

Ituran Location & Control Ltd.
Form 20-F
June 26, 2006

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 20-F

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

For the fiscal year ended December 31, 2005
Commission file no. 001-32618

ITURAN LOCATION AND CONTROL LTD.

(Exact name of Registrant as specified in its charter and
translation of Registrant's name into English)

Israel

(Jurisdiction of incorporation or organization)

3 Hashikma Street, Azour, Israel

(Address of principal executive offices)

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

Title of each class	Name of each exchange on which registered
Ordinary Shares, par value NIS 0.33¹/₃ per share	Nasdaq National Market

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

None

(Title of Class)

Securities for which there is reporting obligation pursuant to Section 15(d) of the Act:

None

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

None

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23,244,542 Ordinary Shares

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

Yes ☐ No ☒

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

Yes ☐ No ☒

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

Yes ☒ No ☐

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

Large Accelerated Filer ☐ Accelerated Filer ☐ Non-accelerated filer ☒

Indicate by check mark which financial statement item the Registrant has elected to follow:

Item 17 ☐ Item 18 ☒

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

Yes ☐ No ☒

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USE OF CERTAIN TERMS

As used herein, and unless the context suggests otherwise, the terms we, us, our or Ituran refer to Ituran Location and Control Ltd. and its consolidated subsidiaries.

We have prepared our consolidated financial statements in US Dollars. Our consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP). All references herein to dollars or \$ or USD are to United States dollars, and all references to NIS are to New Israeli Shekels.

FORWARD LOOKING STATEMENTS

This Annual Report on Form 20-F contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The use of the words projects, believes, expects, may, plans intends, or words of similar import, identifies a statement as forward-looking. The forward-looking statements included herein are based on current expectations that involve a number of risks and uncertainties. These forward-looking statements are based on the assumption that we will not lose a significant customer or customers or experience increased fluctuations of demand or rescheduling of purchase orders, that our markets will continue to grow, that our products will remain accepted within their respective markets and will not be replaced by new technology, that competitive conditions within our markets will not change materially or adversely, that we will retain key technical and management personnel, that our forecasts will accurately anticipate market demand, and that there will be no material adverse change in our operations or business. Assumptions relating to the foregoing involve judgments with respect to, among other things, future economic, competitive and market conditions, and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond our control. In addition, our business and operations are subject to substantial risks which increase the uncertainty inherent in the forward-looking statements. In light of the significant uncertainties inherent in the forward-looking information included herein, the inclusion of such information should not be regarded as a representation by us or any other person that our objectives or plans will be achieved. Factors that could cause actual results to differ from our expectations or projections include the risks and uncertainties described in this annual report in Item 3: Risk Factors.

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. SELECTED FINANCIAL DATA

We have provided selected financial data under generally accepted accounting principles in the U.S. (U.S. GAAP). You should read the selected consolidated financial data presented in this Item together with Item 5 Operating and Financial Review and Prospects and with our consolidated financial statements included elsewhere in this annual report.

Our selected consolidated statements of operations data for the years ended December 31, 2003, 2004 and 2005 and our selected consolidated balance sheet data as of December 31, 2004 and 2005 have been derived from our consolidated financial statements, included elsewhere in this report. The selected consolidated statements of operations data for each of the years ended December 31, 2001 and 2002 and the selected consolidated balance sheet data as of December 31, 2001, 2002 and 2003 are derived from other audited financial statements not included in this report.

Selected Financial Data Under U.S. GAAP:**Consolidated Statements of Operations**

Year Ended December 31,				
2005	2004	2003	2002	2001
<i>In USD</i>				
<i>In thousands, except per share amounts</i>				

Revenues:

Location based services	44,128	36,549	32,088	24,053	19,757
Wireless communications products	43,806	33,461	23,527	17,782	19,516
Other	2,192	7,916	8,456	7,856	8,689
Total Revenues	90,126	77,926	64,071	49,691	47,962

Cost of Revenues:

Location based services	14,987	12,944	12,258	12,159	14,042
Wireless communication products	30,956	23,224	19,071	12,928	17,081
Other	1,643	5,720	6,119	5,746	6,922

Total cost of revenues	47,586	41,888	37,448	30,833	38,045
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Gross profits	42,540	36,038	26,623	18,858	9,917
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Operating Expenses:

Research and development expenses	2,799	2,020	1,692	1,717	1,362
Selling and marketing expenses	4,876	4,074	2,888	2,365	3,241
General and administrative expenses	14,959	11,693	11,443	9,757	11,551
Other expenses (income), net	(16)	(12)	314	740	--

Total operating expenses	22,618	17,775	16,337	14,579	16,154
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Operating Income (loss)	19,922	18,263	10,286	4,279	(6,237)
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Financing income (expenses), net	906	(2,059)	(616)	(6,039)	5,369
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Other non-operating expenses, net	--	--	--	528	753
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Income (loss) before taxes on income	20,828	16,204	9,670	(2,288)	(12,359)
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Taxes on (income) loss	(5,295)	(4,423)	(3,417)	2,955	198
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Income (loss) after tax on income	15,533	11,781	6,253	667	(12,161)
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Share in losses of affiliated companies, net	(355)	(324)	(235)	(529)	(955)
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Minority interest in income (losses) of subsidiaries	(803)⁽¹⁾	(238)	(173)	731	174
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Net income (loss)	14,375	11,219	5,845	869	(12,942)
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Earning per share⁽²⁾

Basic	\$ 0.73	\$ 0.60	\$ 0.32	\$ 0.05	\$ (0.86)
Diluted	\$ 0.71	\$ 0.58	\$ 0.31	\$ 0.05	\$ (0.86)

Weighted average number of shares outstanding⁽²⁾

Basic	19,736	18,585	18,273	17,634	15,135
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	Year Ended December 31,				
Diluted	20,254	19,192	19,086	18,264	15,135

⁽¹⁾ including \$287 thousand for prior years (a decrease of \$0.02 earning per share) as a result of recalculation of minority interests in income from subsidiaries, which does not have a material effect on our financial results

⁽²⁾ Earning per share and weighted average number of shares outstanding were adjusted to reflect the three to one share split of our ordinary shares that was affected on September 22, 2005.

Consolidated Balance Sheets Data

	As of December 31,				
	2005	2004	2003	2002	2001
	<i>In USD</i>				
	<i>In thousands, except per share amounts</i>				
Cash & Cash Equivalent	58,429	4,604	3,918	1,327	1,014
Working Capital	60,995	2,508	(3,624)	(11,650)	(15,825)
Total Assets	116,484	59,023	54,731	54,412	57,926
Total Liabilities	40,722	44,022	50,942	57,333	65,768
Retained Earnings (accumulated deficit)	4,048	(7,630)	(17,522)	(23,367)	(24,236)
Shareholders Equity (deficit)	75,762	15,001	3,789	(2,921)	(7,842)

Other Data:

	As of December 31,				
	2005	2004	2003	2002	2001
	(unaudited)				
Subscribers of our location-based services ⁽¹⁾	339,000	262,000	210,000	178,000	150,000
Average monthly churn rate	1.5%	1.5%	1.4%	1.0%	1.0%

(1) Number of subscribers is approximate

B. CAPITALIZATION AND INDEBTEDNESS

Not applicable.

C. REASONS FOR THE OFFER AND USE OF PROCEEDS

Not applicable.

D. RISK FACTORS

Our business, operating results and financial condition could be seriously harmed due to any of the following risks, among others. If we do not successfully address the risks to which we are subject, we could experience a material adverse effect on our business, results of operations and financial condition and our share price may decline, which may result in a loss of all or part of your investment. We cannot assure you that we will successfully address any of these risks. You should carefully consider the following factors as well as the other information contained and incorporated by reference in this annual report before taking any investment decision with respect to our securities. See Forward Looking Statements on page iv above.

RISKS RELATED TO OUR BUSINESS

Failure to maintain our existing relationships or establish new relationships with insurance companies could adversely affect our revenues and growth potential.

Revenues from our stolen vehicle recovery services, which we refer to as SVR services, and automatic vehicle location products, which we refer to as AVL products, are primarily dependent on our relationships with insurance companies. In Israel, insurance companies drive demand for our SVR services and AVL products by encouraging and, in some cases, requiring customers to subscribe to vehicle location services and purchase vehicle location products such as ours. In Brazil and Argentina, insurance companies, such as Porto Seguro in Brazil and La Caja in Argentina, enter into written agreements to subscribe to our services and purchase or lease our products directly. Our inability to maintain our existing relationships or establish new relationships with insurance companies could adversely affect our revenues and growth potential.

Changes in practices of insurance companies in the markets in which we provide our SVR services and sell our AVL products could adversely affect our revenues and growth potential.

We depend on the practices of insurance companies in the markets in which we provide our SVR services and sell our AVL products. In Israel, insurance companies either mandate the use of SVR services and AVL products, or their equivalent, as a prerequisite for providing insurance coverage to owners of certain medium- and high-end vehicles, or provide insurance premium discounts to encourage vehicle owners to subscribe to services and purchase products such as ours. In Brazil and Argentina, insurance companies purchase or lease our AVL products directly and subsequently require their customers to subscribe to our SVR services.

Therefore, we rely on insurance companies' continued practice of:

- n accepting vehicle location and recovery technology as a preferred security product;
- n requiring or providing a premium discount for using location and recovery services and products;
- n mandating or encouraging use of our SVR services and AVL products, or similar services and products, for vehicles with the same or similar threshold values and for the same or similar required duration of use; and
- n with respect to insurance companies in Brazil and Argentina, deciding to purchase or lease SVR services and AVL products from us directly.

If any of these policies or practices change, revenues from sales of our SVR services and AVL products could decline, which could adversely affect our revenues and growth potential.

A reduction in vehicle theft rates may adversely impact demand for our SVR services and AVL products.

Demand for our SVR services and AVL products depends primarily on prevailing or expected vehicle theft rates. Vehicle theft rates may decline as a result of various reasons, such as the availability of improved security systems, implementation of improved or more effective law enforcement measures, or improved economic or political conditions in markets that have high theft rates. If vehicle theft rates in any or all of our existing markets decline or stabilize, or if insurance companies or our other customers believe that vehicle theft rates have declined or stabilized or are expected to decline or stabilize, demand for our SVR services and AVL products may decline.

A decline in sales of new medium- and high-end cars and commercial vehicles in the markets in which we operate could result in reduced demand for our SVR services and AVL products.

Our SVR services and AVL products are primarily used to protect medium- and high-end cars and commercial vehicles and are often installed before or immediately after their initial sale. Consequently, a reduction in sales of new medium- and high-end vehicles could reduce our addressable market for SVR services and AVL products. New vehicle sales may decline for various reasons, including an increase in new vehicle tariffs, taxes or gas prices. A decline in vehicle production levels or labor disputes affecting the automobile industry in the markets where we operate may also impact the volume of new vehicle sales. A decline in sales of new medium- and high-end vehicles in the markets in which we provide our SVR services or sell our AVL products could result in reduced demand for such services and products.

In the event that we are not successful in penetrating the Chinese and South Korean markets, as a result of contractual or governmental constraints, or if our relevant counterparties are not able or willing to effectively market location-based services in China or South Korea, we will not be able to implement a substantial portion of our current growth strategy.

In 2004 we entered into material agreements for the sale of our AVL infrastructure and end-units in China and South Korea. See Item 10.C Additional Information under the caption Material Contracts below. Our current growth strategy depends, in large part, on our ability to maximize our opportunities pursuant to such agreements. Performance under such agreements is subject to various contractual and governmental constraints, including the receipt of various licenses and permits required for the establishment of our AVL infrastructure and specialized approvals, such as the Telecommunication Equipment Network Access Type Approval in China and the Business License and Spectrum License in South Korea, some of which are difficult to obtain or require a substantial time investment. In addition, our ability to sell our products in the relevant markets is dependent upon the local operators' ability to effectively provide location-based services based on our AVL infrastructure or market our end-units in China and South Korea. Their failure to provide any such services or market our products effectively, or such operators failure to obtain any necessary governmental licenses, would preclude us from being able to optimize our growth in China and South Korea.

There is significant competition in the markets in which we offer our services and products and our results of operations could be adversely affected if we fail to compete successfully.

The markets for our services and products are highly competitive. We compete primarily on the basis of the technological innovation, quality and price of our services and products. Our most competitive market is the location-based services market and the related AVL products market, due to the existence of a wide variety of competing services and products and alternative technologies that offer various levels of protection and tracking capabilities, including global positioning systems, or GPS, satellite- or network-based cellular systems and direction-finding homing technologies. Some of these competing services and products, such as certain GPS-based products, are installed in new cars by vehicle manufacturers prior to their initial sale, which effectively precludes us from competing for such subscribers. Furthermore, providers of competing services or products may extend their offerings to the locations in which we operate or new competitors may enter the location-based services market. Our AVL products also compete with less sophisticated theft protection devices such as standard car alarms, immobilizers, steering wheel locks and homing devices, some of which may be significantly cheaper. Some of these competing products have greater brand recognition than our AVL products, including LoJack Corporation in the United States.

Over 90% of the automatic meter reading market, which we refer to as the AMR market, exists in the United States, where we compete with a number of established companies with greater financial resources. The radio frequency identification market, which we refer to as the RFID market, in the United States is characterized by a small number of established and accepted providers, including Mark IV, the provider of the E-ZPass solution, many of which have greater experience and name recognition in this market than we do. Many of our current and potential competitors in all of the markets in which we operate have significantly greater name recognition, larger customer base and greater financial, technical, manufacturing, marketing and other resources than we do. If our competitors succeed in marketing products more effectively than we do, our results of operations could be adversely affected.

The development of new or improved competitive products, systems or technologies that compete with our wireless communications products may render our products less competitive or obsolete, which could cause a decline in our revenues and profitability.

We are engaged in businesses characterized by rapid technological change and frequent new product developments and enhancements. The number of companies developing and marketing new wireless communications products has expanded considerably in recent years. The development of new or improved products, systems or technologies that compete with our wireless communications products may render our products less competitive and we may not be able to enhance our technology in a timely manner. In addition to the competition resulting from new products, systems or technologies, our future product enhancements may not adequately meet the requirements of the marketplace and may not achieve the broad market acceptance necessary to generate significant revenues. Any of the foregoing could cause a decline in our revenues and profitability.

The inability of local law enforcement agencies to timely and effectively recover the stolen vehicles we locate could negatively impact customers' perception of the usefulness of our SVR services and AVL products, adversely affecting our revenues.

Our AVL products identify the location of vehicles in which our products are installed. Following a notification of an unauthorized entry, or if we receive notification of the vehicle's theft from a subscriber, we notify the relevant law enforcement agency of the location of the subscriber's vehicle and generally rely on local law enforcement or governmental agencies to recover the stolen vehicle. We cannot control nor predict the response time of the relevant local law enforcement or other governmental agencies responsible for recovering stolen vehicles, nor that the stolen vehicles, once located, will be recovered at all. Over the past three years, some stolen vehicles in which our AVL products were installed were not recovered and the average stolen vehicle recovery time in the markets in which we operate was 20 minutes from the time an unauthorized entry is confirmed or reported to the time the vehicle is recovered. Over the past three years, the average response time of the relevant law enforcement agencies in the markets in which we provide SVR services was approximately 20 minutes. To the extent that the relevant agencies do not effectively and timely respond to our calls and recover stolen vehicles, our recovery rates would likely diminish, which may, in turn, negatively impact customers' perception of the usefulness of our SVR services and AVL products, adversely affecting our revenues.

The ability to detect, deactivate, disable or otherwise inhibit the effectiveness of our AVL products could adversely affect demand for such products and our revenues.

The effectiveness of our AVL products is dependent, in part, on the inability of unauthorized persons to deactivate or otherwise alter the functioning of our AVL products or the vehicle anti-theft devices that work in conjunction with our AVL products. As sales of our AVL products increase, criminals in the markets in which we operate may become increasingly aware of our AVL products and may develop methods or technologies to detect, deactivate or disable our tracking devices or the vehicle anti-theft devices that work in conjunction with our AVL products. We believe that, as is the case with any product intended to prevent vehicle theft, over time, there may be an increased ability of unauthorized persons to detect, deactivate, disable or otherwise inhibit the effectiveness of our AVL products, although it is difficult to verify this fact. An increase in the ability of unauthorized persons to detect, deactivate, disable or otherwise inhibit the effectiveness of our AVL products could adversely affect demand for our products and our revenues.

We rely on some intellectual property that we license from a third party, the loss of which could preclude us from providing our SVR services or market and sell some of our AVL products, which would adversely affect our revenues.

We license from Teletrac, Inc. some of the technology that we need in order to provide our SVR services and market and sell some of our AVL products. In the event that such licenses were to be terminated, or if such licenses were rendered unenforceable or invalid, we would not be able to license similar technology from other parties, which would require us, at a minimum, to obtain rights to a different technology and reconfigure our AVL products accordingly. Our license agreements with Teletrac are perpetual in term unless terminated by mutual agreement or for breach, including bankruptcy, dissolution or insolvency. As a result, our failure to maintain our intellectual property licenses from Teletrac could preclude us from providing our SVR services or market and sell some of our AVL products, which would adversely affect our revenues.

We depend on proprietary technology and our failure to protect and enforce our intellectual property rights or our need to defend against infringement claims could result in a significant increase in costs and decline in revenues.

Our business is dependent on the uninterrupted use of proprietary technology, both owned and licensed, from third parties. If we fail to protect, enforce and maintain our intellectual property rights, we may not be able to compete and our business and operating results could be negatively impacted. We seek to protect our intellectual property rights through a combination of patents, trademarks, copyrights, trade secret laws, know-how, confidentiality procedures and licensing arrangements. Even with the intellectual property protection currently in place, we may not be able to protect our technology from misappropriation or infringement and we may lose, or the relevant owners may restrict or lose, our current rights of use of the technology that we license from such owners. Any of our existing intellectual property rights may be invalidated, circumvented, challenged or rendered unenforceable. In addition, the laws of some countries in which we operate or plan to operate, may not protect intellectual property rights to the same extent as the laws of Israel or the United States, increasing the possibility of piracy of our technology and products. It may be necessary for us to litigate in order to enforce our intellectual property rights or to determine the validity and scope of the proprietary rights of others, which litigation can be time consuming, distracting to management, expensive and difficult to predict.

It is possible that we have or will inadvertently violate the intellectual property rights of other parties and those other parties may choose to assert infringement claims against us. If a court were to determine that our technology infringes on third parties' intellectual property, in addition to exposure to substantial damages, we could be required to expend considerable resources to modify our products, to develop non-infringing technology or to obtain licenses to permit our continued use of the technology that is the subject matter of the litigation.

Our failure to protect and enforce our intellectual property rights, or our need to defend against claims of infringement of intellectual property rights of others or the loss of any such claims, could result in a significant increase in costs and decline in revenues.

Our ability to sell our services and products depends upon the prior receipt and maintenance of various governmental licenses and approvals and our failure to obtain or maintain such licenses and approvals, or third-party use of the same licenses and frequencies, could result in a disruption or curtailment of our operations, a significant increase in costs and a decline in revenues.

We are required to obtain specific licenses and approvals from various governmental authorities in order to conduct our operations. For example, our AVL products use radio frequencies that are licensed and renewed periodically from the Ministry of Communications in Israel and similar agencies worldwide. As we continue to expand into additional markets, we will be required to obtain new permits and approvals from relevant governmental authorities. Furthermore, once our AVL infrastructure is deployed and our AVL end-units are sold to subscribers, a change in radio frequencies would require us to recalibrate all of our antennas and replace or modify all end-units held by subscribers, which would be costly and may result in delays in the provision of our SVR services. In addition, some of the governmental licenses for radio frequencies that we currently use may be preempted by third parties. In Israel, our license is designated as a joint license, allowing the government to grant third parties a license to use the same frequencies, and in Brazil our license is designated as a secondary license, which allows the government to grant a third party a primary license to use such frequencies, which third-party use could adversely affect, disrupt or curtail our operations. Our inability to maintain necessary governmental licenses and approvals, or third-party use of the same licenses or frequencies, could result in a significant increase in costs and decline in revenues.

Our SVR services business model is based on the existence of certain conditions, the loss or lack of which in existing or potential markets could adversely affect our revenues generated in existing markets or our growth potential.

Our SVR services business model and, consequently, our ability to provide our SVR services and sell our AVL products, relies on our ability to successfully identify markets in which:

- n the rate of car theft or consumer concern over vehicle safety is high;
- n satisfactory radio frequencies are available to us that allow us to operate our business in an uninterrupted manner; and
- n insurance companies or owners of cars believe that the value of cars justifies incurring the expense associated with the deployment of SVR services.

The absence of such conditions, our inability to locate markets in which such conditions exist or the loss of any one of the above conditions in markets we currently serve could adversely affect our revenues generated in existing markets or our growth potential.

Some of our agreements restrict our ability to expand into new markets for our SVR services and our AMR products, which could adversely affect our growth potential.

We have entered into the following agreements that include restrictions on our ability to sell certain of our services and products:

- n We have granted Korean Location Information and Communications Company Ltd., a South Korean company, a right of first refusal to provide location-based services, based on AVL infrastructure and end-units supplied by us, in the far east and south-east Asia, including Japan, but excluding China, Hong Kong, Macao and Taiwan.
- n We have granted Golden Net Communication Technology Ltd., a Chinese company, the exclusive rights to provide SVR services, based on an AVL infrastructure and AVL end-units supplied by us, in China, Hong Kong, Macao and Taiwan. In addition, once we receive \$150 million in revenues from sales of our AVL products to Golden Net, we are obligated to transfer title and ownership to all of our intellectual property rights, including know-how, patents and source code, relating to our AVL system to Golden Net for its use in China, Hong Kong, Macao and Taiwan.

- n We have granted Arad Technologies Ltd. the exclusive right (subject to certain limited exceptions) to purchase our AMR products. As a result, we are not permitted to independently market our AMR products to any entity other than Arad Technologies. Furthermore, Arad Technologies currently uses our AMR products only with respect to water meter products and applications and not in the gas and electricity meter markets, which we believe to be potential new markets for our AMR products.

These agreements restrict our ability to expand our business and operations in certain markets, which could adversely affect our growth potential.

We rely on a single customer for the sale of our AMR products and the loss of such customer or such customer's failure to effectively market and sell our AMR products could have an adverse effect on our revenues and growth potential.

We sell our AMR products exclusively to Arad Technologies who incorporates our AMR products into a water meter product that it markets and distributes to utilities in the United States through its wholly-owned subsidiary Master Meter, Inc. Therefore, the volume of our existing AMR products sales is wholly dependent upon Arad Technologies' demand for our products, which demand may not match or exceed historical levels. Any factors that adversely impact the operations of Arad Technologies, or result in our loss of its business, could adversely impact our AMR business. For example, Arad Technologies exclusively sells our AMR products to customers in the utility industry where sales cycles are often long and unpredictable. Furthermore, because we sell our AMR products exclusively to Arad Technologies, we rely on Arad Technologies for the effective marketing and sale of our AMR products to end-users. The failure of Arad Technologies to maintain or increase current demand for its products that incorporate our AMR products could have an adverse effect on our revenues and growth potential.

The loss of key personnel could adversely affect our business and prospects for growth.

Our success depends upon the efforts and abilities of key management personnel, including our Chairman of the Board of Directors, our Co-Chief Executive Officers and the President and Chief Executive Officer of our subsidiary, Telematics Wireless Ltd. Loss of the services of one or more of such key personnel could adversely affect our ability to execute our business plan. In addition, we believe that our future success depends in part upon our ability to attract, retain and motivate qualified personnel necessary for the development of our business. If one or more members of our management team or other key technical personnel become unable or unwilling to continue in their present positions, and if additional key personnel cannot be hired and retained as needed, our business and prospects for growth could be adversely affected.

We rely on third parties to manufacture our wireless communications products, which could affect our ability to provide such products in a timely and cost-effective manner, adversely impacting our revenues and profit margins.

We outsource the manufacturing of most of our wireless communications products to third parties. Furthermore, we use one manufacturer for production of a significant portion of our wireless communications products and we do not maintain significant levels of inventories to support us in the event of an unexpected interruption in its manufacturing process. If our principal manufacturer or any of our other manufacturers is unable to or fails to manufacture our products in a timely manner, we may not be able to secure alternative manufacturing facilities without experiencing an interruption in the supply of our products or an increase in production costs. Any such interruption or increase in production costs could affect our ability to provide our wireless communications products in a timely and cost-effective manner, adversely impacting our revenues and profit margins.

We depend on the use of specialized quality assurance testing equipment for the production of our wireless communications products, the loss or unavailability of which could adversely affect our results of operations.

We and our third-party manufacturers use specialized quality assurance testing equipment in the production of our products. The replacement of any such equipment as a result of its failure or loss could result in a disruption of our production process or an increase in costs, which could adversely affect our results of operations.

The adoption of industry standards that do not incorporate the technology we use may decrease or eliminate the demand for our services or products and could harm our results of operations.

There are no established industry standards in all of the businesses in which we sell our wireless communications products. For example, vehicle location devices may operate by employing various technologies, including network triangulation, GPS, satellite-based or network-based cellular or direction-finding homing systems. The development of industry standards that do not incorporate the technology we use may decrease or eliminate the demand for our services or products and we may not be able to develop new services and products that are in compliance with such new industry standards on a cost-effective basis. If industry standards develop and such standards do not incorporate our wireless communications products and we are unable to effectively adapt to such new standards, such development could harm our results of operations.

Expansion of our operations to new markets involves risks and our failure to manage such risks may delay or preclude our ability to generate anticipated revenues and may impede our overall growth strategy.

Our contracts with third-party providers for the establishment of AVL systems in China and South Korea represent important growth opportunities for the sale of our AVL infrastructure and AVL end-units. The expansion into these new markets involves challenges and risks, including tariffs, trade restrictions and foreign import export regulations as well as weak intellectual property law protection in China, and restrictive regulatory schemes or local customs in South Korea.

In addition, although we do not have current plans to expand our operations to new countries, we anticipate future growth to be attributable to our business activities in new markets, particularly in developing countries, where we may encounter additional risks and challenges, such as longer payment cycles, potentially adverse tax consequences, potential difficulties in collecting receivables and potential difficulties in enforcing agreements or other rights in foreign legal systems. The challenges and risks of entering a new market, and in particular the risks associated with us commencing operations in China and South Korea, may delay or preclude our ability to generate anticipated revenues and may impede our overall growth strategy.

Specifically, with regard to our operations in China, China's economy differs from the economies of most developed countries in many respects, including with respect to the amount of government involvement, level of development, growth rate, control of foreign exchange and allocation of resources. While the Chinese economy has experienced significant growth in the past 20 years, growth has been uneven across different regions and among various economic sectors of China. In recent years the Chinese government has implemented measures emphasizing the utilization of market forces for economic reform, the reduction of state ownership of productive assets and the establishment of sound corporate governance in business enterprises. However, a substantial portion of the productive assets in China is still owned by the Chinese government. Additionally, our partner in China has informed us that the Chinese government may hold a direct or indirect interest in the local operating companies established by our Chinese partner and that it has a controlling interest in the operating company in Shanghai, Shanghai Golden Net Location & Measurement Co. Ltd. As of the date of this report, we do not know what the scope of such interest will be or what control or influence the Chinese government will exercise over the other operating companies that will be formed. Any such exercise or control may adversely impact the business activities of these operating companies, and thus adversely impact our growth potential and revenues derived pursuant to our contractual arrangements with our Chinese partners. In addition, a change in policies by the Chinese government could adversely affect the operations of our Chinese partner, by, among other things, imposing confiscatory taxation, restricting currency conversion, imports and sources of supplies, or expropriating private enterprises, which may adversely impact our growth potential and revenues derived pursuant to our contractual arrangements with our Chinese partners. Although the Chinese government has been pursuing economic reform policies for nearly two decades, no assurance can be given that the Chinese government will continue to pursue such policies or that such policies may not be significantly altered, especially in the event of a change in leadership or other social or political disruption.

Part of our fleet management business relies on GPS-based technology owned and controlled by others, the loss, impairment or increased expense of which could negatively impact our immediate and future revenues from, or growth of, our fleet management services and adversely affect our results of operations.

Part of our fleet management business relies on signals from GPS satellites built and maintained by third parties. If GPS satellites become unavailable to us, or if the costs associated with using GPS technology increase such that it is no longer feasible or cost-effective for us to use such technology, we will not be able to adequately provide our fleet management services. In addition, if one or more GPS satellites malfunction, there could be a substantial delay before such satellites are repaired or replaced, if at all. The occurrence of any of the foregoing events could negatively impact our immediate and future revenues from, or growth of, our fleet management services and adversely affect our results of operations.

Due to the already high penetration of SVR services and AVL products in Israel and moderate overall growth of the addressable market in Israel, our prospects for growth in such market may be limited.

Our AVL products are primarily installed in medium- and high-end cars and commercial vehicles. Therefore, our ability to increase demand for our SVR services and revenues from sales of our AVL products is limited by the number of potential vehicles in which our products can be installed in each relevant market. We currently estimate that our AVL products are installed in a significant portion of the medium- and high-end cars and commercial vehicles in Israel. We anticipate that revenues from sales of our SVR services and AVL products in Israel will not increase significantly due to the already high penetration of SVR services and AVL products in Israel and moderate overall growth of the addressable market in Israel, which could adversely affect our prospects for growth in such markets.

We may not be able to offset the loss of revenues from the decline in our cellular services, which would adversely affect our results of operations when compared to results of operations of prior periods.

We derived 13.2%, 10.2%, and 2.4% of our total revenues in 2003, 2004 and 2005, respectively, from the provision of our cellular services. Our revenues from such services have declined significantly due to the expiration and non-renewal of our agreement with Partner Communications Co., Ltd. as of March 31, 2005, which agreement was the source of a significant portion of our revenues for this business. If we are unable to substitute these revenues, in whole or in part, with increasing revenues from our existing business segments, our results of operations will decline when compared to our results of operations for prior periods.

Some of our employees are members of labor unions and a dispute between us and any such labor union could result in a labor strike that could delay or preclude altogether our ability to generate revenues in the markets where such employees are located.

Some of our employees are members of labor unions. If a labor dispute were to develop between us and our unionized employees, such employees could go on strike and we could suffer work stoppage for a significant period of time. A labor dispute can be difficult to resolve and may require us to seek arbitration for resolution, which arbitration can be time consuming, distracting to management, expensive and difficult to predict. The occurrence of a labor dispute with our unionized employees could delay or preclude altogether our ability to generate revenues in the markets where such employees are located.

We are subject to litigation that could result in significant costs to us, a reduction in the price of our ordinary shares or dilution of our shareholders' ownership percentage.

We are a party to a litigation between us and Leonardo L.P. (and certain of its related parties) arising from a financial transaction concluded in February 2000. Pursuant to such transaction, Leonardo invested \$12 million in our company in return for notes that were convertible into our ordinary shares. We believe that the terms of the transaction dictated that the notes could be converted into a maximum of 2,250,000 of our ordinary shares and that upon conversion of the notes, the notes would be fully discharged and we would have no further obligation to the holders of the notes. Through the maturity date of the notes, March 3, 2003, Leonardo exercised its right to convert the notes into 2,241,594 of our ordinary shares. Immediately following the maturity date of the notes, however, Leonardo sent us a demand to repay in cash the balance of the notes plus accrued interest which had not been previously converted into our ordinary shares, which, according to Leonardo, was approximately \$6.2 million. We subsequently commenced this litigation to obtain a judicial determination of the proper disposition of the Leonardo notes and to obtain a declaration that our sole remaining obligation under the notes was to issue 8,406 of our ordinary shares. In its pleadings, Leonardo is seeking alternative remedies and relief, including, among others, (a) the repayment in cash of the balance of the notes in the amount of approximately \$6.2 million plus interest and expenses, (b) the delivery to Leonardo of the maximum number of our ordinary shares into which the notes could have been converted on the maturity date without regard to the 2,250,000 share limitation, or 3,516,462 ordinary shares, plus additional monetary damages, or (c) the payment of a cash amount equal to the amount obtained by multiplying the 3,516,462 shares mentioned in the preceding clause by the highest trading price of our ordinary shares between the maturity date and the date of the court's decision, plus interest or expenses. In addition, in June 2006, Leonardo was permitted to amend its claim to add an additional cause of action, claiming that on January 29, 2002 we also breached the same agreement because Moked Ituran Ltd. distributed some of our shares to other parties, in violation of the covenant that entitles Leonardo the option to redeem the notes Moked Ituran to maintain at least 70% of the number of our shares that it held at the time we entered into the financial transaction with Leonardo. Based on such alleged breach, Leonardo is seeking an additional alternative remedy of \$9.6 million, plus interest and expenses. Although there can be no assurances as to the final outcome of this litigation, we believe that the maximum liability that we could have in this matter, assuming that a court rejects our interpretation of the agreements or determines that we have otherwise defaulted on the notes, is approximately \$9.6 million plus interest and expenses. We intend to appeal the decision allowing Leonardo to amend its claim on legal grounds and intend to vigorously defend ourselves in this litigation. While we cannot predict the outcome of this litigation at this time, if Leonardo prevails, the award to Leonardo of damages, either in cash or by delivery of our ordinary shares, could result in significant costs to us, adversely affecting our results of operations. In addition, the issuance of our ordinary shares to Leonardo may impact the share price of our ordinary shares and would dilute our shareholders' ownership percentage. See also Item 8.A Consolidated Statements and other Financial Information under the caption Legal Proceedings below.

We have not obtained nor applied for several of the permits required for the operation of some of our base sites. To the extent enforcement is sought, the breadth, quality and capacity of our network coverage could be materially affected.

The provision of our SVR services depends upon adequate network coverage for accurate tracking information. In Israel, we have installed 92 base sites that provide complete communications coverage in Israel. Similarly, we have established complete communications coverage in Sao Paulo, Brazil, Buenos Aires, Argentina and Miami, Florida. The installation and operation of most of our base sites require building permits from local or regional zoning authorities as well as a number of additional permits from governmental and regulatory authorities.

Currently most of our base sites in Israel and Brazil operate without local building permits or the equivalent. Although relevant authorities in Israel and Brazil have not historically enforced penalties for non-compliance with certain permit regulations, following ongoing press coverage and actions by various public interest groups, relevant Israeli authorities have recently begun seeking enforcement of permit regulations, especially with respect to antennas constructed for cellular phone operators. Some possible enforcement measures include the closure or demolition of existing base sites. Should these enforcement measures be imposed upon us in Israel or should the relevant authorities in Brazil similarly begin enforcing permit requirements, or impose penalties on us for non-compliance with such permit requirements, the extent, quality and capacity of our network coverage and, as a result, our ability to provide SVR services, may be adversely affected.

Currency fluctuations may result in valuation adjustments in our assets and liabilities and could cause our results of operations to decline.

The valuation of our assets and liabilities and our revenues received and the related expenses incurred are not always denominated in the same currency. This lack of correlation between revenues and expenses exposes us to risks resulting from currency fluctuations. These currency fluctuations could have an adverse effect on our results of operations. In addition, fluctuations in currencies may result in valuation adjustments in our assets and liabilities which could cause our results of operations to decline.

RISKS RELATED TO OUR OPERATIONS IN ISRAEL

We are headquartered in Israel and therefore our results of operations may be adversely affected by political, economic and military instability in Israel.

Our headquarters and sole research and development facilities are located in Israel and our key employees, officers and directors are residents of Israel. Accordingly, security, political and economic conditions in Israel directly affect our business. Over the past several decades, a number of armed conflicts have taken place between Israel and its Arab neighbors. Since 2000, hostilities have increased in intensity and regional political uncertainty has also increased. Continued or increased hostilities, future armed conflicts, political developments in other states in the region or continued or increased terrorism could make it more difficult for us to conduct our operations in Israel, which could increase our costs and adversely affect our financial results.

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Israel has experienced in recent years, unionized general strikes in connection with the legislation of new economic reforms. A prolonged general strike in Israel would affect our ability provide our wireless communications products that are manufactured in Israel and would negatively impact our operations. Furthermore, there are a number of countries, primarily in the Middle East, as well as Malaysia and Indonesia, that restrict business with Israel or Israeli companies and as a result our company is precluded from marketing its products in these countries. Restrictive laws or policies directed toward Israel or Israeli businesses could have an adverse affect on our ability to grow our business and our results of operations.

We receive tax benefits that may be reduced or eliminated in the future, which reduction or elimination could result in us paying increased taxes thereby adversely affecting our results of operations.

Some of our operations in Israel have been granted approved enterprise status by the Investment Center in the Israeli Ministry of Industry and Trade that resulted in us being eligible for tax benefits under the Israeli Law for Encouragement of Capital Investments, 1959. The availability of these tax benefits is subject to certain requirements, including, among other things, making specified investments in fixed assets and equipment, financing a percentage of those investments with our capital contributions, compliance with our marketing program which was submitted to the Investment Center, filing of certain reports with the Investment Center and compliance with Israeli intellectual property laws. If we do not meet these requirements in the future, these tax benefits may be cancelled and we could be required to refund any tax benefits that we have already received plus interest and penalties thereon. The tax benefits that our current approved enterprise program receives may not be continued in the future at their current levels or at all. If these tax benefits were reduced or eliminated, the amount of taxes that we pay would likely increase, which could adversely affect our cash from operations. See Item 10.E. Taxation under the caption Israeli Tax Considerations below.

Under Israeli law, we are considered a monopoly and therefore subject to certain restrictions that may negatively impact our ability to grow our business in Israel.

We have been declared a monopoly under the Israeli Restrictive Trade Practices Law, 1988, in the market for the provision of systems for the location of vehicles. Under Israeli law, a monopoly is prohibited from taking certain actions, such as predatory pricing and the provision of loyalty discounts, which prohibitions do not apply to other companies. The Israeli antitrust authority may further declare that we have abused our position in the market. Any such declaration in any suit in which it is claimed that we engage in anti-competitive conduct would serve as *prima facie* evidence that we are a monopoly or that we have engaged in anti-competitive behavior. Furthermore, we may be ordered to take or refrain from taking certain actions, such as set maximum prices, in order to protect against unfair competition. Restraints on our operations as a result of being considered a monopoly in Israel could adversely affect our ability to grow our business in Israel.

It may be difficult and costly to enforce a judgment issued in the United States against us, our executive officers and directors, or to assert United States securities laws claims in Israel or serve process on our officers and directors.

We are incorporated and headquartered in Israel. As a result, our executive officers and directors are non-residents of the United States and a substantial portion of our assets and the assets of these persons are located outside of the United States. Therefore, service of process upon any of these officers or directors may be difficult to effect in the United States. Furthermore, it may be difficult to enforce a judgment issued against us in the United States against us or any of such persons in both United States courts and other courts abroad.

Additionally, there is doubt as to the enforceability of civil liabilities under United States federal securities laws in actions originally instituted in Israel or in actions for the enforcement of a judgment obtained in the United States on the basis of civil liabilities in Israel.

Provisions of Israeli corporate and tax law may delay, prevent or otherwise encumber a merger with, or an acquisition of, our company, which could prevent a change of control, even when the terms of such transaction are favorable to us and our shareholders.

Israeli corporate law regulates mergers, requires tender offers for acquisitions of shares above specified thresholds, requires special approvals for transactions involving directors, officers or significant shareholders and regulates other matters that may be relevant to these types of transactions. In addition, our articles of association contain, among other things, provisions that may make it more difficult to acquire our company, such as classified board provisions. In the future, we may amend our articles of association to include certain additional provisions that may be required by the Ministry of Communications limiting the voting power that could be acquired, absent Ministry of Communications approval, by any person other than our founding shareholders. Furthermore, Israeli tax considerations may make potential transaction structures involving the acquisition of our company unappealing to us or to some of our shareholders. See Item 10.B. Our Corporate Practices under Israeli Law under the caption Approval of Transactions under Israeli law and Item 10.E. Taxation under the caption Israeli Tax Considerations for additional discussion about some anti-takeover effects of Israeli law. These provisions of Israeli law and our articles of association may delay, prevent or otherwise encumber a merger with, or an acquisition of, our company or any of our assets, which could have the effect of delaying or preventing a change in control of our company, even when the terms of such a transaction could be favorable to our shareholders.

The rights and responsibilities of our shareholders will be governed by Israeli law and may differ in some respects from the rights and responsibilities of shareholders under United States law.

We are incorporated under Israeli law. The rights and responsibilities of holders of our ordinary shares are governed by our memorandum of association, articles of association and by Israeli law. These rights and responsibilities differ in some respects from the rights and responsibilities of shareholders in typical US-based corporations. In particular, a shareholder of an Israeli company has a duty to act in good faith toward the company and other shareholders and to refrain from abusing his, her or its power in the company, including, among other things, in voting at the general meeting of shareholders on certain matters. Israeli corporate law has undergone extensive revisions in the recent years and, as a result, there is little case law available to assist in understanding the implications of these provisions that govern shareholders actions, which may be interpreted to impose additional obligations on holders of our ordinary shares that are typically not imposed on shareholders of US-based corporations.

RISKS RELATED TO THE MARKET AND OUR ORDINARY SHARES

Future sales of our ordinary shares could reduce the market price of our ordinary shares.

If we or our shareholders sell substantial amounts of our ordinary shares, either on the Tel Aviv Stock Exchange or the Nasdaq National Market, the market price of our ordinary shares may decline.

The market price of our ordinary shares is subject to fluctuation, which could result in substantial losses for our investors.

The stock market in general, and the market price of our ordinary shares in particular, are subject to fluctuation, and changes in our share price may be unrelated to our operating performance. The market price of our ordinary shares has fluctuated in the past, and we expect it will continue to do so, as a result of a number of factors, including:

- n the gain or loss of significant orders or customers;
- n recruitment or departure of key personnel;
- n the announcement of new products or service enhancements by us or our competitors;
- n quarterly variations in our or our competitors' results of operations;
- n announcements related to litigation;
- n changes in earnings estimates, investors' perceptions, recommendations by securities analysts or our failure to achieve analysts' earning estimates;
- n developments in our industry; and
- n general market conditions and other factors unrelated to our operating performance or the operating performance of our competitors.

These factors and price fluctuations may materially and adversely affect the market price of our ordinary shares and result in substantial losses to our investors.

A significant portion of our ordinary shares are held by a small number of existing shareholders and you may not agree with some or all of the decisions taken by such shareholders.

Our directors and officers, in the aggregate, currently beneficially own or control approximately 34.25% of our outstanding ordinary shares. Other than applicable regulatory requirements under applicable law, these shareholders are not prohibited from selling a controlling interest in our company to a third party. These shareholders, acting together, could exercise significant influence over our operations and business strategy and may use their voting power to influence all matters requiring approval by our shareholders, including the ability to elect or remove directors, to approve or reject mergers or other business combination transactions, the decision to raise additional capital and the amendment of our articles of association that govern the rights attached to our ordinary shares. In addition, this concentration of ownership may delay, prevent or deter a change in control, or deprive our shareholders of a possible premium for ordinary shares as part of a sale of our company.

US investors in our company could suffer adverse tax consequences if we are characterized as a passive foreign investment company.

If, for any taxable year, our passive income or our assets that produce passive income exceed levels provided by law, we may be characterized as a passive foreign investment company, which we refer to as PFIC, for US federal income tax purposes. This characterization could result in adverse US tax consequences to our shareholders who are US Holders. See Item 10.E. Taxation under the caption United States Tax Considerations below, for more information about which shareholders may qualify as US Holders. If we were classified as a PFIC, a US Holder could be subject to increased tax liability upon the sale or other disposition of our ordinary shares or upon the receipt of amounts treated as excess distributions. Under such rules, the excess distribution and any gain would be allocated ratably over the US Holder's holding period for the ordinary shares and the amount allocated to the current taxable year and any taxable year prior to the first taxable year in which we were a PFIC would be taxed as ordinary income. The amount allocated to each of the other taxable years would be subject to tax at the highest marginal rate in effect for the applicable class of taxpayer for that year, and an interest charge for the deemed deferral benefit would be imposed on the resulting tax allocated to such other taxable years. In addition, holders of shares in a PFIC may not receive a step-up in basis on shares acquired from a decedent. US shareholders should consult with their own US tax advisors with respect to the United States tax consequences of investing in our ordinary shares as well as the specific application of the excess distribution and other rules discussed in this paragraph. For a discussion of how we might be characterized as a PFIC and related tax consequences, please see Item 10.E. Taxation under the caption United States Tax Considerations Passive foreign investment company considerations

Our ordinary shares are traded on more than one market and this may result in price variations.

Our ordinary shares are traded on the Nasdaq National Market and the Tel Aviv Stock Exchange. Trading in our ordinary shares on these markets takes place in different currencies (dollars on the Nasdaq National Market and NIS on the Tel Aviv Stock Exchange), and at different times (resulting from different time zones, different trading days and different public holidays in the United States and Israel). The trading prices of our ordinary shares on these two markets may differ due to these and other factors. Any decrease in the trading price of our ordinary shares on one of these markets could cause a decrease in the trading price of our ordinary shares on the other market.

Securities we issue to fund our operations or in connection with acquisitions could dilute our shareholders ownership or impact the value of our ordinary shares.

We may decide to raise additional funds through a public or private debt or equity financing to fund our operations or finance acquisitions. If we issue additional equity securities, the percentage of ownership of our shareholders will be reduced and the new equity securities may have rights superior to those of our ordinary shares, which may, in turn, adversely affect the value of our ordinary shares.

ITEM 4. INFORMATION ON THE COMPANY

A. HISTORY AND DEVELOPMENT OF THE COMPANY

Our History

We are mainly engaged in the area of location-based services, consisting of stolen vehicle recovery and tracking services. We also provide wireless communication products used in connection with our location-based services and various other applications, including automatic meter reading and radio frequency identification. We currently provide our services and sell our products in Israel, Brazil, Argentina and the United States. In addition, we have entered into contracts to deploy our automatic vehicle location, infrastructure and sell our end-units in China and South Korea, and commenced deploying such infrastructure in China in 2004 and in South Korea in 2005.

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Ituran was initially incorporated in February 1994 in Israel as a subsidiary of Tadiran Ltd., an Israeli-based designer and manufacturer of telecommunications equipment, software and defense electronic systems, whose original business purpose was to adapt military-grade technologies for the civilian market. In July 1995, Moked Ituran Ltd. purchased us and the assets used in connection with our operations from Tadiran and Tadiran Public Offerings Ltd. The AVL infrastructure and AVL end-units for the operation of our SVR services were originally developed by an independent division of Tadiran Communications and Systems Group. These operations were later transferred to a Tadiran subsidiary, Tadiran Telematics Ltd. In November 1999, we purchased Tadiran Telematics from Tadiran and in 2002, we changed its name to Telematics Wireless.

In May 1998, we completed the initial public offering of our ordinary shares in Israel and our ordinary shares began trading on the Tel-Aviv Stock Exchange. In September 2005, we began trading on the New York Stock Exchange and our ordinary shares are quoted on the Nasdaq under the symbol ITRN. The address of our principal executive office is 3 Hashikma Street, Azour 58001, Israel. Our telephone number is 972-3-557-1333. Our agent in the United States is Ituran USA Inc., 3330 N.W. 53rd Street, Suite 302, Fort Lauderdale, Florida 33355.

Capital Expenditures and Divestitures

We had capital expenditure of \$3.5 million in 2005, \$2.4 million in 2004 and \$2.3 million in 2003. We have financed our capital expenditure with cash generated from operations.

Our capital expenditures in 2005, 2004 and 2003 consisted primarily of acquisition of operational equipment for \$2.4 million, \$1.3 million and \$1.5 million, respectively.

B. BUSINESS OVERVIEW

OVERVIEW

We believe we are a leading provider of location-based services, consisting predominantly of stolen vehicle recovery and tracking services. We also provide wireless communications products used in connection with our location-based services and for various other applications, including automatic meter reading and radio frequency identification. We currently provide our services and sell our products in Israel, Brazil, Argentina and the United States. In addition, we have entered into contracts to deploy our automatic vehicle location infrastructure and sell our end-units in China and South Korea, and commenced deploying such infrastructure in China in 2004 and in South Korea in 2005, which we expect will initially be used to provide primarily SVR services in China and primarily personal tracking services in South Korea. We utilize technologies that enable precise and secure high-speed data transmission and analysis. Some of the technology underlying our products was originally developed for the Israeli Defense Forces in order to locate downed pilots.

We generate our revenues from subscription fees paid for our location-based services and from the sale of our wireless communications products. Since 1998, we have achieved sequential growth in quarterly revenues from subscription fees. Our revenues and net income have increased from \$49.7 million and \$0.9 million in 2002, to \$90.1 million and \$14.4 million in 2005, representing annualized growth rates of 81% and 1,500%, respectively.

We were incorporated in Israel in 1994 and began marketing our location-based services and wireless communications products in 1995. In May 1998, we completed the initial public offering of our ordinary shares in Israel and our ordinary shares began trading on the Tel Aviv Stock Exchange. In September 2005, we completed the initial public offering of our ordinary shares in the United States and our ordinary shares began trading on the Nasdaq National Market.

Location-Based Services

In 2005, 49% of our revenues were attributable to our location-based services. As of December 31, 2005, we provided our services in Israel, Brazil, Argentina and the United States to approximately 161,000, 107,000, 61,000 and 10,000 subscribers, respectively.

Stolen vehicle recovery services

Our stolen vehicle recovery and tracking services, which we refer to as SVR services, enable us to locate, track and recover stolen vehicles for our subscribers. Our customers include both individual vehicle owners who subscribe to our services directly and insurance companies that either require their customers to install a security system or offer their customers financial incentives to subscribe to SVR services such as ours. In certain countries, insurance companies directly subscribe to our SVR services and purchase automatic vehicle location products supporting these SVR services from us on behalf of their customers. In 2005, we recovered 5,429 vehicles with a total value of approximately \$67 million. We have been experiencing strong penetration in Brazil and Argentina where we have grown our subscriber base from approximately 25,000 and 5,000 in 2002 to approximately 107,000 and 61,000 in 2005, representing an increase of 328% and 1120% respectively over such 3 year period. Over the last three years, our monthly subscriber churn rates have averaged under 1.5% per month, our stolen vehicle recovery rates have averaged approximately 85%, based on the total number of our subscribers' vehicles stolen and recovered in cases of either a real time call is made by our subscriber advising us of the theft or a call is received from our control center in the markets we serve, and our average vehicle recovery time, from the time an unauthorized entry is confirmed or reported to the time the vehicle is recovered, has, based on our records, averaged approximately 20 minutes.

Fleet management services

Our fleet management services enable corporate customers to track and manage their vehicles in real time. Our services improve appointment scheduling, route management and fleet usage tracking, thereby increasing efficiency and reducing operating costs for our customers. We market and sell our services to a broad range of vehicle fleet operators in different geographic locations and industries. As of December 31, 2005, we provided our services to approximately 30,000 end-users through 2,290 corporate customers in Israel, Brazil and the United States.

Value-added services

Our Personal Advanced Locator, which we refer to as PAL, services allow customers to protect valuable merchandise and equipment, as well as track individuals. In addition, through a call center we provide 24-hour on-demand navigation guidance, information and assistance to our customers. We currently provide our PAL services in Israel only and, as of December 31, 2005, we had approximately 4,400 subscribers to this service. In addition, through a call center, we provide 24-hour on-demand navigation guidance, information and assistance to our customers. Such services include the provision of traffic reports, help with directions and information on the location of gas stations, car repair shops, post offices, hospitals and other facilities. We provide our concierge services to our subscribers in Israel and have recently begun offering such services in Argentina and Brazil. As of December 31, 2005, we had approximately 11,500 subscribers to our concierge service in Israel.

Wireless Communications Products

In 2005, 48.6% of our revenues were attributable to the sale of our wireless communications products. Our wireless communications products employ short- and medium-range communication between two-way wireless modems and are used for various applications, including:

- n automatic vehicle location, which we refer to as AVL;
- n automated meter reading, which we refer to as AMR; and
- n radio frequency identification, which we refer to as RFID.

Our AVL products enable the location and tracking of vehicles, as well as assets and persons, and are used by us primarily to provide SVR and fleet management services to our customers. Each subscriber to our SVR services has our AVL end-unit installed in his or her vehicle. Subscribers to services for locating persons will either use our PAL product or will have our end-unit installed in a watch or other accessory, an additional option currently under development. As part of our expansion into new markets, we entered into contracts with third-party service providers who intend to provide location-based services in China and South Korea. These contracts involve the setting up and deployment of the necessary terrestrial network and base stations throughout the relevant regions, establishing the control centers and providing the necessary end-units to be installed in vehicles, watches or other accessories, or PAL products. In 2004, we commenced deploying our AVL infrastructure in China and in 2005, we commenced deploying our AVL infrastructure in South Korea. Once the infrastructure for our AVL system is established in these regions, we expect a significant increase in sales of our end-units, initially in China and, at a later stage, in South Korea. We expect that the relevant third-party operators will initially provide primarily SVR, fleet management and personal tracking services in China and primarily vehicle and personal tracking services in South Korea.

Our AMR products enable the remote reading of water meters from a range of up to 1,000 feet. This allows the operator to extract information by walking or driving by the water meter, thus reducing the time and manual labor required to obtain the necessary information. In addition, our AMR wireless transmitter is integrated into the water meter, as opposed to systems where the transmitter and the water meter are separate components connected by a wire, which makes our system less susceptible to damage and tampering. As a result, we believe that our AMR products improve billing accuracy, reduce costs and increase reliability of collecting consumer usage data. We sell our AMR products exclusively to Arad Technologies that incorporates our AMR products into a water meter product that it markets and distributes to utilities in the United States through its wholly-owned subsidiary, Master Meter.

Our RFID products enable high-speed communication between mobile transponders and roadside readers and are primarily used for electronic toll collection systems. Other applications of our RFID products include electronic security seals for containers and border crossings, and electronic weigh station devices. We sell our electronic toll collection devices to Derech Eretz, the sole toll road operator in Israel, and to the transit authority of the State of Minnesota. We sell our electronic weigh station devices to ACS-SLS, a subsidiary of ACS, and to Norpass, a provider of mainline screening systems at weigh stations. In addition, we are currently engaged as the sole technology provider in several pilot programs for our RFID products with various federal and state governmental agencies, such as the United States Department of Homeland Security and the United States Customs and Border Protection Agency. We were selected to participate in these pilot programs on the basis of our competitive bids to provide our RFID products in response to requests for proposal made by the relevant federal or state governmental agencies or through third-party bidders or pilot program participants seeking to outsource the production of RFID products for use in their RFID-based systems. We believe our selection for these pilot programs represents a first step in our attempt to penetrate the radio frequency identification market in the United States and is strategically important for producing revenue-generating contracts.

Industry Overview and Trends

While we believe that the statistical data, industry data forecasts and market research discussed below are reliable, we have not independently verified the data, and we do not make any representation as to the accuracy of the information.

(a) Location-based services

Stolen vehicle recovery

The demand for vehicle security products and services is driven by vehicle theft rates, increasing security awareness among customers and insurance companies' efforts to reduce incidents of loss. According to a 2003 report by Ward's Communication, an independent provider of automobile industry research, approximately 55 million vehicles were sold globally in 2002. According to a March 2005 report by the Insurance Information Institute, in the United States alone, vehicle thefts accounted for 2% of the premiums paid for private passenger car insurance in 2003, or \$3 billion. According to a March 2004 report by the Freedonia Group, an independent market research firm, the United States market for vehicular security monitoring services, which includes dedicated alarm monitoring and integrated telematics systems, was valued at \$800 million in 2003 and is expected to increase to \$2.2 billion in 2008, representing an average annual growth rate of 22.4%, at which time the market is expected to support 7.9 million subscribers for these services. In some of our markets, demand for SVR services has been further enhanced by incidents of carjackings and car-related kidnappings that have increased consumers' perceived crime risk. Additionally, theft of trucks carrying valuable or hazardous cargo (e.g., microchips and chemicals) represents a threat to commercial, industrial, public and personal safety and security.

A wide range of vehicle security products, with varying degrees of sophistication and pricing, are available to vehicle owners today. These products can be divided roughly into two categories:

- 1) Traditional products, such as locks, alarms and traditional immobilizers. These devices are limited in their effectiveness as most can be disarmed easily and typically require the driver to activate the device upon leaving the vehicle. Also, unmonitored alarms that set off sirens are routinely ignored by people as the incidence of false alarms has been historically high. Furthermore, these products can only help in preventing theft and not in recovering the vehicle once it is stolen.
- 2) More sophisticated products that include some form of remote monitoring and communication. This category can be further separated into devices that simply provide information on the general direction of the vehicle and those that enable the location, tracking and recovery of the vehicle in real time.

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AVL technology is typically used to report stolen vehicles to police, provide real-time location and tracking information and immobilize the vehicle if necessary. The application of AVL technology has proven to be effective in increasing the recovery rates of stolen vehicles. As a result, many insurance companies in countries such as Israel, Brazil and Argentina either offer discounts between 15% and 25% on insurance premiums for vehicles equipped with AVL systems or require customers to install such AVL systems in vehicles above a pre-determined value.

Fleet management

The market for fleet management services ranges from very large fleets of thousands of vehicles to very small fleets of five vehicles or less, with smaller fleets constituting a significant portion of the market given the large number of companies that maintain a fleet today. Fleet management services allow fleet operators to locate, monitor and communicate with their vehicles and employees in the field in real time. This helps them to better track loads, predict arrival times, schedule customer appointments, reduce fuel usage and manage vehicles' maintenance schedules. By increasing efficiency and reducing costs, fleet management can provide a quantifiable return on investment for fleet operators, as well as improve customer satisfaction. In addition, fleet management services can enhance driver security and can notify the fleet operator if a vehicle leaves a prescribed geographic region, reducing theft-related liabilities.

A principal factor supporting fleet management industry growth is the presence of millions of vehicles that are in commercial use but which are not yet equipped with fleet management systems.

(b) Wireless communications products

Automatic vehicle location

AVL is one of the many possible applications for wireless location technology and is an umbrella term used for communication equipment and services that facilitate wireless tracking of vehicles, as well as assets and persons.

Typical AVL applications include:

Security	Transportation	Emergency and health care	Telecommunication services	Government
Vehicle tracking	Fleet management	Patient tracking	Maintenance vehicle tracking	Government vehicle tracking
Personal tracking	Parcel tracking	Ambulance tracking		
Asset tracking	Public transit			

Currently, the main underlying technologies available for wireless location and tracking in the AVL industry are terrestrial network triangulation, GPS (in combination with wireless communication), network-based cellular communication and radio frequency-based homing.

- n Terrestrial network triangulation uses the wireless signals transmitted by an end-unit in the vehicle and received by a network of land-based wireless antennas (base stations) installed in the relevant coverage region in order to determine the precise location of the transmitter.
- n GPS-based systems utilize specially designed GPS devices in the vehicle that receive data from three or more satellites in order to determine the location of the device. Once located, GPS-based systems require a cellular or another wireless network to communicate with a remote control center.
- n Network-based cellular systems utilize signals between the wireless device and the cellular operator's network of land-based antennas in order to triangulate the location of the relevant device. These systems require two-way communication between the device and antennas and, therefore, both a transmitter and receiver need to be installed in the vehicle.

- n RF-based homing systems utilize direction-finding technology based on a tracking signal transmitted by the end-unit in the vehicle, which is activated by a unique radio signal from the tracking unit once the vehicle is reported stolen.

Automatic meter reading

The AMR market includes systems that enable water, gas and electricity meters to be read remotely. Drive-by and walk-by systems are the primary AMR market segments today and are most economical for rural and suburban areas. The overall benefit of AMR technology is the enhanced access to data relating to the use of the relevant utility at a lower cost. Demand for AMR products is primarily driven by the potential for utilities to improve billing accuracy, reduced costs and increased reliability.

We estimate that the United States represents a significant portion of the global market for AMR products. Demand for AMR systems in the United States is driven by the approximate five- to seven-year replacement cycle for existing water meters, the trend towards automatic meter readers versus legacy meters and the increase in the number of customers as a result of increased levels of housing starts since 2001.

Radio frequency identification

The segment of the RFID market that we address includes three principal applications: electronic toll collection, electronic security seals and electronic weigh stations. Wireless communications technology is used in RFID applications where data exchange is rapid, communication zones are dynamically and rapidly changing and where battery life of months or even years is desirable.

Electronic toll collection is a technology that allows for electronic payment of highway tolls and replaces the need for manual collection tollbooths. In addition, it can allow such transactions to be performed while vehicles travel at near-highway cruising speeds. Electronic toll collection systems are a significant improvement over conventional toll collection techniques because such systems reduce lines at toll plazas, reduce toll collection costs, save fuel, reduce mobile emissions by reducing or eliminating waiting times, and enhance audit control by centralizing user accounts. In the United States, the increase in the overall number of vehicles has led to growing congestion on roads and an increase in the average time a commuter spends sitting idle in the car due to traffic jams. This has led to an increased demand for paid express lanes, which enable paying commuters to save time and avoid traffic jams. Approximately 25 states in the United States have passed legislation allowing some form of private toll roads, including the transit authority of the State of Minnesota, which is converting car pool lanes on Interstate 394 into paid express lanes.

Electronic sealing is commonly used as a freight security system where transponders are used to automatically identify individual containers or trucks at border entry points. The growth of the RFID market for this application in the United States has largely been driven by the recent standardization of the communications protocols on which RFID technology operates. Such standardization increases the interoperability of devices which, in turn, increases demand for such products from various organizations, including the United States Department of Homeland Security and the United States Customs and Border Protection Agency.

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Electronic weigh stations allow for identification and weighing of trucks in real time at near-highway cruising speeds, thus allowing trucks that comply with the weight limitations to bypass conventional weigh stations.

Products

Location-based services

Stolen vehicle recovery

Our stolen vehicle recovery system is based on three main components: an AVL end-unit that is installed in the vehicle, a network of base stations and a 24-hour manned control center. Once the control center receives indication of an unauthorized entry into a vehicle equipped with our AVL end-unit, our operators decide whether it is a false alarm or an actual unauthorized entry. If it is determined to be an unauthorized entry, or if a notification of the vehicle's theft is received directly from the vehicle operator, our operators transmit a signal that activates the transmitter installed in the vehicle. We then pinpoint the location of the transmitter with terrestrial network triangulation technology and notify the relevant law enforcement agency. In Israel, Brazil and Argentina, we also maintain private enforcement units, which work together with local police to recover the vehicle. In addition, we have the capability to immobilize vehicles remotely from our control centers.

Fleet management

We are among the few companies that offer their customers the use of a comprehensive application for fleet management both by using an Internet site and workstations. Our system allows our customers 24-hour access to information on their fleets through our active control center and also provides alerts on vehicle temperature and driver emergencies.

Value-added services

Personal advanced locator services. Our services allow consumers to protect valuable merchandise and equipment, as well as to track individuals. Currently, we provide our PAL services in Israel and Argentina only.

The PAL device is a two-way pager that helps us determine the location of the relevant equipment or person being tracked. Our PAL services, which are based on terrestrial network triangulation, have numerous applications, including location of patients with amnesia, portable distress buttons for the elderly and children, theft protection for valuable equipment and merchandise and other assets, such as computer equipment and beehives. In addition, there has been an increased use of our PAL devices in vehicles as back-up to our AVL systems.

Concierge services Through a call center, we provide 24-hour on-demand navigation guidance, information and assistance to our customers. Such services include the provision of traffic reports, help with directions and information on the location of gas stations, car repair shops, post offices, hospitals and other facilities. We provide our concierge services to subscribers in Israel and have recently begun offering such services in Argentina and in Brazil.

Wireless communications products

Our wireless communications products are used for various applications in the AVL, AMR and RFID markets.

Automatic vehicle location

Our AVL products enable the location and tracking of vehicles, as well as assets or persons, and are primarily used by us in providing our SVR and fleet management services. Each subscriber to our SVR services has one of our end-units installed in his or her vehicle. Subscribers to services for locating persons will either use our PAL product or will have our end-unit installed in a watch or other accessory, an additional option currently under development. We have entered into two contracts with third-party service providers for the deployment of our turn-key location-based solution consisting of our AVL infrastructure and end-units that includes the deployment of a network of base stations throughout a region, the establishment and operation of a control center, the supply and installation of end-units and a range of value-added services, in China and South Korea and we are currently in the set-up and network deployment phase in Beijing, Shanghai and Seoul. We expect that the relevant third-party operators will initially provide primarily SVR, fleet management and personal tracking services in China and primarily vehicle and personal tracking services in South Korea. Our key wireless communications products for AVL applications include:

- n **TULIP:** a transmitter installed in vehicles that sends a signal to the base site, enabling the location of a vehicle;
- n **MAPLE:** an alarm system that identifies an intruder and activates the transmitter to send a signal to the base site;
- n **PAL:** a portable transmitter located on an asset or on an individual that sends a signal to the base site, enabling the location of the asset or individual;
- n **Base Site:** a radio receiver, which includes a processor and a data computation unit to collect and send data to and from transponders and send that data to control centers as part of the terrestrial infrastructure of the location system; and
- n **Control Center:** a center consisting of software used to collect data from various base sites, conduct location calculations and transmit location data to various customers and law enforcement agencies.

Automatic meter reading

Our AMR products enable the remote reading of water meters. Our AMR systems include wireless modems that are installed inside water meters and transmit relevant metering data for the purposes of automatic billing, prevention of leaks and the preparation of on-line reports. Our AMR products, which were jointly developed by Arad Technologies and us, are commercially named Dialog-3G. Our key AMR products include:

- n **TMW:** a transponder installed inside a water meter for the purpose of receiving measurement data and wirelessly transmitting such data to the MMR;
- n **UNIVERSAL:** a transponder functionally similar to the TMW, but which is installed outside the relevant water meter for add-on applications;
- n **MMR:** a transceiver that is used for remote reception of the TMW's transmission data, either as a hand-held or drive-by unit; and
- n **DS Line of Products:** a new product line launched in the second quarter of 2005, functionally parallel to the TMW, UNIVERSAL and MMR devices, but with further reception range and improved resistance to interference.

Radio frequency identification

Our RFID products enable communication between mobile transponders and roadside readers and are primarily used for electronic toll collection systems. Other emerging applications include electronic security seals for containers and border crossings, and electronic weigh stations. Our key RFID products include:

- n **FP-100AT:** a transponder designed to send signals to the FP-300 or FP100RA reader for use on toll roads and at border crossings and electronic weigh stations;
- n **FP-300/FP100RA:** a transceiver/reader that is used for remote reception of the FP-100AT transponders that are installed along the relevant roadside, border crossings and weigh stations;
- n **Electronic Seal for Containers FP-200SA:** these products are used for the identification and reporting of unauthorized entry to containers in transit that employs such systems and are interoperable with FP-300, FP100RA, FP-200HH readers; and
- n **FP-200HH:** a hand-held transceiver used primarily at border crossings and for other short distance reading and programming.

The following table lists the key services and products that we currently sell or intend to sell in different regions of the world:

Country	Services offered or intended to be offered	Products sold or intended to be sold
Israel	SVR Fleet management Value-added services	AVL RFID
Brazil	SVR Fleet management Value-added services	AVL
Argentina	SVR Value-added services	AVL
United States	SVR Fleet management	AVL AMR RFID
China ⁽¹⁾	SVR Fleet management Value-added services	AVL ⁽²⁾
South Korea ⁽¹⁾	SVR Fleet management Value-added services	AVL(2)

(1) Location-based services to be provided by third parties.

(2) Currently only includes sale of AVL infrastructure. We intend to sell end-units to third-party providers of location-based services.

The following is a short description of key operating statistics about our location-based services in the countries in which we operate:

- n **Israel:** We commenced operations in Israel in 1995 and we had approximately 161,000 subscribers as of December 31, 2005. We maintain 92 base stations in Israel, which provide complete coverage within the country. Our control center operates 24 hours a day, 365 days a year and is located in Azour. In addition, our RFID products are used in the Derech Eretz toll road.

- n **Brazil:** We commenced operations in Brazil in 2000 and we had approximately 107,000 subscribers as of December 31, 2005. We currently operate only in the metropolitan areas of Sao Paulo and Campinas.
- n **Argentina:** We commenced operations in Argentina in 2002 and we had approximately 61,000 subscribers as of December 31, 2005. We currently operate only in the metropolitan area of Buenos Aires.
- n **United States:** We commenced operations in the United States in 2000 and until 2004 we operated only in Florida. As of December 31, 2005, we had approximately 10,000 subscribers for our location-based services in the United States.

Customers, Marketing and Sales

We market and sell our products and services to a broad range of customers that vary in size, geographic location and industry. In 2003 and 2004, other than Arad Technologies, which represented 10.2% of our revenues in 2004, no single customer or group of related customers comprised more than 10% of our total revenues. In 2005, no single customer or group of related customers comprised more than 10% of our total revenues.

(A) Location-based services

Stolen vehicle recovery

Our marketing and sales efforts are principally focused on four target groups: insurance companies and agents, car dealers and importers, cooperative sales channels (mostly vehicle fleet operators and owners) and private subscribers.

We maintain marketing and sales departments in each geographical market in which we operate. Each department is responsible for maintaining our relationships with our principal target groups. These responsibilities also include advertising and branding, sales promotions and sweepstakes.

In Israel, Brazil and Argentina, we focus our marketing efforts primarily on insurance companies. In the United States, we believe that insurance companies do not constitute a material influence in the marketing of SVR services or AVL products. Most of our sales in the United States are made through car dealers for new or used cars. Our customers in the SVR market include insurance companies as well as individual vehicle owners. As of December 31, 2005, we had approximately 339,000 subscribers.

Fleet management

Vehicle fleet management systems are marketed through a vehicle fleets department, which is a part of our marketing department. We conduct in-depth research to identify companies that will gain efficiency and cost savings through the implementation of our products and services, and conduct targeted marketing campaigns to these companies. In addition, we participate in professional conventions and advertise in professional publications and journals designed for our target customers. Currently, our fleet management services are also marketed by the sales force of one of the largest cellular service providers in the United States. Our customers in the fleet management market include small-, mid- and large-size enterprises. As of December 31, 2005, approximately 2,290 corporate customers had installed our wireless communications products in approximately 30,000 vehicles in industries such as telecommunications, courier/delivery, field service, distribution, construction, security, facilities/waste management, cable/broadband, freight and passenger transportation and utilities.

Value-added services

Our concierge services are provided to existing SVR customers. As of December 31, 2005, we had approximately 11,500 subscribers to our concierge service in Israel and approximately 4,400 of our PAL devices were installed in valuable merchandise and equipment, or carried by individuals.

(B) Wireless communications products

Our AVL end-units are primarily used by us in providing our location-based services in Israel, Brazil, Argentina and the United States. In China and South Korea, we plan to sell our AVL end-units, including our PAL products, to third parties who intend to provide location-based services based on these products.

Our AMR products are incorporated into products of Arad Technologies, which, through its wholly-owned subsidiary Master Meter, markets and distributes its products independently. Our exclusive agreement with Arad Technologies is in effect until 2009 and covers, in addition to water meters, electricity, gas meters and other applications using AMR technology.

In Israel, Derech Eretz undertakes marketing and distribution of our RFID products. In the United States, we market our RFID products independently, focusing our efforts on corporations and/or integrators that market our products to consumers and state agencies.

Historically, we only provided our AVL products in connection with our own SVR services. However, we signed an agreement with third-party service providers in China and South Korea to provide a turn-key location-based solution consisting of deploying our AVL infrastructure and selling our end-units. We are currently in the set-up and deployment phase of our infrastructure in Shanghai, Beijing and Seoul. We commenced initial sales of our end-units in Beijing in the second quarter of 2006 and expect to commence sales in Shanghai in the second half of 2006 and in Seoul in 2007.

We believe that we have sold our AMR products to over 1,000 water utilities through Master Meter, a wholly-owned subsidiary of Arad Technologies, with whom we have an exclusive agreement. Our RFID products are sold in Israel and the United States. Our electronic toll collection devices are deployed by Derech Eretz, the sole toll road operator in Israel, and by the transit authority of the State of Minnesota and we sell our electronic weigh station devices to ACS-SLS, a subsidiary of ACS, and Norpass. In addition, we are currently engaged as the sole technology provider in several pilot programs for our RFID products with various federal and state governmental agencies, including the United States Department of Homeland Security and the United States Customs and Border Protection Agency. Although these pilot programs do not currently represent a material portion of our business or revenues, and we do not know if they may lead to revenue-generating contracts in the future, we believe our selection for these pilot programs represents a first step in our attempt to penetrate the RFID market in the United States.

Our selling and marketing objective is to achieve broad market penetration through targeted marketing and sales activities. December 31, 2005, our selling and marketing team consisted of 62 employees.

Competition

We face strong competition for our services and products in each market in which we operate. We compete primarily on the basis of superior technology, functionality, ease of use, quality, price, service availability, geographic coverage, track record of recovery rates and response times and financial strength.

(A) Location-based services

We currently compete with a variety of companies in each of our markets. The three major technologies utilized by our competitors are GPS/cellular, network-based cellular and radio frequency-based homing systems. In addition, new competitors utilizing other technologies may continue to enter the market.

Stolen vehicle recovery

The specific competitive challenges we face in each geographic region that we operate in are described below:

- n **Israel.** Our primary competitors in Israel are Eden Telecom Ltd. (Pointer) and Rav-Bariah Satellite Location Ltd.
- n **Brazil.** Brazil is a highly fragmented market with many companies selling competing products and services (including immobilizers and other less-sophisticated vehicle security systems). Our main competitors in Brazil are LoJack Corporation, Car System and Sascar Corporation.
- n **Argentina.** Argentina is also a highly fragmented market with many companies selling competing products and services (including immobilizers and other less-sophisticated vehicle security systems). Our principal competitors in Argentina are LoJack Corporation, Ovi Car, Pointer Telocation Ltd. and Hawk Corporation.
- n **United States.** In the United States, there are at least three major companies offering various theft protection and recovery products that compete with our product and service offerings, including LoJack Corporation, OnStar Corporation and Air Cept Corporation.

We are currently unable to provide market share information other than our market share information for the vehicle location market in Israel for various reasons, including the broad range of services and products that compete in these markets, the non-existence of trade publications with respect to the products and services we offer in such markets and the lack of meaningful or accurate market research or data available to us.

Fleet Management

The vehicle fleet management market is highly fragmented with many corporations offering location products and services. Our major competitors in the United States are @Road, Navtrack and Teletrac. In Brazil, our main competitors are Autotrack, Controlsat and Omnilink.

(B) Wireless communications products

Automatic vehicle location

Our AVL system is based on terrestrial network triangulation technology and primarily competes with companies that use one of three main technologies: GPS (in combination with wireless communication), network-based cellular communication and radio frequency-based homing.

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Although AVL products based on GPS, network-based cellular and homing technologies do not require the construction of a separate infrastructure of base stations as with terrestrial network triangulation systems such as ours, such solutions have certain drawbacks. GPS receivers require line of sight to at least three satellites, which reduces their effectiveness in areas where the satellite signals are subject to interference and noise (such as urban areas, buildings or parking garages, forests and other enclosed or underground spaces). GPS and network-based cellular systems are also prone to jamming since the tracking signal receivers are located in the vehicle and can be easily tampered with. In addition, the satellites utilized by GPS devices are managed by the United States Department of Defense and can be subject to forced temporary outages. The main disadvantage of homing systems is that they provide only the general direction and not the precise location of the end-unit. In addition, homing systems require that the vehicle be reported stolen before the tracking signal can be activated, which may result in a delay between vehicle theft and recovery.

Terrestrial network triangulation systems have succeeded in overcoming some of the challenges faced by systems based on other technologies. Terrestrial network triangulation technology does not require line of sight and the signals are not easily interrupted in densely populated or obstructed areas. Also, the signals are transmitted from the end-unit in the vehicle to a network of base stations. Therefore, in order to jam the system, receivers in each individual base station within range of the end-unit would have to be jammed, which is difficult to accomplish. Additionally, since the primary application of terrestrial network triangulation systems in the AVL industry is vehicle location and not continuous two-way communication, short bursts of data are sufficient for tracking purposes, which enable the network of base stations to be deployed at a much lower density in the coverage area than traditional network-based cellular base stations. Terrestrial network triangulation systems are capable of determining the precise location, and not just the general direction, of a vehicle at any moment in time. Furthermore, when connected with the existing theft protection system in the vehicle, terrestrial network triangulation systems automatically alert the control center when a vehicle is stolen and do not require that the vehicle be reported stolen, which can potentially reduce stolen vehicle recovery times to a few minutes. The main disadvantage of terrestrial network triangulation systems is the necessity to deploy a physical infrastructure, including the construction, development and deployment of a network of base stations and a control center and the need to address the various financial, legal and practical issues associated with such deployment. Any such deployment entails an investment of a sizable amount of money prior to the receipt of any revenues.

Automatic meter reading

Our AMR product, which is marketed through Master Meter, competes with products developed and marketed by Hexagram Inc., Itron Inc. Invensys, Neptune Technology Group, Inc., Datamatic, Ltd., Ramar Technology Ltd., American Meter Company and DSCI Corp. Our AMR products enable the remote reading of water meters from a range of up to 1,000 feet. This allows the operator to extract information by walking or driving by the water meter, thus reducing the time and manual labor required in order to obtain the information. In addition, our AMR wireless transmitter is integrated into the water meter, as opposed to systems where the transmitter and the water meter are separate components connected by a wire, which makes our system less susceptible to damage and tampering.

Radio frequency identification

In the United States, the principal market in which we operate, our primary competitors are Mark IV (the provider of the E-ZPass product), Delco and Raytheon. Our RFID products are characterized by the ability of the reader to process transmissions from the in-vehicle unit, even when the vehicle is traveling at speeds of as high as 120 miles per hour. This eliminates the need for the vehicle to slow down in the toll booth area, as is required with currently available electronic toll products, such as the E-ZPass product in the United States.

Manufacturing Operations and Suppliers

Most of our wireless communications products are manufactured and assembled by a limited number of unaffiliated manufacturers in Israel. We usually engage with our manufacturers either on a full turn-key basis, where we supply detailed production files and materials list and receive a final product that we sell directly to our clients, or on a partial turn-key basis in which we purchase the raw materials and deliver them to our manufacturers that do the manufacturing, assembly and quality assurance checks. We do not depend on a single manufacturer for the production of our products. Our main manufacturers are R.H. Electronics, Ltd., an enterprise located in Nazareth, Israel, Flextronics (Israel) Ltd., an enterprise located in Migdal Haemek, Israel, and Teliran, Ltd., an enterprise located in Petach Tikva, Israel.

Our quality assurance and testing operations are performed by our manufacturers at their facilities, while using our quality assurance and testing equipment and in accordance with the test procedures designated by us. We monitor quality with respect to key stages of the production process, including the selection of components and subassembly suppliers, warehouse procedures, assembly of goods, final testing, packaging and shipping. We are ISO 9001 certified. We believe that our quality assurance procedures have been instrumental in achieving the high degree of reliability of our products.

Some of our products (principally the integration and testing of base sites, which are manufactured in low quantities and tend to be more technically sophisticated) are manufactured by us in Telematics Wireless facilities in Holon.

Several components and subassemblies included in our products are presently obtainable from a single source or a limited group of suppliers and subcontractors. We maintain strong relationships with our manufacturers and suppliers to ensure that we receive an adequate supply of products, components and raw materials at favorable prices and to access their latest technologies and product specifications.

Our engagements in China and South Korea require us to gradually commence manufacturing activity of our AVL products in both countries, which we intend to do once the performance of these contracts progresses.

Proprietary Rights

We seek to protect our intellectual property through patents, trademarks, contractual rights, trade secrets, know-how, technical measures and confidentiality, non-disclosure and assignment of inventions agreements and other appropriate protective measures to protect our proprietary rights in the primary markets in which we operate. We do not believe that our viability or profitability substantially depends on any single patent, trademark, trade secret, know-how or other piece of intellectual property other than some of the licenses obtained from Teletrac.

We typically enter into non-disclosure and confidentiality agreements with our employees and consultants. We also seek these protective agreements from some of our suppliers and subcontractors who have access to sensitive information regarding our intellectual property. These agreements provide that confidential information developed or made known during the course of a relationship with us is to be kept confidential and not disclosed to third parties, except in specific circumstances.

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Our stolen vehicle recovery system is based on three main components: (i) an AVL end-unit that is installed in the vehicle, the components of which were originally developed by Tadiran and were acquired and improved by us, (ii) a network of base stations that relay information between the vehicle location units and the control center, certain components of which were developed by Teletrac and are currently licensed to us by Teletrac and (iii) a 24-hour manned control center consisting of software used to manage communications and the exchange of information among the hardware components of the AVL system, certain components of which were developed by Teletrac and licensed to us under exclusive and non-exclusive licenses.

Certain technology for our AVL end-units is subject to the terms of a grant Telematics Wireless received from the Israeli Office of Chief Scientist to partially fund the development of certain components of our AVL system. Pursuant to the terms of this grant, which required repayment and has already been paid in full, we are not permitted to transfer the relevant technology to a foreign entity without the prior approval of the Israeli Office of Chief Scientist.

Ituran, Mr. Big, Rav-Tag and the related logos are our trademarks, which have been registered in Israel. This report also refers to brand names, trademarks, service marks and trade names of other companies and organizations, each of which is the property of its respective holder.

Regulatory Environment

In order to provide our SVR services in the locations where we currently operate, we need to obtain four primary types of licenses and permits: (i) a license that allows us to use designated frequencies for broadcasting, transmission or reception of signals and information and to provide telecommunication services to our customers, (ii) a building permit, which permits us to erect our base sites and transmit therefrom, (iii) product specific licenses (commonly known as type approvals), which enable us to use the equipment necessary for our services, and (iv) a general commerce license, which allows us to offer our services to the public.

The frequency license and general commerce licenses we require are granted by the applicable national agency regulating communications in the markets in which we operate, specifically, the Ministry of Communication, in Israel, Anatel Agência Nacional de Telecomunicações, in Brazil, the Comisión Nacional de Comunicaciones, in Argentina, and the Federal Communications Commission, in the United States. The product specific licenses we require are granted in Israel by the Ministry of Communication, in Brazil by IBRACE (the Instituto Brasileiro de Certificação de Produtos para Telecomunicações), in Argentina by the National Technological Institute of Argentina and in the United States by the Federal Communications Commission.

Our frequency licenses in all of the locations where we operate are secondary or joint, which means that the government may grant another person or persons, typically a cellular operator, a primary license to the same frequencies and, to the extent our operations interfere with the operations of the other person, we would have to modify our operations to accommodate the joint use of the frequencies. In our discussions with the Ministry of Communications, the Ministry notified us that in connection with the granting of the new license they may require us, as licensees, to amend our articles of association to add several provisions, including, among other things, a provision whereby if any person, other than our founding shareholders, acquires 25% or more of our outstanding share capital without obtaining the Ministry's approval, any shares owned by such person in excess of such 25% threshold will not have any voting rights. The Ministry has also informed us that the new license may impose certain conditions on the ability of persons to serve as directors and officers of our Company, including a requirement that some (as many as a majority) of our directors and officers be residents and citizens of the State of Israel and that they be pre-approved by the Israeli security authorities in advance. We cannot be certain that any of these requirements will be included in the new license or that additional requirements may not be imposed on us in connection therewith or when the new license will be granted, if at all. All of these licenses are also subject to revocation, alteration or limitation by the respective authority granting them. While any events that would cause us to change frequencies or to modify our operations could have a material adverse effect on us, we do not believe that this is a likely event in any of the locations where we provide our SVR services.

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Our frequency license in Israel was extended until June 29, 2006 and we are currently in the process of acquiring a further extension of this license until January 31, 2007. Our frequency licenses in Brazil expire in 2009 and, in Miami and Orlando, our licenses expire between 2009 and 2013. We have options to extend all of our frequency licenses for periods ranging from three- to 10-year periods.

In Israel and Brazil, like our competitors and most cellular operators, we are not in compliance with all relevant laws and regulations in connection with the erection of transmission antennas (our base sites). As of June 21, 2006, most of our base sites in Israel and Brazil are operating without local building permits. Currently, there is heightened awareness of this issue in Israel, particularly in connection with base sites of cellular providers, and possible sanctions could include fines and even the closure or demolition of these base sites. However, we do not believe this is likely. Obtaining such required permits may involve additional fees as well as payments to the Land Administration Authority.

The required permits and approvals include:

- n erection and operating permits from the Israeli Ministry of the Environment;
- n permits from the Israeli Civil Aviation Authority, in certain cases;
- n permits from the Israeli Defense Forces;
- n approval from Israel's Land Administration, which usually also involves payment for the land use rights; and
- n building permits from local or regional zoning authorities in Israel and Brazil.

We are currently in the process of obtaining the relevant permits required for the construction of our base sites in Israel, however, to date, we have not been issued these permits. With respect to the general permit from Israel's Land Administration, in 2005, we entered into an agreement with the Israel's Land Administration, effective until December 31, 2008, pursuant to which the general permit has been issued to us against an annual consideration based on the date of approval of our base sites. . The process for obtaining these approvals in Israel is generally a time-consuming, highly bureaucratic and lengthy process. As a result, it is common practice among providers of wireless telecommunications services in Israel to continue operations while engaged in the approval process. In Brazil, very few providers of wireless telecommunications services obtain the required permits due to the nature of the approval process. We have applied for the necessary permits, but do not expect to receive such permits in the near future. In Brazil, we try to minimize our risk by locating most of our equipment in sub-leased sites which are already used by other telecommunication service providers, such as cellular operators.

We have been declared a monopoly under the Israeli Restrictive Trade Practices Law, 1988, in the provision of systems for the location of vehicles in Israel. This law prohibits a monopoly from abusing its market position in a manner that might reduce competition in the market or negatively affect the public. For instance, a monopoly is prohibited from engaging in predatory pricing and providing loyalty discounts, which prohibitions do not apply to other companies. The law empowers the Commissioner of Restrictive Trade Practices to instruct a monopoly abusing its market power to perform certain acts or to refrain from taking certain acts in order to prevent the abuse. Additionally, any declaration by the Israeli antitrust authority that a monopoly has abused its position in the market may serve in any suit in which it is claimed that such a monopoly engages in anti-competitive conduct, as *prima facie* evidence that it has engaged in anti-competitive behavior. Our declaration as a monopoly in the market of provision of systems for the location of vehicles in Israel was not accompanied with any instructions or special restrictions beyond the provisions of the Restrictive Trade Practices Law. Although we may be ordered to take or refrain from taking certain actions, to date we have not been subject to such restrictions.

C. ORGANIZATIONAL STRUCTURE

We were initially incorporated as a subsidiary of Tadiran, an Israeli-based designer and manufacturer of telecommunications equipment, software and defense electronic systems, whose original business purpose was to adapt military-grade technologies for the civilian market. In July 1995, Moked Ituran Ltd. purchased our company and the assets used in connection with its operations from Tadiran and Tadiran Public Offerings Ltd. The AVL infrastructure and AVL end-units for the operation of our SVR services were originally developed by an independent division of Tadiran Communications and Systems Group. These operations were later transferred to a Tadiran subsidiary, Tadiran Telematics Ltd. In November 1999, we purchased Tadiran Telematics from Tadiran and in 2002, we changed its name to Telematics Wireless.

List of Significant Subsidiaries

Name of Subsidiary	Country of Incorporation	Proportion of Ownership Interest
Telematics Wireless Ltd.	Israel	97%
Ituran Cellular Communication Ltd.	Israel	100%*
Hotas Holding Ltd.	Israel	100%**
Ituran USA Inc.	USA	100%
Ituran NY Corporation	USA	100%***
Ituran Beheer B.V.	The Netherlands	100%
Ituran Florida Corporation	USA	94%****
Ituran License Corp.	USA	100%*****
Ituran de Argentina S.A.	Argentina	91%*****
Ituran Sistemas de Monitoramento Ltda.	Brazil	97.5%*****
Teleran Holding Ltda.	Brazil	99.99%*****

*55% of the shares are directly owned by us. Another 45% of the shares are owned by Ituran Network Ltd. (of which we own all of the shares, other than one share that is owned by Moked Ituran).

**wholly owned subsidiary of Ituran Cellular Communication Ltd.

>*** a wholly owned subsidiary of Ituran USA Inc. which is our wholly owned subsidiary.

**** 94% of the shares are held by Ituran U.S.A. Inc. which is our wholly owned subsidiary.

***** our shares are held through Ituran U.S.A. Inc., which is our wholly owned subsidiary.

***** our shares are held through Ituran U.S.A. Inc., which is our wholly owned subsidiary, with the remaining shares owned by Mr. Avi Anais, the CEO of Ituran de Argentina.

***** we indirectly hold 97.5% of the shares with one share being held by Mr. Avner Kurz, the President of Teleran Holding Ltda.

***** one share (quota) is held by the Mr. Avner Kurz, President of Teleran Holding Ltda.

D. PROPERTY, PLANTS AND EQUIPMENT

As of the date of this report, we do not own any real estate, other than a property consisting of an office building of 8 floors in the area of approximately 5,356 sqm which was purchased by our subsidiary Ituran Sistemas de Monitoramento Ltda (Ituran Brazil) in Sao Paulo, Brazil in June 2006 for the total acquisition price of 7.5 million Brazilian Reals (approximately \$3.3 million). We financed the acquisition of the property from self-means.

Other than the property in Brazil acquired by Ituran Brazil, all of our offices, headquarters, control centers and facilities are leased in accordance with our specific needs in the areas in which we operate. Additionally, we lease space for our base sites, in order to operate the reception and transmission stations of the system, in each area in which we provide our SVR services.

We currently lease an aggregate of approximately 26,180 square feet of office space in Azour, Israel. In 2005, annual lease payments for this facility were approximately \$388,000. This lease expires on March 31, 2008 and may be renewed by us for an additional 48-month period, subject to a 10% increase in the amount of rent and maintenance payments. These premises include our executive offices and the administrative and operational centers for our operations as well as our customer service, value-added services and technical support centers for the Israeli market.

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Our subsidiary Telematics Wireless currently leases approximately 17,600 square feet of office space and other facilities in Holon, Israel. Annual lease payments for this space in 2005 were approximately \$125,000. This lease expires on November 30, 2006 and is automatically extended at Telematics Wireless' election, for successive two-year periods, until November 30, 2016. In addition, Ituran Cellular Communication Ltd. leases 8,800 square feet of office space and other facilities in Holon, Israel, at an annual rent of approximately \$73,800. This lease has expired in February 2006 and was automatically extended for additional successive two-year periods until February 2012. Both facilities in Holon are leased from a related party. See Item 7.B. Transactions with related parties below.

In Brazil, until our recent purchase of the new premises, we leased approximately 1,040 square feet of office space and our control center for approximately \$22,600 annually. Our lease of said premises expired on March 2006 and we expect to relocate to our new premises within the following six months.

In Buenos Aires, Argentina, we lease approximately 1059 square feet of office space for approximately \$ 22,500 annually, approximately 213 square feet for our control center for approximately \$ 4500 annually and approximately 1600 square feet for our own installation center for approximately \$ 32,000 annually

We lease approximately 7,500 square feet for our offices and control center in Florida for an approximate monthly rate of \$7,530, subject to a 3% annual increase.

We believe that our facilities are suitable and adequate for our operations as currently conducted. In the event that additional facilities will be required, we believe that we could obtain such facilities at commercially reasonable rates.

The size of our base station sites varies from approximately one to eight square feet. In Israel, we have 92 base stations and we rent most base station sites independently for a monthly rate ranging from \$100 to \$1,400 per site depending on the location, size and other factors; for certain sites we do not pay any rent. The typical duration of a lease agreement for our base stations in Israel is five years and we generally have a right to renew the term of the lease agreements for a period ranging between two and five years. In Brazil, we have 96 base station sites, of which 33 sites are leased from the same entity for a monthly rate ranging from \$534 to \$1490 per site and the duration of each lease is 10 years. The remaining 63 sites are leased independently for an annual rate ranging from \$100 to \$685 depending on the location, size and other factors, and the typical duration for these leases is five years. In Argentina, we have 24 base station sites, all of which are leased from two entities for a monthly rate ranging from \$250 to \$660 per site. The duration of the lease ranges from two to three years. In Florida, we have 35 base station sites, leased primarily from property management companies. The annual rental rates vary from \$3,829 to \$26,709 and the duration of most leases is between three and five years, typically with options to renew for additional similar periods.

We do not believe that we have a legal retirement obligation associated with the operating leases for our base sites pursuant to FAS No. 143, Accounting for Asset Retirement Obligations, since we do not own any real property. However, we are obligated pursuant to certain of the operating leases for our base sites, mainly for base sites in Israel, Brazil and Argentina, to restore facilities or remove equipment at the end of the lease term. Since the restoration is limited to any construction or property installed on the property, which in our case is only the installed antennas, we do not believe that these obligations, individually or in the aggregate, will result in us incurring a material expense.

ITEM 4.A. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 5: OPERATING AND FINANCIAL REVIEW AND PROSPECTS

A. OPERATING RESULTS

The following discussion and analysis should be read in conjunction with our consolidated financial statements and notes thereto included elsewhere in this report.

Introduction

We believe we are a leading provider of location-based services, consisting predominantly of stolen vehicle recovery, which we refer to as SVR, and tracking services. We also provide wireless communications products used in connection with our SVR services and for various other applications, including automatic meter reading, which we refer to as AMR, and radio frequency identification, which we refer to as RFID. We currently provide our services and sell our products in Israel, Brazil, Argentina and the United States. In addition, in 2004 we have entered into contracts to deploy our automatic vehicle location, which we refer to as AVL, infrastructure and sell our end-units in China and South Korea, and commenced deploying such infrastructure in China in 2004 and in South Korea in 2005, which we expect will initially be used to provide primarily SVR, fleet management and personal tracking services in China and primarily vehicle and personal tracking services in South Korea.

Our operations consist of two segments: location-based services and wireless communication products.

Our location-based services segment consists of our SVR, fleet management and value-added services. We currently operate stolen vehicle recovery services throughout Israel, in Sao Paulo, Brazil, in Buenos Aires, Argentina and in Miami, Florida in the United States.

Our wireless communications products segment consists of our short- and medium-range two-way wireless communications products that are used for various applications, including AVL, AMR, and RFID. We sell our AVL end-units to customers that subscribe to our SVR services, as well as to third-party operators of location-based services in China and in South Korea. We sell our AMR products exclusively to Arad Technologies Ltd. that incorporates our AMR products into a water meter product that it markets and distributes to utilities in the United States through its wholly-owned subsidiary Master Meter, Inc. We sell our RFID products to toll road and weigh station operators in the United States and Israel.

Outlook

We have historically experienced significant growth in the markets in which we provide our location-based services. Going forward, the Brazilian and Argentine markets continue to represent significant growth potential for our location-based services. These markets are characterized by high car theft rates and insurance companies that are seeking solutions to limit their actual losses resulting from car theft. The growth in subscribers within our location-based services segment also has a direct impact on the sale of our AVL products, as they are an integral component of our location-based services and are installed in each subscriber's vehicle. In addition, our recent contracts with third-party service providers for the deployment of our AVL infrastructure and the subsequent sale of our end-units in China and South Korea represent important growth opportunities for the sale of these products.

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As of December 31, 2005, we had approximately 168,000 subscribers in Brazil and Argentina. We estimate that the total addressable market in our current coverage areas of Sao Paulo and Buenos Aires is several million vehicles, and therefore we have a significant opportunity to grow our subscriber base and increase sales of our AVL products.

We expect growth over the next 12 months in our location-based services segment to be driven by increased demand from existing insurance company customers in Brazil and Argentina, as a result of our strong operating results and their increased familiarity with and confidence in our services, as well as additional insurance companies who could seek to establish relationships with us, as well as increased direct sales of SVR services to individual subscribers in Brazil who, due to prevailing high insurance costs, are self-insured and represent an additional market opportunity for our SVR services and AVL products. In connection with such potential markets and additional growth opportunities, we are looking to enhance our brand recognition through additional advertising efforts that we started in 2004. We expect our growing representation in the SVR market in Brazil and Argentina to result in additional revenues from sales of our AVL products. We also intend to commence providing SV