

TEFRON LTD

**CONSOLIDATED FINANCIAL STATEMENTS
AS AT DECEMBER 31, 2018**

IN DOLLARS THOUSANDS

TEFRON LTD.

Consolidated Financial Statements as at December 31, 2018

In Dollars Thousands

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Auditor's Report
To the Shareholders of Tefron Ltd.

We have audited the accompanying consolidated balance sheets of Tefron Ltd. (hereinafter -"the Company") as at December 31, 2018 and 2017, and the consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2018. These financial statements are the responsibility of the Company's Board of Directors and management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, based on our audit, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company and its subsidiaries as at December 31, 2018 and 2017, and the results of their operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2018, in conformity with the International Financial Reporting Standards ("IFRS") and with the provisions of the Israeli Securities Regulations (Annual Financial Statements), 2010 .

Respectfully,

Brightman Almagor Zohar & Co.
Certified Public Accountants
Member of Deloitte Touche Tohmatsu Limited

Haifa, March 18, 2019

Tefron Ltd.

Consolidated Balance Sheets

		As at December 31	
		2018	2017
	Note	Dollars thousands	
<u>Current assets</u>			
Cash		1,876	1,220
Trade receivables, net	5	20,915	17,714
Other receivables	6	3,827	3,244
Inventory	7	29,485	25,684
		<u>56,103</u>	<u>47,862</u>
<u>Non-current assets</u>			
Property, plant and equipment, net	8	17,481	21,554
Goodwill and intangible assets, net	9a	124	75
Computer software, net	9b	1,722	1,612
Long-term receivables		-	118
Deferred taxes, net	17e	2,890	2,890
		<u>22,217</u>	<u>26,249</u>
		<u>78,320</u>	<u>74,111</u>

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

Tefron Ltd.

Consolidated Balance Sheets

	<u>Note</u>	<u>As at December 31</u>	
		<u>2018</u>	<u>2017</u>
		<u>Dollars thousands</u>	
<u>Current liabilities</u>			
Bank credit	10	18,908	14,185
A loan from the controlling shareholders	24l	2,000	-
Trade payables	11	22,103	21,854
Other payables	12	2,736	2,136
		45,747	38,175
<u>Non-current liabilities</u>			
Long-term loans from banks	13	6,707	9,202
A loan from the controlling shareholders	24l	-	1,852
Liabilities for bank options	15	37	20
Liabilities for benefits to employees, net	16	1,296	1,000
		8,040	12,074
<u>Equity attributed to the Company's shareholders</u>			
	19		
Share capital		33,617	33,617
Additional paid-in capital		99,686	99,686
Capital reserve for remeasurement of defined benefit plans		(2,072)	(1,541)
Accumulated deficit		(99,568)	(100,830)
Treasury shares		(7,408)	(7,408)
Capital reserve for hedging transactions		(144)	-
Other capital reserves		422	338
		24,533	23,862
<u>Total equity</u>		78,320	74,111

March 18, 2019

**Date of approval of the
financial statements**

**Arnon Tiberg
Chairman of the Board**

**Ben Lieberman
CEO**

**Eliezer Parnafes
CFO**

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

Tefron Ltd.

Consolidated Statements of Income

		For the year ended December 31		
		<u>2018</u>	<u>2017</u>	<u>2016</u>
		Dollars thousands (excluding data on earnings (loss) per share)		
	<u>Note</u>			
Sales		141,493	121,499	116,402
Cost of sales	21a	<u>113,204</u>	<u>99,103</u>	<u>92,531</u>
Gross profit		29,289	22,396	23,871
Development expenses, net	21b	3,897	4,468	3,991
Selling and marketing expenses	21c	19,130	15,479	13,401
General and administrative expenses	21d	3,373	2,985	3,055
Other expenses (income)	21e	<u>34</u>	<u>(235)</u>	<u>1,099</u>
Operating profit (loss)		<u>1,855</u>	<u>(301)</u>	<u>2,325</u>
Income from debt recycling, net	21f	2,818	-	-
Financing income	21f	113	75	9
Financing expenses	21f	<u>(3,411)</u>	<u>(2,892)</u>	<u>(2,673)</u>
Financing expenses, net		<u>(480)</u>	<u>(2,817)</u>	<u>(2,664)</u>
Income (loss) before taxes on income		1,375	(3,118)	(339)
Taxes on income	17	<u>(113)</u>	<u>(81)</u>	<u>(782)</u>
Net income (loss)		<u>1,262</u>	<u>(3,199)</u>	<u>(1,121)</u>
<u>Income (loss) per share attributable to equity shareholders of the Company</u>	22			
Basic and diluted income (loss) per share		<u>0.11</u>	<u>(0.27)</u>	<u>(0.09)</u>

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

Tefron Ltd.

Consolidated Statements of Comprehensive Income

	For the year ended		
	December 31		
	2018	2017	2016
	Dollars thousands		
Net income (loss)	<u>1,262</u>	<u>(3,199)</u>	<u>(1,121)</u>
Other comprehensive loss (after the effect of the tax):			
<u>Amounts that will not be reclassified subsequently to the statements of income:</u>			
Loss for re-measurement of defined benefit plan	<u>(531)</u>	<u>(282)</u>	<u>(27)</u>
Subtotal of items that will not be reclassified subsequently to the statements of income	<u>(531)</u>	<u>(282)</u>	<u>(27)</u>
<u>Amounts that will be reclassified or are reclassified to the statements of income provided that specific terms are met:</u>			
Unrealized loss due to interest rate transaction (Swap)	<u>(144)</u>	<u>-</u>	<u>-</u>
Subtotal of items that will be reclassified or are reclassified to the statements of income	<u>(144)</u>	<u>-</u>	<u>-</u>
Total other comprehensive loss	<u>(675)</u>	<u>(282)</u>	<u>(27)</u>
Total comprehensive income (loss) attributable to the Company's shareholders	<u>587</u>	<u>(3,481)</u>	<u>(1,148)</u>

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

Tefron Ltd.

Consolidated Statements of Changes in Shareholders' Equity

	Relating to the Company's shareholders							
Share capital	Additional paid-in capital	Reserve for actuarial losses	Accumulated deficit	Treasury shares	Capital reserve for hedging transactions	Other capital reserves	Total equity	
Dollars thousands								
<u>Balance as at January 1, 2018</u>	33,617	99,686	(1,541)	(100,830)	(7,408)	-	338	23,862
Net income	-	-	-	1,262	-	-	-	1,262
Total other comprehensive loss	-	-	(531)	-	-	(144)	-	(675)
Benefit from a shareholder	-	-	-	-	-	-	84	84
<u>Balance as at December 31, 2018</u>	33,617	99,686	(2,072)	(99,568)	(7,408)	(144)	422	24,533

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

Tefron Ltd.

Consolidated Statements of Changes in Share holders' Equity

	Relating to the Company's shareholders						Total equity
	Share capital	Additional paid-in capital	Reserve for actuarial losses	Accumulated deficit	Treasury shares	Other capital reserves	
	Dollars thousands						
<u>Balance as at January 1, 2017</u>	33,617	99,686	(1,259)	(97,631)	(7,408)	190	27,195
Loss	-	-	-	(3,199)	-	-	(3,199)
Total other comprehensive loss	-	-	(282)	-	-	-	(282)
A loan from the controlling shareholders	-	-	-	-	-	148	148
<u>Balance as at December 31, 2017</u>	<u>33,617</u>	<u>99,686</u>	<u>(1,541)</u>	<u>(100,830)</u>	<u>(7,408)</u>	<u>338</u>	<u>23,862</u>

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

Tefron Ltd.

Consolidated Statements of Changes in Shareholders' Equity

	Relating to the Company's shareholders						Total equity
	Share capital	Additional paid-in capital	Reserve for actuarial losses	Accumulated deficit	Treasury shares	Other capital reserves	
	Dollars thousands						
<u>Balance as at January 1, 2016</u>	33,617	99,627	(1,232)	(96,510)	(7,408)	237	28,331
Loss	-	-	-	(1,121)	-	-	(1,121)
Total other comprehensive loss	-	-	(27)	-	-	-	(27)
Share based payment to employees and directors	-	12	-	-	-	-	12
Expiry of rights to shares of the consultant	-	47	-	-	-	(47)	-
<u>Balance as at December 31, 2016</u>	33,617	99,686	(1,259)	(97,631)	(7,408)	190	27,195

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

Tefron Ltd.

Consolidated Statements of Cash Flows

**For the year ended
December 31**

2018	2017	2016
Dollars thousands		

Cash flows from operating activities

Net income (loss)	1,262	(3,199)	(1,121)
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Adjustments required to present cash flows from operating activities:

Adjustments to the statement of income items:

Depreciation and amortization:

Depreciation and amortization of fixed and intangible assets	5,041	4,940	5,257
Capital gain on sale of fixed assets	(2)	-	-
Gain due to the cancellation of a provision for impairment	-	(351)	-
Benefit from a shareholder	84	-	-
Cost of share based payments	-	-	12
Net income from debt recycling	(2,818)	-	-
Loss due to impairment of slow inventory	907	627	436
	3,212	5,216	5,705

Change in deferred taxes, net	-	-	340
Change in liabilities for benefits to employees, net	(235)	(79)	8
Change in fair value of liabilities for bank options	1	(75)	(9)
Taxes on income	415	415	303
Financing expenses, net	2,022	1,998	1,926
	2,203	2,259	2,568

Changes in assets and liabilities items:

Decrease (increase) in trade receivables	(3,201)	(1,033)	163
Decrease (increase) in other receivables	(465)	767	(1,091)
Increase in inventory	(4,708)	(1,737)	(6,186)
Increase in trade payables	1,325	4,124	3,724
Increase (decrease) in other payables	(689)	(410)	234
	(7,738)	1,711	(3,156)

Cash paid and received during the year for:

Interest paid	(1,874)	(1,972)	(1,897)
Interest received	-	-	6
Taxes paid	(415)	(415)	(303)
	(2,289)	(2,387)	(2,194)

Net cash provided from (used for) operating activities	(3,350)	3,600	1,802
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The accompanying notes are an integral part of the interim consolidated financial statements

Tefron Ltd.

Consolidated Statements of Cash Flows

	For the year ended December 31		
	2018	2017	2016
	Dollars thousands		
<u>Cash flows from investing activities</u>			
Purchase of fixed assets and intangible assets	(738)	(1,491)	(1,815)
Purchase of software	(422)	(411)	(286)
Proceeds from disposal of securities available for sale	35	-	-
Net cash used for investing activities	<u>(1,125)</u>	<u>(1,902)</u>	<u>(2,101)</u>
<u>Cash flows from financing activities</u>			
Short-term bank credit, net	5,551	(971)	3,756
Repayment of long-term loans	(9,344)	(1,650)	(1,650)
Receiving a long-term loan	10,000	-	-
Repayment of long-term credit for fixed assets	(1,076)	(1,211)	(1,217)
A loan from the controlling shareholders	-	2,000	-
Net cash provided by (used for) financing activities	<u>5,131</u>	<u>(1,832)</u>	<u>889</u>
<u>Increase (decrease) in cash and cash equivalents</u>	565	(134)	590
<u>Balance of cash and cash equivalents at beginning of year</u>	<u>1,220</u>	<u>1,354</u>	<u>764</u>
<u>Balance of cash and cash equivalents at end of year</u>	<u><u>1,876</u></u>	<u><u>1,220</u></u>	<u><u>1,354</u></u>

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

Tefron Ltd.

Notes to the 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 through subcontractors as well as by a self-production process in plants located in the Far East, Israel and Jordan. The Company and its subsidiaries focus on the development, production, marketing and sale of intimate apparel and activewear which are sold throughout the world to companies with leading brands. The Company operates in two operating business segments – brands and retail. For details regarding the business segments and operating markets, see Note 23 below.

The Company's shares are traded on the Tel Aviv Stock Exchange. For additional details, also see Note 19.

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

b. Definitions

In these financial statements:

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

Note 2 - Significant accounting principles

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

a. Basis of presentation of the financial statements

The financial statements are prepared in accordance with the International Financial Reporting Standards (hereinafter: "IFRS").

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

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

The Company has chosen to present profit or loss items according to the nature-of-expense method.

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 2 - Significant accounting principles (cont.)

b. Consolidated financial statements

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

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

c. Functional, presentation and foreign currency

1. Functional and presentation currency

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

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

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

2. Transactions, assets and liabilities in foreign currency

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

d. Exclusion of separate financial information in the framework of the periodic reports

In the framework of the periodic reports for 2018 the Company did not include separate financial information in accordance with Regulation 9c and the Tenth Addendum to the Securities Regulations (Periodic and Immediate Reports -1970) since the Company believes the

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 2 - Significant accounting principles (cont.)

d. Exclusion of separate financial information in the framework of the periodic reports (cont.)

information contained in it is negligible from a qualitative standpoint, in spite of its quantitative scope, the reason for which is mainly due to the fact that as stated in Note 13(2)b, the Group's credit agreement with the lending bank refer to Tefron Group as a whole with cross-guarantees between the entities of the Group and providing information regarding separate financial statements will not carry with it any additional material information to the reasonable investor (shareholder) or to the creditors regarding the liquidity risk of the parent company, that is not already included in the framework of the consolidated financial statements of the Company.

e. Allowance for doubtful accounts

The allowance for doubtful accounts is determined specifically in respect of trade receivables whose collection, in the opinion of the Company's management, is doubtful. Impaired trade receivables will be withdrawn once they are assessed as uncollectible. The Company does not carry out any further review at the level of the customer groups for those for which no allowance for impairment has been made separately, as aforementioned, since it believes that it has no material impact on the financial statements.

f. Inventory

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

The cost of inventory is determined as follows:

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

g. Revenue recognition

Revenue is measured and recognized at fair value of the consideration expected to be received in accordance with the terms of the contract, net of the amounts collected in favor of third parties (such as taxes). Revenue is recognized in the statements of income to the extent that the economic benefits are expected to flow to the Group, and the revenue and costs, if relevant, can be measured reliably.

The Group sells intimate apparel and activewear products which are sold to customers in the brands and retail segments worldwide.

While selling the products, the revenue is recognized when control of the goods is transferred to the customer. Usually, the delivery date is the date on which the control over the goods is transferred.

Revenues from the sale of goods

Revenues from the sale of goods are recognized once the significant risks and rewards derived from the ownership of the goods have been transferred to the buyer and the seller no longer

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 2 - Significant accounting principles (cont.)

g. Revenue recognition (cont.)

retains any continued managerial involvement. Usually the date of the delivery is the date on which the ownership was transferred.

Discounts to customers

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

h. Government grants

Government grants relating to assets such as fixed assets are presented as a deduction of the assets for which the grants were received.

i. Taxes on income

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

Deferred taxes

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

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

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

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

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

j. Discontinued operation

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

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 2 - Significant accounting principles (cont.)

k. Leasing

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

The Group as a lessee

Operating lease

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

The Group as a lessor

Operating lease

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

l. Fixed assets

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

	%
Land and buildings	2
Machinery and equipment (mainly 6.67%)	5-15
Office furniture and equipment (mainly 10%)	6-10
Leasehold improvements	see below

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

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

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

m. Investment Property

Investment property comprises real estate (land or building) held by the Group for the purpose of earning rentals or for capital appreciation or both, rather than for use in the production or supply of goods or services, or for administrative purposes or sale in the ordinary course of business.

The investment property of the Group includes buildings and land that are owned or leased under a finance lease. Investment property is initially recognized at cost which includes

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 2 - Significant accounting principles (cont.)

m. Investment Property (cont.)

transaction costs, as well as costs which can be directly attributed to bringing the asset to the condition necessary for it to be used in the manner intended by the management. In the periods subsequent to the initial recognition, the investment property is presented in the consolidated balance sheets at cost less accumulated depreciation and less accumulated impairment losses.

Depreciation of investment property is carried out by using the straight-line method over its estimated useful life from the date on which the asset is ready for its intended use. The depreciation expenses are recognized in profit or loss.

n. Computer software

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

Cost of software is measured on initial recognition at cost with the addition of costs directly attributable to the acquisition and capitalization of the expenses related to their cost.

The useful lifespan of the software is as follows:

	<u>%</u>
Computer software	25-33
ERP system	10

o. Intangible assets

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

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

The useful lifespan of the intangible assets is as follows:

	<u>Years</u>
Customer lists	8

Goodwill is not amortized methodically and is subject to consideration of its loss of impairment on a yearly basis, as well as any time there is an indication that there might be a loss from impairment (see also Note 9a, as follows).

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 2 - Significant accounting principles (cont.)

o. Intangible assets (cont.)

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

p. Impairment of non-financial assets

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

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

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

Goodwill

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

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

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 2 - Significant accounting principles (cont.)

q. Financial assets

(1) Classification of financial assets:

On January 1, 2018, the International Financial Reporting Standard IFRS 9 "Financial Instruments" (hereinafter: "IFRS 9") came into force.

The Company's policy regarding financial instruments that is implemented as of January 1, 2018, according to IFRS 9 is as follows:

The Company classifies its financial assets into the following categories: "financial assets at fair value through profit or loss" and "financial assets at amortized cost". The classification depends on the business model within which the financial assets are held and on the contractual terms of the cash flows in respect thereof.

The Company reclassifies its financial assets which are debt instruments only, and only when a change occurs in its business model for the management of the financial assets

a. Financial assets at amortized cost

Financial assets at amortized cost are financial assets held within the framework of a business model whose objective is to hold financial assets in order to collect contractual cash flows, and their contractual terms provide entitlement on defined dates to cash flows that are only principal and interest payments in respect of the principal amount that has not been repaid yet.

These assets are classified as current assets, except for maturities in respect of a period longer than 12 months after the date of the balance sheet statement, and then they are classified as non-current assets

b. Financial assets at fair value through profit or loss

These assets are classified as non-current assets unless the management intends to realize the investment therein within a period of up to 12 months after the date of the balance sheet statement or whose redemption date does not exceed 12 months after the date of the balance sheet statement and then are classified as current assets.

(2) Recognition and measurement:

Financial assets are recognized in the balance sheet statement when the Group becomes a party to the contractual terms of the instrument. Financial assets at amortized cost are initially recognized at fair value plus transaction costs and are measured in subsequent periods at amortized cost, based on the effective interest method. Financial assets that are presented at fair value through profit or loss are initially recognized at fair value and transaction costs are charged to the profit and loss statements. Financial assets at fair value through profit or loss are presented in subsequent periods at fair value. Any gain or loss arising from changes in fair value, including those arising from changes in exchange rates, is recognized in profit or loss in the period in which the change occurs (except for those used in hedging relationships). Regarding the method of measuring the fair value of the Group's financial instruments, see Note 14.

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 2 - Significant accounting principles (cont.)

q. Financial assets (cont.)

(3) Impairment of financial assets:

The Company examines at each reporting date whether there has been a significant increase in the credit risk of the financial asset since its initial recognition, either on an individual basis or on a group basis. For this purpose, the Company compares the risk of a default in the financial instrument at the reporting date with the risk of a default in the financial instrument on the initial recognition date, while considering all reasonable and supportable information, including forward-looking information. For financial assets with a significant increase in credit risk as of the date of initial recognition, the Company measures the provision for loss in an amount equal to the expected credit losses throughout the lifetime of the instrument. Otherwise, the provision for loss will be measured in an amount equal to expected credit losses in a period of 12 months. The amount of the expected credit differentials (or cancellation thereof) is recognized in profit or loss as part of "gains (losses) from impairment of financial assets and assets in respect of contracts with customers, net". For financial instruments with low credit risk, the Company assumes that the credit risk did not increase significantly from the date of initial recognition thereof.

(4) Derecognition of financial assets

Financial assets are derecognized when the rights to receive cash flows from the investments have expired or been transferred, and the Company has transferred all risks and rewards of ownership of these assets. During the derecognition of a financial asset that is measured at amortized cost, the difference between the carrying amount of the asset and the consideration received or that is supposed to be received is recognized in profit or loss

r. Financial liabilities and equity instruments issued by the Group

Classification as a financial liability or an equity instrument:

Liabilities and equity instruments issued by the Group are classified as financial liabilities or as equity instruments in accordance with the nature of the contractual arrangements and the definition of a financial liability and an equity instrument.

An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities. Equity instruments issued by the Group are recorded at the proceeds received, net of costs directly related to the issuance of these instruments.

Financial liabilities are presented and measured in accordance with the following classification:

- Financial liabilities at fair value through profit or loss.
- Other financial liabilities at an amortized cost.

Financial liabilities at fair value through profit or loss:

Financial liabilities at fair value through profit and loss are presented at fair value with any gains or losses arising from changes in fair value recognized in profit or loss.

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 2 - Significant accounting principles (cont.)

r. Financial liabilities and equity instruments issued by the Group (cont.)

Financial liabilities at amortized cost:

Financial liabilities at amortized cost are recognized initially at fair value after deducting transaction costs. After the initial recognition, other financial liabilities are measured at amortized cost using the effective interest method.

The effective interest method is a method of calculating the amortized cost of a financial liability and of allocating interest expenses over the relevant period. The effective interest rate is the rate that exactly discounts the flow of estimated future cash flows over the expected life of the financial liability to the carrying amount thereof, or, where appropriate, over a shorter period.

Derecognition of financial liabilities:

The Group derecognizes a financial liability only when the financial liability is discharged, canceled or expires. The difference between the carrying amount of the financial liability settled and between the consideration paid is recognized in profit or loss.

s. Derivative financial instruments for hedging accounting

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

Gains or losses resulting from changes in the fair value of derivatives which are not used for hedging purposes are immediately recorded to profit or loss.

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

Hedging fair value

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

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 2 - Significant accounting principles (cont.)

s. Derivative financial instruments for hedging accounting (cont.)

Hedging cash flows

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

Other comprehensive income (loss) is transferred to profit or loss when the results of the hedging transaction are recorded to profit or loss; for example, when the hedged revenue or expense is recognized in profit or loss 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 related other relative comprehensive income (loss) which is transferred from shareholders' equity on the date of the recognition of the asset or liability.

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

t. Fair value measurement

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

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

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

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

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

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

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 2 - Significant accounting principles (cont.)

t. Fair value measurement (cont.)

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

u. Treasury shares

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

v. Provisions

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

Legal claims

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

Restructuring costs

Provisions for restructuring costs are recognized when the Group has formulated a detailed formal plan for restructuring and has created a valid expectation among those affected by it for the execution of the plan by way of commencing the implementation of the plan or by way of giving notice to those affected by it.

The provision for restructuring costs includes the costs that are directly associated with the restructuring. As part of the provision the costs which are needed for the execution of the restructuring and which are unrelated to the Group's continuing operations, are included.

w. Liabilities for benefits to employees

The Group has several employee benefits:

1. Short-term employee benefits:

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

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 2 - Significant accounting principles (cont.)

w. Liabilities for benefits to employees (cont.)

2. Post-employment benefits

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

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

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

In addition, the Group also has a defined benefit plan with regard to severance pay pursuant to the Israeli Severance Pay Law. According to the Law, employees are entitled to severance pay upon dismissal or retirement. The liability in regards with termination of employment is determined using the actuarial value of the projected entitlement unit method. The actuarial calculation takes into account future salary increases and rates of employee turnover based on the estimated time of payment. The amounts are presented based on discounted expected future cash flows, at interest rates in accordance with the expected yield at the reporting date of index-linked high-quality corporate bonds with maturity dates that are close to the liability period in respect of the severance pay.

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

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

Remeasurement of the liability net is recorded as other comprehensive income in the period in which they occur.

x. Share-based payment transactions

The Company's employees, directors and service providers are entitled to benefits in the form of share-based payment which are 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 on the granting date. Fair value is determined using an appropriate pricing model, for additional details see Note 20, as follows.

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 2 - Significant accounting principles (cont.)

x. Share-based payment transactions (cont.)

Transactions settled with equity instruments (cont.)

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

The cost of transactions settled with equity instruments is recognized in profit or loss, together with a corresponding increase in equity, over the period in which the performance conditions exist, and ends on the date on which the relevant employees and directors become entitled to the benefit (hereinafter – “the vesting period”). The cumulative expense recognized for transactions settled with equity instruments at the end of 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 profit or loss represents the change in cumulative expense recognized at the beginning and end of that reporting period.

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

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

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

y. Earnings (loss) per share

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

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

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 3 - New financial reporting standards, published interpretations and amendments to standards

a. Amendments to standards affecting the current period and/or previous reporting periods

IFRS 9 – "Financial Instruments"

International Financial Reporting Standard (IFRS 9) "Financial Instruments" (hereinafter: the "standard") is the final standard of the financial instruments project. The standard presents a new model to examine a forecasted loss from impairment as detailed as follows.

The new model for impairment which is based on expected credit losses is applied to debt instruments measured at amortized cost or at fair value through other comprehensive income, receivables in respect of lease, contract assets recognized under IFRS 15 and written obligations to provide loans and financial guarantee contracts. The provision for impairment is for expected losses according to the probability of default in the following 12 months (the coming year), or according to the probability of default throughout the lifetime of the instrument. Examination over the lifetime of the instrument is required if the credit risk has increased significantly from the initial recognition date of the asset. Another approach applies with originated credit-impaired financial assets. The standard adds presentation guidelines and disclosures relating to the impairment of financial instruments.

The effect of the initial implementation of this standard on the Group's financial statements is not material.

IFRS 15 – "Revenue from Contracts with Customers"

The standard replaced the directives regarding the recognition of revenue from contracts with customers and presented a new model for recognition of this revenue. According to the standard, revenue from contracts is recognized in profit or loss when the control of the asset is transferred to the customer.

In order to determine the point in time at which the customer obtains control over a promised asset and the Group satisfies a performance obligation, the Group considers indicators of the transfer of control, which mainly include the following:

- The Group has a present right to payment for the asset;
- The customer has legal title to the asset;
- The Group has transferred physical possession of the asset;
- The customer has the significant risks and rewards of ownership of the asset;
- The customer has approved the acceptance of the asset;

Revenue is measured and recognized according to the fair value of the consideration expected to be received in accordance with the terms of the contract, net of the amounts collected in favor of third parties (such as taxes). Revenue is recognized in profit or loss to the extent that it is probable that the economic benefits will flow to the Group, and the revenue and costs, if relevant, can be measured reliably.

Regarding the disaggregation of revenue from contracts with customers into groups that depict the manner in which the nature of the amount, timing and uncertainty of revenue and cash flows are affected by economic factors, see Note 23, below.

The effect of the initial implementation of this standard on the Group's financial statements is not material.

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 3 - New financial reporting standards, published interpretations and amendments to standards (cont.)

b. Standards, interpretations and amendments thereto which have been published and are not in effect, and were not adopted early by the Group, which are expected or likely to have an effect on future periods:

IFRS 16 – "Leases"

The new standard replaces IAS 17 "Leases" and the related interpretations thereto, and sets out the principles for the recognition, measurement, presentation and disclosure of leases in relation to both parties of a transaction, meaning the customer ('lessee') and the supplier ('lessor'). The standard does not change the current accounting treatment of the books of the lessor.

The new standard eliminates the existing distinction regarding lessee, between finance leases and operating leases and determines a uniform accounting model in relation to all types of leases. In accordance with the new model, for every leased asset, the lessee is required to recognize the asset for right-of-use on the one hand, and on the other hand, the financial liability for the leasing fees.

The provisions for recognizing the asset and liability, as aforementioned, shall not apply in respect of assets leased for a period of up to 12 months and in relation to leases of low-value assets (for example, personal computers).

Accordingly, leases of real estate and vehicles within the Group that are currently treated as operating leases will be recognized as assets and liabilities in the Group's balance sheets statements once the standard is applied.

The standard shall take effect regarding annual reporting periods beginning on January 1, 2019 or thereafter. Earlier application is permitted; however, this provided that IFRS 15 "Revenue from Contracts with Customers" is also applied.

The Group estimates that it will choose not to retroactively adjust the comparative data.

The management of the Group estimates that the main effects expected at the date of the initial application of the standard, are as follows:

The main effects expected on the balance sheets of the Group as at January 1, 2019 (in thousands of dollars) (*):

<u>The leased asset</u>	<u>Asset in respect of right-of-use</u>	<u>Liability in respect of leasing</u>
Real estate	1,175	(1,175)
Vehicles	339	(339)
Total	<u>1,514</u>	<u>(1,514)</u>

The discount rates used for the above calculations are based on the price of the Group's incremental debt regarding each lease, depending on the amount of the lease, its average life span, the quality of the leased asset, etc. The range of the discount rate is primarily between 4% and 5% in respect of real estate and 3% in respect of vehicles.

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 3 - New financial reporting standards, published interpretations and amendments to standards (cont.)

b. Standards, interpretations and amendments thereto which have been published and are not in effect, and were not adopted early by the Group, which are expected or likely to have an effect on future periods (cont.)

The expected main effects on the statements of income for the year 2019 (in thousands of dollars) (*):

<u>The leased asset</u>	<u>Decrease in lease expenses under IAS 17</u>	<u>Increase in depreciation expenses under IFRS 16</u>	<u>Total increase in profit from ordinary operations</u>	<u>Increase in financing expenses under IFRS 16</u>	<u>Decrease in tax expenses under IFRS 16</u>	<u>Total decrease in revenue for the year</u>
Real estate	(271)	235	36	59	(5)	(18)
Vehicles	(160)	152	8	10	(1)	(1)
Total	<u>(431)</u>	<u>387</u>	<u>44</u>	<u>69</u>	<u>(6)</u>	<u>(19)</u>

The expected main effects on the statements of cash flows for the year 2019 (in thousands of dollars) (*):

<u>The leased asset</u>	<u>Increase in the cash flow from operating activities</u>	<u>Decrease in cash flow from financing activities</u>
Real estate	213	(213)
Vehicles	150	(150)
Total	<u>363</u>	<u>(363)</u>

(*) The above estimates are based on the balance of the relevant leased assets that exist within the Group as at the date of the balance sheets statements, according to the expected manner of implementation thereof

It should be emphasized that the information presented in this Note regarding the scope of the effects of the initial implementation of the standard constitutes an estimation of the Company based on the current mapping, the Company's lease agreements and, in accordance with the Company's understanding, the provisions of the standard at this stage. The quantitative data that will be included in the financial statements for the initial implementation period may differ from the Company's estimation at this stage as a result of the continuation of the formulation of the accounting policy regarding this subject and completion of the examination of the overall impact of the implementation of IFRS 16 on its financial statements.

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 4 – Considerations in applying accounting policies and key factors of uncertainty in an estimate

While implementing the Group's accounting policies, as described in Note 2 above, the Company's management is required, in some cases, to exercise comprehensive accounting discretion concerning the accounting estimates and assumptions regarding the carrying amounts of assets and liabilities that are not necessarily available from other sources. The related estimates and assumptions are based on past experience as well as other relevant factors. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed regularly by the management. Revisions to the accounting estimates are recognized only at the period of time in which a change in the estimate was carried out, provided that the change has an impact only on that period of time or are recognized at the aforementioned period of time and in future periods of time, provided that the change has an impact on both the current period and future periods.

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

Impairment of fixed assets

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

Deferred tax assets

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

Note 5 - Trade receivables, net

	<u>As at December 31,</u>	
	<u>2018</u>	<u>2017</u>
	<u>Dollars thousands</u>	
Open receivables	20,867	17,746
Checks for collection	81	1
	<u>20,948</u>	<u>17,747</u>
With deduction - provision for doubtful debts	<u>(33)</u>	<u>(33)</u>
Trade receivables, net	<u>20,915</u>	<u>17,714</u>

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 5 - Trade receivables, net (cont.)

Out of the total balance of trade receivables as at December 31, 2018, US 2.4 million dollars (2017: US 8.1 million dollars) are in respect of a debt of the customer A.

The Company had an agreement with a financial corporation in a factoring contract in respect of certain debts of its customers.

Following the financing agreement with HSBC, the Company stopped carrying out factoring transactions during the second quarter of 2018.

As at December 31, 2017, the total sum of debts for which a discount was carried out amounted to US 2.5 million dollars. The balance of trade receivable is shown net of the aforementioned amount.

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

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

	Dollars thousands
<u>Balance as at January 1, 2017</u>	113
Amounts of written off doubtful debts	(80)
<u>Balance as at December 31, 2017</u>	33
Provision during the year	111
Amounts returned during the year	-
Amounts of written off doubtful debts	(111)
<u>Balance as at December 31, 2018</u>	33

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

	Trade receivables whose debts have not yet fallen due (no delay in collection)	Past due trade receivables and the delay in their collection is					
		Under 30 days	30 – 60 days	60 – 90 days	90 – 120 days	Over 120 days	
Dollars thousands							
December 31, 2018	19,023	1,252	210	188	7	235	20,915
December 31, 2017	15,439	890	168	427	164	626	17,714

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 6 - Other receivables

	December 31,	
	2018	2017
	Dollars thousands	
Prepaid expenses	1,403	1,096
Advances to vendors	280	536
Institutions	1,173	944
Other receivables	971	668
	<u>3,287</u>	<u>3,244</u>

Note 7 – Inventories

	December 31,	
	2018	2017
	Dollars thousands	
Raw Materials	2,911	2,043
Work in process	3,801	2,743
Finished goods	22,773	20,898
	<u>29,485</u>	<u>25,684</u>

(*) An impairment of slow inventory recognized as part of cost of sales amounted to 907 thousand dollars (2017 – 627 thousand dollars).

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 8 – Fixed assets

a. Composition and movement:

The year of 2018

	<u>Land and buildings</u>	<u>Machinery and equipment (*)</u>	<u>Office furniture and equipment</u>	<u>Leasehold improve- ments</u>	<u>Total</u>
	<u>Dollars thousand</u>				
<u>Cost</u>					
Balance as at January 1, 2018	3,863	127,716	3,222	7,738	142,539
Additions during the year	-	230	249	246	725
Withdrawals during the year	-	(160)	-	-	(160)
Balance as at December 31, 2018	3,863	127,786	3,471	7,984	143,104
<u>Accumulated depreciation</u>					
Balance as at January 1, 2018	1,802	109,151	2,406	6,260	119,619
Additions during the year	70	4,220	350	650	5,290
Withdrawals during the year	-	(127)	-	-	(127)
Balance as at December 31, 2018	1,872	113,244	2,756	6,910	124,782
<u>Provision for impairment</u>					
Balance as at January 1, 2018	119	1,209	38	-	1,366
Amortization during the year	-	(498)	(27)	-	(525)
Balance as at December 31, 2018	119	711	11	-	841
<u>Balance of amortized cost as at December 31, 2018</u>	1,872	13,831	704	1,074	17,481

(*) Machinery and equipment are presented net of investment grants.

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 8 – Fixed assets (cont.)

a. Composition and movement (cont.)

The year of 2017

	<u>Land and buildings</u>	<u>Machinery and equipment (*)</u>	<u>Office furniture and equipment</u>	<u>Leasehold improve- ments</u>	<u>Total</u>
	<u>Dollars thousand</u>				
<u>Cost</u>					
Balance as at January 1, 2017	3,863	126,826	2,898	7,461	141,048
Additions during the year	-	890	324	277	1,491
Balance as at December 31, 2017	<u>3,863</u>	<u>127,716</u>	<u>3,222</u>	<u>7,738</u>	<u>142,539</u>
<u>Accumulated depreciation</u>					
Balance as at January 1, 2017	1,724	104,563	2,104	5,660	114,051
Additions during the year	78	4,588	302	600	5,568
Balance as at December 31, 2017	<u>1,802</u>	<u>109,151</u>	<u>2,406</u>	<u>6,260</u>	<u>119,619</u>
<u>Provision for impairment</u>					
Balance as at January 1, 2017	470	2,055	124	-	2,649
Cancellation of provision for impairment	(351)	-	-	-	(351)
Amortization during the year	-	(846)	(86)	-	(932)
Balance as at December 31, 2017	<u>119</u>	<u>1,209</u>	<u>38</u>	<u>-</u>	<u>1,366</u>
<u>Balance of amortized cost as at December 31, 2017</u>	<u>1,942</u>	<u>17,356</u>	<u>778</u>	<u>1,478</u>	<u>21,554</u>

(*) Machinery and equipment are presented net of investment grants.

b. Regarding liens, see Note 18c

c. Examining the recoverable amount of a cash-generating unit

In 2017, in view of the losses of the brands segment, the Company estimated the recoverable amount of a cash-generating unit to which machinery and equipment and some of the improvements in leased properties are attributed by an external independent appraiser. The valuation was carried out at fair value less costs of sale. In accordance with the examination as described above, it was determined that no impairment is required. As of December 31, 2018, the said loss continued. The Company, through its external appraiser, reviewed the assumptions and estimates at the basis for the aforesaid valuation and found that no change has occurred therein, and therefore, based on the model used in the previous valuation, it was determined that no impairment is required.

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 8 – Fixed assets (cont.)

d. Purchase of fixed assets on credit

Between the years 2016 - 2018 the Company did not purchase fixed assets on credit. In 2015 the Company purchased fixed assets on credit on the sum of US 2,750 thousand dollars for a period of three years and nine months, so as of March 31, 2015 till September 30, 2018 the principal and interest were repaid.

Note 9 - Other assets

a. Goodwill and intangible assets

The year of 2018

	<u>List of customers</u>	<u>Patents</u>	<u>Goodwill</u>	<u>Total</u>
	Dollars thousand			
Balance as at January 1, 2018	2,037	62	49	2,148
Additions during the year	-	13	-	13
Balance as at December 31, 2018	2,037	75	49	2,161
<u>Accumulated amortization</u>				
Balance as at January 1, 2018	2,011	-	-	2,011
Amortization recognized during the year	26	-	-	26
Balance as at December 31, 2018	2,037	-	-	2,037
Amortized balance as at December 31, 2018	-	75	49	124

The year of 2017

	<u>List of customers</u>	<u>Patents</u>	<u>Goodwill</u>	<u>Total</u>
	Dollars thousand			
Balance as at January 1, 2017	2,037	-	49	2,086
Additions during the year	-	62	-	62
Balance as at December 31, 2017	2,037	62	49	2,148
<u>Accumulated amortization</u>				
Balance as at January 1, 2017	1,873	-	-	1,873
Amortization recognized during the year	138	-	-	138
Balance as at December 31, 2017	2,011	-	-	2,011
Amortized balance as at December 31, 2017	26	62	49	137

The list of customers and goodwill were bought through business combinations. The customer list is amortized over a period of 8 years.

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 9 - Other assets (cont.)

b. Computer software

The year of 2018

	<u>Computer software</u> <u>Dollars</u> <u>thousand</u>
<u>Cost</u>	
Balance as at January 1, 2018	3,760
Additions during the year	<u>422</u>
Balance as at December 31, 2018	----- 4,182
<u>Accumulated amortization</u>	
Balance as at January 1, 2018	2,210
Amortization recognized during the year	<u>250</u>
Balance as at December 31, 2018	----- 2,460
Amortized balance as at December 31, 2018	<u><u>1,722</u></u>

The year of 2017

	<u>Computer software</u> <u>Dollars</u> <u>thousand</u>
<u>Cost</u>	
Balance as at January 1, 2017	3,411
Additions during the year	<u>349</u>
Balance as at December 31, 2017	----- 3,760
<u>Accumulated amortization</u>	
Balance as at January 1, 2017	2,044
Amortization recognized during the year	<u>166</u>
Balance as at December 31, 2017	----- 2,210
Amortized balance as at December 31, 2017	<u><u>1,550</u></u>

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 10 - Credit from banks

a. Composition

	<u>In NIS</u>	<u>Unlinked</u>	<u>Total</u>
	<u>Dollars thousands</u>		
December 31, 2018			
Short-term credit from banks	-	15,615	15,615
Current maturities of long-term loans	-	3,293	3,293
	<u>-</u>	<u>18,908</u>	<u>18,908</u>
December 31, 2017			
Short-term credit from banks	914	11,621	12,535
Current maturities of long-term loans	-	1,650	1,650
	<u>914</u>	<u>13,271</u>	<u>14,185</u>

b. Regarding collateral and liens see Note 18c, as follows.

Note 11 - Trade payables

	<u>As at December 31</u>	
	<u>2018</u>	<u>2017</u>
	<u>Dollars thousands</u>	
Open accounts	19,026	16,446
Notes payable	3,077	5,408
	<u>22,103</u>	<u>21,854</u>

Note 12 - Other payables

	<u>As at December 31</u>	
	<u>2018</u>	<u>2017</u>
	<u>Dollars thousands</u>	
Liability to employees and other liabilities for wages and salaries	2,165	1,807
Accrued expenses	427	259
Derivative financial instrument	144	-
Institutions	-	70
	<u>2,736</u>	<u>2,136</u>

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 13 - Long-term loans from banks

1. Composition:

As at December 31, 2018

	<u>Nominal rate of interest</u> <u>%</u>	<u>Balance</u> <u>Dollars</u>	<u>Balance less current maturities</u> <u>thousands</u>
Loans from banks	Libor + 2.35	<u>10,000</u>	<u>6,707</u>

On June 29, 2018, the Company executed a swap transaction (interest swap) with the bank in order to fix the LIBOR interest at 3.03% on the long-term loan received from the bank. (The Libor interest on the date of the swap transaction was 2.33%).

As at December 31, 2017

	<u>Nominal rate of interest</u> <u>%</u>	<u>Balance</u> <u>Dollars</u>	<u>Balance less current maturities</u> <u>thousands</u>
Loans from banks	Libor + 4.5-5	<u>10,852</u>	<u>9,202</u>

2. Financing reorganization

- a. On March 22, 2018, the Company received the consent of the banks which finance the Company's operations, Bank Leumi Le-Israel Ltd., Israel Discount Bank Ltd. And Bank Hapoalim Ltd. (hereinafter: the "banks") according to which for the purpose of replacing the financing of the Company's operations in financing led by a foreign bank and/or banks (if and to the extent that such financing is received), the banks agree that the Company will repay its debts to the banks in an early repayment in such a manner that 82% of the debts will be repaid and the remaining 18% will be forgiven by the banks (hereinafter: the "early repayment"). A condition for the early repayment was a change in the exercise price of 300,000 options allocated by the Company to the banks, so the exercise price shall be US 1 dollar instead of US 1.43 dollars. The aforesaid consent is subject to the early repayment being made no later than April 26, 2018. If such a repayment as aforesaid is not carried out, the existing debt arrangement between the Company and the banks will remain in effect. The total debt of the Company to the banks as at March 20, 2018 amounted to US 23.6 million dollars.

On March 29, 2018, a financing agreement was signed (for details see Clause b as follows) which enabled the execution of the early repayment. Immediately following the Passover holiday, on April 10, 2018, the early repayment to the banks was carried out in accordance with the conditions detailed above.

- b. On March 29, 2018, a financing agreement was signed with the following parties: Tefron Canada Inc., a private Canadian subsidiary wholly-owned by the Company, as the borrower (hereinafter: "Tefron Canada"), the Company, as the parent company (hereinafter: "Tefron Israel") and the bank HSBC Canada as the lender (hereinafter: "the bank"), for the purpose of providing alternative financing to the current bank financing (hereinafter: the "agreement") whose principal terms are as follows:

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 13 - Long-term loans from banks (cont.)

2. Financing reorganization (cont.)

b. (cont.)

1. The financing amounts to a total cumulative principal of up to US 38 million dollars (hereinafter: "dollars") which will be divided as follows:
 - (1) Credit to Tefron Canada in the amount of 13 million dollars by means of a bank guarantee that shall guarantee credit to Tefron Israel, through HSBC Israel (hereinafter: the "**bank in Israel**"), as follows: (a) a long-term loan in the principal amount of US 10 million dollars (hereinafter: the "**long-term loan**"), and (b) credit for working capital in the principal amount of 3 million dollars. It should be noted that any repayment of the long-term loan, in whole or in part, as applicable, will reduce the amount of the credit line in the sum of 13 million dollars, respectively;
 - (2) Credit up to an amount of 25 million dollars that shall be provided to Tefron Canada by the bank on the basis of volume of collateral, which will be examined monthly. The eligibility for credit withdrawals will be based on the following eligibility amounts:
 - a. Cumulative debt amounts of the trade receivables of Tefron Canada and the trade receivables of Tefron Israel's subsidiary, Tefron USA Inc. (hereinafter: "**Tefron USA**"), all in accordance with the terms of the agreement (with a multiplier of 75% - 90% according to the type of customer); plus;
 - b. The lower of: (1) 50% of the inventory value of the finished goods of Tefron Canada and Tefron USA, subject to pledges under the agreement; and (2) US 10 million dollars; plus;
 - c. 100% of the value of the cash in the bank accounts of Tefron Canada and Tefron USA; plus;
 - d. 50% of the appraised value of 2 real estate properties owned by Tefron USA in North Carolina, USA, after these properties are pledged in accordance with the provisions of the agreement; Less amounts secured by a pledge which has priority or may have priority over the collateral given to the bank pursuant to the agreement.
2. In addition to the financing mentioned in Clause 1 above, the bank will provide, at its discretion, a facility for the execution of hedging transactions on interest differentials in the amount of 4 million dollars and a facility for the execution of hedging transactions on currency exchange differences in the amount of 2.3 million dollars.
3. The long-term loan will be repaid in seven equal annual payments, when in any case there is free cash flow, the repayment will be accelerated (within 120 days as of the end of the calendar year) at a rate of one percent of the free cash flow determined by Tefron Israel's annual EBITDA (on consolidated basis), based on the ratio of debt to EBITDA¹ of Tefron Israel, on a consolidated basis, as follows:

¹ In the framework of the agreement, it was agreed upon that in respect of the period of up to September 30, 2018, to the calculation of EBITDA according to the financial statements and in accordance with the terms of the agreement, will be added an amount of 2 million dollars.

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 13 - Long-term loans from banks (cont.)

2. Financing reorganization (cont.)

b. (cont.)

When R represents the ratio of debt to EBITDA:	Percentage of repayment out of the free cash flow
$R \leq 1.00$	0%
$1.00 < R \leq 2.00$	15%
$2.00 < R \leq 3.00$	25%
$R > 3.00$	40%

When for this purpose the "free cash flow" is the amount of EBITDA less interest payments, tax payments, unfinanced investments and long-term loan principal payments according to its amortization schedule.

4. The interest on the financing will be variable interest, which will include a margin above the base interest rate, such as LIBOR or prime as detailed as follows:

When R represents the ratio of debt to EBITDA:	Percentage of margin
$R \leq 1.50$	1.25% - 2.25%
$1.50 < R \leq 2.00$	1.5% - 2.5%
$2.00 < R \leq 3.00$	1.75% - 2.75%
$R > 3.00$	2% - 3%

5. The collateral for the financing will be as follows:
- First ranking charge in Canada by Tefron Canada on all of its assets.
 - Floating and fixed charge first in rank in Israel and Jordan on all assets of Tefron Israel.
 - First ranking charge on all shares held by Tefron Israel in Tefron Canada Inc. and Tefron US Holdings Inc. (a subsidiary holding Tefron USA).
 - First ranking charge on the bank accounts of Tefron Israel and its subsidiaries.
 - Tefron Israel and its subsidiaries' guarantee to the debts of Tefron Canada to the bank.
 - The guarantee of EDC - Export Development Canada, which assists the Canadian government in financing the export activities of Canadian companies (hereinafter: "EDC"), in an amount equal to 75% of the credit line on the sum of 13 million dollars given to the bank in Israel by the bank.

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 13 - Long-term loans from banks (cont.)

2. Financing reorganization (cont.)

b. (cont.)

6. The financing is subject to the fulfillment of the financial covenants which will be examined on a quarterly basis on the basis of the financial statements of Tefron Israel, on a consolidated basis, as follows:
 - a. Debt service cover ratio of at least 1.25 times.

"Debt service cover ratio" means - for the last consecutive twelve months preceding the calculation date, the ratio between the total payments to the bank (principal and interest) and net EBITDA (as defined in the agreement).
 - b. Debt to EBITDA ratio of no more than:
 - (1) 6.00 times for the quarter ending March 31, 2018.
 - (2) 4.00 times for the quarter ending June 30, 2018.
 - (3) 3.50 times any time thereafter.
7. In accordance with the agreement, Tefron Israel and its subsidiaries in connection with the financing are subject, *inter alia*, to the following restrictions:
 - a. A negative pledge by Tefron Israel and its subsidiaries (excluding pledges permitted under the agreement);
 - b. Until full repayment of the provided credits, Tefron Israel will continue to hold, directly or indirectly, full ownership of each of its subsidiaries;
 - c. The Lieberman family will continue to hold the control of the Company;
 - d. The total amount of annual investments of the Group shall not exceed 2 million dollars;
 - e. Prohibition on taking loans as defined in the agreement;
 - f. Prohibition of dividend distribution.
8. The agreement determines that the financing is at the bank's full discretion at any time, and in addition, in the framework of the agreement accepted grounds for immediate repayment were determined, granting the bank the right to call for an immediate repayment of Tefron Canada's liabilities to it, including upon the occurrence of a breach of Tefron Israel's loan agreements with HSBC Israel and/or a breach by any party of Tefron Group of the agreements or other documents relating to the provision of the credit and/or in an amount exceeding 750,000 dollars.

The early repayment involved a payment to the banks of an early repayment fee of 160,000 dollars.

The financing was provided immediately after Passover, on April 10, 2018.

On November 5, 2018, an additional line of credit was granted by the Bank to Tefron Canada, as part of the general terms of the financing agreement which is intended to issue documentary letters of credit up to a total amount of US 3 million dollars, when each letter of credit, as aforementioned, is given for a period of up to 12 months (hereinafter: the "additional financing"). The additional financing is secured by a guarantee of EDC as well as by the Company's guarantee, in the full amount of the additional financing.

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 13 - Long-term loans from banks (cont.)

2. Financing reorganization (cont.)

b. (cont.)

Subsequent to the date of the report, on February 21, 2019, an addendum to the financing agreement was signed, whose main principals are:

- (1) the provision of an additional line of credit of up to US 5 million dollars to finance advances to be received from Walmart. It should be noted that the Company executes the sales to Walmart through its wholly owned subsidiary Hosiery Lamour Inc. ("Lamour"). Lamour is able to advance payments from Walmart through Walmart's special plan to advance payments to suppliers that is used by Walmart and the bank Wells Fargo Bank ("Wells"). The additional credit line is intended to advance the payments received by Lamour from Wells.
- (2) The amendment of the commitment to comply with the financial covenant of the debt to EBITDA ratio, which according to the financing agreement was 3.5 times as of the third quarter of 2018, to no more than: (a) 4.00 times for the quarter ending December 31, 2018 (b) 4.00 for the quarter ending on March 31, 2019 (c) 3.5 any time thereafter.

As at December 31, 2018, the Company met the financial covenants that were determined in the financing agreement, as detailed above, according to the following:

Debt service cover ratio of at least 1.25 times, was 2.69.

Debt to EBITDA ratio of no more than 3.5 times was 3.05.

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 14 - 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:

	<u>As at December 31,</u>	
	<u>2018</u>	<u>2017</u>
	<u>Dollars thousands</u>	
<u>Financial assets</u>		
Financial assets measured at amortized cost:		
Trade receivables	20,915	17,714
Receivables	2,654	2,300
Long-term receivables	-	118
Total financial assets measured at amortized cost	<u>23,569</u>	<u>20,132</u>
Total financial assets	<u>23,569</u>	<u>20,132</u>
Total current financial assets	<u>23,569</u>	<u>20,014</u>
Total non-current financial assets	<u>-</u>	<u>118</u>
<u>Financial liabilities</u>		
Financial liabilities measured at amortized cost:		
Loans and short-term credit from banks	25,615	23,387
A loan from the controlling shareholders	2,000	1,852
Trade payables	22,103	21,854
Payables	2,253	1,556
Total financial liabilities measured at amortized cost	<u>51,971</u>	<u>48,649</u>
Financial liabilities at fair value through profit or loss:		
Liabilities in respect of options to banks	37	20
Derivative financial instrument	144	-
Total financial liabilities at fair value through profit or loss	<u>181</u>	<u>20</u>
Total financial liabilities	<u>52,152</u>	<u>48,669</u>
Total current financial liabilities	<u>45,408</u>	<u>37,566</u>
Total non-current financial liabilities	<u>6,744</u>	<u>11,103</u>

b. Financial risk factors

The Group's activities expose it to various financial risks such as market risks (including foreign exchange risk and interest rate risk), credit risk and liquidity risk. The Group's comprehensive risk management plan focuses on activities that reduce to a minimum any possible negative effects on the Group's financial performance. The Group utilizes derivative financial instruments in order to hedge certain exposures to risks.

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

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 14 - Financial instruments (cont.)

b. Financial risk factors (cont.)

1. Foreign currency risk

The Group operates in a large number of countries and is exposed to foreign currency risk resulting from the exposure to different currencies, mainly the NIS and the Euro. Foreign exchange risk arises from future commercial transactions, recognized assets and liabilities denominated in a different currency from the functional and the reporting currency of the Company (US Dollar). The finance department is responsible for managing the net position of each foreign currency by the use of forward contracts and currency options, according to the Company's hedging policy. In general, the management's policy is to hedge the forecasted payroll expenses denominated in NIS, payments in NIS to suppliers and payments in Euro to suppliers. The hedging level is examined each period, according to the market conditions and the Company's ability to provide collateral for hedging transactions. In 2017 no hedging transactions were carried out due to working capital limitation.

2. Credit risk

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

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

Terms of sale to customers

Management of customer credit risk is managed in accordance with the policy, procedures and controls of the Company with respect to the management of customer credit risk. The evaluation of the credit quality of a customer is based on performance analysis and credit rating of each customer, according to which credit terms are determined for each specific customer. Outstanding customer balances that have yet to be repaid are reviewed regularly and shipments to major customers are usually covered by credit insurance. It should be noted that the sales to a material customer that are carried out through an interested party, are not insured.

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

3. Interest risk

The Group is exposed to the risk of changes in market interest rates resulting from short-term and long-term loans that were received which bear adjustable interest rate (the loans are linked to the Libor interest rate).

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 14 - Financial instruments (cont.)

b. Financial risk factors (cont.)

4. Liquidity risk

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

The Company holds cash and other financial instruments with various financial institutions in Israel and in additional countries in which the Group operates. The Group's policy as a borrower of credit is to operate under the limitations of the financing agreement with the banks.

As at December 31, 2018 the cash balance amounted to US 1,876 thousand dollars. And the Company also had an unutilized line of credit derived from the Company's current volume of collateral in the amount of US 5,133 thousand dollars.

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

As at December 31, 2018

	<u>Up to one year</u>	<u>1 to 2 years</u>	<u>2 to 3 years</u>	<u>3 to 4 years</u>	<u>4 to 5 years</u>	<u>Over 5 years</u>	<u>Total</u>
<u>Dollars thousands</u>							
Loans from banks	18,908	1,429	1,429	1,429	1,429	991	25,615
A loan from the controlling shareholders	2,000	-	-	-	-	-	2,000
Trade payables	22,103	-	-	-	-	-	22,103
Other payables	2,253	-	-	-	-	-	2,253
	<u>45,264</u>	<u>1,429</u>	<u>1,429</u>	<u>1,429</u>	<u>1,429</u>	<u>991</u>	<u>51,971</u>

As at December 31, 2017

	<u>Up to one year</u>	<u>1 to 2 years</u>	<u>2 to 3 years</u>	<u>3 to 4 years</u>	<u>4 to 5 years</u>	<u>Over 5 years</u>	<u>Total</u>
<u>Dollars thousands</u>							
Loans from banks	14,156	1,624	1,627	1,632	1,636	2,712	23,387
A loan from the controlling shareholders	-	1,852	-	-	-	-	1,852
Trade payables	21,854	-	-	-	-	-	21,854
Other payables	1,556	-	-	-	-	-	1,556
	<u>37,566</u>	<u>3,476</u>	<u>1,627</u>	<u>1,632</u>	<u>1,636</u>	<u>2,712</u>	<u>48,649</u>

c. Fair Value

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

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 14 - Financial instruments (cont.)

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 the 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.
- 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, 2018

	Level 2
	Dollars thousand
Derivative financial instrument	(144)
Liabilities for bank options	(37)
Total	(181)

December 31, 2017

	Level 2
	Dollars thousand
Liabilities for bank options	(20)
Total	(20)

e. Change in interest rates

A change in the interest rates of the financial liabilities as at December 31 would have increased (decreased) the shareholders' equity and the gain or loss in the amounts presented below. This analysis assumes that all other variables will remain constant and ignores tax effects.

	Sensitivity test to changes in interest rates	
	Gain (loss) from change	
	10% increase in interest	10% decrease in interest
	Dollars thousands	
2018	(37)	37
2017	(48)	48

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 14 - Financial instruments (cont.)

f. Foreign currency risk

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

As at December 31, 2018, the Company has surplus of financial liabilities in NIS over financial assets in the amount of US 3,049 thousand dollars (as at December 31, 2017 – US 3,930 thousand dollars).

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

	Sensitivity test to changes in NIS exchange rates	
	Gain (loss) from change	
	10% increase in exchange rate	10% decrease in exchange rate
	Dollars thousands	
2018	305	(305)
2017	393	(393)

Sensitivity tests and principal work assumptions:

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

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

The sensitivity test for loans with variable interest was performed on the variable component of interest.

Note 15 - Liability for options to banks

On July 9, 2014 the Company issued 300,000 cashless option warrants to the lending banks exercisable into 300,000 shares, in accordance with the provisions of the amended re-organization of the credit lines agreement with the financing banks dated March 27, 2014. These options replace two series of 100,000 and 200,000 cashless option warrants which were allocated in March 2010 and December 2010, respectively.

On September 9, 2015, and in accordance with the provisions of the amended financing agreement as at May 18, 2015, the Company issued to the banks an amendment to the allocation letters that were granted to them, according to which the terms of the options were changed, in such a manner that the exercise price of each option shall be US 1.43 dollars (instead of US 2.5 dollars) and the exercise period of each option shall be until March 31, 2023 (instead of December 31, 2019).

On March 29, 2018, and in accordance with the terms of the early repayment as aforesaid in Clause 13(2)a above, the Company's Board approved the updating of the terms of the 300,000 options allocated on July 9, 2014, to Bank Leumi Le-Israel Ltd., Israel Discount Bank Ltd. and Bank Hapoalim Ltd., in such a manner that the exercise price of each option shall be US 1 dollars (instead of US 1.43 dollars). The other terms of the options have remained unchanged.

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 15 - Liability for options to banks (cont.)

The value of the benefits inherent in granting these options amounted to US 37 thousand dollars as at December 31, 2018 and was recorded as a liability for options to banks, against the recording of financing expenses. This liability is measured periodically, according to the option evaluation model. In 2018, the Company recorded financing income of US 1 thousand dollars as a result of the revaluation of the liability for the banks' options (2017 - financing income on the sum of US 75 thousand dollars).

Note 16 - Assets and liabilities for employee benefits

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

Post-employment benefits

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

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

1. Defined contribution plans

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

	<u>For the year ended December 31</u>		
	<u>2018</u>	<u>2017</u>	<u>2016</u>
	<u>Dollars thousands</u>		
Expenses in respect of defined contribution plans	<u>463</u>	<u>516</u>	<u>471</u>

2. Defined benefit plans

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

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 16 - Assets and liabilities for employee benefits (cont.)

Post-employment benefits (cont.)

2. Defined benefit plans (cont.)

a. Changes in the defined benefit plan's liabilities and in fair value of the plan's assets

The year of 2018

	<u>Expenses recorded to profit or loss</u>					<u>Loss due to remeasurement in other comprehensive income</u>							<u>Balance as at December 31, 2018</u>	
	<u>Balance as at January 1, 2018</u>	<u>Cost of current service</u>	<u>Interest Expenses, net</u>	<u>Cost of past service and effect of clearing</u>	<u>Total expenses recorded to profit or loss in the period</u>	<u>Payments from the plan</u>	<u>Return on plan's assets (excluding amounts recognized in interest expenses, net)</u>	<u>Actuarial loss due to changes in demographic assumptions</u>	<u>Actuarial loss due to changes in financial assumptions</u>	<u>Actuarial gain due to experience deviations</u>	<u>Total effect on other comprehensive income in the period</u>	<u>Effect of changes in the exchange rates of foreign currency</u>		<u>Contributions deposited by the employer</u>
Liabilities for defined benefit	1,104	58	31	-	89	248	-	478	(20)	71	529	(75)	-	1,399
Fair value of plan's assets	(104)	-	(2)	-	(2)	-	2	-	-	-	2	9	(8)	(103)
Liability (asset) net for defined benefit	<u>1,000</u>	<u>58</u>	<u>29</u>	<u>-</u>	<u>87</u>	<u>248</u>	<u>2</u>	<u>478</u>	<u>(20)</u>	<u>71</u>	<u>537</u>	<u>(66)</u>	<u>(8)</u>	<u>1,296</u>

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 16 - Assets and liabilities for employee benefits (cont.)

Post-employment benefits (cont.)

2. Defined benefit plans (cont.)

a. Changes in the defined benefit plan's liabilities and in fair value of the plan's assets

The year of 2017

	<u>Expenses recorded in profit or loss</u>						<u>Loss due to remeasurement in other comprehensive income</u>							<u>Balance as at December 31, 2017</u>
	<u>Balance as at January 1, 2017</u>	<u>Cost of current service</u>	<u>Interest Expenses, net</u>	<u>Cost of past service and effect of clearing</u>	<u>Total expenses recorded in profit and loss in the period</u>	<u>Payments from the plan</u>	<u>Return on plan's assets (excluding amounts recognized in interest expenses, net)</u>	<u>Actuarial loss due to changes in demographic assumptions</u>	<u>Actuarial loss due to changes in financial assumptions</u>	<u>Actuarial gain due to experience deviations</u>	<u>Total effect on other comprehensive income in the period</u>	<u>Effect of changes in the exchange rates of foreign currency</u>	<u>Contributions deposited by the employer</u>	
Liabilities for defined benefit	951	66	35	31	132	324	-	2	(14)	253	241	104	-	1,104
Fair value of plan's assets	(154)	-	(4)	-	(4)	(35)	41	-	-	-	41	(15)	(7)	(104)
Liability (asset) net for defined benefit	<u>797</u>	<u>66</u>	<u>31</u>	<u>31</u>	<u>128</u>	<u>289</u>	<u>41</u>	<u>2</u>	<u>(14)</u>	<u>253</u>	<u>282</u>	<u>89</u>	<u>(7)</u>	<u>1,000</u>

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 16 - Assets and liabilities for employee benefits (cont.)

Post-employment benefits (cont.)

2. Defined benefit plans (cont.)

b. Principal assumptions used in determining the defined benefit plan

	<u>2018</u>	<u>2017</u>
	<u>%</u>	<u>%</u>
Discount rate (*)	3.3%	3.3%
Expected salary increase rate	1%	1%

(*) The discount rate is based on index-linked high-quality corporate bonds.

Subsequent to the signing of the agreement for the establishment of a joint company in Jordan, as stated in Note 26a as follows, a specific calculation was carried out regarding employees related to the signing of the agreement. The employee departure rate for the rest of the employees were estimated according to the previous actuarial valuation.

c. Amounts, timing and uncertainties of future cash flows

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

	<u>The change in the defined benefit obligation</u>
	<u>Dollars thousand</u>
As at December 31, 2018:	
<u>Sensitivity test to changes in expected salary increase rate</u>	
The change as a result of:	
Salary increase of 1%	34
Salary decrease of 1%	(30)
<u>Sensitivity test to changes in the discount rate of the plan's liabilities and assets</u>	
The change as a result of:	
1% increase of the discount rate	(29)
1% decrease of the discount rate	33

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 17 - Taxes on income

a. Tax laws applicable to the Group's companies

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

b. Tax rates applicable to the Group:

In the beginning of January 2016, the Law for the Amendment of the Israeli Tax Ordinance was published (Amendments to Legislation for the Achievement of the Budget targets for the 2017 and 2018 Budget Years), which set a further reduction of corporate tax from 25% in 2015 to 23% in 2018 and thereafter. However, a temporary provision was set in the said law according to which the corporate tax rate in 2017 would be 24%. As a result, the corporate tax rate in 2017 was 24% and the corporate tax rate starting from 2018 onwards would be 23%. The tax rate on a subsidiary in the US is 25% (including federal tax and state tax). The tax rate on a subsidiary in Canada is 24%.

c. Final tax assessments

Final tax assessments were issued to the Company up to and including the tax year 2015. For the company Tefron-Macro which operates in Israel, were issued tax assessments up to and including the tax year of 2013. The main subsidiary operating outside Israel has final tax assessments until 2014.

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

In continuation of Note 24p regarding the merger between the Company and the subsidiary Hi-Tex, the merged company has carry-forward losses for tax purposes amounting to, as at December 31, 2018 a sum of US 43.1 million dollars which may be used over an unlimited period of time, and subject to the merger's limitations as specified in Note 24p as follows. In respect of these balances and other deductible temporary differences, the Company recorded in its financial statements deferred tax assets on the sum of 2.9 million dollars (due to the expectation of their utilization as a result of the expected profit forecast in the coming years and the existence of deferred tax reserves in the amount of 3 million dollars, mainly in respect for fixed assets, and the expectation of realizing them against taxable income). Another subsidiary Tefron-Macro has carry-forward losses for tax purposes in the sum of US 8.4 million dollars for which no deferred taxes have been accumulated since they are not expected to be utilized in the foreseeable future. A subsidiary which is registered in the United States, Tefron USA, has carry-forward losses for tax purposes on the sum of US 9.8 million dollars, for which no deferred taxes have been accumulated for reasons of immateriality. The utilization of the carry forward losses of Tefron USA is subject to restrictions concerning the period in which it will be possible to utilize the losses in the future and the amount the Company could utilize each year.

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 17 - Taxes on income (cont.)

e. Deferred taxes

Composition:

	Balance sheets		Statements of income		
	December 31		The year ended December 31		
	2018	2017	2018	2017	2016
	Dollars Thousands				
<u>Deferred tax liabilities</u>					
Fixed assets	(2,979)	(3,585)	606	597	(2,433)
	(2,979)	(3,585)			
<u>Deferred tax assets</u>					
Carry-forward losses for tax purposes	5,461	6,128	(667)	(708)	1,976
Provision for doubtful accounts	-	-	-	(16)	-
Employee benefits	408	347	61	127	117
	5,869	6,475			
Deferred tax income (expenses)			-	-	(340)
Deferred tax assets, net	2,890	2,890			

Deferred taxes are presented in the balance sheet as follows:

	December 31	
	2018	2017
	Dollars thousands	
Non-current assets	2,890	2,890

f. Tax to be paid (tax benefit) included in statement of income

	For the year ended December 31		
	2018	2017	2016
	Dollars thousands		
Current tax expenses	130	211	-
Expenses (income) in respect of taxes from previous years	(17)	(130)	442
Deferred taxes	-	-	340
	113	81	782

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

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 17 - Taxes on income (cont.)

g. Theoretical tax

The reconciliation between the theoretical tax rate that would have applied assuming that all the income and expenses, gains and losses in profit or loss were taxed at the statutory tax rate, and the taxes on income recorded in profit or loss, is as follows:

	<u>For the year ended December 31</u>		
	<u>2018</u>	<u>2017</u>	<u>2016</u>
	<u>Dollars thousands</u>		
Income (loss) before taxes on income	<u>1,375</u>	<u>(3,118)</u>	<u>(339)</u>
Statutory tax rate	<u>23%</u>	<u>24%</u>	<u>25%</u>
Tax expenses (income) computed at the statutory tax rate	316	(748)	(85)
Increase (decrease) in taxes on income resulting from the following factors:			
Non-deductible expenses for tax purposes	23	12	25
Temporary differences for which no deferred taxes were recorded	940	1,034	(1,204)
Income subject to special tax rates (including capital gains)	(941)	-	-
A difference in the tax rate applicable to income in consolidated subsidiaries located in other jurisdictions	8	(12)	1,173
Adjustments carried out during the year in respect of taxes from previous years	(17)	(130)	442
Adjustments to deferred tax balances due to changes in tax rates	-	-	397
Others	<u>(216)</u>	<u>(75)</u>	<u>34</u>
Tax expenses	<u>113</u>	<u>81</u>	<u>782</u>

Note 18 - Contingent liabilities, commitments and liens

a. Contingent liabilities

Legal proceedings

- a. On November 23, 2016, the Company reported that an indictment was submitted to the Labor Court against the Company's subsidiary, the Company's former CEO and a former employee of the subsidiary, claiming that the defendants have violated the workplace safety regulations in connection with a work accident, which occurred at the subsidiary in 2013. On April 7, 2017, the Company reached a plea bargain concerning the said indictment, which was approved by the Court, and according to which the former CEO of the Company was deleted from the indictment, the Company's subsidiary was fined NIS 15,000 and the former employee was fined NIS 10,000.

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 18 - Contingent liabilities, commitments and liens (cont.)

a. Contingent liabilities (cont.)

Legal proceedings (cont.)

- b. The Company has two open claims of dismissed employees, for the refund of the wages that were deducted as part of the Company's recovery program from the end of 2008, in which it was decided to reduce the salary for all employees, claiming that they did not agree to continue the deduction in respect of the last 7 years of their employment in the Company. In addition, it is claimed that the Company completes the social contributions in respect of the aforementioned deduction amount. The amount of the claim is estimated at 82 thousand dollars. The Company's management, based on its legal advisors, estimates that the chances of realization of the claim are slim, and therefore no provision has been included in the Company's financial statements.

b. Commitments to pay rent

The Company's plants and installations and most of those of its subsidiaries are located in buildings leased for various terms ending during the years 2019 - 2021.

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

	<u>2018</u>	<u>2017</u>
	<u>Dollars thousands</u>	
Year 1	1,788	1,995
Year 2	-	1,644
Year 3	-	-
	<u>1,788</u>	<u>3,639</u>

As at the date of the report, the leased space was reduced - the liability is presented net of the leased space that was returned to the property owner. Furthermore, the Company also entered into lease agreements with a number of third parties to whom it has sub-leased part of the spaces for which it has a liability as mentioned above.

c. Liens

1. All liabilities to a bank are secured by a fixed and floating charge on the existing and future assets of the Company and its subsidiaries in both the present and the future.

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 19 - Capital

a. Composition of the share capital and the convertible securities

	As at December 31,	
	2018	2017
	Number of shares	
Authorized share capital (ordinary shares of NIS 10 par value each)	20,000,000	20,000,000
Issued share capital (ordinary shares of NIS 10 par value each)	11,970,026	11,970,026
Paid up share capital (ordinary shares of NIS 10 par value each)	11,870,286	11,870,286
Option warrants (non-tradable) for the Company's employees and managers, directors and service providers exercisable into ordinary shares of NIS 10 par value each	419,605	464,605
treasury shares held by a subsidiary	99,740	99,740

b. Rights conferred by the shares

Ordinary shares

Voting rights at the general meeting, right to a dividend, rights upon liquidation of the Company and the right to appoint directors of the Company.

c. Treasury shares

Tefron Holdings (98) Ltd., a wholly-owned subsidiary of the Company, holds 99,740 Company shares, which constitute 0.83% of the Company's shares and whose cost is US 7,408 thousand dollars, as at December 31, 2018 and 2017. The investment in these shares is recorded according to the "treasury shares" method in the shareholders equity.

d. Capital management in the Company

The Company's capital management objectives are:

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

The Company operates to achieve a return on capital at a level that is customary in the industry and markets in which the Company operates. This return is subject to changes depending on market factors in the Company's industry and business environment. In 2018 the Company achieved a return on equity of 5%. In 2017 and 2016 the Company had a negative return on capital.

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 20 - Share-based payment transactions

a. Expense recognized in the financial statements

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

	For the year ended December 31		
	2018	2017	2015
	Dollars thousands		
Share based payment plans settled with equity instruments for employees and directors	-	-	12
Total share-based payment plans settled with equity instruments	-	-	12

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

Option plan to the managers and employees of the Company

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

On December 30, 2013, the general meeting of the shareholders of the Company approved the option plan for employees, officers and consultants. The option warrants shall vest and become exercisable and the offeree's eligibility to those warrants shall expire according to the following:

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

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

Subsequent to the date of the report, on January 16, 2019, the Company's Remuneration Committee and the Board of Directors approved the allocation of 700,000 non-tradeable options (hereinafter: "the options"), exercisable for up to 700,000 ordinary shares of NIS 10 par value each (hereinafter: "the exercise shares"). The offeree is Mr. Michael Goldenblatt (or a corporation under his control through which he provides management services to the Company), who is the CEO of the Company's subsidiary, Tefron USA, Inc. (Hereinafter: "the offeree"). The Options will be allocated to the offeree for no consideration as part of the offeree's remuneration in respect of his position in the Company. The exercise price of each option determined by the Company's Board is NIS 4.18 for each ordinary share of NIS 10 par value each, which was determined according to the average price of the Company's share on the Tel Aviv Stock Exchange Ltd. (hereinafter: "the Stock Exchange") during the 90 (ninety) trading days preceding the date of the resolution of the Board of Directors regarding the allocation, plus a premium of 5% (hereinafter: "the exercise price"). The options will be exercised using the "cashless" method. The economic value of each option offered to the offeree (in an average calculation of the three series) is NIS 1.72. As of the date of publication of the report the options have not been allocated in practice.

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Notes to the Consolidated Financial Statements

Note 20 - Share-based payment transactions (cont.)

c. Movement during the year

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

	As at December 31, 2018		As at December 31, 2017	
	Number of share options	Weighted average exercise price (dollar)	Number of share options	Weighted average exercise price (dollar)
Options for shares granted at the beginning of the year	464,605	2.0	614,605	2.1
Options for shares granted during the year	-	-	-	-
Options for shares forfeited or expired during the year	(45,000)	3.4	(150,000)	-
Options for shares at the end of the year	419,605	1.6	464,605	2.0
Options for shares which can be exercised at the end of the year	419,605	1.6	464,605	2.0

- d. The weighted average of the remaining contractual term of the share options as at December 31, 2018 is 3.7 years (2017 – 4.6 years).

e. Measurement of the fair value of the share options settled with equity instruments

The Company uses the Black & Scholes model to measure the fair value of options to shares settled with equity instruments that have been granted to employees. The measurement is carried out on the date of granting the options for shares which are settled with equity instruments. The Company uses the Monte Carlo simulation method for measuring the fair value of the options granted to the banks. The measurement is carried out on the date of granting the options and a remeasurement is conducted quarterly.

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

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

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Notes to the Consolidated Financial Statements

Note 21 - Supplementary information to the profit and loss items

a. Cost of sales

	For the year ended December 31		
	2018	2017	2016
	Dollars thousands		
Materials	87,392	72,205	72,575
Payroll and benefits	8,416	8,938	8,096
Sub-contracted work	9,959	10,635	7,265
Depreciation	4,573	4,457	4,744
Other manufacturing expenses	5,797	5,275	5,967
	<u>116,137</u>	<u>101,510</u>	<u>98,647</u>
Decrease (increase) in work-in-progress and finished goods inventories (*)	(2,933)	(2,407)	(6,116)
	<u>113,204</u>	<u>99,103</u>	<u>92,531</u>
(*) Including provision for impairment of slow inventory	<u>907</u>	<u>627</u>	<u>436</u>

b. Development expenses, net

	For the ended December 31		
	2018	2017	2016
	Dollars thousands		
Payroll and benefits	2,627	3,048	2,639
Manufacturing expenses	720	720	720
Depreciation and amortization	240	240	240
Materials	239	351	314
Others	71	109	78
	<u>3,897</u>	<u>4,468</u>	<u>3,991</u>

c. Selling and marketing expenses

	For the year ended December 31		
	2018	2017	2016
	Dollars thousands		
Payroll and benefits	5,383	4,267	3,825
Transport, export and distribution	6,330	4,788	4,655
Commissions to agents and franchisees	4,791	4,029	3,166
Overseas office maintenance	744	466	255
Overseas excursions	1,101	1,076	831
Depreciation and amortization	228	243	271
Others	553	610	398
	<u>19,130</u>	<u>15,479</u>	<u>13,401</u>

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 21 - Supplementary information to the profit and loss items (cont.)

d. General and administrative expenses

	For the year ended		
	December 31		
	2018	2017	2016
	Dollars thousands		
Payroll and benefits	1,242	1,232	1,030
Consulting	904	670	814
Remuneration and insurance for directors	236	291	288
Provision for doubtful and bad debts	111	-	14
Others	880	792	909
	<u>3,373</u>	<u>2,985</u>	<u>3,055</u>

e. Other expenses (income)

	For the year ended		
	December 31		
	2018	2017	2016
	Dollars thousands		
Reorganization (1)	-	120	1,128
Other income (expenses)	34	(4)	(29)
Capital gain from canceling a provision for impairment (2)	-	(351)	-
	<u>34</u>	<u>(235)</u>	<u>1,099</u>

(1) In 2017, the Company included in its financial statements reorganization expenses in respect of the merger of the subsidiary Hi-Tex with and into the Company. For additional details regarding the merger, see Note 24p as follows.

In 2016 the Company included in its reports reorganization expenses in the total amount of US 1,128 thousand dollars, which resulted from executing the Company's plan for the relocation of the dyeing operation which is carried out by a subcontractor in Israel to a number of other subcontractors in Jordan. This was carried out as part of the risk management policy of the Company to reduce its dependence on a material supplier and to enable the Company operational flexibility. The reorganization expenses include the costs of the relocation of the dyeing plant as well as the costs related to the termination of employer-employee relations.

(2) In 2017 the Company incurred a capital gain as a result of a partial cancelation of a provision for the impairment of buildings in the United States that had been performed in the past.

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Notes to the Consolidated Financial Statements

f. Financing income (expenses)

	For the year ended		
	December 31		
	2018	2017	2016
	Dollars thousands		
<u>Financing income</u>			
Income from debt forgiveness	2,818	-	-
Net gain from change in rates of exchange	77	-	-
Revaluation of liability for options to banks	36	75	9
	<u>2,931</u>	<u>75</u>	<u>9</u>
<u>Financing expenses</u>			
Financing expenses for short-term credit and bank loans	1,350	1,323	1,186
Net loss from change in foreign exchange rates	200	462	240
Reduction of discounting of options to banks	40	26	34
Revaluation of liability for options to banks	37	-	-
Bank expenses and other expenses	1,784	1,081	1,204
	<u>3,411</u>	<u>2,892</u>	<u>2,673</u>

Note 22 - Earnings (loss) per share

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

	For the year ended December 31,					
	2018		2017		2016	
	Weighted average number of shares	Earnings attributed to sharehold- ers of the Company	Weighted average number of shares	Loss attributed to sharehold- ers of the Company	Weighted average number of shares	Loss attributed to shareholders of the Company
Thousands	Dollars thousands	Thousands	Dollars thousands	Thousands	Dollars thousands	
For the purpose of calculating basic and diluted net earnings (loss)	11,870	1,262	11,870	(3,199)	11,870	(1,121)

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 23 – Operating segments

a. General

The information that the Company provides in accordance with the IFRS 8 definitions is based on the available financial information which is reviewed regularly and is used by the Company's CEO who is the Company's chief operating decision maker (CODM), for the purpose of making decisions regarding the resources to be allocated to the segment and in order to evaluate the segment's performance.

Based on the criteria in IFRS 8 for determining reportable operating segments, and the available financial information which is reviewed by the Company's CEO, the Company has determined that it operates in two reportable operating segments:

- (a) Brands – This segment engages in the design, development, production and marketing of seamless intimate apparel and activewear and leisurewear, to customers in North America and Europe with leading brands such as Under Armour.
- (b) Retail – This segment engages in the design, development, production and marketing of seamless intimate apparel and activewear and leisurewear which are characterized by purchasing large quantities of less complex products to private brands as well as brands for which the Company received a franchise to customers in the retail market in North America and Europe such as Walmart.

b. Information on reportable segments' sales, income (loss) and assets:

- (a) Measurement of segment sales, income (loss) and assets:
Segment sales, income (loss) and assets are measured according to the same accounting principles as those applied in the consolidated financial statements.
The income (loss) of the segments reflect the profit (loss) from the operations of the segment and do not include net financing expenses and income taxes, since these items are not attributed to segments and are not analyzed by the CODM by segment.
- (b) The segments' assets mostly include inventory, trade receivables and other receivables. Assets not attributed to the segments mostly include fixed assets, intangible assets, cash, financial derivative and deferred taxes.

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Notes to the Consolidated Financial Statements

Note 23 – Operating segments (cont.)

c. Primary segment reporting in respect of business segments

	For the year ended December 31, 2018			
	Brands	Retail	Adjustments	Total
	Dollars thousand			
Total segment revenues	45,264	96,229		141,493
Direct profit (loss)	(3,452)	9,518		6,066
Indirect costs	(1,337)	(2,874)		(4,211)
Segment results	(4,789)	6,644		1,855
Financing expenses, net				(480)
Tax expenses				(113)
Income				1,262
Segment assets	19,782	34,447	24,091	78,320
Segment liabilities	8,954	16,626	28,207	53,787
Cost of purchasing long-term assets	-	-	1,160	1,160
Depreciation and amortization	-	-	5,041	5,041

	For the year ended December 31, 2017			
	Brands	Retail	Adjustments	Total
	Dollars thousand			
Total segment revenues	38,926	82,573		121,499
Direct profit (loss)	(8,642)	12,548		3,906
Indirect costs	(1,349)	(2,858)		(4,207)
Segment results	(9,991)	9,690		(301)
Financing expenses, net				(2,817)
Tax expenses				(81)
Loss				(3,199)
Segment assets	17,404	29,195	27,512	74,111
Segment liabilities	9,507	14,823	25,919	50,249
Cost of purchasing long-term assets	-	-	1,902	1,902
Depreciation and amortization	-	-	4,940	4,940

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 23 – Operating segments (cont.)

c. Primary segment reporting in respect of business segments (cont.)

	For the year ended December 31, 2016			Total
	Brands	Retail	Adjustments	
	Dollars thousand			
Total segment revenues	40,302	76,100		116,402
Direct profit (loss)	(5,211)	11,767		6,556
Indirect costs	(1,485)	(2,746)		(4,231)
Segment results	(6,696)	9,021		2,325
Financing expenses, net				(2,664)
Tax expenses				(782)
Loss				(1,121)
Segment assets	22,695	22,360	30,501	75,556
Segment liabilities	12,185	8,259	27,917	48,361
Cost of purchasing long-term assets	-	-	1,675	1,675
Depreciation and amortization	-	-	5,156	5,156

d. Secondary reporting regarding geographical segments

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

	For the year ended December 31		
	2018	2017	2016
	Dollars thousands		
North America	119,388	111,206	114,083
Europe	22,040	10,201	753
Israel	65	92	1,566
	<u>141,493</u>	<u>121,499</u>	<u>116,402</u>

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

	Balance of non-current assets (*)		Capital expenditures		
	December 31,		for the year ended December 31		
	2018	2017	2018	2017	2016
Dollars thousands					
Israel	16,684	20,750	733	1,481	1,474
North America	2,386	2,315	322	279	102
Others	257	294	105	142	99
	<u>19,327</u>	<u>23,359</u>	<u>1,160</u>	<u>1,902</u>	<u>1,675</u>

(*) Excluding deferred taxes, net.

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 23 – Operating segments (cont.)

e. Major customers

	For the year ended December 31		
	2018	2017	2016
	Percentage of total sales		
Customer A (part of the retail segment)	45.0	43.6	46.6
Customer B (part of the brands segment)	16.2	16.5	2.4
Customer C (part of the retail segment)	13.5	15.2	14.8
	<u>74.7</u>	<u>75.3</u>	<u>63.8</u>

Note 24 - Balances and transactions with interested parties and related parties

a. Balances with interested parties and related parties

Composition:

As at December 31, 2018

	Linkage terms	Related and interested parties	Key executives
Dollars thousands			
Trade receivables		430	-
Trade payable		(488)	(19)
A loan from a controlling shareholder	Unlinked	(2,000)	-
		<u>(2,058)</u>	<u>(19)</u>

As at December 31, 2017

	Linkage terms	Related and interested parties	Key executives
Dollars thousands			
Trade receivables		8,615	-
Trade payable		(696)	(34)
A loan from a controlling shareholder	Unlinked	(1,852)	-
		<u>6,067</u>	<u>(34)</u>

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 24 - Balances and transactions with interested parties and related parties (cont.)

b. Benefits to interested parties and related parties

	<u>For the year ended December 31</u>		
	<u>2018</u>	<u>2017</u>	<u>2016</u>
	<u>Percentage of total sales</u>		
Salaries and benefits for employees of the Company or on its behalf, including the CEO	<u>263(*)</u>	<u>321</u>	<u>304</u>
Fees of directors not employed by or on behalf of the Company	<u>202</u>	<u>247</u>	<u>230</u>
<u>Number of beneficiaries of salaries and benefits</u>			
Related and interested parties employed by or on behalf of the Company	1	1	1
Directors not employed by the Company	<u>5</u>	<u>5</u>	<u>8</u>
	<u>6</u>	<u>6</u>	<u>9</u>

(*) This amount includes the remuneration of the CEO, who is a controlling shareholder as stated in Section n below, for 9 months and does not include a salary of approximately 84 thousand dollars in respect of the remaining 3 months due to his waiver of this salary. The said amount recognized in a capital reserve for transactions with a controlling shareholder

c. Transactions with related parties and interested parties

For the year ended December 31, 2018

	<u>Related and interested parties</u>	<u>Senior officers in management</u>
	<u>Dollars thousands</u>	
Sales	38,339	-
Cost of sales	(673)	-
Sales and marketing expenses	(206)	-
General and administrative expenses	-	(464)
Financing expenses	(30)	-

For the year ended December 31, 2017

	<u>Related and interested parties</u>	<u>Senior officers in management</u>
	<u>Dollars thousands</u>	
Sales	56,498	-
Cost of sales	(687)	-
Sales and marketing expenses	(114)	-
General and administrative expenses	(247)	(321)

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 24 - Balances and transactions with interested parties and related parties (cont.)

c. Transactions with related parties and interested parties (cont.)

For the year ended December 31, 2016

	Related and interested parties	Senior officers in manange- ment
	Dollars thousands	
Sales	56,561	-
Cost of sales	(441)	-
Sales and marketing expenses	(23)	-
General and administrative expenses	(230)	(304)

d. Commitment by controlling shareholders

Nouvelle Intimes Seamless Inc., a private company incorporated in Canada (through which the Lieberman family previously held shares in the Company) ("Nouvelle"), and Messrs. Ben and Martin Lieberman, the controlling shareholders of the Company, signed a on December 30, 2010, a non-competition commitment concerning the Company in the field of "seamless" products for a fixed period of 5 years as of the date of signing the letter of commitment for non-competition. In the framework of an agreement for investing in the Company in 2015, it was agreed upon that Litef Holdings Inc. ("Litef") (a private Canadian company owned by Mr. Lieberman, which holds the Company's shares) will join as a party to the non-competition letter of commitment and it will remain in force as long as Nouvelle, Mr. Ben and Martin Lieberman and Litef, each of them individually, will be amongst the controlling shareholders of the Company .

e. Purchase of related party shares

On May 31, 2018, the Company's Audit Committee and Board of Directors approved a transaction between the Company and its controlling shareholders, which does not require the approval of the general meeting of the Company pursuant to Regulation 1(2) of the Companies Regulations (Relief for Transactions with Interested Parties), 2000, whereby the subsidiary of the Company in the United States, which is wholly owned by the Company, Tefron USA Inc. (hereinafter: the "subsidiary"), shall engage in an agreement for the purpose of purchasing shares of the company Lamour Hosiery, Inc. (hereinafter: "Lamour"), a private company incorporated in Delaware state and owned by the Lieberman family, whose members are the controlling shareholders of the Company (hereinafter: the "agreement") with the Lieberman family members (hereinafter: the "sellers"). The subsidiary carries out all the Group's sales in the United States, and for which Lamour executes the transactions opposite Walmart. The acquisition of Lamour, which has a manufacturer's identification number with Walmart, will enable the Company to directly engage in negotiations with Walmart.

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 24 - Balances and transactions with interested parties and related parties (cont.)

e. Purchase of related party shares (cont.)

The purchase of the shares has been carried out according to the following terms:

1. The transaction's price is US 1 dollar.
2. The transfer of shares to the subsidiary was carried out concurrently with the signing of the agreement
3. The agreement includes accepted representations in share purchase transactions, including a representation stating that the financial statements of Lamour as at March 31, 2018 are accurate and reflect the Company's financial position as at that date, and that Lamour is not exposed to any claims by any party, and that any third party has no demands and/or claims against Lamour and/or the sellers.
4. In the agreement, the sellers gave the subsidiary a representation, according to which all of Lamour's interests had been managed in the ordinary course of business as of the date of the previous said financial statements until the signing of the agreement (this representation does not refer to the operations opposite Walmart, since this aspect is already managed by the subsidiary, and in practice, this is the sole operation which is conducted at Lamour).
As at the signing date of the agreement, Lamour has no obligation other than the liabilities relating to the Company's operations opposite Walmart
5. The sellers, together with Mr. Martin Lieberman (one of the shareholders and a director) have provided in the agreement a commitment to indemnify the subsidiary for any damage that might be caused to it due to any breach of the representations detailed in the agreement, except for any matter arising out of being a "channel" for the operations of the subsidiary opposite Walmart, and all whether the events are known or not. The period of indemnification shall be equivalent to the statutory limitation period during which a claim can be filed, as applicable, in accordance with the relevant law.

f. Lease agreement with a related party

On March 28, 2016, the Company's Board decided, after obtaining the approval of the Audit Committee of the Company, to approve the engagement of the Company in a non-extraordinary transaction, as this term is defined in the Companies Law, with a subsidiary of Lamour, for the purpose of sublease of office space in Montreal, Canada, in an area of 540 square meters for a monthly payment of US 3,950 dollars (excluding taxes). The approval of the Company's Board, as stated above, will remain in effect for a period of up to three years. On November 22, 2018, the Company's Board decided, after obtaining the approval of the Company's Audit Committee, to approve the expansion of the lease in Montreal by an additional 240 square meters. Subsequent to the date of the report, on March 18, 2019, the Company's Board, after receiving the approval of the Company's Audit Committee on that date, approved the Company's continued engagement in the said lease agreement for an additional period of three years.

g. Agreement for invoicing services with a related party

In February 2012, the Company's Board approved, following the approval of the Audit Committee of the Company, the Company's engagement in a non-extraordinary transaction with Lamour which shall serve as a channel for the sale of the Company's products to Walmart, and this for the reasons described below: Walmart is a significant customer of the Company. In order for the Company to sell products directly to Walmart, it must first complete the process of issuing a manufacturer's identification number. As at this date, the Company has not yet completed the process of issuing the said manufacturer's identification number due to the difficulty to obtain it

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 24 - Balances and transactions with interested parties and related parties (cont.)

g. Agreement for invoicing services with a related party (cont.)

opposite Walmart. In light of the aforesaid, the Company decided to sell its products to Walmart through Lamour which already acquires a Walmart's manufacturer's identification number. According to the agreements between Lamour and the Company, the proceeds from Walmart which is paid to Lamour, is transferred to the Company upon receiving it and under the same payment terms. On March 22, 2015 and March 29, 2018, the Company's Board of Directors approved the extension of the term of the agreement by an additional three years, after receiving the recommendation of the Audit Committee, according to which the extension of the period, as aforesaid, is reasonable under the circumstances. Upon completion of the acquisition of Lamour as stated in Clause e above, the Group has only sales to Walmart Canada in an insignificant amount to the Company, which are executed through a company owned by the controlling shareholders in Canada as a pipeline transaction. This transaction was approved by the Audit Committee and the Board of Directors of the Company, for the reason that a direct sale of the Company to Walmart Canada will be under inferior commercial terms compared to the selling through a pipe transaction as aforesaid.

h. Payment of director remuneration to controlling shareholders

Pursuant to the appointment of Messrs. Ben Lieberman and Martin Lieberman (hereinafter: "Messrs. Lieberman"), who are amongst the controlling shareholders of the Company, as directors of the Company as of August 12, 2015, on November 30, 2015, the Company's Board approved, after obtaining the approval of the Company's Remuneration Committee, the granting of director remuneration in accordance with the provisions of the Companies Regulations (Relief in Transactions with Interested Parties) 2000, as of the date of the commencement of their term of service as directors of the Company, in accordance with the director remuneration paid for the other directors of the Company. As of the date of Mr. Ben Lieberman's appointment as the CEO of the Company, he does not receive director remuneration from the Company.

i. Inclusion of a related party in the director and officer policy of the Company

Pursuant to the appointment of Messrs. Lieberman, who are amongst the controlling shareholders of the Company, as directors of the Company as of August 12, 2015, on November 30, 2015, the Company's Board approved, after obtaining the approval of the Remuneration Committee of the Company the inclusion thereof in the director and officer policy of the Company in accordance with the provisions of the Companies Regulations (Relief in Transactions with Interested Parties) 2000.

j. Granting a letter of indemnity to controlling shareholders

On February 11, 2016, the general meeting of the shareholders of the Company approved, after obtaining the approval of the Remuneration Committee and the Board of Directors of the Company, the granting of letters of indemnity to Messrs. Lieberman in the Company's customary wording for its officers. On March 6, 2019, the general meeting of the shareholders of the Company approved, after receiving the approval of the Remuneration Committee and the Board of Directors of the Company, the renewal of the validity of the said letter of indemnification to Messrs. Lieberman.

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 24 - Balances and transactions with interested parties and related parties (cont.)

k. Negligible transactions

On March 22, 2015, the Company adopted, after obtaining the approval of the Audit Committee and the Board of the Company, the procedure concerning transactions with interested parties and officers, in the framework of which the Company adopted guidelines and rules for the classification of a Company's transaction with an interested party as negligible.

As part of the procedure, it was determined that in any transaction that is tested for negligibility, all of the criteria relevant to such transaction will be examined prior to the event, such as the ratio of assets, ratio of liabilities, ratio of shareholders' equity, ratio of revenues and the ratio of expenses, and in the event that the rate of each of the relevant standards is less than half a percent (0.5%) or less than 300,000 dollars, whichever is lower, the transaction shall be deemed as negligible, subject to the following:

1. In cases where, at the discretion of the Company, the aforementioned criteria are not relevant to the transaction at issue, the Company will determine another criterion provided that the relevant criterion concerning such transaction is at a rate of less than half a percent (0.5%) or less than 300,000 dollars, whichever is lower.
2. The negligibility of the transaction will be reviewed on an annual basis for the periodic report, the financial statements and prospectus (including shelf prospectus reports), while including all the transactions of the same type that have been carried out with an interested party or controlling shareholder, as applicable, in the same year.
3. A preliminary condition for the examination of a transaction whether it is negligible or not, is that the transaction is carried out under market conditions. Any transaction which is not being carried out under market conditions, does not meet the definition of a negligible transaction, and is considered as an extraordinary transaction which requires approval procedures as required by law in relation to an extraordinary transaction.
4. A transaction shall not be considered as negligible when it is not negligible from a qualitative standpoint. (Examination of the qualitative considerations of the transaction of the interested party may contradict the negligibility of the transaction, as noted above. For example, and for the purpose of example only, a transaction with an interested party will not generally be considered as negligible if it is seen as a significant event by the Company's management and it serves as a basis for managerial decisions, or if in the framework of the transaction of the interested party, interested parties are expected to receive benefits and it is important to report them to the public).

l. Loans from the shareholders in an aggregate amount of US 2 million dollars

On September 27, 2017, the Company's Audit Committee and Board of Directors approved at their meetings a transaction to obtain a subordinated loan from a controlling shareholder of the Company, Litef Holdings Inc., a private Canadian company wholly owned and controlled by Ben Lieberman and Martin Lieberman. On September 28, 2017, the Company was granted a loan in the amount of US 1 million dollars (hereinafter: "the loan principal"), according to the following terms:

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 24 - Balances and transactions with interested parties and related parties (cont.)

l. Loans from the shareholders in an aggregate amount of US 2 million dollars (cont.)

1. The principal of the loan shall bear annual interest at a rate equal to the annual interest of the US Government's annual bonds, on the basis of which the interest was set at 1.3% per year (hereinafter: "the interest"). The interest and the loan principal shall be referred together as: "the loan".
2. The loan is not secured by any collateral.
3. The loan will be repaid by the Company until September 30, 2018 (hereinafter: "the maturity date"), subject to the provisions of Clause 4 as follows.
4. The loan is subordinated to the loans that the Company took from its financing banks - Bank Leumi Le-Israel Ltd., Bank Hapoalim Ltd. and Israel Discount Bank Ltd. (hereinafter: "the banks"), whereas according to its subordination terms, it could be repaid (in whole or in part, as applicable) only in the event where on the repayment date (a) the Company's tangible shareholders' equity will not be less than US 27.5 million dollars after the repayment of the loan (in whole or in part, as applicable), and (b) the Company will meet all of its obligations to the banks, including its undertaking to comply with financial covenants; all according to the reviewed quarterly financial statements of the Company as at June 30, 2018 (hereinafter together: "the preconditions for repayment of the loan"). As at the date of the report, the repayment of the loan is subject to the approval of the Groups' financing bank, HSBC Canada.
5. If the preconditions for repayment of the loan are not fulfilled by the maturity date, in whole or in part, the fulfillment of the preconditions will be reexamined at the subsequent date of approval of the Company's financial statements, audited or reviewed, as applicable, and so forth (hereinafter: the "periodic examination date"), and if at the time of the periodic examination date the preconditions for repayment of the loan are fulfilled, the loan will be repaid, in whole or in part, as applicable, within 30 days as of the periodic examination date.
6. The Company is given the possibility of an early repayment of the loan, in whole or in part, at its sole discretion, without requiring any other additional consideration in respect of the loan in regards with the early repayment, provided that it complies with the covenants stated in Clause 4 above.

On December 25, 2017, the Company reported an additional loan of US 1 million dollars from the controlling shareholders. The additional loan was granted under terms similar to the first loan (1.7% interest).

m. Approval of the remuneration policy for officers of the Company

On March 27, 2017, the extraordinary general meeting of the Company approved the updated remuneration policy for officers of the Company. On August 3, 2017, the general meeting of the Company approved the amendment of the annual bonus clause in the remuneration policy for officers of the Company.

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 24 - Balances and transactions with interested parties and related parties (cont.)

n. The Company's engagement with Mr. Ben Lieberman in an agreement to provide management services to the Company as CEO

On February 1, 2017, Mr. Ben Lieberman, a director and controlling shareholder of the Company, was appointed as Acting CEO until the appointment of a new CEO for the Company. On May 4, 2017, the general meeting of the shareholders of the Company approved the engagement of the Company with Mr. Ben Lieberman in an agreement to provide management services to the Company as Acting CEO. On June 18, 2017, the Company's Board decided to appoint Mr. Lieberman as the Company's CEO as of June 19, 2017. On August 3, 2017, the Company's general meeting approved the engagement with Mr. Lieberman in an agreement to provide management services to the Company as CEO.

o. Approval of a transaction between the Company and its controlling shareholders for the purpose of leasing showrooms

On August 24, 2017, the Company's Audit Committee and Board of Directors approved a transaction between the Company and its controlling shareholders. The transaction revolves around three companies jointly renting showrooms in Manhattan, New York, which will be used by the three companies (1/3 each) for the purpose of presenting their products. For this purpose, the Company (through a wholly-owned subsidiary) engaged in an agreement with a private company controlled by the controlling shareholders of the Company, Ben Lieberman and Martin Lieberman (hereinafter: "the lessee"), whereby the lessee will lease to the Company, through a back-to-back lease, part of the showrooms' space which the lessee leased in a building in Manhattan, New York, which constitute one-third of the showrooms, which will serve, as aforementioned, the three companies (hereinafter: the "showroom complex"). The three companies are the Company and two other companies, one of which is owned by the said controlling shareholders, and the other is a company in which the controlling shareholders own 50%. All three companies operate in the textile sector, while the Company is the only company operating in the field of seamless technology. The holding of a joint showroom complex by a number of companies is acceptable, when it serves all of the companies participating in it, which enjoy greater exposure and exploit economies of scale (hereinafter: "the lease agreement").

The terms of the engagement are as follows:

- a.** As aforesaid, the terms of the lease agreement will be back-to-back to the terms of the lease agreement signed between the lessee and the owners of the showroom complex (hereinafter: the "main lease agreement"), when it refers to 1/3 of the showroom complex area. The lease refers to 290 square meter (gross) (3,147 square feet) of the showroom complex area which constitutes one-third of the area of the entire showroom complex. The two additional companies will each bear a third of the lease fees of the showroom complex.
- b.** The lease term - the lease term is as of July 1, 2017 and until December 31, 2021.
- c.** The lease fees - for the sublease, the Company will pay a 1/3 of the lease costs of the showroom complex, on the dates of their payment, as stipulated in the main lease agreement. Accordingly, the cost of the lease fees for the Company will be 11,500 dollars monthly.

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 24 - Balances and transactions with interested parties and related parties (cont.)

- o. Approval of a transaction between the Company and its controlling shareholders for the purpose of leasing showrooms (cont.)**
- d. Other joint expenses** - In addition to the lease fees, the Company will bear one-third of the additional current expenses of the showroom complex, such as cleaning expenses, maintenance costs, water, electricity, municipal taxes, etc. The cost of the joint expenses for the Company is estimated at 1,150 dollars per month.
 - e. Showroom complex renovation expenses** - The renovation and adjustment work were carried out by a third party unrelated to any of the three companies, whereas each of the companies bears a third of the renovation and adjustment costs. The Company's share in this renovation is US 154,000 dollars.
- p. The Company' merger with a wholly-owned subsidiary**

On December 21, 2016, the Boards of Directors of the Company (hereinafter: "the surviving company") and of the wholly owned subsidiary of the Company Hi-Tex founded by Tefron Ltd. ("the target company"), approved the merger between the companies so that on the date of the merger the target company will merge with and into the surviving company, so that the target company ceases to exist as a separate legal entity and will be dissolved without liquidation, while the surviving company will own all assets, rights, agreements, authorities and powers and will be charged with any debt and/or undertaking of the target company. On December 22 the agreement regarding the merger was signed by the companies and on September 29, 2017 and October 30, 2017 an additional amendment to the agreement was signed, extending its validity for an additional period the last of which is December 31, 2017. Accordingly, to the extent that the conditions precedent specified in the agreement are not fulfilled for any reason until December 31, 2017, and the parties have not agreed to extend this date, then either party may cancel this agreement, and the other party shall have no claim and/or demand against the other party in connection therewith.

On December 26, 2017, a decision was made regarding the taxation of the agreement concerning the merger of Hi-Tex, founded by Tefron Ltd. with and into Tefron Ltd., in accordance with the provisions of Section 103b of the Ordinance.

The date of the merger was set for December 31, 2016, and all as determined and detailed in the merger decision and subject to the terms of Section E2 of the Ordinance, including:

- a. No new rights will be allocated to the shareholders of the acquiring company due to the merger.
- b. The provisions of Section 103e of the Ordinance and provisions of Section 103c(2) shall apply to the assets transferred to the surviving company.
- c. Section 103h will be implemented, so that the losses of the companies participating in the merger that are transferable will be allowed to be offset against the income of the surviving company starting from the tax year following the merger, provided that in any tax year this amount is no more than 20% (five-year spread) of the total losses of the target company and the surviving company or 50% of the taxable income of the surviving company in that tax year before offsetting the loss from previous years, whichever is lower.
- d. Advances in respect of excess on the eve of the merger will be offset as determined in the taxation decision.
- e. A succession of rights will apply in respect of the transferred employees.

On February 18 the merger was completed.

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 25 - Significant events during the reporting period

a. Agreements with the financing banks concerning an early repayment

On March 22, 2018, the Company received the consent of the banks which finance the Company's operations, Bank Leumi Le-Israel Ltd., Israel Discount Bank Ltd. and Bank Hapoalim Ltd. (hereinafter: the "banks") according to which for the purpose of replacing the financing of the Company's operations in financing led by a foreign bank and/or banks (if and to the extent that such financing is received), the banks agree that the Company will repay its debts to the banks in an early repayment in such a manner that 82% of the debts will be repaid and the remaining 18% will be forgiven by the banks (hereinafter: the "early repayment"). For further details regarding the terms of the early repayment, see Note 13(2)a.

On March 29, 2018, a financing agreement was signed (for details see Clause b as follows) which enabled the execution of the early repayment. Immediately following the Passover holiday, on April 10, 2018, the early repayment to the financing banks was carried out in accordance with the conditions detailed in Note 13(2)a above.

b. Signing a financing agreement

On March 29, 2018, the financing agreement was signed with the following parties: Tefron Canada Inc., a private Canadian subsidiary wholly-owned by the Company, as the borrower (hereinafter: "Tefron Canada"), the Company, as the parent company and the bank HSBC Canada as the lender (hereinafter: "the bank"), for the purpose of providing alternative financing to the current bank financing (hereinafter: the "agreement"). For further details concerning the principal terms thereof Note 13(2)a above. The financing was provided on April 10, 2018.

c. On November 5, 2018, an additional line of credit was granted by the Bank to Tefron Canada. For details regarding this matter see Note 13(2)a above.

d. On May 31, 2018, the subsidiary of the Company in the United States, which is wholly owned by the Company, Tefron USA Inc. (hereinafter: the "subsidiary"), purchased the shares of the company Lamour Hosiery, Inc. (hereinafter: "Lamour"), a private company incorporated in Delaware state and owned by the Lieberman family, whose members are the controlling shareholders of the Company. For details see Note 24e above.

Note 26 – Significant events subsequent to the reporting period

a. An agreement for the purpose of establishing a joint company in Jordan

On January 17, 2019, the Company engaged in an agreement to establish a jointly owned company in Jordan (through a wholly-owned subsidiary of the Company), for the purpose of local production in Jordan, exclusively for Tefron, of products made by the seamless technology (hereinafter: "the agreement"). The other party to the agreement is a company incorporated in Jordan (which is not related to the Company and/or its controlling shareholders), which engages in the local manufacturing of textile products for international brands and to customers in the retail market while using cut & sew technology (hereinafter: "the partner").

In accordance with the agreement, the parties will work to establish a jointly owned company in equal shares in Jordan, the Company itself appointing the chairman of the board of directors of the joint company, and he shall have a decisive vote in any case of equality of votes on the board of directors of the joint company. As part of the agreement, arrangements were set in all matters

Tefron Ltd.

Notes to the Consolidated Financial Statements

Note 26 – Significant events subsequent to the reporting period (cont.)

a. An agreement for the purpose of establishing a joint company in Jordan (cont.)

relating to the management and operation of the joint company and in all matters pertaining to the rights and obligations of the parties as shareholders therein. Including with regard to the right of first refusal and the right to participate in the sale of shares, as well as instructions regarding non-competition of the partner in the Company in all matters relating to the manufacturing of seamless technology products. For the purpose of its operations, the joint company will lease an industrial building from the partner and knitting machines from the Company. The parties intend to commence the joint operations in the first quarter of 2019.

The entry into force of the agreement is subject to the approval of the bank that finances Tefron's operations (HSBC) within 30 days as of the signing date of the agreement, and if the approval is not received as aforesaid, the agreement will be void.

On February 7, 2019, the approval of the bank that finances Tefron's operations (HSBC) was received for the said agreement.

b. For details regarding a material private placement of 700,000 share options of the Company to the CEO of the Company's subsidiary, Tefron USA Inc., see Note 20b above.

c. Signing a collective agreement with the General Federation of Labor and the Employee Association

On February 20, 2019, the Company signed a collective agreement with the new General Federation of Labor and the Company's Employee Association (hereinafter: "the agreement"), whose main points are detailed as follows: The agreement applies to employees of the Company's production, development, maintenance and technical departments (hereinafter: "the employees"). The agreement stipulates a one-time salary increment to the employees at a rate of 2.5%, to be paid as of October 2018. In addition, the agreement stipulates entitlement of employees to seniority increment, which will be paid to employees employed by the Company for at least 5 years and up to over 16 years at a gradual rate of 0.5% to 3.5%, not on a cumulative basis. The seniority increment will be paid as of January 1, 2020. The agreement regulates the practice of the Company in all matters relating to pension insurance, including the regulation of pension fees' components, severance pay, vacation days, sick leave, other related working conditions, procedures and rules of conduct. In addition, the agreement regulates the dismissal proceedings of the employees, as applicable. The employees will be entitled, each and every one, to a signing grant concerning the agreement in the amount of NIS 1,000. The agreement guarantees industrial quiet throughout the period of the agreement in all matters relating to the issues settled in the agreement. The agreement will be for three years as of date of signing thereof, with the Company having the option to extend it by one additional year against a one-time salary increment to the employees at a rate of 2.5%. The Company believes that the estimate of the increase in the total cost of manpower in the Company for 2019, based on the manpower data on the signing date of the agreement (consists of the cost of the signing grants only, since the one-time increase of 2.5% was paid in 2018, as aforesaid) is US 40 thousand dollars and for the year 2020 and until the end of the period of the agreement US 110 thousand dollars.

d. On February 21, 2019, an addendum to the financing agreement with the Company's financing bank, was signed. For details see Note 13(2)b above.

Tefron Ltd.

Notes to the Consolidated Financial Statements

Details regarding significant subsidiaries held by the Company as at December 31, 2018:

Name of the subsidiary	Country of incorporation and principal place of business activity	% of rights of ownership as at December 31,	
		2018	2017
		%	%
Tefron USA Inc.	U.S.A.	100%	100%
Lamour Hosiery, Inc., wholly- owned by Tefron USA Inc.	U.S.A.	100%	100%
El-Masira Textile Co., wholly- owned by Tefron USA Inc.	Jordan	100%	100%
Tefron Canada Inc., wholly-owned by Tefron Ltd.	Canada	100%	100%
Tefron Hong Kong Limited	Hong Kong	100%	100%
Tefron Holdings (98) Ltd.	Israel	100%	100%
Tefron Trading (Shanghai) Company Limited – owned by Tefron Hong Kong	China	100%	100%

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