451)
Total other comprehensive income (loss)	(177)	(429)	(571)
Total comprehensive loss relating to the Company's shareholders	(635)	(4,683)	(23,257)

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	Accumulated deficit	Treasury shares	Capital reserve for financial assets available for sale	Capital reserve for hedging transactions	Other capital reserves	Total equity
	Dollars thousands							
Balance as at January 1, 2012	19,818	107,198	(88,429)	(7,408)	(148)	-	190	31,221
Total comprehensive loss	-	-	(720)	-	30	55	-	(635)
Share-based payment for employees and directors	-	123	-	-	-	-	-	123
Share-based payment for consultant	-	-	-	-	-	-	190	190
Balance as at December 31, 2012	19,818	107,321	(89,149)	(7,408)	(118)	55	380	30,899

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	Share capital	Additional paid-in capital	Accumulated deficit	Treasury shares	Capital reserve for financial assets available for sale	Capital reserve for hedging transactions	Capital reserve for transactions with a controlling shareholder	Total equity
	Dollars thousands							
Balance as at January 1, 2011	19.818	107,204	(83,803)	(7,408)	(91)	-	190	35,910
Total comprehensive loss	-	-	(4,626)	-	(57)	-	-	(4,683)
Share-based payment for employees and directors	-	204	-	-	-	-	-	204
Classification of options for banks for liabilities	-	(210)	-	-	-	-	-	(210
Balance as at December 31, 2011	19,818	107,198	(88,429)	(7,408)	(148)	-	190	31,221

Consolidated statements of changes in shareholders' equity

	Relating to the Company's shareholders							
	Share capital	Additional paid-in capital	Accumulated deficit	Treasury shares	Capital reserve for financial assets available for sale	Capital reserve for hedging transactions	Capital reserve for transactions with a controlling shareholder	Total equity
	Dollars thousands							
Balance as at January 1, 2010	7,518	107,522	(60,666)	(7,408)	(86)	115	-	46,995
Total comprehensive loss	-	-	(23,137)	-	(5)	(115)	-	(23,357)
Cost of share-based payment	-	490	-	-	-	-	-	490
Issue of rights (less issue expenses of 240 thousand dollars)	2,833	927	-	-	-	-	-	3,760
Private placement (less issue expenses of 297 thousand dollars)	9,467	(1,735)	-	-	-	-	-	7,732
Capital benefit from a transaction with a controlling shareholder	-	-	-	-	-	-	190	190
Balance as at December 31, 2010	19,818	107,204	(83,803)	(7,408)	(91)	-	190	35,910

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

Consolidated statements of cash flows

	For the year ended December 31		
	2012	**2011**	**2010**
	Dollars thousands		
Cash flows from operating activities			
Loss	(458)	(4,254)	(22,686)
Reconciliations required to present cash flows from operating activities:			
Adjustments to the statement of income items:			
Depreciation of fixed assets and intangible assets	4,999	6,105	9,503
Increase (decrease) in provision for impairment of fixed assets, non current assets held for sale and intangible assets	33	(433)	6,260
Inventory write-off	864	607	3,065
Loss from impairment of securities available for sale	-	80	-
Cost of share based payments	197	204	280
Capital loss from disposal of fixed assets	2	29	142
Change in deferred taxes, net	(992)	(392)	(2,643)
Change in liabilities for benefits to employees, net	(270)	(238)	(664)
Change in the fair value of liabilities for bank options	64	(366)	-
Taxes on income	112	173	(20)
Financing expenses, net	1,334	1,457	1,452
	6,343	7,226	17,375
Changes in assets and liabilities items:			
Increase (decrease) in trade receivables	(4,665)	(4,352)	5,258
Increase (decrease) in other receivables	(610)	(324)	924
Increase (decrease) in inventory	2,892	(2,723)	1,950
Increase (decrease) in trade payables	196	1,120	(3,178)
Decrease in other payables	(117)	(3,844)	(631)
	(2,304)	(10,123)	4,323
Cash paid and received during the year for:			
Interest paid	(1,201)	(1,324)	(1,482)
Interest received	18	25	30
Taxes paid	(112)	(173)	(171)
Taxes received	-	-	191
	(1,295)	(1,472)	(1,432)
Net cash provided from (used in) operating activities	2,286	(8,623)	(2,420)

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

Consolidated statements of cash flows

	For the year ended December 31		
	2012	2011	2010
	Dollars thousands		
Cash flows from investing activities			
Acquisition of fixed assets	(454)	(353)	(111)
Acquisition of intangible assets	(100)	(125)	(2)
Proceeds from disposal of fixed assets	21	237	367
Proceeds from disposal of tradable securities	-	260	-
Net cash provided by (used for) investing activities	(533)	19	254
Cash flows from financing activities			
Short-term bank credit, net	2,491	(1,616)	(8,052)
Repayment of long-term loans	(1,264)	(335)	(11,601)
Receipt of long-term loans	-	3,800	20,000
Proceeds from a private placement, net	-	-	5,516
Proceeds from an issue of rights, net	-	-	3,760
Net cash provided by financing activities	1,227	1,849	9,623
Increase (decrease) in cash and cash equivalents	2,980	(6,755)	7,457
Balance of cash and cash equivalents at beginning of year	2,606	9,361	1,904
Balance of cash and cash equivalents at end of year	5,586	2,606	9,361

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

	For the year ended December 31		
	2012	2011	2010
	Dollars thousands		
(A) Significant transactions not in cash			
Acquisition of operations (See Note 3)			
Assets from operations on the acquisition date:			
Inventory	-	-	1,896
Customer base	-	-	1,551
Order backlog	-	-	408
NB Brand license	-	-	78
Goodwill	-	-	49
	-	-	3,982
Acquisition of assets through an exchange (See Note 7f)	1,777	228	-
Disposal of assets through an exchange (See Note 7f)	2,005	-	-

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

Note 1 – General

a. Tefron Ltd. (hereinafter - "the Company") is a company registered in Israel. The Company's production operations are carried out in plants located in Israel, Jordan, and the Far East. The Company focuses on the development, production, marketing and sale of intimate apparel, activewear and swimwear and beachwear which are sold throughout the world to companies with leading brands such as T.J. Maxx, Adidas, JCP, Calvin Klein, Victoria's Secret and other brands known in the US and Europe. The Company's products include activewear, bras, undershirts, underwear, shirts, bodysuits, shape wear, sleepwear, socks, legwarmers, swimwear and beachwear. The Company's operations are divided into two fields of operation: the Seamless field and the Cut & Sew field.

The Company shares are traded on the Tel Aviv Stock Exchange. For additional details, also see Note 18.

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 (as defined in IAS 27 (2008)) and their statements are consolidated with those of the Company.
Related Parties	-	As defined in IAS 24.
Interested party and controlling shareholder	-	As defined in the Securities Regulations (Annual Financial Statements) – 2010.

c. During the years ended December 31, 2012 and 2011, the Company recorded losses of 458 thousand dollars and 4,254 thousand dollars respectively.

The management's plans to advance the Company's business situation include, amongst else: expanding its customer base, developing new products, making the production floor and headquarters more efficient, expanding operations with factors of production in the Far East and developing the brand. In 2012 the Company expanded its distribution channels, for the first time, to the field of direct distribution of the X-Technology Swiss Research & Development GmbH brands (hereinafter - "XTS"), in the activewear field. In the framework of the business cooperation with XTS the Company would market and distribute exclusively in the USA area, the apparel in the field of activewear and socks for which XTS is the right-holder and they will be distributed across America during the manufacturing period. For additional, details also see Note 17b(1).
Furthermore, the Company has started negotiations with a private company incorporated in China for the purpose of establishing a long-term joint venture between the parties, the main purpose of which is the manufacturing of clothing in Seamless technology.

Note 1 – General (cont.)

These activities support the Company's efforts to restore its position as a world leader of seamless technology.

The Company's management estimates, as of the date of signing the financial statements, that the chance of the Company meeting the financial covenants in the coming year , as was determined in the restructuring of the financial credit agreement with the lending banks on March 2, 2010, and were amended occasionally, as detailed in Note 12b as follows, is reasonable; although, there is no certainty that it will meet the financial covenants in the coming year, as meeting them is subjected to events occurring in the future.

Note 2 – Significant accounting principles

a. Basis of presentation of the financial statements

The Company's financial statements are prepared on the basis of cost, excluding derivatives and financial assets available for sale which are measured according to their fair value and excluding liabilities for employee benefits. The Company chose to present the statement of income by a method which characterizes its operations.

Format of preparation of the financial statements

These financial statements are prepared in accordance with international financial reporting standards (hereinafter – IFRS Standards). These standards include:

1. International Financial Reporting Standards (IFRS).
2. International Accounting Standards (IAS).
3. Clarifications to International Financial Reporting Standards (IFRIC) and to International Accounting Standards (SIC)

In addition, the financial statements are prepared in accordance with provisions of the Securities Regulations (Annual Financial Statements) – 2010.

Consistent accounting policy

The accounting policy detailed below has been applied in the financial statements consistently, during all the periods presented, unless noted otherwise.

b. The key considerations, estimates and assumptions in the preparation of the financial statements

At the time of preparation of the financial statements the Company's management is required to use its discretion and to be assisted by estimates, evaluations and assumptions which affect implementation of the accounting policy and the amounts reported on assets, liabilities, revenues and expenses. The estimates and assumptions on which they are based are reviewed regularly. Changes in accounting estimates are recorded during the period in which the change in estimate is made.

Note 2 – Significant accounting principles (cont.)

b. The key considerations, estimates and assumptions in the preparation of the financial statements (cont.)

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 are likely to change the value of the assets and liabilities in the financial statements in the next 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 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.

- Deferred tax assets

  Deferred tax assets are recognized for carry forward tax losses and temporary differences not yet utilized to the extent that it is probable that taxable income will be available against which the losses can be utilized. 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 and with tax planning strategies. For further information, see Note 16.

- Slow-moving inventory

  The Company periodically reviews the state and age of inventories and records a provision for slow-moving inventories accordingly. In assessing whether the inventory is obsolete or slow moving, the Company relies on technical data and on assumptions with regard to anticipated order backlog - see Note 6.

- Provision for impairment of fixed assets

  A provision for impairment of fixed assets is recorded if the recoverable amount is less than the asset's carrying amount, should this amount be lower than its cost in the Company's financial statements. The recoverable amount is the higher between its net realizable value less selling costs and the net value of use based on discounted cash flows. A provision for impairment of fixed assets is determined for every cash-generating unit separately. In order to determine the recoverable amount of its fixed assets, the Company has engaged a qualified independent valuator that has based his evaluation on predictions and assessments.

- Evaluating the fair value of share-based payment transactions

  The fair value of share-based payment transactions is determined using the options costing model. The model's assumptions include the price of the share, its realization

Note 2 – Significant accounting principles (cont.)

b. The key considerations, estimates and assumptions in the preparation of the financial statements (cont.)

price, expected fluctuations, expected lifespan, expected dividends, and the zero risk rate of interest.

c. Consolidated financial statements:

The consolidated financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) and also include the disclosure directives of the Securities Regulations (Annual Financial Statements) – 2010 (hereinafter – the Securities Regulations).
The consolidated financial statements include the statements of companies controlled by the Company (wholly-owned subsidiaries). Control exists when the Company has the power, directly or indirectly, to direct the financial and operating policies of the controlled company. The consolidation of the financial statements commences as of the date on which control is obtained and ends when such control ceases.

All significant intra-group balances, gains and losses resulting from intra-group transactions were eliminated in full in the consolidated financial statements.

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 those implemented in the Company's financial statements.

d. Functional and foreign currency

1. Functional and presentation currencies

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 are then measured its financial position and operating results. The functional currency of the Company is the US dollar.

2. Transactions, assets and liabilities in foreign currency

Transactions denominated in a foreign currency (a currency other than the functional 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 are recognized in the statement of income. Non-monetary assets and liabilities denominated in foreign currency are presented at fair value and retranslated to the functional currency, in accordance with the rates of exchange on the date on which the fair value is determined.

Note 2 – Significant accounting principles (cont.)

e. Allowance for doubtful accounts

The allowance for doubtful accounts is determined in respect of specific trade receivables whose collection, in the opinion of the Company's management, is doubtful. Impaired trade receivables are withdrawn when 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 raw materials, additional materials, packaging and costs of its manufacturing. 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 make the sale.

The cost of inventories is determined as follows:

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

The Company periodically evaluates the condition and age of inventory and records a provision for slow-moving inventory accordingly.

g. Financial instruments

Financial assets:

Financial assets within the scope of IAS 39 are initially recognized at fair value plus directly attributable transaction costs.

The fair value of financial instruments that are actively traded in organized financial markets is determined by reference to market prices on the balance sheet date. For investments where there is no active market, fair value is determined using valuation methods. Such methods include using recent arm’s length market transactions, reference to the current market value of another instrument which is substantially the same, discounted cash flows or other valuation methods. The valuator has taken into consideration the interest and credit risk components.

After initial recognition, the accounting treatment of investments in financial assets is based on their classification to one of the following four groups:

- Financial assets at fair value through the statement of income.
- Investments held to maturity.
- Loans and receivables.
- Financial assets available for sale.

Note 2 – Significant accounting principles (cont.)

g. Financial instruments (cont.)

The Company has chosen to classify its financial assets as follows:

1. Financial assets available for sale

The Group has financial assets available for sale which are financial assets (non-derivative) that are designated as available for sale. After initial recognition, available for sale financial assets are measured at fair value. Gains or losses from fair value adjustments, except exchange differences that relate to monetary debt instruments that are carried to the statement of income in the financing item, are recognized directly to shareholders' equity to capital reserve as unrealized gains. When the investment is disposed of or in case of impairment, the accumulated gain or loss that used to be recognized to shareholders' equity, is recognized to the statement of income. Interest revenues on investments in debt instruments are recognized in the statement of income using the effective interest method.

2. Loans and receivables

The Group has loans and receivables which are financial assets (which are not derivatives) with fixed payments or payments which can be determined and which are not traded in an active market. After initial recognition, the loans are presented at amortized cost. Short-term credit (such as credit to customers and other receivables) is presented according to its terms, generally at its nominal value. Profits and losses are recognized in the statement of income when the loans and receivables are withdrawn or if any impairment is recognized for them, as well as the result of methodical amortization

Financial liabilities

Financial liabilities measured at amortized cost:

Interest-bearing loans and credit are initially recognized at fair value less directly attributable transaction costs. After initial recognition, interest bearing loans and credit are measured at amortized cost using the effective interest method which also takes into account the relative direct transaction costs. Gains and losses are recognized to the statement of income when the loan is withdrawn as a result of methodical amortization.

Financial liabilities measured at fair value through the statement of income

Financial liabilities measured at fair value through the statement of income include options which can be measured 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.

Treasury shares

Company shares held by the Company's subsidiary are presented at cost and deducted from the Company's shareholders' equity. Gains or losses from the purchase, sale, issue or cancellation of treasury shares are carried directly to shareholders' equity.

Note 2 – Significant accounting principles (cont.)

g. Financial instruments (cont.)

Withdrawal of financial assets

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

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

When the Company transferred its rights to receive cash flows from an asset and did not transfer or did not really 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 continues by way of a guarantee for the asset transferred and is measured at the lower of the balance in the financial statements of the assets, and the maximum amount of the consideration that the Company is likely to be required to pay in return.

A financial liability is withdrawn when it is settled, hence, when the obligation 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.

Where an existing financial liability is replaced by another liability from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is accounted for as a withdrawal of the original liability and as a recognition of a new liability. The difference between the carrying amounts of the above liabilities is recognized in the statement of income. If the exchange or modification is immaterial, it is accounted for as a change in the terms of the original liability and no gain or loss is recognized from the exchange.

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 is impaired:

Financial assets available for sale

For debt instruments classified as financial assets available for sale, objective evidence of impairment may arise as a result of one or more events that have a negative impact on the estimated future cash flows of the asset since the recognition of the asset. Evidence of impairment may include indications that the debtor is experiencing financial difficulties, including liquidity difficulty and default in interest or principal payments. When there is evidence of impairment, the cumulative loss carried to equity which is measured as the difference between the acquisition cost (less amortization using the effective interest method

Note 2 – Significant accounting principles (cont.)

g. Financial instruments (cont.)

and previous impairment losses) and the fair value, is removed from equity and 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 credited to the statement of income up to the amount of the loss recognized.

Derivative Financial Instruments for Hedging Purposes (Hedging)

The Group often carries out engagements in derivative financial instruments such as forward contracts, for foreign currency 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 initial recognition, the financial derivatives are measured at fair value. The derivatives are recognized in the Statement of Financial Position as assets whose 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.

For accounting reporting purposes, hedging transactions are classified as follows:

Hedging fair value – against an exposure of changes in the fair value of an asset or liability recognized, or in a firm commitment which has not yet been recognized (excluding the event of a risk of the rate of exchange of foreign currency); or

Hedging cash flows – against exposure to changes in the cash flows which cannot be related to a certain risk in connection with an asset or liability recognized or due to a forecasted transaction or due to the risk of a rate of exchange of foreign currency for a firm commitment not yet recognized.

According to the amendment to IAS 39 (hereinafter – the Amendment) the Group may earmark part of the change in the fair value or fluctuations in the cash flows of a financial instrument as a hedged instrument

Hedging transactions that meet the criteria of hedging transactions are handled as follows:

Hedging fair value

A change in fair value of the derivative (the hedge item) is recognized in the statement of income. A change in the fair value of the hedged item is also recognized in the statement of income.

In the event of hedging of fair value relating to a hedged item presented at amortized cost, the adjustments to the balance in the financial statements are recognized in the statement of income over the remaining period until repayment. The 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.

Note 2 – Significant accounting principles (cont.)

g. Financial instruments (cont.)

Hedging cash flows

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

Other comprehensive profit (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 profit (loss) which is transferred from capital 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 capital in the past, are transferred to the statement of income. Once the hedging instrument expired or was sold, settled or realized, or when its object as a hedging instrument was cancelled, the amounts recognized in capital in the past, remain in capital until the date in which the forecasted transaction or the firm commitment occur.

h. Leasing:

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

The Group as a lessee:

The Group has lease agreements in which all risks and benefits inherent in the ownership of the leased asset are not actually transferred, and therefore they are classified as operative leasing. 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:

The Group has lease agreements in which all risks and benefits inherent in the ownership of the leased asset are not actually transferred and therefore they are classified as operating leases. Lease income is recognized as revenue in the statement of income on a straight-line basis over the lease period.

i. Business combinations and goodwill

Business combinations are handled through implementing the acquisition method. In this method, assets and liabilities of the acquired company are identified at their fair value on the acquisition date. The cost of acquisition is the aggregate fair value on the acquisition date of the assets given, the liabilities taken on and the capital rights issued by the acquirer. The direct costs connected with the acquisition are immediately recorded as an expense in the statement of income, excluding costs of raising funds handled in accordance with IAS 32.

Notes to the consolidated financial statements

Note 2 – Significant accounting principles (cont.)

i. Business combinations and goodwill (cont.)

Goodwill is first measured at cost, which is surplus consideration of the acquisition and the non-controlling rights (if such exist) over the net amount of the assets acquired which can be identified, and the liabilities taken on as measured on the acquisition date.

After initial recognition, goodwill is measured at cost less the accumulated loss from the impairment, should there be any. Goodwill is not amortized methodically.

j. Fixed assets

Items of fixed assets are measured 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.

Deprecation is calculated at equal annual rates based on the straight line method over the useful life of the asset, as follows:

	%
Buildings	2
Machinery and equipment	7
Motor vehicles	15
Office furniture and equipment (mainly 6%)	6-25
Leasehold improvements	see below

Leasehold improvements are depreciated using the straight line method over the lease period (including any optional extension term available to the Company which it intends to exercise), or over the expected useful life of the assets, whichever is shorter.

The useful life, depreciation method and residual value of an asset are reviewed at least each year end 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 l 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.

An asset is withdrawn on disposal or when no further economic benefits are expected from its use. The gain or loss arising from the withdrawal of the asset (determined as the difference between the net disposal proceeds, if any, and the amortized cost) is included in the statement of income when the asset is withdrawn. See Note 7.

k. 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.

Note 2 – Significant accounting principles (cont.)

k. Intangible assets (cont.)

The useful lifespan of intangible assets is as follows:

	Years
Computer software	4
Customer relations	8
Brand license	2.75
Order backlog	Period of orders' delivery

Software:

The Group's assets include computer systems comprising hardware and software. 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 that adds additional functionality to the hardware is classified as an intangible asset.

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

l. Impairment of non-financial assets

The Company examines the need to record an impairment of the carrying amount of non-financial assets (except for deferred taxes assets, see Clause n) whenever events or changes in circumstances indicate that the carrying amount is not recoverable. If the carrying amount of non-financial assets exceeds its recoverable amount, the assets are reduced to their recoverable amount. The recoverable amount is the higher of the selling price, net, and the value of its use. 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 impairment loss was recognized. Reversal of an impairment loss will be 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 is recognized in the statement of income in the same section in which the impairment was written. See Note 7.

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

Goodwill (for subsidiaries):

In order to examine impairment, goodwill acquired in a business combination is allocated, on the acquisition date, to each of the Group's cash generating units that is expected to benefit from the synergy of the combination.

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

Note 2 – Significant accounting principles (cont.)

l. Impairment of non-financial assets (cont.)

Impairment is recognized for goodwill by comparing the recoverable amount of the cash-generating unit (or a group of cash-generating units) to which the goodwill was allocated. When the recoverable amount of the cash-generating unit (or a group of cash-generating units) is lower than the carrying amount of the cash-generating unit (or a group of cash-generating units), to which the goodwill was allocated, it is recognized as a loss from an impairment first relating to goodwill. Losses recognized for goodwill cannot be reversed in consecutive periods.

m. Government grants

Government grants from the Office of the Chief Scientist in Israel for supporting research and 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. Government grants relating to assets such as fixed assets have been recorded as a reduction in the carrying amount of the fixed asset.

n. 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, except for a limited number of exceptions. Deferred taxes related to items recorded directly to shareholders' equity are also recorded to the relative item in shareholders' equity.

Deferred tax balances are measured at the tax rate that is expected to apply to the period when these taxes are recorded to the statement of income or to equity, based on tax laws that have been enacted or substantively enacted by the balance sheet date.

The amount for deferred taxes in the statement of income represents the changes in these balances during the period of report, excluding changes attributable to items recorded directly to shareholders' equity.

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. Simultaneously, temporary differences (such as losses transferred for tax purposes) for which deferred tax assets have not been recognized are reassessed and deferred tax assets are recognized to the extent that their recoverability has become probable. Any resulting reduction or reversal is recognized in the taxes on income item.

When calculating deferred taxes, taxes that would apply 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

Note 2 – Significant accounting principles (cont.)

n. Taxes on income (cont.)

Deferred taxes (cont.):

probable that the sale of the investments in subsidiaries is not expected in the foreseeable future. Equally, deferred taxes that would apply in the event of distribution of earnings by investee companies as dividends have not been taken into account in computing the 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 that triggers 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 taxpayer and the same tax authority.

o. Share-based payment transactions

The Company's employees, directors and service providers are entitled to remuneration in the form of share-based payment transactions in exchange for equity instruments (hereinafter- “transactions settled with equity instruments").

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 granted on the granting date. Fair value is determined using an accepted pricing model, for additional details, see Note 19.

The cost of transactions to service providers is measured at the fair value on the date of granting, it is revalued at 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, during the period which the performance and service conditions exist, and end 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.

Cancellation of granting 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 granting is immediately recognized. Nevertheless, if the granting cancelled is replaced by a new granting which is intended as an alternative granting on the date on which it is granted, the cancelled granting and the new granting will both be handled as a change in the original granting as described above.

No expense is recognized for benefits that do not ultimately vest. Except for benefits where vesting is conditional on market conditions, which are treated as benefits which vested irrespective of whether the market conditions are met, provided that all other vesting conditions

Note 2 – Significant accounting principles (cont.)

o. Share-based payment transactions (cont.)

(service and/or performance) were satisfied.

When the Company modifies the conditions on which equity instruments were granted, the additional expense is recognized in addition to the original expense that was calculated. An additional expense is recognized for any modification that increases the total fair value of the share-based payment arrangement or is otherwise beneficial to the employee or director according to the fair value on the modification date.

p. Liabilities for benefits to employees

The Group has several employee benefit plans:

1. Short-term employee benefits:

Short-term employee 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.

2. Post-employment benefits

The Group has defined contribution plans pursuant to Section 14 of the Israeli Severance Pay Law under which the Group pays fixed contributions and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient amounts to pay all employee benefits relating to 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 simultaneously with receiving the employee's services and no additional provision is required in the financial statements.

The Group also operates 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 cost of providing benefits under this plan 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 on the estimated timing of payment. The amounts are presented based on discounted expected future cash flows using a discount rate on government bonds with maturity dates that are close to the liability period of the severance pay.

The Company makes current deposits in respect of its liabilities to pay severance pay to certain of its employees in pension funds and insurance companies (hereinafter- "the plan’s assets"). The plan’s assets comprise assets held in eligible insurance policies. The plan’s assets are not available to the Group's own creditors and cannot be returned directly to the Group.

Actuarial gains and losses are recorded as other comprehensive income (loss) in the period in which they occur.

The liability for employee benefits presented in the balance sheet represents the present value forecasted future payments required in order to settle the obligation resulting from the

Note 2 – Significant accounting principles (cont.)

p. Liabilities for benefits to employees (cont.)

2. Post-employment benefits (cont.)

employee's service during the current period and previous periods, less the fair value of the plan's assets.

q. Revenue recognition

Revenues are recognized in the statements of income when the amount of revenues can be reliably measured, it is probable that the economic benefits associated with the transaction will flow to the Company and the costs incurred or to be incurred can be reliably measured. Revenues are measured at the fair value of the consideration received excluding any credits or volume rebates.

The following specific recognition criteria must also be met before revenue is recognized:

Revenues from the sale of goods

Revenues from the sale of goods are recognized when all the significant risks and rewards of ownership of the goods have passed to the buyer and the seller no longer retains managerial involvement. The delivery date is usually the date on which ownership passes.

Discounts to customers

Current discounts to customers are included in the financial statements on their granting and recorded to the sales item.

Discounts to customers at the end of the year, for which the customer is not required to meet certain targets, are included in the financial statements on making the proportional sales which entitle the customer to these discounts.

Discounts to customers which the right to receive them, is conditional on the customer meeting certain targets, such as meeting a minimum annual level of purchases (quantity or financial), an increase in the level of purchases compared to previous periods and more, are included in the financial statements, proportionally according to the level of purchases that the customer made during the period of report which advance him to meeting the targets, and this only when it is expected the targets will be achieved and it is possible to reasonably estimate the discount. An estimate of meeting the target is based, *inter alia*, on past experience, on the relationships of the Company with the customers and on the forecasted level of purchases of the customers during the balance of the period.

r. Cost of sales and discounts from suppliers

The cost of sales includes expenses for loss, storage and transport of inventory until the final selling point. In addition, the cost of sales includes losses for impairment in value of inventory, a write-off of inventory and provisions for slow moving inventory.

Note 2 – Significant accounting principles (cont.)

r. Cost of sales and discounts from suppliers (cont.)

The discounts are deducted from the cost of purchases on the date where the terms entitling them to the discounts are made. Part of the discounts for that part of the purchases which is added to the closing inventory, is related to the inventory and the remaining part reduces the costs to sales.

s. Financing revenues and expenses

Financing revenues include interest revenues for amounts invested (including financial assets available for sale), changes in the fair value of financial assets measured at fair value through the statement of income, profits from rate differences and profits from hedging instruments recognized in the statement of income. Interest revenues are recognized on their accrual by the effective interest method.

Financing expenses include interest expenses on loans received, changes in the fair value of financing instruments measured at fair value through the statement of income, losses from an impairment in value of financial assets and losses from hedging instruments recognized in the statement of income, profits from the sale of financial assets classified as available for sale.

t. Operating segments

According to IFRS 8, the Company adopted the "management approach" in reporting on the financial performance of the operating segments.

An operating segment is defined as a component of an entity when:

1. It is engaged in business activities from which are likely to generate revenues and expenses are likely to accrue (including revenues and expenses relating to transactions with other components of that entity);
2. Whose operating results are regularly reviewed by the Group's Chief Operating Decision Maker of the entity (CODM – CEO of the Company), in order to make decisions about resources to be allocated to a segment and in order to assess its performance; and
3. Separate financial information is available.

The decision on the allocation of resources and the financial reporting that the CODM receives are on the basis of the two operating segments of the Company: Seamless and Cut & Sew, as detailed in Note 22 as follows. Furthermore, the Company did not identity other operating segments.

u. Earnings (loss) per share

Earnings (loss) per share are calculated by dividing the net income (loss) attributable to equity holders of the Company by the weighted average number of ordinary shares outstanding during the period. Potential ordinary shares (employee options) are included in the computation of diluted earnings (loss) per share only when their conversion decreases earnings per share or increases loss per share. Furthermore, potential ordinary shares that are converted during the period are included in diluted earnings (loss) per share only until the conversion date and from that date in basic earnings (loss) per share.

Note 2 – Significant accounting principles (cont.)

v. Provisions

A provision in accordance with IAS 37 is recognized when the Group has a present legal obligation or an implied obligation 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. If the effect is material, the provisions are measured according to the estimated future cash flows discounted using a pre-tax interest rate that reflects the market assessments of the time value of money and, where appropriate, those risks specific to the liability as well.

w. Non-current assets held for sale

A non-current asset or a group of assets are classified as held for sale when their return will be carried out mainly through a sale transaction and not through continuing use. This exists when the asset is immediately available for sale in its present condition, the Company then has an obligation to sell, there is a plan to locate a buyer and it is highly probable that it will be completed within a year from the date of the classification (these conditions must exist correctly as of the balance sheet date). These assets are not depreciated from the date of their first classification as such and are presented as separate current assets in the consolidated balance sheet, at the lower of their carrying value and fair value less selling expenses. When the balance in the financial statements is higher than the fair value less selling cost, the loss from the impairment relating to the asset (or the group of assets) is recognized up to the amount of the difference. Concurrently, the liabilities relating to these items are presented separately in the consolidated balance sheet in a similar way.

x. Disclosure to new IFRS during the period prior to their implementation

IAS 1 – Presentation of financial statements

In June 2011 the IASB published an amendment to IAS1 (hereinafter – the Amendment).

The amendment deals with the subject of the presentation of other comprehensive income.
According to the amendment, items which can be transferred to the Statement of Income at a later stage (e.g. at the time of withdrawal or settlement) will be presented separately from the items which will never be transferred to the Statement of Income.

The amendment will be implemented retrospectively as from the financial statements for annual periods starting January 1, 2013 or thereafter. Earlier adoption is possible.

In the Company's opinion, the amendment is not expected to have a significant effect on the financial statements.

IAS 19 (Amended) employee benefits

In June, 2011, the IASB published the IAS 19 (amended) (hereinafter – the Amendment).

The amendment will be implemented retrospectively as from the financial statements for annual periods starting January 1, 2013 or thereafter.

In the Company's opinion, the amendment is not expected to have a significant effect on the financial statements.

Note 2 – Significant accounting principles (cont.)

x. Disclosure to new IFRS during the period prior to their implementation (cont.)

IAS 32 - Financial instruments: Presentation and IFRS 7 Financial instruments: Disclosure

The IASB published amendments to IAS 32 (hereinafter – the Amendments to IAS 32) on the subject of setting off financial assets and financial liabilities.

The IASB also published amendments to IFRS 7 (hereinafter – the amendments to IFRS 7) on the subject of setting off financial assets and financial liabilities.

The amendments to IAS 32 will be implemented retrospectively as from the financial statements for annual periods starting January 1, 2014 or thereafter. Early adoption is possible. The amendments to IFRS 7 will be implemented retrospectively as from the financial statements for periods starting January 1, 2013 or thereafter.

In the opinion of the Company, the amendments to IAS 32 are not expected to have a significant effect on the financial statements. The disclosures required according to amendments IFRS 7 will be included in the Company's financial statements.

IFRS 9 – Financial instruments

1. In November 2009, the first stage of phase 1 of IFRS 9 was published - Financial Instruments, as part of the project to replace 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.

2. In October 2010, amendments were published to IFRS 9 on the subject of withdrawals and the subject of financial liabilities. According to the amendments, the Company must continue to implement the provisions of IAS 39 regarding a withdrawal and regarding financial liabilities for which the fair value alternative was not chosen (the designation of fair value through the statement of income). Hence, the provisions of classification and measurement of IAS 39 will continue to apply to financial liabilities held for trading and financial liabilities measured at reduced cost.

   The date of the start of the amendment is January 1, 2015. Early adoption is possible, on condition that the Company also adopts the provisions of the Standard relating to classification and measurement of financial assets (the assets stage). First adoption of the amendments will be done retrospectively while providing the required disclosure or restating the comparative figures, subject to certain exemptions in the amendment.

   In the Company's opinion, the amendments are not expected to have a significant effect on the financial statements.

IFRS 10, IFRS 11, IFRS 12, IFRS 13 – Consolidated financial statements, joint arrangements, disclosure regarding rights in other entities, measurement of fair value

The IAS published four new standards: IFRS 10 – consolidated financial statements, IFRS 11 – Joint arrangements, IFRS 12 – Disclosure regarding rights in other entities (hereinafter – the

Note 2 – Significant accounting principles (cont.)

x. Disclosure to new IFRS during the period prior to their implementation (cont.)

New Standards) and IFRS 13 – Measurement of fair value, and amended two existing standards – IAS 27R (Amendment 2011) Separate financial statements and IAS 28R (2011) – Investments in affiliated companies and joint ventures.

The New Standards will be implemented retrospectively as from the financial statements for annual periods starting January 1, 2013 or thereafter. Early adoption is possible but if the Company chooses to implement it, it must adopt the new standards in totality (excluding the requirements of disclosure, in accordance with IFRS 12 which can be adopted separately). The amendments include transitory provisions with certain relief at the time of their first implementation.

The following are the main directives of these standards and their expected effects on the Company:

IFRS 10 – Consolidated financial statements

IFRS 10 (hereinafter – Standard 10), replaces IAS 27 regarding the accounting treatment of consolidated financial statements and includes the accounting treatment in consolidating structured entities handled in the past by SIC 12 – consolidation – entities for special purposes.

Standard 10 will be implemented retrospectively as from the financial statements for annual periods commencing January 1, 2013 or thereafter.

In the Company's opinion, Standard 10 is not expected to have a significant effect on the financial statements.

IFRS 13 – Measurement of fair value

IFRS 13 (hereinafter Standard 13) sets forth directives regarding the measurement of fair value and required disclosures, as long as this measurement is required according to international standards.

The relative disclosures will be included in the Company's financial statements on the adoption of the new Standard.

Regarding the effect on the financial statements, in the Company's opinion, Standard 13 is not expected to have a significant effect on the financial statements.

Note 3 - Business combinations

Acquisition of Intimes Nouvelle Seamless Inc.

On December 30, 2010, a transaction was completed in the framework of which, *inter alia*, the Company acquired operations in the field of women's intimate apparel products of Intimes Nouvelle Seamless Inc. (hereinafter: "Nouvelle") which are manufactured using the seamless technology, and this against the private placement to Nouvelle of 600,000 ordinary shares of the Company at a value of 2,216 thousand dollars. Moreover, a total amount of 5,813 thousand dollars was invested by (i) Litef Holdings Inc.; (ii) Mivtach Shamir Holdings Ltd.; (iii) Zilkha Partners, L.P.; (iv) Fima Trust; and (v) Rimon Investment Master Fund L.P. (hereinafter jointly: "the Investors"), and all this against a private placement of 3,368,094 ordinary shares of the Company comprising, immediately after the allotment, 51.5% of the Company's issued capital and voting rights in it (44.4% fully diluted), and an allotment to Ben and Martin Lieberman of 450,000 option warrants

Note 3 - Business combinations (cont.)

Acquisition of Intimes Nouvelle Seamless Inc. (cont.)

which can be exercised up to 450,000 ordinary shares of the Company. For further details see Note 17b(3) below.

The fair value of the identified assets and identified liabilities of Nouvelle and the balance in the financial statements on the acquisition are as follows:

	Fair value on the day of acquisition
	Dollars thousands
Inventory	1,896
Customer relations	1,551
Order backlog	408
License to use the New Balance brand	78
Net assets	3,933
Goodwill created by the acquisition	49
Total	3,982

Regarding the period of amortization of the intangible assets see Note 8a below.

Note 4 - Trade receivables, net

	As of December 31,	
	2012	2011
	Dollars thousands	
Open receivables (1)	18,134	13,415
Checks for collection	222	276
	18,356	13,691
(1) After deduction of provision for doubtful debts	114	469

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:

Note 4 - Trade receivables, net (cont.)

(a) Acquisition of Intimes Nouvelle Seamless Inc. (cont.)

	Dollars thousands
Balance as of January 1, 2011	1,061
Cancellation for doubtful debts collected	(167)
Cancellation of provision against the balance of a trade receivable	(425)
Balance as of December 31, 2011	469
Provision during the year	270
Cancellation of doubtful debts collected	(306)
Cancellation of provision against the balance of a trade receivable	(319)
Balance as of December 31, 2012	114

The following are the balances of customers, net according to the period of arrears in collection from the reporting date:

	Customers whose debts have not yet fallen due (not in arrears)	Past due trade receivables of					
		Under 30 days	30 – 60 days	60 – 90 days	90 – 120 days	Over 120 days	Total
	Dollars thousands						
December 31, 2012	17,102	729	288	44	160	33	18,356
December 31, 2011	12,191	1,151	242	73	16	18	13,691

Note 5 - Other receivables

	As of December 31, 2012	As of December 31, 2011
	Dollars thousands	
Prepaid expenses	541	298
Advances to suppliers	1,011	415
Institutions	967	708
Derivatives for forward transactions	221	-
Revenues receivable	41	417
Other receivables	205	364
	2,986	2,202

Note 6 - Inventories

	As of December 31,	
	2012	2011
	Dollars thousands	
Raw Materials	3,742	3,697
Work in process	6,150	6,148
Finished goods	5,132	8,935
	15,024	18,780

* An impairment in the value of inventory of 864 thousand dollars (2011 – 607 thousand dollars, 2010 – 3,065 thousand dollars) was recorded to the cost of sales.

Note 7 – Fixed assets

a. Composition and movement:

2012

	Land and buildings	Machinery and equipment (*)	Vehicles	Office furniture and equipment	Leasehold improve-ments	Total
	Dollars thousands					
Cost						
Balance as at January 1, 2012	3,857	88,647	221	3,896	10,903	107,524
Additions during the year	6	1,836	-	136	244	2,222
Withdrawals – realizations	-	(1,140)	-	(1,109)	-	(2,249)
Balance as at December 31, 2012	3,863	89,343	221	2,923	11,147	107,497
Accumulated depreciation						
Balance as at January 1, 2012	1,423	62,567	219	3,196	3,998	71,412
Addition during the year	70	3,950	1	190	953	5,164
Withdrawals – realizations	-	(1,117)	-	(1,109)	-	(2,226)
Balance as at December 31, 2012	1,493	65,409	220	2,277	4,951	74,350
Provision for impairment in value						
Balance as at January 1, 2012	490	3,692	-	242	(28)	4,396
Amortization during the year	(20)	(695)	-	(118)	28	(805)
Balance as at December 31, 2012	470	2,997	-	124	-	3,591
Balance of depreciated cost as at December 31, 2012	1,900	20,937	1	522	6,196	29,556

(*) The balance is recorded after the deduction of the investment grants on the sum of 24,959 thousand dollars which their amortized cost as at December 31, 2012, is 4,154 thousand dollars.

Note 7 – Fixed assets (cont.)

a. Composition and movement (cont.):

2011

	Land and buildings	Machinery and equipment	Vehicles	Office furniture and equipment	Leasehold improve-ements	Total
	Dollars thousands					
Cost						
Balance as at January 1, 2011	3,855	133,398	422	5,464	11,346	154,485
Additions during the year	2	337	-	14	228	581
Withdrawals – realizations	-	(2,217)	(8)	-	-	(2,225)
Transfer to assets held for sale	-	(42,871)	(193)	(1,582)	(671)	(45,317)
Balance as at December 31, 2011	3,857	88,647	221	3,896	10,903	107,524
Accumulated depreciation						
Balance as at January 1, 2011	1,349	99,602	419	4,344	3,724	109,438
Addition during the year	74	4,748	1	215	945	5,983
Withdrawals – realizations	-	(1,906)	(8)	-	-	(1,914)
Transfer to assets held for sale	-	(39,868)	(193)	(1,363)	(671)	(42,095)
Balance as at December 31, 2011	1,423	62,576	219	3,196	3,998	71,412
Provision for impairment in value						
Balance as at January 1, 2011	500	5,106	-	301	204	6,111
Adjustment of provision according to the recoverable amount	-	(658)	-	-	(191)	(849)
Amortization during the year	(10)	(728)	-	(59)	(41)	(838)
Transfer to assets held for sale	-	(28)	-	-	-	(28)
Balance as at December 31, 2011	490	3,692	-	242	(28)	4,396
Balance of depreciated cost as at December 31, 2011	1,944	22,379	2	458	6,933	31,716

(*) The balance is recorded after the deduction of the investment grants on the sum of 24,959 thousand dollars which their amortized cost as at December 31, 2011, is 5,268 thousand dollars.

b. Impairment of fixed assets

The Company has four cash-generating units:

- Cut & Sew – including design, production and marketing of intimate apparel an activewear by the Cut & Sew method.
- Seamless – including design, production and marketing of intimate apparel and activewear by the Seamless method.

Note 7 – Fixed assets (cont.)

b. Impairment of fixed assets (cont.)

- Macro – including production in the Far East through sub-contractors. Swimwear is mostly sold to the USA and Europe.
- A building in the United States – the Company has cash flows from rent of offices in the United States. This building produces independent cash flows.

In 2010 the Company recorded a loss from a net impairment of 6,333 thousand dollars: for the Cut & Sew cash generating unit the Company recorded a loss from an impairment of 2,039 thousand dollars, for the Seamless cash generating unit the Company recorded a loss from an impairment of 4,104 thousand dollars and for the leased sewing machine cash generating unit the Company recorded a loss from an impairment of 190 thousand dollars.

In 2011 the Company did an additional revaluation, through an external evaluator. As a result of the revaluation the Company reduced the provision for the impairment recorded in 2010 for a total amount of 433 thousand dollars. This reduction in the provision is the net result of a reduction in the provision of 849 thousand dollars in the Seamless segment and an increase in the provision of 416 thousand dollars in the Cut & Sew segment.

In 2012 the Company had an indication of impairment in the Macro cash generating unit. The Company did not record a loss from the impairment since the recoverable amount of the cash generating unit was higher than the value of the fixed assets and other assets in the books. Regarding the other cash generating units, in 2012 the Company had no indication of any change in the fixed assets value and as a result did not do any additional revaluation and no provision or reversed provision was recorded for the impairment of the fixes assets. Provision for the impairment of non-current assets held for sale was recorded in 2012, as detailed in Note 7f below.

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 sewing machines operating lifespan in the Company. Regarding part of the sewing machines, the evaluator determined the remaining lifespan is at least 6-7 additional years as of June 30, 2012. The balance of the sewing machines' average lifespan prior to the evaluator's work was about 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 aforementioned is a decrease in quarterly depreciation expenses by approximately 120 thousand dollars.

d. Change in the estimated lifespan of the knitting machines

In June 2011 the Company engaged with an independent qualified evaluator who was required to determine the balance of the sewing machines operating lifespan in the Company. Regarding part of the sewing machines, the evaluator determined the remaining lifespan is at least 5 additional years as of June 29, 2011. Accordingly, the balance of the lifespan of these machines was amended to five years as of the third quarter of 2011. The effect of the change in estimation aforementioned is a decrease in quarterly depreciation expenses by approximately 90 thousand dollars.

Note 7 – Fixed assets (cont.)

e. Regarding liens see Note 17c.

f. Non-current assets held for sale

1) In November of 2010, the Company formulated a plan regarding the replacement of old Santoni knitting machines in new ones. As of December 31, 2011, these machines were recorded in the non-current assets held of sale item on the amount of 2,005 thousand dollars. During 2012 the old machines have been replaced with new ones, and so the transaction was completed

2) 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 decline in production in Israel was due to the transfer of production lines abroad and also due to the discontinuation of production of losing products. The Company took a decision to realize the production assets and started a process of locating a potential buyer. As a result the Company reclassified the machines used in these operations from the fixed assets item to assets held for sale. Since a long period of time has passed and the Company was successful in a partial realization of those assets, during the period of the report the Company reclassified the rest of the assets that were yet to be realized, to the non-current assets held for sale item. This was done based on an evaluation of an independent qualified evaluator who evaluated the value of the equipment at 2.75 million dollars, as at June 30, 2012, after deducing the sale costs. Consequently, during the year of 2012, the Company has recorded a loss of 33 thousand dollars from depreciation. As of December 31, 2012, the evaluator has given his opinion that was no material change in the fair value of those assets in regard to the evaluation that was done in June 2012, aforementioned.

Note 8 - Goodwill and intangible assets

a. Composition and movement:

2012

	Computer software	List of customers and brand license	Goodwill	Total
	Dollars thousands			
Cost				
Balance as at January 1, 2012	1,840	3,330	49	5,219
Additions – Acquired separately	99	-	-	99
Balance as at December 31, 2012	1,939	3,330	49	5,318
Accumulated amortization				
Balance as at January 1, 2012	1,536	1,708	-	3,271
Amortization recognized during the year	92	494	-	586
Balance as at December 31, 2012	1,655	2,202	-	3,857
Balance, net as at December 31, 2012	284	1,128	49	1,461

Note 8 - Goodwill and intangible assets (cont.)

a. Composition and movement (cont.):

2011

	Computer software	List of customers backlog and brand license	Goodwill	Total
	Dollars thousands			
Cost				
Balance as at January 1, 2011	1,715	3,330	49	5,094
Additions – Acquired separately	125	-	-	125
Balance as at December 31, 2011	1,840	3,330	49	5,219
Accumulated amortization				
Balance as at January 31, 2011	1,435	876	-	2,311
Amortization recognized during the year	128	832	-	960
Balance as at December 31, 2011	1,563	1,708	-	3,271
Total, net as at December 31, 2011	277	1,622	49	1,948

The list of customers, backlog and brand license for production and marketing were bought through business combinations. Customers' relationships are amortized over a period of 8 years, backlog was amortized fully in 2011 over the period of orders' delivery and brand marketing is amortized over a period of 2.75 years.

b. Amortization expenses

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

	For the year ended December 31		
	2012	2011	2010
	Dollars thousands		
Cost of sales	92	128	140
Selling and marketing expenses	494	832	222
	586	960	362

Note 9 - Credit from banks

a. Composition

	Weighted rate of interest December 31, 2012	December 31, 2012		
		In NIS	Unlinked	Total
	%	Dollars thousands		
Short-term credit from banks	Libor+2.5	471	6,598	7,069
Current maturities of long-term loans		-	2,435	2,435
		471	9,033	9,504

	Weighted rate of interest December 31, 2012	December 31, 2011		
		In NIS	Unlinked	Total
	%	Dollars thousands		
Short-term credit from banks	Libor+1.7	49	4,529	4,578
Current maturities of long-term loans		-	1,185	1,185
		49	5,714	5,763

b. Regarding collateral and liens, see Note 17c.

Note 10 - Trade payables

	December 31	
	2012	2011
	Dollars thousands	
Open accounts	9,741	11,467
Notes payable	2,746	1,745
	12,487	13,212

Note 11 - Other payables

	December 31	
	2012	2011
	Dollars thousands	
Liability to employees and other liabilities for wages and salaries	2,411	2,508
Accrued expenses	804	570
Institutions	1,101	1,289
Derivatives for forward transactions	-	128
Other payables	71	9
	4,387	4,504

Note 12 - Long-term loans from banks

a. Composition:

As at December 31, 2012

	Nominal rate of interest	Balance	Balance less current maturities
	%	Dollars thousands	
Loans from banks	Libor + 3.2-2.15	21,919	19,484
Loans from trade payables	Libor + 4.4%	935	716
		22,854	20,200

As at December 31, 2011

	Nominal rate of interest	Balance	Balance less current maturities (*)
	%	Dollars thousands	
Loans from banks	Libor + 3.2-2.15	23,032	19,042

(*) Including 2,805 thousand dollars loans repayable from the proceeds of assets held for sale.

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 had 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 following is a summary of the main provisions of the signed agreement:

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

1. Loan A

The principal of Loan A of a total of 15 million dollars will be 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 from the end of the seventh year, from 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 10th year after the date of providing Loan A.

2. Loan B

The principal of Loan B of a total amount of 5 million dollars will be provided by the banks for a period of six years. The interest will be paid quarterly and the principal

Note 12 - Long-term loans from banks (cont.)

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

will be paid in four equal annual installments of 1.25 million dollars each, as from the end of the third after the date of the provision of Loan B by the banks.

On December 24, 2010, the Company signed on a Letter of Amendment to the agreement with the banks that included providing additional credit for a long term and a short term in favor of the Company. The long term credit included a loan of 3.8 million dollars for a period of three years that will be paid in 36 equal installments as from a year from the date of signing the Letter of Amendment. The loan carries an annual interest that is paid by the Company in consequent monthly installments as from the date of the provision of the loan.

Financial covenants

The financial covenants determined in the original agreement were cancelled, and in their place the following financial covenants were determined as defined in the Letter of Amendment to the agreement with the banks as of December 24, 2010:

1. The rate of tangible shareholders' equity to 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 – then the amounts stated below:

   a) In 2010 – 28 million US dollars.
   b) In 2011 –29 million and five hundred thousand US dollars.
   c) In 2012 – 32 million US dollars.
   d) As from 2013 and thereafter – 35 million US dollars.

2. The trade receivables (less balances of trade receivables which have been Factored by the Company) of the Company will not be less at any time from the following amounts:

   a) In 2010 – 9 million US dollars.
   b) In 2011 –12 million and five hundred thousand US dollars.
   c) As from 2012 and thereafter – 14 million US dollars.

   A deviation of up to 5% of amounts stated in trade receivables balances for 2011 and thereafter will not be a violation of the Company's undertakings regarding the trade receivables balances, as mentioned above.

3. Up to December 31, 2012, the Company will be entitled to carry out factoring transactions (factoring transactions and/or sale of customers' notes in favor of third parties to provide financing), subject that the consideration from the transaction will be at least a rate of 80% of the amount of the note or the invoice, which will serve to finance working capital needs; and that the total amount for which factoring transactions will be carried out will not exceed at any time 5 million US dollars.

4. The total amount of the balances of the Company's cash, inventory and trade receivables will not be less at any time than 33 million US dollars excluding relating to the financial statements of the third quarter of every calendar year, where the total amount

Note 12 - Long-term loans from banks (cont.)

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

of the balance of the Company's cash, inventory and receivables will not be less than 29 million dollars.

5 . 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 annual consolidated statements:

a) In 2011 – will not exceed 9.5.
b) In 2012 – will not exceed 8.5.
c) In 2013 – will not exceed 7.5.
d) In 2014 – will not exceed 6.5.
e) As from 2015 and thereafter – will not exceed 5.5.

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

Receipt of a Letter of Waiver from the lending banks

On March 28, 2012 the Company received a letter of waiver from the three lending banks. In the framework of the letter of waiver the landing banks informed the Company that the agreed upon financial ratios in the financial statements of the Company for 2012, including each of the quarters of 2012, will be as follows:

(1) The tangible shareholders equity that is defined in the agreement with the banks will not be less than 27.5 million dollars instead of 32 million dollars as defined in the Letter of Amendment to the agreement with the banks as of December 24, 2010.

(2) The balance of the Company's trade receivables (less the trade receivables' balances for which the Company carried out factoring transactions) will not be less than 12 million dollars instead of 14 million dollars as defined in the Letter of Amendment to the agreement with the banks as of December 24, 2010. A deviation of up to 5% will not be a breach of this condition.

In August and November 2012 the Company received a Letter of Waiver from the three lending banks, regarding the financial convents that were determined in regard of the first three quarters of the year 2013, as detailed as follows.

(1) The tangible shareholders equity that is defined in the agreement with the banks will not be less than 27.5 million dollars instead of 35 million dollars as defined in the Letter of Amendment to the agreement with the banks as at December 24, 2010.

(2) The balance of the Company's trade receivables (less the trade receivables' balances for which the Company carried out factoring transactions) will not be less than 13 million dollars instead of 14 million dollars as defined in the Letter of Amendment to the agreement with the banks as at December 24, 2010.

Note 12 - Long-term loans from banks (cont.)

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

Receipt of a Letter of Waiver from the lending banks (cont.)

On March 7, 2013 and in continuation of the aforesaid, the Company received a Letter of Waiver from the lending banks, regarding the financial convents that are described as

follows, in regard of the fourth quarter of the year 2013, as detailed in Note 24a, as follows.

Correct as of December 31, 2012, the Company met all the financial covenants as stated in the Letter of Amendment to the agreement with the banks.

Note 13 - Financial instruments

a. 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,	
	2012	2011
	Dollars thousands	
Financial assets:		
Financial assets (liabilities) at fair value through the statement of income:		
Derivatives for forward transactions	221	(128)
Financial assets available-for-sale	323	334
Financial liabilities:		
Financial liabilities measured at amortized cost	29,923	27,610

b. Financial risks factors

The Group's activities expose it to various financial risks such as market risk (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 possible adverse effects on the Group's financial performance. The Group utilizes derivative financial instruments in order to hedge certain exposures to risks.

The Board discussed the principles of overall risk management activities as well as specific policies with respect to certain exposures to risks such as currency risk, interest rate risk, credit risk, liquidity risk and the use of derivative financial instruments and non-derivative financial instruments.

Note 13 - Financial instruments (cont.)

b. Financial risks factors (cont.)

1. Market risks:

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 Dollars). The finance department is responsible for managing the net position of each foreign currency by the use of forward exchange contracts, according to the Company's hedging policy.

Management's policy is to hedge forecasted payroll expenses denominated in NIS, payments to suppliers in NIS and Company’s sales in Euro. The hedging level is examined from time to time, according to market conditions.

2. Credit risk:

The Group has no significant concentrations of credit risk. The Group has a policy to ensure collection through sales of its products 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 their financial strength.

Terms of sale to customers

The Company makes provisions for doubtful debts based on factors which affect the credit risk of certain customers, past experience and other information.

The Group's revenues are mainly from customers in the USA and Europe. The Group follows trade receivables on a current basis, and the financial statements include provisions for doubtful debt which properly reflect, in the Group'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 on short-term and long-term loans from banks which bear adjustable interest rates (the long-term loans are linked to the Libor and Prime base interest rate).

4. Liquidity risk:

Liquidity risk is the risk that the Company will not be able to pay 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 risks and liquidity for the short, medium and long terms according to the Company's needs. The Company manages

Note 13 - Financial instruments (cont.)

b. Financial risks factors (cont.)

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 Company operates. The Company's policy is to spread its investments between various institutions.

Correct as of December 31, 2012 cash aggregated an amount of 5,586 thousand dollars.

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

As of December 31, 2012

	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	9,504	2,435	1,400	1,250	1,251	13,148	28,988
Trade payables	12,487	229	239	248	-	-	13,203
Other payables	4,387	-	-	-	-	-	4,387
	26,378	2,664	1,639	1,498	1,251	13,148	46,578

As of December 31, 2011

	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	5,763	2,435	2,435	1,400	1,250	14,327	27,610
Trade payables	13,212	-	-	-	-	-	13,212
Other payable	4,504	-	-	-	-	-	4,504
	23,479	2,435	2,435	1,400	1,250	14,327	45,326

c. Fair Value

The carrying amount of cash, trade receivables, other receivables, banks' credit and long term loans, trade payables and other payables approximate their fair value.

d. 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 fair value:

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.

Note 13 - Financial instruments (cont.)

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

Level 3 - Data that are not based on observable market data (valuation techniques which use inputs that are not based on observable market data).

December 31, 2012

	Level 1	Level 2	Level 3
	Dollars thousands		
Investment in securities available for sale	-	-	323
Liabilities for bank options	-	(318)	-
Derivatives for forward transactions	-	221	-
Total	-	(97)	323

December 31, 2011

	Level 1	Level 2	Level 3
	Dollars thousands		
Investment in securities available for sale	-	-	334
Liabilities for bank options	-	(254)	-
Derivatives for forward transactions	-	(128)	-
Total	-	(382)	334

e. Derivatives and cash flow hedging

The Group in Israel is exposed mainly to foreign currency risks.
For December 31, 2011 and 2012, the Group held forward contracts in foreign currency that were designated as a hedging for foreseen expenses in NIS for wages payments and suppliers payments. The Company also held forward contracts in Euros that were designated as a hedging for foreseen future sales for customers in Europe for which the Company has high probable foreseen transactions. The forward contracts in foreign currency are used for hedging the risk of the currency of firm liabilities.

	December 31	
	2012	2011
	Asset (liability	Asset (liability)
	Dollars thousand	
Fair value of forward contracts in foreign currency	221	(128)

Note 13 - Financial instruments (cont.)

f. Sensitivity analyses relating to changes in market factors

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

	Sensitivity analyses to changes in interest rates	
	Gain (loss) from change	
	10% increase in interest	10% decrease in interest
	Dollars thousands	
2012	(54)	54
2011	(49)	49

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

	Gain (loss) from change	
	10% increase in exchange rate	10% decrease in exchange rate
	Dollars thousands	
2012	720	(720)
2011	682	(682)

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

	Gain (loss) from change	
	10% increase in exchange rate	10% decrease in exchange rate
	Dollars thousands	
2012 – in respect of forward transactions and options	(300)	300
2011 – in respect of forward transactions and options	(300)	300

Note 13 - Financial instruments (cont.)

f. Sensitivity analyses relating to changes in market factors (cont,)

Sensitivity tests and principal work assumptions:

The selected changes in the relevant risk variables were determined based on the management's estimates as to reasonable 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 position. 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 of 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 14 - Liability for options to banks

The Company allotted to the lending banks 100,000 and 200,000 cash-less option warrants in March 2010 and December 2010, respectively, which can be exercised to 300,000 shares as part of the agreement for the reorganization of the Company's credit lines as detailed in Note 12c aforementioned. The value of the benefits inherent in granting these options aggregated 620 thousand dollars and was recorded as a liability for options to banks, against discounting long-term loans. This liability is measured periodically, according to the option evaluation model. In 2012, the Company recorded financing expenses of 64 thousand dollars as a result of the revaluation of the liability for the banks' options.

Note 15 - Assets and liabilities for employee benefits

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

a. 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 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 employment terms 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.

b. Defined contribution plans

Section 14 of the Severance Pay Law, 1963, in Israel 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

Note 15 - Assets and liabilities for employee benefits (cont.)

b. Defined contribution plans (cont.)

employees for whom such contributions were made as follows. These contributions and contributions for compensation represent defined contribution plans.

	For the year ended December 31		
	2012	2011	2011
	Dollars thousands		
Expenses in respect of defined contribution plans	695	789	929

c. 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 above, 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.

1. Expenses charged to the statements of income:

	For the year ended December 31		
	2012	2011	2010
	Dollars thousands		
Current servicing cost	80	118	144
Interest cost on benefit liabilities	47	52	55
Expected return on plan assets	(17)	(24)	(22)
Others	(3)	(15)	149
Total expenses in respect of employee benefits	107	131	326
Actual return on plan assets	25	21	8
Expenses presented in the statements of income are as follows:			
Cost of sales	87	87	277
Selling and marketing expenses	8	28	27
General and administrative expenses	12	16	22
	107	131	326

Note 15 - Assets and liabilities for employee benefits (cont.)

c. Defined benefit plans (cont.)

2. The Plan's assets (liabilities), net

	As of December 31, 2012	As of December 31, 2011
	Dollars thousands	
Defined benefit obligation	(1,208)	(1,243)
Fair value of plan's assets	612	639
Total liabilities, net	(596)	(604)

3. Changes in present value of defined benefit obligation

	2012	2011
	Dollars thousands	
Balance as of January 1	1,243	1,261
Interest expenses	47	52
Current servicing cost	80	118
Past servicing cost	-	22
Updating demographic data	(6)	10
Benefits paid	(444)	(470)
Net actuarial loss (gain)	262	374
Exchange rate differences	26	(124)
Balance as of December 31	1,208	1,243

4. Plan assets

a) Plan's assets

The plan's assets include assets held by a long-term employee benefit fund and by appropriate insurance policies.

Note 15 - Assets and liabilities for employee benefits (cont.)

c. Defined benefit plans (cont.)

b) Movement in fair value of plan assets

	As of December 31	
	2012	2011
	Dollars thousands	
Balance as of January 1	639	745
Expected return	17	24
Employer's deposits for the plan	49	65
Benefits paid	(114)	(155)
Net actuarial (loss)	8	(2)
Update of plan's assets	-	11
Exchange rate differences	13	(49)
Balance as of December 31	612	639

5. Principal assumptions used in determining the defined benefit plan

	2012	2011	2010
		%	
Discount rate of the plan's liability	4.4	4.7	5.08
Expected rate of return on plan's assets	5.7-2.3	6.6-2.8	7.3-2.6
Expected salary increase rate	2%	1%	0%

6. The amounts for the current and previous years:

	2012	2011	2010
		Dollars thousands	
Present value of defined benefit obligation	1,208	1,243	1,261
Fair value of plan assets	612	639	745
Surplus in the plan	596	604	516

Note 16 - Taxes on income

a. Tax laws applicable to Group 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.

The Law for the Encouragement of Capital Investments, 1959 (“the Law”)

The Company's enterprises received the status of "approved enterprises" under the Law for the Encouragement of Capital Investment, 1959. According to the Law, income from the approved enterprises, during the seven years from the first year the approved enterprise earns taxable income provided that 14 years have not passed since the approval was granted or 12 years have not passed since the enterprise began operating, whichever is earlier ("benefit period"), will be taxed at reduced tax rate of between 10% and 25% (in accordance with the rate of foreign investments in the company).

A company, in which foreign investments exceed 25%, is entitled to an additional 3-year benefit period (10 years all together). Approval letters dated January 1997 or later are entitled to a tax exemption for the first two years of the benefit period.

Shareholders are taxed at a 15% tax rate (withheld) on dividends distributed from revenues from the approved operations, and at a 25% tax rate on dividends distributed from revenues from other sources, unless otherwise stipulated by tax treaties.

Tefron - Tefron has 9 approved plans under the grants track. The benefit period of 8 approved plans of the Company has ended, and as such, income derived from these investments is taxable at the regular corporate tax rate in Israel. The ratio of the revenue derived from these investments is calculated according to growth in Company’s sales over and above sales before the beginning of these investments. The benefit period of one approved plan of the Company has yet to be ended. It should be mentioned that due to the Company's losses in 2008-2011, the Company estimates that it will not use the benefit in the above plan also in 2012.

The ratio between income produced from investments for approved plan which have been completed and approved plans not yet completed was calculated according to the increase in the Company's sales, over and above the sales before the start of the aforementioned investments.

Hi-Tex - Hi-Tex has 3 approved plans under the grants track. The benefit period of two of the plans has ended, and as such, the income resulting from these investments is liable to the usual tax rates of companies in Israel. The ratio of the revenue derived from these investments is calculated according to the increase in the Company's sales over and above the sales prior to the beginning of these investments. The benefit period of an additional approved plan has yet to be ended. In addition, Hi-Tex has a fourth plan in the framework of Amendment 60 of the Law (hereinafter: "the Amendment"), under the Alternative Track Law. Under the alternative track, the benefit period starting date was set as from the year in which taxable revenue is first generated by the approved enterprise, provided that 12 years have not passed since the start of the elective year. The Company is entitled to a tax exemption on the taxable revenues derived from the approved plan during the whole benefits period (10 years).

The basic condition for receiving the benefits under this track is that the enterprise is "a competitive enterprise".

Note 16 - Taxes on income (cont.)

a. Tax laws applicable to Group companies (cont.)

The Law for the Encouragement of Capital Investments, 1959 (“the Law”) (cont.)

Another condition for receiving the benefits under the alternative track is a minimum qualifying investment. This condition requires an investment in the acquisition of productive assets such as machinery and equipment, which must be carried out within three years. The minimum qualifying investment required for plant expansion is the higher of NIS 300 thousand and an amount equivalent to the "qualifying percentage" of the value of the productive assets. Productive assets that are used by the plant but not owned by it will also be viewed as productive assets.

The value of productive assets before the expansion (NIS in millions)	The new proportion that the required investment bears to the value of productive assets
Up to 140	12%
140 - 500	7%
Over 500	5%

The income qualifying for tax benefits under the alternative track is the taxable income of a company that has met certain conditions as determined by the Law ("a beneficiary enterprise") and which is derived from an industrial enterprise or a hotel. Amendment 60 to the Law specifies the types of qualifying income that is entitled to tax benefits under the alternative track both in respect of an industrial enterprise and of a hotel, whereby income from an industrial enterprise includes, among others, revenues from the production and development of software products and revenues from industrial research and development activities performed for a foreign resident (and approved by the Head of the Administration of Industrial Research and Development).

The Hi-Tex enterprise has chosen 2007 as its elective year. Furthermore, on June 30, 2008 an application for a pre-ruling was filed with the Income Tax Professional Department, requesting beneficiary enterprise status and determination of 2007 as the elective year (hereinafter "the application for a pre-ruling"). The application has not been approved yet.

In January 2010 the Group placed all of the activewear and intimate apparel operations under Hi-Tex. To this end, Tefron transferred most of its assets to Hi-Tex against allotment of additional Hi-Tex shares, and in a tax-exempt transaction, pursuant to Section 104 of the Israeli Income Tax Ordinance as detailed in Note 18d below.

In view of this, Tefron applied to the Investment Center to endorse its letter of approval to Hi-Tex. In addition, Hi-Tex updated the application for a pre-ruling accordingly.

Macro – Macro has chosen 2005 as the elective year under the alternative track, pursuant to the Directives 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 of December 27, 2006.

Notes to the consolidated financial statements

Note 16 - Taxes on income (cont.)

a. Tax laws applicable to Group companies (cont.)

Amendment to the Law for the Encouragement of Capital Investments – 1959

In December 2010, the Knesset passed the Law for the Economic Policy for the Years 2011 and 2012 (Legislative Amendment) – 2011, which sets forth, *inter alia*, amendments to the Law for the Encouragement of Capital Investments – 1959 (hereinafter: "the Law"). The implementation of the amendment is from 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. As from 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 from that tax year for which the choice is made, the amended tax rate will apply. According to the amendment to the law, the tax rates are as follows: In 2011 and 2012 15% (Development area A – 10%), in 2013 and 2014 12.5% (Development area A – 7%), and in 2015 and thereafter 12% (Development area A - 6%).

The Company examined the influence of the amendment to the Law on its financial statements, and correct as of the date of publishing the financial statements, the Company estimates that it would start the transition to applying the amendment during the tax year of 2013, and in light of this the Company adjusted its deferred taxes balances for December 31, 2012, on the amount of 218 thousand dollars, and this against the section of taxes on income.

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

Hi-Tex (a subsidiary) operates in Israel as "an industrial company" in conformity with the Law for the Encouragement of Industry (Taxes), 1969, and by virtue of this law they are 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 are used for the plant's development or promotion, and for a deduction of expenses for issue of shares listed on the Stock Exchange.

b. rates applicable to the income of the companies of the Group:

The rate of company tax in Israel in 2009 was 26% in 2010 - 25% and in 2011 – 24%.
A corporation is liable to tax on real capital gains at the company tax rate applying in the year of sale. As temporary order for the years 2006 – 2009, it was determined that the sale of an asset which is not traded on the stock exchange (excluding goodwill which was not paid for) acquired before January 1, 2003 and sold by December 31, 2009 – on the real capital gains part which is linearly related to the period until December 31, 2002, corporate tax at a rate stated in the ordinance in the year of the sale will apply and regarding the share of the real capital gains relating linearly to the period from January 1, 2003 until the date of the sale, tax at a rate of 25% will apply.

On December 5, 2011, the Knesset passed the Law for a Change in the Tax Burden (Legislative Amendments) – 2011 (hereinafter – the Law). In the framework of the Law, *inter alia*, as from 2012 the outline for reducing the rate of corporate tax was cancelled. In the framework of the law the corporate tax was also increased to a rate of 25% as from 2012.

Notes to the consolidated financial statements

Note 16 - Taxes on income (cont.)

b. rates applicable to the income of the companies of the Group:(cont.)

In view of the increase in the rate of corporate tax to 25% as mentioned above, the rate of tax on real capital gains was also raised as was the rate of tax on real betterment.

The effect of this change resulted in a reduction in the loss in 2011 by 148 thousand dollars which is recorded to the tax on income item.

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

El-Marisra 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%.

c. Final tax assessments

The Company and its subsidiaries operating in Israel have final tax assessments up to and including the 2005 tax year. The main subsidiaries operating outside Israel have final tax assessments until 2011.

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. At this stage, the Company is unable to estimate the effect, if any, of the amended report and therefore did not record any benefit in the financial statements

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, 2012 amounting to 38,939 thousand dollars, which may be used over an unlimited period. In respect of these balances and other deductible temporary differences relating to employee benefits and provision for doubtful debts, the Company recorded in its financial statements deferred tax assets amounting to 4,174 thousand dollars (due to their expected utilization as a result of a reserve for deferred taxes of 1,825 thousand dollars, mainly for fixed assets, and due to the expectation of realizing them against taxable income). The Company has carry-forward losses for tax purposes of two subsidiaries amounting to 17,819 thousand dollars for which no deferred tax has been created, in the absence of any expected utilization of them in the foreseeable future.

Note 16 - Taxes on income (cont.)

e. Deferred taxes

Composition:

	Balance sheets		Statements of income		
	December 31		For the year ended December 31		
	2012	2011	2012	2011	2010
	Dollars thousands				
Deferred tax liabilities					
Fixed assets	(1,532)	(7,705)	6,173	(636)	3,580
Cost surplus from operations acquisition	(293)	(427)	134	(310)	41
	(1,825)	(8,132)			
Deferred tax assets					
Losses transferred for tax purposes	3,996	9,017	(5,021)	1,384	(976)
Provision for doubtful accounts	7	101	(89)	(100)	(29)
Employee benefits	128	332	(204)	38	(147)
Profit not yet realized- from securities available for sale	39	-			
Hedging of cash flow	4	-			
	4,174	9,450			
Deferred tax income (expenses)			993	376	2,469
Deferred tax assets (liabilities), net	2,349	1,318			

Deferred taxes are presented in the balance sheet as follows:

	December 31	
	2012	2011
	Dollars thousands	
Non-current assets	2,659	1,318
Non-current liabilities	310	-
	2,349	1,318

The deferred taxes are computed at the average tax rate of 12.7% (2011- 25%) based on the tax rates that are expected to apply upon reversal.

Note 16 - Taxes on income (cont.)

e. Deferred taxes (cont.)

Taxes on income relating to capital items:

	For the year ended December 31		
	2012	2011	2010
	Dollars thousands		
Loss from investment in securities available for sale	39	-	-
Actuarial gain (loss) from a defined benefit plan	-	30	(30)
Gain from cash flow hedging transactions	4	-	-
	43	30	(30)

f. Tax benefits (expenses) included in statements of income

	For the year ended December 31		
	2012	2011	2010
	Dollars thousands		
Deferred taxes	(993)	(376)	(2,469)
Taxes in respect of previous years	-	22	-
	(993)	(354)	(2,469)

The Company does not intend to distribute dividends which would create a tax liability on its income from an "approved enterprise".

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:

Note 16 - Taxes on income (cont.)

g. Theoretical tax (cont.)

	For the year ended December 31		
	2012	2011	2010
	Dollars thousands		
Loss before taxes on income	(1,451)	(4,608)	(25,155)
Statutory tax rate	25%	24%	25%
Tax benefit computed at the statutory tax rate	(363)	(1,106)	(6,289)
Increase (decrease) in taxes on income resulting from the following factors:			
Non-deductible expenses for tax purposes	311	75	55
Losses for which no deferred taxes were recorded	1,626	690	3,788
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	218	(148)	-
Taxes in respect of previous years	-	22	-
Others	29	113	(23)
Taxes benefit	(993)	(354)	(2,469)
Average effective tax rate	68.4%	7.7%	9.8%

Note 17 - Contingent liabilities, commitments and liens

a. Contingent liabilities

1. According to the Law for the Encouragement of Capital Investments - 1959, the Company and its subsidiaries received grants 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 also 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 from the date of the grant. In the opinion of the Company’s management and its subsidiaries, 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.

Note 17 - Contingent liabilities, commitments and liens (cont.)

a. Contingent liabilities (cont.)

2. Legal proceedings

a. 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 working relations. At this stage, one claim is in its preliminary stages, and in the other claim, both parties have presented their summaries, and at this stage the parties are waiting for the arbitrator's ruling.

In the opinion of the Company's management, based on the opinion of its legal counselors, the provisions included in its financial statements are sufficient to cover potential damage caused to it, if any, from those claims. These provisions were presented in the statements of income under "general and administrative expenses" in the statements of income in 2010.

b. A claim has been filed against the Company by a former supplier for 270 thousand dollars due to the Company's debts for work performed by the former supplier. A preliminary hearing was held at court after which the parties were referred to a mediation procedure, which wasn’t successful after the date of the balance sheet. Until the day of the balance sheet’s publication, a pre-trial hearing was held in which instructions were given regarding starting preliminary procedures between the parties. At this stage as the claim is still in its preliminary stage, and based upon the opinion of legal counsel, it is not possible to evaluate the chances of the claim. The provisions included in the financial statements are sufficient to cover possible damage that may be caused to it, if any. These provisions were recorded in the "general and administrative" item in the statement of income.

c. In September 2010, a Statement of Claim was filed for NIS 2.5 million in the Magistrates Court in Petach Tikva by a former supplier of the Company, against the Company and a subsidiary of the Company. The claim alleges that the Company and the subsidiary withdrew from undertakings, presentations, and agreements in connection with the opening of a shop in the Gold Shopping Mall in Rishon Le'Zion through the plaintiff as part of the Company's "chain of shops". The dispute between the parties was discussed in the framework of mediation proceedings which was not successful, therefore, the mediator decided to return the file to the court. In December 2012 a preliminary hearing was held at court and dates were set for the submission of complementary views by both parties, as well as a date for an additional preliminary hearing.

The provisions included in the financial statements are sufficient to cover possible damage that may be caused to it, if any, from this claim. These provisions were recorded in the "general and administrative" item in the statement of income.

d. The Company records in its books a provision for claims of third parties which will be handled by the insurance company and covered by them. The indemnity expected to receive from the insurance company is certain and has been recorded as an asset in the framework of the 'other receivables' item. The Company has third party insurance policy and according to it the Company has to pay an excess of 1,000 US dollars per claim. Any changes in the of the above is recorded as an expense in the Company's

Note 17 - Contingent liabilities, commitments and liens (cont.)

a. Contingent liabilities (cont.)

2. Legal proceedings (cont.)

books on submission of a demand from the insurance company at the end of the claim.

b. Commitments

1. Engagement in a manufacturing and distribution agreement with X-technology Swiss Research & Development

On September 27, 2012, the Board of Directors approved the Company's engagement in an agreement with X-technology Swiss Research & Development GmbH (hereinafter -"XTS") regarding a business cooperation in the framework of which the Company would provide exclusive manufacturing and distribution services to XTS (hereinafter - "the agreement with XTS" or "the agreement"), as detailed as follows:

Providing manufacturing services to XTS

According to the terms of the agreement, XTS has appointed the Company to be the sole manufacturer of clothing in the field of activewear and socks for which XTS is the right-holder (hereinafter - "the products") which will be distributed across the American continent during the manufacturing period (defined as follows). In the framework of the agreement, XTS will grant the Company a limited license to use its intellectual property for the purpose of manufacturing the products, and the Company will provide manufacturing, packaging, designing, labeling and delivery services of the products to XTS. Furthermore, the parties would be entitled to reach a future agreement regarding additional geographical regions for which the Company would have manufacturing rights, though this would not be based on exclusivity.

The initial manufacturing period would be for 3 years, after which the manufacturing period could be extended for additional periods of 12 months, unless a notice of cancellation of 6 months was given, prior to the end of one of these periods (hereinafter, the initial manufacturing period and the extended periods would referred to together as "the manufacturing period").

Providing distribution services to XTS

According to the terms of the agreement, XTS appointed the Company to be the sole distributer of the products in the United States and Canada (as well as in additional regions that might be agreed upon in the future) during the distribution period (as defined as follows), as well as granted the Company a limited license to use its intellectual property for this purpose. In the framework of the Company's operations as a distributer, it would act for the purpose of selling, advertising and promoting the products. Subjected to the parties' agreement in advance, the Company would be entitled to distribute the products in additional areas though not on the basis of exclusivity. During the distribution period, the Company would assume responsibility for the logistics organization as well as for all other administrative operations that would be required for the distribution and sales operations. The Company assumes

Notes to the consolidated financial statements

Note 17 - Contingent liabilities, commitments and liens (cont.)

b. Commitments (cont.)

1. Engagement in a manufacturing and distribution agreement with X-technology Swiss Research & Development (cont.)

responsibility for the advertising, marketing and promotion of the products under the trademark of XTS, to the best of its ability. Furthermore, the Company would be responsible for the management and training of the sales representatives and the retailers' training. During the initial distribution period (as defined as follows), the Company would not be obligated to reach a certain sales turnover and as this period might be extended, the parties would reach a future agreement on the minimal sales turnovers.
The initial distributing period would be for one year (hereinafter: "the initial distribution period), after which it would be extended for an additional period of 3 years, unless a notice of cancellation of 6 months was given, prior to the end of the initial distribution period. Thereafter, the distribution period might be extended for additional periods of 12 months, unless a notice of cancellation of 6 months was given, prior to the end of one of these periods, (hereinafter, the initial distributing period and the extended periods would referred to together as "the distributing period"). It is also noted that XTS would have a right to terminate the agreement for distribution services after the initial period of distribution if the Company would not meet the minimal sales turnover which would be agreed upon by both parties at the end of the initial distribution period.

Intellectual property rights

In order for the Company to fulfill its obligations, XTS granted the Company a limited license to use its intellectual property. The license shall automatically expire in part or full upon the termination or expiry of the manufacturing services and/or the distribution services.

In the framework of the agreement with XTS, agreements were made regarding the intellectual property rights that might arise as a result of a jointed cooperation, and these would be jointly owned by both parties.

2. Engagement in consultation and development agreement with Professor Bodo W. Lambertz (hereinafter: "the consultant"), and an essential private offer for 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 (hereinafter "the agreement"). In the framework of this agreement, *inter alia*, the Company would allot the consultant up to 400,000 ordinary shares of NIS 10 per value each.

Notes to the consolidated financial statements

Note 17 - Contingent liabilities, commitments and liens (cont.)

b. Commitments (cont.)

2. Engagement in consultation and development agreement with Professor Bodo W. Lambertz (hereinafter: "the consultant"), and an essential private offer for the consultant (cont.)

The consultant assumes responsibility for the development of up to 4 fashion-concepts for the Company every year (hereinafter "the concept"), according to the Company's demands that would include design and specification of activewear and apparel in the sports field. The Company would examine the proposed concepts and would be entitled to purchase from the consultant a license for the concept that has been developed by him.

The terms of the license that the company will receive from the consultant of the concept or the products that were determined in the agreement between the parties are: an exclusive license, unlimited by any time period (subjected to exceptions that were determined in the agreement), and that is non-transferable (with the exception of Out-License under the terms that were agreed upon in the agreement) in regard of all the rights of the 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 has been determined in the agreement, during the period in which the Company would manufacture, distribute or sell the products. In the case the Company would manufacture and distribute products that are patent-protected by XTS, the Company would pay royalties for the period during which it would distribute the products and up to 20 years at the most. 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, the consultant would provide the Company 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 has been agreed upon in the agreement.

In addition to the aforementioned payment and royalties, in respect to the license and to the period of use by the Company, and subjected to receiving the listing approval by the Tel Aviv Stock Exchange Ltd., the Company would allot the consultant the offered shares according to the following milestones:

1) An initial series of 65,000 shares once the Company's Board of directors approves the agreement and subjected to the receiving the listing approval from the Tel Aviv Stock Exchange..

2) A second series of 100,000 shares once reaching the Net Sales Objective of licensed products on the sum of 2.0 million dollars within 18 months as of the day of signing the agreement.

3) A third series of 100,000 shares once reaching the Net Sales Objective of licensed products on the sum of 4.0 million dollars within 30 months as of the day of signing the agreement.

Note 17 - Contingent liabilities, commitments and liens (cont.)

b. Commitments (cont.)

2. Engagement in consultation and development agreement with Professor Bodo W. Lambertz (hereinafter: "the consultant"), and an essential private offer for the consultant (cont.)

4) A fourth series of 135,000 shares once reaching the Net Sales Objective of licensed products on the sum of 6.0 million dollars within 42 months as of the day of signing the agreement.

The agreement is for an unlimited period of time, but can be cancelled with a notice of 30 days; nevertheless the consultant is obligated for a minimal period of a year that ends on September 30, 2013. Furthermore, additional common causes for terminating the agreement were determined in the agreement.

3. Nouvelle Transaction

On December 30, 2010, the transaction was completed in the framework of which, *inter alia*, the Company acquired the operations in the field of women's intimate apparel products of Intimes Nouvelle Seamless Inc. (hereinafter: "Nouvelle"), which are manufactured using the seamless technology, and this against the private placement to Nouvelle of 600,000 ordinary shares of the Company which comprise 9.6% of the Company's issued and paid-up share capital and voting rights in it (8.2% fully diluted). In addition, a total amount of 5,813,000 dollars was invested in the Company by: (i) Litef Holdings Inc. (hereinafter: "the Nouvelle Investors"); (ii) Mivtach Shamir Holdings Ltd. (hereinafter: "Mivtach Shamir"); (iii) Zilkha Partners, L.P.; (iv) Fima Trust; and (v) Rimon Investments Master Fund L.P. (hereinafter jointly: "the Investors" and the "Transaction". respectively).

The following are the condensed details of the main agreements, in the framework of this transaction:

1) An agreement between the Company and Nouvelle according to which the Company will acquire from Nouvelle its operations in the field of women's intimate apparel products manufactured using the seamless technology in consideration for an allotment of 600,000 ordinary shares of the Company, which will comprise, immediately after the allotment (subject to fully completing the transaction), 9.2% of the Company's issued capital and voting rights in it (7.9% fully diluted).
2) An agreement between the Company and the Nouvelle's investors, according to which the Nouvelle investors will invest an amount of 3,313,000 dollars in consideration for an allotment of 1,577,619 ordinary shares of the Company (at a price of 2.1 dollars per share) which will comprise immediately after the allotment (subject to fully completing the transaction) 24.1% of the Company's issued capital and voting rights in it (20.8% fully diluted).
3) An agreement between the Company and Mivtach Shamir, according to which Mivtach Shamir will invest in the Company an amount of 1,300,000 dollars in consideration for an allotment of 619,047 ordinary shares of the Company (at a price of 2.1 dollar per share) which will comprise immediately after the allotment

Note 17 - Contingent liabilities, commitments and liens (cont.)

b. Commitments (cont.)

3. Nouvelle Transaction (cont.)

(subject to fully completing the transaction) 9.5% of the Company's issued capital and voting rights in it (8.2% fully diluted).

4) An agreement between the Company and Rimon, according to which the Rimon Group would invest 1,200,000 dollars in return for an allotment of 571,428 ordinary shares of the Company (at a price of 2.1 dollars per share) which will comprise immediately after the allotment (subject to fully completing the transaction) 8.7% of the Company's issued capital and voting rights in it (7.5% fully diluted).

5) An option agreement between Ben and Martin Lieberman according to which they will be allotted (or a company for them) 450,000 option warrants (225,000 option warrants each) which can be exercised to up to 450,000 ordinary shares of the Company, which will comprise immediately after the allotment (subject to fully completing the transaction) 6.4% of the Company's issued capital and voting rights in it on the assumption of exercising these option warrants only for the Company's shares (6% fully diluted). The option warrants will vest subject to the Company meeting the sales targets.

4. Commitment to pay rent

The Company's plants and installations and those of most of its subsidiaries are located in buildings leased for various terms ending between 2012 and 2019.

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

	2012	2011
	Dollars thousands	
Year 1	1,914	2,004
Year 2	1,706	1,675
Year 3	1,706	1,675
Year 4	1,706	1,675
Years 5 and thereafter	4,563	6,156
	11,595	13,185

c. Liens

1. All liabilities to banks are secured by a floating charge on the existing and future assets of the Company's 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 18 - Capital

a. Allotment 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 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 (hereinafter "the agreement"). In the framework of this agreement, inter alia, the Company would allot the consultant up to 400,000 ordinary shares of NIS 10 per value each in four series: an initial series of 65,000 shares upon the date of signing the agreement and the other series in accordance with reaching the agreed upon Net Sales Objectives.

On the date of the signing the agreement the Company recorded a capital reserve for the initial series of shares. Upon issuing the shares, the amount would be sorted into shares equity. The minimal period of the agreement is one year, therefore a quarter the shares would be revaluated according to the average market value of the share in that period, which presumably represents the value of service that was given during that period of time. Furthermore, the Company would examine on every accounting period if the estimated amount fits with the definition of an intangible asset, in order to reclassify this amount from the future expanses item to the intangible asset item. The intangible asset would be reduced correspondently to the period of financial benefits from the concepts that would be purchased. As of December 31 2012, the Company believes that the terms for acknowledging future development as an intangible asset, have yet to be fulfilled. Accordingly, the Company recorded a quarter of the estimated shares' value to the development expenses item. The sum of the expenses recorded in the 4th quarter for the initial series of shares, aggregates 49 thousand dollars.

Registration of the shares' equity which their issue depends on meeting the sales objectives would be executed according to the probability of meeting the objectives.

For additional details see Note 17b(2) 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 stocks, bonds and warrants. At this stage the shelf-prospectus does not include an immediate fundraising.

c. Discontinuation of Registering the Company's Shares under the US Securities Law

In September 2011, the Company submitted documents in the US in order to discontinue the listing of its shares under the US Securities Laws (deregistration), in such a manner that upon the continuation of such registration aforementioned, the Company's reporting obligations to the US Securities Authority will be cancelled. As a result of the deregistration process, trading in the trading of the Company's shares "Over The Counter Bulletin Board" (hereinafter: "OTCBB") in the US will be discontinued. It should be emphasized that the Company's shares will continue to be traded on the Tel Aviv Stock Exchange. The application was approved on September 13, 2011.

Notes to the consolidated financial statements

Note 18 - Capital (cont.)

d. Nouvelle Transaction

On December 30, 2010, the transaction was completed in the framework of which, *inter alia*, the Company acquired the operations in the field of women's intimate apparel products of Intimes Nouvelle Seamless Inc. (hereinafter: "Nouvelle"), which are manufactured using the seamless technology, and this against the private placement to Nouvelle of 600,000 ordinary shares of the Company which comprise 9.6% of the Company's issued and paid-up share capital and voting rights in it (8.2% fully diluted). In addition, a total amount of 5,813,000 dollars was invested in the Company by: (i) Litef Holdings Inc. (hereinafter: "the Nouvelle Investors"); (ii) Mivtach Shamir Holdings Ltd. (hereinafter: "Mivtach Shamir"); (iii) Zilkha Partners, L.P.; (iv) Fima Trust; and (v) Rimon Investments Master Fund L.P. (hereinafter jointly: "the Investors" and the "Transaction". respectively).

For additional details regarding the aforementioned agreement see Note 17b(3) above.

e. Share capital composition

	December 31 2012		
	Authorized	Issued	Paid-up
	Number of shares		
Ordinary shares of NIS 10 par value each	20,000,000	6,641,476	6,541,736

	December 31 2011		
	Authorized	Issued	Paid-up
	Number of shares		
Ordinary shares of NIS 10 par value each	10,000,000	6,641,476	6,541,736

On September 23, 2012, a General Meeting of shareholders of the Company approved to increase the authorized capital of the Company from NIS 100,000,000 which are comprised of 10,000,000 Company's ordinary shares of NIS 10 par value each, to NIS 200,000,000 comprised of 20,000,000 ordinary shares of NIS 10 par value each and to amend the Company's Articles and Memorandum accordingly

f. Rights conferred by the shares

Ordinary shares

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

Notes to the consolidated financial statements

Note 18 - Capital (cont.)

g. Treasury shares

As of the balance sheet date, Tefron Holdings (98) Ltd., a wholly-owned subsidiary of the Company, holds 99,740 Company shares, which constitute 4.49% of Company shares and whose cost is 7,408 thousand dollars. The investment in these shares is recorded according to the "treasury shares" method in the equity.

The shares are pledged to a bank to secure a loan received.

Capital reserve for hedging transactions

The reserve serves to record profits and losses (less the tax effect) from the effective hedging of cash flows.

In 2012 the capital reserve recorded a profit from hedging cash flows on the amount of 55 thousand dollars which was recognized during the year (2011 – no profit was recorded).

Capital reserve for transactions with a controlling shareholder

Assets and liabilities on which there was a transaction between the Company and a controlling shareholder in it or between companies under the same control are recognized on the date of the transaction at their fair value. The difference between the fair value and the consideration determined in the transaction is recorded to equity. In 2010 a credit difference of 190 thousand dollars was created for a debt for management fees to the controlling shareholder which was waived to the Company. A debit difference is a type of dividend and therefore reduces retained earnings. A credit difference is a type of shareholder’s investment and therefore is presented in a separated item in shareholders’ equity (as part of “Other capital reserves”).

h. 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 of products and services adjusted to the level of risk in the Group's business activity.

The Company acts 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 tangible equity as defined in the amendment of the agreement with the banks described in Note 12 above, a minimum of 27.5 million dollars, 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 yield on capital. In 2012, 2011 and 2010 the Company had a negative yield on capital.

Note 19 - Share-based payment plan to employees and service providers

a. Expense recognized in financial statements

The expense recognized in the Company's financial statements for services rendered by its employees, Board members and advisors is presented in the following table:

	For the year ended December 31		
	2012	2011	2010
	Dollars thousands		
Share based payment plans settled with financial instruments for employees and directors	123	204	280
Share based payment for the consultant	74	-	-
Total share based payment plans settled with financial instruments	197	204	280

Share-based payment transactions granted by the Company to its employees are described as follows. During 2012, 2011 and 2010, there were no modifications or cancellations in the said benefit plans to employees.

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

1. Option plan to managers and employees of the Company

In September 1997, the Company's Board of Directors adopted a share option plan in which options to acquire ordinary shares would be granted to Board members, executives, employees and consultants of the Company. Entitlement to exercise most of the options vests after a period of three to four years and will expire after ten years from the date of their granting or on the discontinuation of the employee's employment. The options plan was originally set for ten years, and in March 2008 was extended for a further ten years – until March 1, 2018.

a. On November 22, 2012, the Company's Board of Directors approved granting 50,000 option warrants which can be exercised to 50,000 ordinary shares of NIS 10 par value each to the CEO of Operations in Israel, who is not an interested party in the Company and will not become an interested party in the Company after granting the options. The allotment of option warrants to the offeree will be carried out according to option plans for employees, officers and consultants of the Company. The exercise price for every option will stand at 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 options will accrue over a period of 3 years as from November 22, 2012. The value of the benefit included in granting these options according the share price on the date of trading on the Stock Exchange aggregates 68 thousand dollars.

b. On August 13, 2012 the Company's Board of Directors approved granting 15,000 option warrants which can be exercised to 15,000 ordinary shares of NIS 10 par

Note 19 - Share-based payment plan to employees and service providers (cont.)

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

1. Option plan to managers and employees of the Company (cont.)

value each to the Company's COO who is not an interested party in the Company and will not become an interested party in the Company after the granting. The allotment of the option warrants to the offeree will be carried out according to the option plan for employees, officers and consultants of the Company. The exercise price for every option will be 3.8 dollars after being translated to NIS at the representative rate of the US dollar on the date prior to the date of granting. Entitlement to realize the options will vest over a period of three years from August 13, 2012. The value of the benefit inherent in granting of these options according to the share price on the date of trading on the stock exchange aggregates 13 thousand dollars.

c. In 2011 the Company's Board of Directors approved granting 124,000 option warrants which can be exercised to 124,000 ordinary shares of NIS 10 par value each to four officers of the Company, who are not interested parties in the Company and will not become interested parties in the Company after granting the options. The exercise price for every option will stand at 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. The value of the benefit included in granting these options according the share price on the date of trading on the Stock Exchange aggregates 136 thousand dollars.

d. In 2010, the Company's Board of Directors approved the granting of 100,000 option warrants to the Company's CEO and 47,605 option warrants to the head of the Board. The exercise price for every option that was granted to the CEO will stand at 3.8 dollars and the exercise price for every option that was granted to the head of the Board will stand at 2.1 dollars. Entitlement to realize the options will accrue over a period of 3 years. The value of the benefit included in granting these options according the share price on the date of trading on the Stock Exchange aggregates 310 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 share of the Company. The entitlement to exercise them is over a period of 3 years as from December 2010, and will expire three years from the date of their granting. The option warrants will vest subject to the Company's meeting its sales targets and EBITDA. The Company made a calculation of the value of the options on the basis of its sales forecasts. These option warrants were granted in the framework of the Nouvelle transaction, as detailed in Note 18d.

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

Note 19 - Share-based payment plan to employees and service providers (cont.)

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

2. Options granted to controlling shareholders (cont.)

In 2011 and 2012 the Company did not meet its targets and accordingly the Company did not record expenses for this benefit.

c. Movement during the year

The following table lists the number of share options, the weighted average exercise prices of share options and modification in employee option plans during the current year:

	As of December 31, 2012		As of December 31, 2011	
	Number of stock options	Weighted average exercise price (dollar)	Number of stock options	Weighted average exercise price (dollar)
Options for shares at the beginning of the year	938,033	13.0	572,150	8.3
Options for shares granted during the year	65,000	3.8	315,000	3.3
Options for shares forfeited or expired during the year	(75,260)	5.1	(42,104)	19.3
Adjustment as a result of issuing rights	-	-	92,987	8.3
Options for shares exercised during the year	-	-	-	-
Options for shares at the end of the year	927,773	5.7	983,033	7.7
Options for shares which can be exercised at the end of the year	581,282	7.1	292,710	13.0

d. The weighted average of the remaining contractual term of the share options as of December 31, 2012 is 4.2 years (2011 – 2.5 years).

e. The range of exercise prices of the share options as of December 31, 2012 and 2011 stands at 35.0 dollars – 2.1 dollars.

f. Measurement of the fair value of options settled with financial instruments

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

Note 19 - Share-based payment plan to employees and service providers (cont.)

f. Measurement of the fair value of options settled with financial instruments (cont.)

The following table lists the data used for the fair value measurement of options for shares settled with financial instruments and which were granted in 2012, according to the Black Scholes option pricing model, for the above plan:

	2012
Dividend yield for the share (%)	0.0
Expected volatility of the share prices (%)	64
Risk-free interest rate (%)	0.91
Average life expectancy of share options (years)	6
Weighted average share price (Dollars)	3

Based on the above data, the fair value of the options granted in 2012 was calculated at 81 thousand dollars on the dates granted.

The expected life of the share options is based on the Company's historical data which is not necessarily indicative of the exercise patterns of share options that may occur in the future.

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

Note 20 - Supplementary information to statements of income items

	For the year ended December 31		
	2012	2011	2010
	Dollars thousands		
a. Cost of sales, net			
Materials	60,084	70,303	46,394
Payroll and benefits	8,614	10,341	10,170
Sub-contracted work	8,323	7,222	7,933
Depreciation	4,017	4,931	8,596
Other manufacturing expenses	8,317	9,061	9,830
	89,355	101,858	82,983
Decrease (increase) in work-in-progress and finished goods inventories	3,801	(1,562)	865
	93,156	100,296	83,848
(**) Including provision for inventories write- off	864	607	3,065

Note 20 - Supplementary information to statements of income items (cont.)

	For the year ended December 31		
	2012	2011	2010
	Dollars thousand		
b. Development expenses, net			
Wages and benefits	2,616	2,590	2,152
Manufacturing expenses	736	1,148	1,134
Depreciation and reductions	240	295	312
Materials	224	249	416
Others	194	-	-
Total	4,010	4,282	4,014
Less: Grant from the Chief Scientist	484	654	1,145
Development expenses, net	3,526	3,628	2,869
c. Selling and marketing expenses			
Wages and benefits	5,264	5,519	5,526
Transport, export and distribution	2,123	2,046	2,049
Commissions paid	1,043	2,680	436
Overseas office maintenance	1,602	2,441	1,732
Others	3,031	2,735	2,107
	13,063	15,421	11,850
d. General and administrative expenses			
Wages and benefits	1,692	1,798	1,790
Consulting	724	952	1,320
Remuneration and directors' insurance	339	447	464
Provision for bad and doubtful debts	(175)	(167)	232
Others	589	(81)	244
	3,169	2,949	4,050
e. Other expenses (income)			
Loss (reversal of loss) from impairment of fixed assets, net (see Note 7)	33	(433)	6,260
Capital loss from the sale of fixed assets	2	29	142
Restitution of mutual fund to employers (1)	-	-	(169)
	35	(404)	6,233

(1) On December 21, 2010, the Company received repayment of participation fees for a total amount of 169 thousand dollars from the mutual fund of employers as a refund for participation fees which were paid by it to the fund. The refund was paid subject to the Company's undertaking to return these amounts, or part thereof, in certain cases whose likelihood, in the Company's opinion, is low.

Note 20 - Supplementary information to statements of income items (cont.)

f. Financial revenues (expenses)

	For the year ended December 31		
	2012	2011	2010
	Dollars thousands		
Financial revenues			
Interest revenues from bank deposits and securities available for sale	18	22	30
Net gain from change in rates of exchange	-	308	-
Net change in fair value of cash flow hedging transferred from equity	46	-	-
Revaluation of liability for options to banks	-	366	-
	64	696	30
Financial expenses			
Financial expenses from short-term credit	274	161	306
Interest expenses on financial liabilities measured at amortized cost	632	689	537
Net loss from change in foreign exchange rates	92	-	573
Net change in fair value of financial assets available for sale	-	68	-
Revaluation of liability for options to banks	63	-	-
Reduction of discounting of options for banks	183	158	24
Bank expenses, hedging-related expenses and other expenses	812	756	939
	2,056	1,832	2,379

Note 21 - Net earnings per share

Details of number of shares and earnings (loss) used to calculate net earnings (loss) per share:

	For the year ended December 31,					
	2012		2011		2010	
	Weighted average number of shares	Loss attributed to equity holders of the Company	Weighted average number of shares	Loss attributed to equity holders of the Company	Weighted average number of shares	Loss attributed to equity holders of the Company
	Thousands	Dollars thousands	Thousands	Dollars thousands	Thousands	Dollars thousands
Amounts of shares and losses to calculate basic loss	6,542	(458)	6,542	(4,254)	2,939	(22,686)
Impact of potentially dilutive ordinary shares	-	-	-	-	-	-
amounts used to calculate diluted earnings (loss) per share	6,542	(458)	6,542	(4,254)	2,939	(22,686)

Notes to the consolidated financial statements

Note 22 - Operating segments

a. General

Group companies are engaged in two operating business segments:

Seamless apparel ("Seamless")	- Design, development, manufacturing and sale of intimate apparel, and activewear using the "seamless" method.
Knitted apparel ("Cut & Sew")	- Design, development, manufacturing and sale of intimate apparel, swimwear, and activewear using the "cut & sew" method. Design and manufacturing are mostly carried out in Israel, in Jordan and in the Far East, and finished goods are mostly sold in the USA and Europe.

T

The Company's two business segments are carried out in a number of principal geographic areas in the world. In Israel, where the Company and its subsidiaries Hi-Tex and Macro are located, the design, development, manufacturing and sales activities of intimate apparel are carried out; and in the Far East the activities of manufacturing and locating suppliers of intimate apparel, activewear and swimwear are carried out. In the subsidiaries Tefron USA and Tefron UK marketing and sales activities are carried out.

The information that the Company provides in accordance with the IFRS 8 definitions is based on available financial information which is reviewed regularly and is used by the Chief Operating Decision Maker (CODM) so as to make decisions regarding the resources to be allocated to the segment, and in order to evaluate the segment's performance. The Chief Operating Decision Maker is the CEO. Based on the criteria in IFRS 8 regarding determining the reportable segment operations and the available financial information that is reviewed by the Company's CEO, the Company has determined that it operates in two reportable operating segments.

The Group's financing (including financing costs and financing revenues) and taxes on income are managed on a group basis and do not relate to operating segments

Note 22 - Operating segments

b. Main reporting regarding operating segments

	For the year ended December 31, 2012		
	Seamless	Cut & Sew	Total
	Dollars thousands		
Revenues from external parties	96,583	16,907	113,490
Gross profit	16,555	3,779	20,334
Segment results	1,786	(1,245)	541
Financial expenses, net			(1,992)
Tax benefit			993
Loss			(458)
Segments assets	74,775	3,926	78,701
Segmental liabilities	34,708	13,094	47,802
Long-term asset acquisition costs	2,307	14	2,321
Depreciation and amortization	4,733	266	4,999

	For the year ended December 31, 2011		
	Seamless	Cut & Sew	Total
	Dollars thousands		
External revenues	94,409	24,009	118,418
Gross profit	12,895	5,277	18,122
Segment results	(2,862)	(610)	(3,472)
Financial expenses, net			(1,136)
Tax benefit			354
Loss			(4,254)
Segment assets	66,010	11,395	77,405
Segment liabilities	38,219	7,965	46,184
Long-term asset acquisition costs	581	125	706
Depreciation and amortization	5,684	421	6,105

Note 22 - Operating segments

b. Main reporting regarding operating segments (cont.)

	For the year ended December 31, 2010		
	Seamless	Cut & Sew	Total
	Dollars thousands		
External revenues	52,850	33,194	86,044
Gross profit	(970)	3,166	2,196
Segment results	(16,278)	(6,528)	(22,806)
Financial expenses, net			(2,349)
Tax benefit			2,469
Loss			(22,686)
Segment assets	66,142	16,610	82,752
Segment liabilities	39,603	7,239	46,842
Long-term asset acquisition costs	99	14	113
Depreciation and amortization	7,204	2,299	9,503

c. Secondary reporting by geographical segments

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

	For the year ended December 31		
	2012	2011	2010
	Dollars thousands		
North America	99,914	101,174	72,754
Europe	12,008	13,989	10,443
Israel	1,481	2,913	2,413
Others	87	342	434
	113,490	118,418	86,044

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

(*)	Balance of non-current assets (*) as of December 31,		Long-term acquisition costs of assets for the year ended December 31		
	2012	2011	2012	2011	2010
	Dollars thousands				
Israel	30,825	30,341	2,297	694	103
North America	2,301	2,398	21	5	10
Others	641	925	4	7	-
	33,767	33,664	2,322	706	113

(
*) Excluding deferred taxes, net.

Note 22 - Operating segments

d. Major customers

	For the year ended December 31		
	2012	2011	2010
	Dollars thousands		
Turnover with major customers	57,426	51,749	40,354
	Percentage of total sales		
Customer A - Seamless segment	24.2	23.1	37.0
Customer A - Cut & Sew segment	0.2	4.2	1.7
Customer B - Seamless segment	15.9	16.5	-
Customer C - Seamless segment	9.7	-	-
	50.0	43.8	38.7

Note 23 - Balances and transactions with interested parties and related parties

a. Balances with interested parties and related parties

Composition:

As of December 31, 2012

	Linkage terms	Related parties	Key executives
	Dollars thousands		
Trade receivables		1,627	-
Other receivables	Unlinked	-	29
Liabilities to trade payable		(1,123)	-
Other payables		(37)	(91)
		467	(62)

As of December 31, 2011

	Linkage terms	Related parties	Key executives
	Dollars thousands		
Trade receivables		951	-
Other receivables		115	-
Liabilities to trade payable	Unlinked	(1,228)	-
Other payables		-	(163)
		(162)	(163)

Note 23 - Balances and transactions with interested parties and related parties (cont.)

b. Benefits to interested parties and related parties

	For the year ended December 31		
	2012	2011	2010
	Dollars thousands		
Payroll and benefits for employees in the Company or on its behalf, including the CEO	949	1,061	568
Fees of directors not employed by or on behalf of the Company	276	300	261
Management fees for those not employed by or on behalf of the Company	-	882	-
Number of beneficiaries of salaries and benefits			
Related parties employed by or on behalf of the Company	2	2	1
Directors not employed by the Company	9	8	8
	11	10	9

c. Transactions with related parties and interested parties

For the year ended December 31, 2012

	Related parties	Interested parties	Executive officers
	Dollars thousands		
Sales	285	10,998	-
Cost of sales	-	(2,337)	-
Sales and marketing expenses	-	(368)	-
General and administrative expenses	(69)	(276)	(949)
Financing expenses	-	(235)	-
	216	7,782	(949)

For the year ended December 31, 2011

	Related parties	Interested parties	Executive officers
	Dollars thousands		
Sales	-	7,096	-
Cost of sales	-	(5,797)	-
Sales and marketing expenses	-	(1,641)	-
General and administrative expenses	-	(968)	-
Financing expenses	-	(45)	-
	-	(1,355)	-

In 2010 there were no transactions with related parties and interested parties.

Note 23 - Balances and transactions with interested parties and related parties (cont.)

d. Share based payment to controlling shareholder

On December 31, 2010 the Company granted two controlling shareholders 450,000 options (225,000 options each) to purchase 450,000 ordinary shares of the Company. For additional details see Note 17b(3) above.

e. Service agreement with a related party

On November 13, 2011 and November 22, 2011, the Audit Committee and the Board of Directors of the Company respectively approved the Company's engagement in agreements to provide Pick and Pack services (Picking, packing and delivering):

1. To BL Intimates (hereinafter: "BLI"), which is a partnership of Lamour Global Inc. Limited (which is a private company incorporated in Hong Kong and connected with the Lieberman family, who are among the controlling shareholders in the Company) and an additional partner.

2. To companies connected with BLI which are controlled by the Lieberman family, the controlling shareholders in the Company.

The Company grants, as part of its current operations in the US, Pick and Pack services to its customers, as part of the Company's regular business. The service is provided through a subsidiary of Tefron in the US (Tefron U.S.A. Inc.) and is carried out in the Company's Logistic Center in North Carolina.

BLI contacted the Company with a request to receive Pick and Pack Services from it, as mentioned above (through the Tefron subsidiary in the US and the Company's Logistic Center in North Carolina). The level of engagement with BLI and its related companies is an amount of revenues of up to 200,000 thousand dollars when the price per unit, which will be collected from BLI and the related companies, 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. The period of engagement which has been approved, is one year from the date of the approval of the engagement.

The Audit Committee and the Board of Directors have approved that the engagement in the agreements, as detailed In this clause, does not constitute as an irregular transaction as defined in the Corporate Law.

f. Factoring agreement with a controlling shareholder

On June 23, 2011, the Company engaged in a factoring agreement with Lamour Global Inc. Limited (Lamour), which is a company connected with the Lieberman family who is among the controlling shareholders in the Company. According to the agreement, the Company assigned to Lamour during 2011 according to the Company's financial needs, the debts of customers (up to an amount a million dollars at any given moment) and in consideration, Lamour transferred 90% of the assigned debt, handled the collection and on collecting the debt, transferred the Company the balance of the amount less

Note 23 - Balances and transactions with interested parties and related parties (cont.)

f. Factoring agreement with a controlling shareholder (cont.)

commission of 0.5% and interest of 4.1% per year for the period from the date on which the debt was assigned to Lamour until it was paid by the customer. On November 23, 2011, the Company announced the extension of the factoring agreement of the Company for an additional year and increased the level of factoring transactions that it is entitled to finance with Lamour to up to 2 million dollars at any given moment.

Note 24 - Events after the balance sheet date

a. Receipt of a Letter of Waiver from the lending banks

In continuation to the Letters of Waiver that the Company has received from the lending banks as detailed in note 12b aforementioned, on March 7, 2013, the Company received Letters of Waiver regarding some of the financial covenants that have been determined in regards of the fourth quarter of 2013, as follows:

(1) The tangible shareholders equity that is defined in the agreement with the banks will not be less than 27.5 million dollars instead of 35 million dollars, as defined in the amended Letter of Agreement with the banks of December 24, 2010.

(2) The balance of the Company's trade receivables (less the trade receivables' balances for which the Company carried out factoring transactions) will not be less than 13 million dollars instead of 14 million dollars, as defined in the Letter of Amendment to the agreement with the banks of 24 December, 2010.

It is noted that no deviation of these aforementioned amounts would be allowed.

b. Negotiations regarding the selling of the swimwear activity

Currently the Company is in the midst of negotiation with a third unrelated party regarding selling the activities in the swimwear and beachwear field (hereinafter – "the sold activity"). At this stage of the negotiation, the amount of the proceeds to be paid by the third party for the sold activity is 300 thousand dollars US. If the negotiation is successful, the transaction would be subjected to several suspending conditions, inter alia, a due diligence and the conformation of the Company's lending banks.

It is hereby clarified that at this stage there is no certainty if and when the negotiation would indeed turn into binding contracts and what their final terms might be.

It is hereby notified that on March 3, 2013, the Board decided on leaving the field of manufacturing and marketing of swimwear and beachwear activities, regardless of the aforementioned transaction's completion or not.

Note 24 - Events after the balance sheet date (cont.)

c. Granting options to consultant

On March 17, 2013 the company's Board of Directors approved granting 12,500 option warrants which can be exercised to 12,500 ordinary shares of NIS 10 per value each to consultant, who is not an interested party of the Company and will not become an interested party in the Company after the granting of the options. The allotment of option warrants to the offeree, will be carried out according to option plans for employees, officers and consultants of the Company. The exercise price for every option will stand at 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 from March 17, 2013. The market value of the Company's shares on the day of granting the options was US Dollar 3.4. The value of the benefit included in granting these options according to the share price on the date of trading on the Stock Exchange aggregates 20 thousand dollars.

Appendix to Consolidated Financial Statements – List of subsidiaries

List of subsidiaries

Company name	Shares conferring voting and dividend rights December 31, 2012	2011 and 2010
Subsidiaries:		
Hi-Tex, founded by Tefron Ltd.	100%	100%
Macro Clothing Ltd.	100%	100%
Tefron USA Inc., wholly-owned by Tefron US Holdings, Corp.	100%	100%
Tefron UK Ltd., wholly-owned by Macro Clothing Ltd.	100%	100%
El-Masira Textile Co., wholly-owned by Tefron USA Inc.	100%	100%
Tefron Holdings (98) Ltd.	100%	100%
Tefron Macro HK Ltd., wholly-owned by Macro Clothing Ltd	100%	100%
Chica Textile marketing	100%	100%
Dormant companies		
Tefron US Holdings, Corp.	100%	100%
New net Industries	100%	100%
R.M.D Robotics Ltd	100%	100%
New Pal Ltd	100%	100%
Tech Style	100%	100%

Additional details regarding investments in subsidiaries as at December 31, 2012:

Subsidiaries wholly-owned and wholly-controlled (100%)	Number of shares the company holds	Shares per value (Dollars thousands)	Book value (Dollars thousands)	Capital notes (Dollars thousands)
Hi-Tex, founded by Tefron Ltd.	162,646	28,339	(13.540)	-
Macro Clothing Ltd	628	150	(11,925)	-
Tefron USA Inc., wholly-owned by Tefron US Holdings, Corp	100	0.0025	(4,672)	48,000
Tefron UK Ltd., wholly-owned by Macro Clothing Ltd.	0.001	0.001 GBP	3,929	-
El-Masira Textile Co., wholly-owned by Tefron USA Inc.	72	72	4,792	-
Tefron Holdings (98) Ltd.	100	27	-	12,095
Tefron Macro HK Ltd., wholly-owned by Macro Clothing Ltd	10,000	10,000 HK Dollar	-	-
Chica Textile marketing	100	27	-	-

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